Citizen’s Guide to the Illinois State Budget & Tax System

A Primer on the Illinois Fiscal System & Budget Pressures

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ABOUT CTBA

Founded in 2000, the Center for Tax and Budget Accountability is a non-profit, bi-partisan research and advocacy think tank committed to ensuring that tax, spending and economic policies are fair and just, and promote opportunities for everyone, regardless of economic or social status.

CTBA uses a data-focused, bipartisan approach to work in partnership with legislators, community groups and other organizations to help change both public policy and perceptions.

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The Illinois State Budget at a Glance

The Illinois State Budget is the state’s fundamental policy document. It defines what programs and services will receive financial support from the state.

In a standard, non-overtime legislative year, Illinois adopts its budget on a fiscal year basis, beginning on July 1 of each calendar year and ending on June 30 of the next succeeding year. In the last, complete state fiscal year (FY) 2007, the total budget for Illinois state government was $48.5 billion. The state’s total budget, however, is actually comprised of several different funds. Because of this, not all $48.5 billion is available for the General Assembly to spend on any public service deemed appropriate. Instead, almost half of the state’s total budget is comprised of three special funds and bond proceeds that can only be used for either very limited statutory defined purposes or the projects identified in the underlying bond. Figure 1 shows the general breakdown of the various funds which together constitute the state’s total budget.

**Figure 1**

**Total Operating Appropriations by Fund Group FY 2007**

Total Appropriated Funds = $48.5 billion

- General Funds: 53.43%
- Highway Funds: 4.27%
- Revolving Funds: 1.68%
- Debt Service Funds: 4.16%
- Federal Trust Funds: 11.62%
- Special State Funds: 23.89%
- Bond Financed Funds: 0.02%

Source: Illinois FY 2007 Budget Book

### The Different Budget Funds

**The General Fund (GF)** is the largest of the funds which constitute the total state budget. FY 2007 appropriations for the GF were $25.7 billion. So, for FY 2007, the GF represented 53 percent of the state’s total appropriated budget.

The GF is the portion of the total state budget that covers most public services the General Assembly has discretion to fund through the appropriation process, such as education, human services, healthcare, environmental protection and aging, as well as the executive, judicial and legislative branches of state governments.

The GF itself consists 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. Most of the revenues generated from state based taxes are deposited into the GF.

Besides the General Fund, the other funds in the total operating budget are:

**Highway Funds** – 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.

**Special State Funds** – are various, smaller funds identified and held in the State Treasury as "special funds" under in Section 5 of the Illinois Finance Act restricted in use to the specific purpose for which they were created. There are over 300 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.

**Bond Financed Funds** – 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, like the $10 billion in pension obligation bonds issued in 2002.

**Debt Service Funds** – 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 Funds — 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 Funds — are established by statute or under statutory authority for a specific purpose. Examples of the intra-governmental services covered include Oil Spill Response and GED Testing.

Other Trust Funds — receive and account for payments identified to designated recipients, such as escrow funds.

University Funds — receive revenues such as fees and tuition. The funds are locally held and administered by the state’s public universities and not subject to appropriation by the state.

Federal Trust Funds — are established pursuant to grants and contracts between state agencies and the federal government and are not subject to discretionary appropriation by the state. Instead, these funds must be utilized solely for the specific purposes established by terms of the grant. Examples of Federal Trust Funds are Federal Aid Disaster and GI Education.

Appropriations

The appropriation process is the legislative mechanism through which the state expends the revenue it collects. Article VIII of the Illinois Constitution specifies a line item budget, which requires the General Assembly to pass a specific dollar amount appropriation for each service to be funded. While appropriating revenue to pay for services is technically a legislative function, the initial state budget is 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.

The General Assembly does not have full discretion to appropriate all revenue the state receives to any purpose. Instead, a significant portion of the state’s budget is made up of revenue like federal trust funds or bond proceeds that must be appropriated solely to the purposes established by the terms of the underlying federal fund agreement or bond. For FY 2007, the state appropriated $48.5 billion in total spending throughout all funds. Of that, $25.7 billion was appropriated for the General Fund budget, which pays for most public services. As previously stated, the largest fund in the General Fund is the General Revenue Fund.

Figure 2 displays appropriations by agency as a percentage of the GRF.

As Figure 2 shows, in FY 2007, the state appropriated 83 percent of the General Revenue Fund budget to health care, education and human services. Medicaid is currently the biggest single state budget item and is appropriated across several budget categories, including health care and human services.1
State Spending Trends

**FIRST: WHY IT IS IMPORTANT TO MEASURE INFLATION**

Frequently, government spending on services is measured solely by reference to annual changes in expenditures expressed in nominal dollars—that is, total dollars expended without adjusting for inflation. This is an inadequate and uninformed method of evaluating growth, or lack of growth, in spending on public services, because, just as in the private sector, inflationary pressures cause the cost of rendering public services to increase. Without taking the impact of inflation into account, growth in spending on services from one year to the next—expressed solely in nominal dollars—could lead analysts to conclude that underlying programs are expanding when in fact they are not. Far more telling is a comparison of budget appropriations from one year to the next that adjusts for inflation, thereby enabling analysts to determine whether, in real terms, expenditures on services are increasing or just keeping pace with economic-based cost growth.

**Historical Appropriation Comparisons**

Figure 3 compares historical enacted General Revenue Fund appropriations from FY2000 through FY2007, to the inflationary cost of maintaining services from year to year over that period, based on the Consumer Price Index (CPI) published by the United States Bureau of Labor Statistics. The CPI is a sound measure of general inflation in the economy, however, it understates the inflationary pressures that affect public service costs annually. That is because labor generally constitutes 80 percent or more of the costs of providing public services and labor costs usually increase at a rate greater than general economy-wide inflation as measured by the CPI. Hence, a more accurate measure of the inflationary cost pressures on public services is the ECI, or Employment Cost Index published by the United States Bureau of Labor Statistics, because it is tied specifically to the growth in labor costs. As Figure 3 shows, from FY 2003 through FY 2006, GRF appropriations did not keep up with inflation.

**Figure 3: Comparison of Historical General Revenue Fund Spending: Inflation-Adjusted CPI & ECI**

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<td>Actual Appropriations (nominal $)</td>
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<td>$22,335</td>
<td>$23,483</td>
<td>$23,779</td>
<td>$24,501</td>
<td>$25,763</td>
<td>$119,861</td>
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<td>Prior Year Inflation Adjusted CPI</td>
<td>$23,971</td>
<td>$22,759</td>
<td>$24,258</td>
<td>$24,587</td>
<td>$25,114</td>
<td>$25,763</td>
<td>$120,689</td>
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<td>Difference CPI</td>
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<td>$724</td>
<td>-$479</td>
<td>-$86</td>
<td>$649</td>
<td>$828</td>
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<tr>
<td>Percentage Change CPI</td>
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</tr>
<tr>
<td>Prior Year Inflation Adjusted ECI</td>
<td>$24,369</td>
<td>$23,072</td>
<td>$24,281</td>
<td>$24,754</td>
<td>$25,506</td>
<td>$25,763</td>
<td>$121,982</td>
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<td>$411</td>
<td>-$502</td>
<td>-$253</td>
<td>$257</td>
<td>$212</td>
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<td>Percentage Change ECI</td>
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Figures 4 and 5 compare General Revenue Fund appropriations for the period from FY2002 through FY2007 for K-12 education and higher education, to the inflation-adjusted cost of maintaining the prior year’s services using both the CPI and the more accurate ECI.

**Figure 4: Comparison of Historical Education (K-12) Spending: Inflation-Adjusted CPI & ECI**

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<td>Actual Appropriations (nominal $)</td>
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<td>$6,110</td>
<td>$6,532</td>
<td>$28,861</td>
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<tr>
<td>Prior Year Inflation Adjusted CPI</td>
<td>$5,424</td>
<td>$5,060</td>
<td>$6,624</td>
<td>$6,007</td>
<td>$6,262</td>
<td>$6,360</td>
<td>$28,377</td>
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<td>Difference CPI</td>
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<td>$103</td>
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<td>Percentage Change CPI</td>
<td>1.70%</td>
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<tr>
<td>Prior Year Inflation Adjusted ECI</td>
<td>$5,514</td>
<td>$5,129</td>
<td>$5,630</td>
<td>$6,047</td>
<td>$6,360</td>
<td>$6,360</td>
<td>$28,680</td>
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<tr>
<td>Difference ECI</td>
<td>-$549</td>
<td>$315</td>
<td>$179</td>
<td>$63</td>
<td>$172</td>
<td>$180</td>
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<tr>
<td>Percentage Change ECI</td>
<td>0.63%</td>
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</tbody>
</table>
### Figure 5: Comparison of Historical Higher Education Spending: Inflation-Adjusted CPI & ECI

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</thead>
<tbody>
<tr>
<td>Actual Appropriations (nominal $)</td>
<td>$2,647</td>
<td>$2,523</td>
<td>$2,123</td>
<td>$2,103</td>
<td>$2,106</td>
<td>$2,154</td>
<td>$11,009</td>
</tr>
<tr>
<td>Prior Year Inflation Adjusted CPI</td>
<td>$2,711</td>
<td>$2,571</td>
<td>$2,193</td>
<td>$2,175</td>
<td>$2,159</td>
<td>$2,159</td>
<td>$11,808</td>
</tr>
<tr>
<td>Difference CPI</td>
<td>-$188</td>
<td>-$448</td>
<td>-$90</td>
<td>-$69</td>
<td>-$5</td>
<td>-$5</td>
<td>-$799</td>
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<td>Percentage Change CPI</td>
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<td></td>
<td></td>
<td>-6.76%</td>
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<td>Prior Year Inflation Adjusted ECI</td>
<td>$2,756</td>
<td>$2,606</td>
<td>$2,195</td>
<td>$2,189</td>
<td>$2,192</td>
<td>$2,192</td>
<td>$11,939</td>
</tr>
<tr>
<td>Percentage Change ECI</td>
<td></td>
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<td></td>
<td></td>
<td>-7.79%</td>
</tr>
</tbody>
</table>

Figure 6 compares General Revenue Fund appropriations for healthcare.

### Figure 6: Comparison of Historical Health Care Spending: Inflation-Adjusted CPI & ECI

[Includes Department of Health Care & Family Services (referred to as Public Aid prior to FY 2006) and Public Health]

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<tbody>
<tr>
<td>Actual Appropriations (nominal $)</td>
<td>$5,398</td>
<td>$5,236</td>
<td>$5,822</td>
<td>$6,167</td>
<td>$7,544</td>
<td>$7,910</td>
<td>$32,679</td>
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<tr>
<td>Prior Year Inflation Adjusted CPI</td>
<td>$5,528</td>
<td>$5,335</td>
<td>$6,014</td>
<td>$6,377</td>
<td>$7,733</td>
<td>$7,308</td>
<td>$30,986</td>
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<tr>
<td>Difference CPI</td>
<td>-$292</td>
<td>$487</td>
<td>$153</td>
<td>$1,167</td>
<td>$177</td>
<td>$1,693</td>
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<tr>
<td>Percentage Change CPI</td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td>5.46%</td>
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<tr>
<td>Prior Year Inflation Adjusted ECI</td>
<td>$5,619</td>
<td>$5,409</td>
<td>$6,020</td>
<td>$6,420</td>
<td>$7,853</td>
<td>$7,522</td>
<td>$31,321</td>
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<tr>
<td>Difference ECI</td>
<td>-$383</td>
<td>$413</td>
<td>$147</td>
<td>$1,124</td>
<td>$57</td>
<td>$1,358</td>
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<tr>
<td>Percentage Change ECI</td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td>4.34%</td>
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Figure 7 compares General Revenue Fund appropriations for the Department of Human Services.

### Figure 7: Comparison of Historical Human Services Spending: Inflation-Adjusted CPI & ECI

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<td>Actual Appropriations (nominal $)</td>
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<td>$3,872</td>
<td>$3,994</td>
<td>$18,912</td>
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<td>Prior Year Inflation Adjusted CPI</td>
<td>$3,894</td>
<td>$3,642</td>
<td>$3,825</td>
<td>$3,897</td>
<td>$3,969</td>
<td>$4,031</td>
<td>$19,227</td>
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<tr>
<td>Difference CPI</td>
<td>-$320</td>
<td>$61</td>
<td>-$56</td>
<td>-$25</td>
<td>$25</td>
<td>-$315</td>
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<tr>
<td>Percentage Difference CPI</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td>-1.64%</td>
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<tr>
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<td>$3,692</td>
<td>$3,829</td>
<td>$3,924</td>
<td>$4,031</td>
<td>$4,094</td>
<td>$19,434</td>
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<tr>
<td>Difference ECI</td>
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<td>$11</td>
<td>-$60</td>
<td>-$52</td>
<td>-$37</td>
<td>-$522</td>
<td></td>
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<tr>
<td>Percentage Difference ECI</td>
<td></td>
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<td></td>
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<td>-2.69%</td>
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Figure 8 compares General Revenue Fund appropriations for Department of Corrections.

### Figure 8: Comparison of Historical Department of Corrections Spending: Inflation-Adjusted CPI & ECI

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<td>Actual Appropriations (nominal $)</td>
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<td>$1,207</td>
<td>$1,270</td>
<td>$1,191</td>
<td>$1,163</td>
<td>$1,126</td>
<td>$5,957</td>
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<td>Prior Year Inflation Adjusted CPI</td>
<td>$1,334</td>
<td>$1,230</td>
<td>$1,312</td>
<td>$1,231</td>
<td>$1,192</td>
<td>$1,192</td>
<td>$6,300</td>
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<td>Difference CPI</td>
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<td>-$121</td>
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<td>-$66</td>
<td>-$343</td>
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<td>-5.44%</td>
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<td>$1,313</td>
<td>$1,240</td>
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<td>$1,211</td>
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<td>Difference ECI</td>
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<td>-$85</td>
<td>-$410</td>
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<tr>
<td>Percentage Change ECI</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td>-6.44%</td>
</tr>
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Figure 9 compares General Revenue Fund appropriations for the Department of Agriculture.

**Figure 9: Comparison of Historical Department of Agricultural Spending: Inflation-Adjusted CPI & ECI**

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<td>$41</td>
<td>$45</td>
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<td>$48</td>
<td>$42</td>
<td>$46</td>
<td>$270</td>
<td></td>
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<td>Difference CPI</td>
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<td>-$7</td>
<td>$3</td>
<td>$3</td>
<td>-$37</td>
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<tr>
<td>Percentage Change CPI</td>
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<td></td>
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<tr>
<td>Prior Year Inflation Adjusted ECI</td>
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<td>$43</td>
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<td>$273</td>
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<tr>
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<td>$2</td>
<td>$2</td>
<td>-$40</td>
<td></td>
</tr>
<tr>
<td>Percentage Change ECI</td>
<td>-14.67%</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

Figure 10 compares General Revenue Fund appropriations for the Department of Children and Family Services.

**Figure 10: Comparison of Historical Department of Children & Family Services Spending: Inflation-Adjusted CPI & ECI**

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Actual Appropriations (nominal $)</td>
<td>$925</td>
<td>$838</td>
<td>$819</td>
<td>$781</td>
<td>$810</td>
<td>$776</td>
<td>$4,024</td>
</tr>
<tr>
<td>Prior Year Inflation Adjusted CPI</td>
<td>$947</td>
<td>$854</td>
<td>$846</td>
<td>$808</td>
<td>$830</td>
<td>$4,285</td>
<td></td>
</tr>
<tr>
<td>Difference CPI</td>
<td>-$109</td>
<td>-$35</td>
<td>-$65</td>
<td>$2</td>
<td>-$54</td>
<td>-$261</td>
<td></td>
</tr>
<tr>
<td>Percentage Change CPI</td>
<td>-6.09%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prior Year Inflation Adjusted ECI</td>
<td>$963</td>
<td>$866</td>
<td>$847</td>
<td>$813</td>
<td>$843</td>
<td>$4,332</td>
<td></td>
</tr>
<tr>
<td>Difference ECI</td>
<td>-$125</td>
<td>-$47</td>
<td>-$66</td>
<td>-$3</td>
<td>-$67</td>
<td>-$308</td>
<td></td>
</tr>
<tr>
<td>Percentage Change ECI</td>
<td>-7.10%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

## Major Budget Pressures

Even if Illinois state government were to pass no new programs nor offer any new services and refused to expand any existing services or programs, four primary, existing budget pressures can be expected to strain the state’s fiscal system for the foreseeable future. These budget pressures are:

- The inflationary increases in the cost of maintaining existing levels of public services from year to year;
- Growing demand for expensive public services like healthcare, long-term care and special education;
- The escalating schedule of payments Illinois must make to its five public employee pension systems to make up the $44.2 billion in unfunded pension liabilities accrued to date; and
- A poorly designed revenue system that underperforms inflation and hence fails to generate the resources to cover the preceding budget pressures.

Moreover, data indicate that inordinate or wasteful spending is not a material problem with the state budget.

- Analyzing state spending for 2004 (the latest Census data available), whether as a percentage of income in a state or state gross product reveals Illinois is a low spending state, ranking 42nd nationally, despite having the fifth largest population and gross state product.
- As Figure 12 demonstrates, on an inflation adjusted basis, over the last decade Illinois has cut aggregate spending on all public services other than education, health care and the pension system by over $1.1 billion.
The inflation comparison presented in Figure 11 is based on the CPI – Consumer Price Index.

### Figure 11
**Inflation-Adjusted Comparison (CPI) of State General Fund Expenditures Over the Last Decade ($ in millions)**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>General Fund</td>
<td>$17,302</td>
<td>$22,614</td>
<td>$24,406</td>
<td>$1,793</td>
</tr>
<tr>
<td>Education</td>
<td>$3,656</td>
<td>$4,778</td>
<td>$6,093</td>
<td>$1,315</td>
</tr>
<tr>
<td>Health Care</td>
<td>$4,319</td>
<td>$5,645</td>
<td>$7,034</td>
<td>$1,390</td>
</tr>
<tr>
<td>Pensions</td>
<td>$519</td>
<td>$678</td>
<td>$938</td>
<td>$260</td>
</tr>
<tr>
<td>All public services except Education,</td>
<td>$8,808</td>
<td>$11,512</td>
<td>$10,341</td>
<td>-$1,171</td>
</tr>
<tr>
<td>Health Care &amp; Pensions</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

• Using the ECI, or Employment Cost Index, the spending habits of Illinois look far more parsimonious than profligate, as Figure 12 demonstrates.

### Figure 12
**Inflation-Adjusted Comparison (ECI) of State General Fund Expenditures Over the Last Decade ($ in millions)**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>GRF</td>
<td>$17,302.0</td>
<td>$24,776.5</td>
<td>$24,406.4</td>
<td>-$370.1</td>
</tr>
<tr>
<td>Education</td>
<td>$3,656.0</td>
<td>$5,235.4</td>
<td>$6,093.0</td>
<td>$857.6</td>
</tr>
<tr>
<td>Health Care</td>
<td>$4,319.0</td>
<td>$6,184.8</td>
<td>$7,034.0</td>
<td>$849.2</td>
</tr>
<tr>
<td>Pension</td>
<td>$519.0</td>
<td>$743.2</td>
<td>$938.4</td>
<td>$195.2</td>
</tr>
<tr>
<td>All public services except Education,</td>
<td>$8,808.0</td>
<td>$12,613.1</td>
<td>$10,341.0</td>
<td>-$2,272.1</td>
</tr>
<tr>
<td>Health Care &amp; Pensions</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Health Care Pressures

Between 1980 and 2005, over 15 percent of Illinois workers in the private sector lost their employer-provided health insurance.4 Today, over 40 percent of the Illinois workforce does not have private, employer-provided health insurance.

• As the private sector scales back this benefit, the demand for the public sector to assist in providing health care coverage for low and increasingly middle income families will grow.

• The impact of reduced availability of private health coverage from employers is reflected in Medicaid data.

• Nationally, more than 75 percent of Medicaid beneficiaries are not on welfare7 and fully 94 percent of Illinois' Medicaid recipients are not receiving welfare, but are either working or unable to do so due to age or disability.8

• Illinois’ chronic fiscal problems make it increasingly difficult for the state to keep up with both increasing demand for health care and soaring health care costs, which historically grow faster than general inflation.9

• 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 nine percent between fiscal years 2000 and 2004 and

• The increase in state tax revenue over that same period, which grew at an average annual rate of only 2.5 percent.10 The Congressional Budget Office currently projects that healthcare costs for the public sector will grow by at least 7.5 percent annually over the next decade.11
Pension Pressures

Figure 14 demonstrates how dramatic the scheduled increase in pension payments is under the current “pension ramp”. In out years, the annual required ramp payment will exceed $15 billion. Illinois state government simply will not be able to fund these pension payments under the current tax system, without drastically cutting public services. For example, in FY 2006, the state was unable to make the required $2.1 billion employer contribution, ultimately paying less than half that amount. As a component of the partial pension holiday table in FY 2007, the state actually reduced the amount it paid to the pension systems down to $1.372 billion that year. The revised pension ramp calls for a contribution of over $2 billion in FY 2008, an increase of $650 million from FY 2007. Note that, total new revenue growth for FY 2008 is projected to be just $670 million. So, if funded, the pension ramp will effectively consume all new revenue growth this year, leaving nothing to cover the inflationary increase in the cost of the public services provided last year (over $900 M), the more than $2 billion in Medicaid liabilities deferred from FY 2007 to FY 2008, nor any increase in education funding. Moreover, in just three short years, the annual contribution to the pension system under the ramp jumps to over $4 billion.
As Figure 15 illustrates, the yearly growth in required state pension contributions, combined with the inflationary cost of just maintaining the prior year’s services, will be greater than anticipated revenue growth from taxes and fees. Given that Illinois has a balanced budget obligation, without enhancing revenue, the state’s current fiscal system will force Illinois to cut spending on services, as it has over the last decade or go back on its obligation to fund the pension systems.

**State Employee Contracts**

The state also must fund cost of living adjustments and other cost increases for state employees, as negotiated with public employee unions in their respective contracts.

**The Cumulative Impact**

Combined, the cost pressures that impact Illinois’ budget collectively leave little discretionary money left to spend on programs like economic development, environmental protection and affordable housing. In fact, after combining all the major state budget categories, including pensions and debt service, there is only 5.3 percent left for everything else.
Bonds & Debt

Overview

Debt owed on state-supported general obligation bonds and state-issued revenue bonds has increased dramatically over the past six years. Illinois uses most 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 cannot afford to pay cash upfront to buy a home, so they take out a mortgage and finance the purchase over a number of years. The homeowner will pay more than the stated purchase price of the home in interest because the purchase is being financed over time. Incurring the debt and paying interest is still a wise investment, however, because the house will have a long useful life, justifying the long term debt-related costs associated with the purchase. The same goes for public indebtedness, if used wisely to create long-term assets, paying more in debt costs over time is both logical and the only way to create public infrastructure sorely needed for economic development and quality of life.

Of course, the more debt the state incurs, the more it must pay back in interest over time. Much of the debt the state incurs is being paid from the same revenue streams that fund public services through the General Fund. Hence, Illinois must monitor its debt position to ensure it is manageable and does not constrain the state’s long-term ability to pay for public services.

Figure 17 shows the growth in outstanding principal owed on state-issued debt from 2000-2007, not including the unfunded pension liability. Since 2000, the state has issued over $20 billion in debt. Much of this increased bond indebtedness - $10 billion - came in the form of pension obligation bonds the state issued in 2003 (the "2003 POBS"). As structured, the 2003 POBS effectively utilized $7.2 billion of the pension obligation bond proceeds to refinance an equal amount of then unfunded pension liability at a lower, far more cost effective rate for the state. The remaining balance of the 2003 POBS proceeds was used to cover the cost of issuing the bonds and fund about $2.3 billion of the then currently required pension contributions, freeing up an equal amount ($2.3 billion) of tax and fee revenue to fund public services that otherwise would have been used to cover the then current pension contributions. Taking advantage of record low interest costs, the state frontloaded its savings from this arbitrage transaction to pay for the long-term cost of diverting the $2.3 billion of bond proceeds used to cover then required pension contributions. So while the transaction did not save the state any money long-term, it did free up over $2 billion in one-time revenue to fund services at no additional cost to the state.

Figure 17
$ in Millions

Commission on Government Forecasting and Accountability, Fiscal Year 2007 Budget Summary of the State of Illinois, August 2006. Note the 2003 increase is due to the Pension Obligation Bond.
As the state incurs more debt over time, it has to pay increased debt service (principal and interest) costs annually on that debt. As Figure 18 shows, since 2000, the percentage of Illinois’ total General Fund devoted to paying debt service costs has risen from under four percent to over seven percent of total revenues. In dollars, that meant almost $2 billion of the General Fund will be used to pay debt and interest in FY 2006, rather than funding public services.

**Figure 18**  
General Obligation and State-Issued Revenue Debt  
As a Percentage of General Fund Revenues - FY 2000 – 2006

For FY 2007, Illinois spent $1.959 billion on general obligation and state issued revenue debt service.

**Figure 19**  
$ in Millions
Debt Comparisons: Illinois v. Other States

By any metric, Illinois has a high level of state debt. In 2004, Moody’s Investor Services reported Illinois had more total debt than only two other states, California and New York and owned 7.5 percent of the total national debt. Moody’s also concluded that one of the reasons the national median debt per capita increased rapidly from 2003 to 2004 was because Illinois issued so much debt in 2004 (i.e. the $10 billion in pension obligation bonds).22

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. For both 2003 and 2004, Illinois jumped from 11th to 6th in the nation in tax-supported debt per capita, primarily because of the issuance of the 2003 POBS.23 Illinois remained there for 2004, the latest national comparison available.24 As Figure 20 shows, state debt per capita in Illinois is currently $2,019, which is more than double the national average of $999 per capita.25 The National Association of State Budget Officers has concluded that, when per capita debt is more than $1,200, as it is in Illinois, the debt is "unmanageable" for the state.26

The final barometer used to evaluate a state’s overall debt position compares total state debt to personal income in that state. Again, Illinois ranks high nationally when comparing tax-supported debt as a percentage of personal income, with a total approaching twice the national average, as shown in Figure 21. It is worth bearing in mind that all the debt figures cited in this section of the report do not include the $42.2 billion in unfunded pension obligations owed by the state as of FY 2008.

How Does Debt Affect the State’s Credit Rating?

In May 2003, Moody’s lowered the state’s credit rating from Aa2 to Aa3, after Illinois sold $1.5 billion in bonds, just to pay overdue bills.27 Fitch also lowered the state’s rating from AA+ to AA.28 Reductions in bond ratings have real-world consequences. When a state’s credit rating is lowered, it faces higher interest and issuance costs when it borrows money. Moody’s currently assigns Illinois a lower bond rating than 30 states in its credit rating, despite the fact that Illinois’ annual gross domestic product of over $590 billion, ranks fifth highest in the country.29 Thirteen states rank similar to Illinois and only three have credit ratings lower than Illinois.30

Both Moody’s and Fitch noted other factors that contributed to Illinois receiving a low bond rating, including poor revenue performance, the 2003 POBS issuance, the state’s increasing GAAP deficit, overall budget uncertainty and an increase in state debt ratios.31 Fitch emphasized Illinois had, “above-average debt levels, a large unfunded pension liability and constrained finances marked by pension and Medicaid fund pressures.”32 Fitch went on to say, “Persistent sizeable accounts payable liabilities remain and large required pension contributions beginning in fiscal 2008 will pose a challenge (for Illinois).”33 Noting that Illinois has not raised broad-based taxes for many years, Fitch concluded the state has had to rely on one-time revenue sources, deficit spending, under-funding the pension systems and delaying payments to health care providers, all of which are poor fiscal practices.
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. Actually creating a balanced budget has eluded decision makers for decades. Consider the most recently completed fiscal Year.

- FY 2007 budget: the state used over $3.4 billion in one-time revenues and deficit spending to balance the budget. Put an other way, in FY 2007 the state spent $3.4 billion more than it had the revenue to cover, which means deficit spending exceeded over 10 percent of the budget.

**Figure 22**

**Effective Deficit Spending FY2007**

<table>
<thead>
<tr>
<th>One-Time Revenues and Deficit Spending ($ in millions)</th>
<th>FY 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fund Sweeps</td>
<td>$200</td>
</tr>
<tr>
<td>Chargebacks</td>
<td>$76</td>
</tr>
<tr>
<td>Deferred Medicaid Payments</td>
<td>$2,000</td>
</tr>
<tr>
<td>Underfunding of Required State Pension Contribution</td>
<td>$1,133</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$3,409</strong></td>
</tr>
</tbody>
</table>

Things do not look much better for FY 2008. Accounting for revenue growth, the deferral of FY 2007 Medicaid liabilities into FY 2008, the increased contribution required for the pension systems and the inflation adjusted cost of continuing FY 2007 service levels into FY 2008, the state will again have a deficit in excess of $3.2 billion, as Figure 23 shows.

**Figure 23**

**FY 2008 Estimated Budget Deficit**

<table>
<thead>
<tr>
<th>Category</th>
<th>Dollar Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Forecasted FY 2008 Revenue Increase*</td>
<td>$670</td>
</tr>
<tr>
<td>Dollar Amount Necessary to Keep Up with the Inflation Costs of Continuing FY 2007 General Fund Levels</td>
<td>-$907</td>
</tr>
<tr>
<td>Dollar Increase in the Required FY 2008 Pension Funding Payment Over FY 2007</td>
<td>-$650</td>
</tr>
<tr>
<td>Dollar Amount of Unpaid Medicaid Bills in FY 2007 Carried Over to FY 2008</td>
<td>-$2,000</td>
</tr>
<tr>
<td>Dollar Amount of FY 2007 One Time Revenues Used to Balance Budget (Fund Sweeps and Charge Backs) Not Available in FY 2008.</td>
<td>-$315</td>
</tr>
<tr>
<td><strong>Total Estimated FY 2008 Deficit</strong></td>
<td><strong>-$3,202</strong></td>
</tr>
</tbody>
</table>

* Revenue estimated based on Final FY 2007 revenues as reported by the Illinois Commission on Government Forecasting and Accountability (COGFA), FY 2008 Budget Summary, compared to COGFA FY 2007 revenue projection, Mar. 2007.
The Illinois Revenue System
Where Does the State Get Its Money?
Illinois state government is funded primarily from three sources: taxes, fees and government transfers.

**Taxes** – These come in various forms. Income taxes are based on a percentage of personal or corporate taxable income. Sales taxes are imposed as a percentage of the sale price of certain goods. Property taxes are a tax an owner pays on the assessed value of a property (state government does not assess property taxes in Illinois). Excise taxes are a flat, charge per unit, like $.50 per gallon of gas or $1.00 per pack of cigarettes.

**Fees** – These are set charges made at the time a person acquires certain services from the state. For example, the amount a driver pays to the Secretary of State for a license. In Illinois fees are constitutionally supposed to be limited to the amount needed to cover administrative costs and are not supposed to generate any excess for use as general revenue.

**Transfers** – These are typically monetary transfers from one unit of government to another, one fund to another, or the shifting of appropriation authority among line items by the legislative or the executive branch.

- About 70 percent of the state’s revenues for the General Fund come from a variety of taxes (e.g. the individual and corporate income tax, the sales tax and the public utility tax).
- About 17 percent of revenues to the General Fund are transfers from the Federal Government. The remaining revenue consists of lottery and riverboat revenues (4.8 percent) and other fees and taxes such as the cigarette (1.5 percent) or liquor tax (0.6 percent).

**Figure 24**
FY 2007 General Fund Revenues by Source as a Percentage of Total

Source: Illinois Commission on Government Forecasting and Accountability Fiscal Year 2007 Budget Summary
Overview of Illinois Taxes and Fees

**Individual Income Tax.** The individual income tax rate in Illinois is 3.0 percent and applies to a person’s federal adjusted gross income, subject to the state’s standard $2,000 deduction. This prohibits imposing slightly higher marginal tax burdens on the wealthy than on low and middle income families, which is problematic from both fiscal and economic policy standpoints. From a fiscal policy standpoint, two fundamental principles of sound, capitalist tax policy are that taxes be imposed in a manner that is fair to taxpayers and responsive to the economy. Both of these requirements are usually satisfied with a progressive income tax, because in the capitalist economy that currently exists, income growth over the past 25 years has gone to upper, rather than lower and middle income families, both in Illinois and the nation as a large. In fact, on an inflation adjusted basis the bottom 40 percent of income earners have seen their wages decline as Figure 25 illustrates.

![Growth of Inflation Adjusted Real Wages in Illinois by Income Group](image)

From an economic policy standpoint, the regressive nature of the Illinois tax system has actually worsened income inequality in the state, which is fairly severe, as Figure 26 demonstrates.

Because the state Individual Income Tax is set at a flat rate across all income levels, rather than the progressive rates most economists recommend, it does not “respond” to how economic growth is distributed in the economy over time. It also contributes to the regressivity of the state's overall tax system as shown in Figure 27. A regressive tax system places a greater tax burden on low and middle income taxpayers than affluent taxpayers, when tax burden is measured as a percentage of income.
• Implementing a progressive income tax would be the best way to make the Illinois tax system both responsive to growth in the economy and fairly assess tax burden across income classes, but that would require a constitutional amendment.

• Most of the revenue generated under the individual income tax goes to the state’s General Fund, although under Section 901 of the Illinois Finance Act, one-tenth of this revenue is distributed to local governments, under the Local Government Distributive Fund. Additional revenue generated from the state’s individual and corporate income taxes fund the individual and corporate “refund funds” which is simply the money used to distribute to taxpayers entitled to a refund under their completed Illinois tax returns.

Figure 28: Historical Performance of the Illinois Individual Income Tax

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Prior Year Inflation Adjusted CPI</td>
<td>$7,686</td>
<td>$7,996</td>
<td>$7,471</td>
<td>$7,341</td>
<td>$7,271</td>
<td>$7,979</td>
<td>$8,635</td>
<td>$9,408</td>
</tr>
<tr>
<td>Difference Actual / Inflation Adj</td>
<td>$7,947</td>
<td>$8,124</td>
<td>$7,650</td>
<td>$7,480</td>
<td>$7,511</td>
<td>$8,250</td>
<td>$8,457</td>
<td></td>
</tr>
<tr>
<td>$49</td>
<td>-$653</td>
<td>-$309</td>
<td>-$209</td>
<td>$468</td>
<td>$385</td>
<td>$951</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Corporate Income Tax. The Illinois Constitution also requires the state’s corporate income tax to be a flat rate. Section 201 of the Illinois State Finance Act sets the rate at 4.8 percent. Constitutionally, the state can impose an income tax on corporations that is no more than 8/5 greater than the rate assessed against individuals.40 The current corporate rate of 4.8 percent is the maximum allowed under constitutional constraints.

• Corporations also pay an additional 2.5 percent of their profits in taxes under the Illinois Personal Property Replacement-Tax.41 The Personal Property Replacement Tax funds local governments not state government.

• The state’s corporate income tax primarily feeds the state’s General Fund, although, like the personal income tax, one-tenth of the revenues from the corporate income tax are distributed to local governments under the Local Government Distributive Fund.
Figure 29: Historical Performance of the Illinois Corporate Income Tax

<table>
<thead>
<tr>
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<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Actual Revenues in Nominal Dollars</td>
<td>$1,237</td>
<td>$1,036</td>
<td>$803</td>
<td>$738</td>
<td>$937</td>
<td>$1,172</td>
<td>$1,428</td>
<td>$1,750</td>
</tr>
<tr>
<td>Prior Year Inflation Adjusted CPI</td>
<td>$1,279</td>
<td>$1,053</td>
<td>$822</td>
<td>$752</td>
<td>$968</td>
<td>$1,212</td>
<td>$1,464</td>
<td></td>
</tr>
<tr>
<td>Difference Actual / Inflation Adj</td>
<td>-$243</td>
<td>-$250</td>
<td>-$84</td>
<td>$185</td>
<td>$204</td>
<td>$216</td>
<td>$286</td>
<td></td>
</tr>
</tbody>
</table>

Sales Tax. The state sales tax (called the "Retailers’ Occupation Tax")\textsuperscript{42} generates revenue for both state and local governments. The general combined state and local rate is 6.25 percent. The state rate is 5.0 percent and the standard base local government rate is 1.25 percent. Local governments that are home rule entities can increase their base sales tax rate.\textsuperscript{43} For instance, using home rule authority the City of Chicago increased its base sales tax rate by 2.75 percent.

- The “base” of a sales tax consists of the transactions that have the tax applied to them. The sales tax base in Illinois is one of the most narrow in the nation.\textsuperscript{44} Thus it fails to respond to the modern economy and does not generate stable revenue. The main flaw is the sales tax applies predominately the sale of consumer goods. It does not include sales of food, drugs or the vast majority of consumer services. Illinois only taxes 17 of 168 class categories of services. The national average is 55 and each of Illinois’ neighboring states—-Iowa, Indiana, Missouri, Kentucky and Wisconsin—tax significantly more services than does Illinois.
- The state’s share of revenue from the sales tax is primarily deposited into the General Fund.

Figure 30: Historical Performance of the Illinois Sales Tax

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Actual Revenues in Nominal Dollars</td>
<td>$6,027</td>
<td>$5,958</td>
<td>$6,051</td>
<td>$6,059</td>
<td>$6,331</td>
<td>$6,595</td>
<td>$7,092</td>
<td>$7,136</td>
</tr>
<tr>
<td>Prior Year Inflation Adjusted CPI</td>
<td>$6,232</td>
<td>$6,053</td>
<td>$6,196</td>
<td>$6,174</td>
<td>$6,540</td>
<td>$6,819</td>
<td>$7,269</td>
<td></td>
</tr>
<tr>
<td>Difference Actual / Inflation Adj</td>
<td>-$274</td>
<td>-$2</td>
<td>-$137</td>
<td>$157</td>
<td>$55</td>
<td>$273</td>
<td>-$133</td>
<td></td>
</tr>
</tbody>
</table>

Public Utility Taxes. The state assesses public utility taxes on three different utilities the electricity excise tax, the telecommunications excise tax and the natural gas excise tax.

- The revenue 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 and into the fund that covers the Interstate Commerce Commission.

Figure 31: Historical Performance of the Illinois Public Utility Tax

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</thead>
<tbody>
<tr>
<td>Actual Revenues in Nominal Dollars</td>
<td>$1,116</td>
<td>$1,146</td>
<td>$1,104</td>
<td>$1,006</td>
<td>$1,079</td>
<td>$1,056</td>
<td>$1,074</td>
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<tr>
<td>Prior Year Inflation Adjusted CPI</td>
<td>$1,154</td>
<td>$1,164</td>
<td>$1,130</td>
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<td>-$8</td>
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<td>-$124</td>
<td>$54</td>
<td>-$59</td>
<td>-$18</td>
<td>$30</td>
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</table>

Lottery Transfers. Annually, 33.5 percent of total lottery sales become general state revenue that is earmarked for the Common School Fund. The remaining lottery proceeds go toward prizes, vendor fees and the lottery budget. Historically, a very small portion of the lottery proceeds have funded both veterans’ affairs programs and women’s health initiatives focusing on breast cancer.

Figure 32: Historical Performance of the Illinois Lottery Transfer

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<tbody>
<tr>
<td>Actual Revenues in Nominal Dollars</td>
<td>$128</td>
<td>$124</td>
<td>$123</td>
<td>$123</td>
<td>$127</td>
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<td>$156</td>
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<tr>
<td>Prior Year Inflation Adjusted CPI</td>
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<td>$125</td>
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<tr>
<td>Difference Actual / Inflation Adj</td>
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<td>$2</td>
<td>$16</td>
<td>$0</td>
<td>$0</td>
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</tr>
</tbody>
</table>
Cigarette Tax. Cigarettes are taxed by the state at a rate of 98 cents per pack. Of the receipts from cigarette taxes, $33.3 million a month are deposited into the General Fund. The amount deposited into the General Fund from the cigarette tax has been statutorily limited to $400 million annually. (The fiscal year 2005 total includes a one time only $50 million deposit in July 2004.) The fiscal year 2007 budget reduced this deposit to $350 million to reflect the historical decline in cigarette tax revenue. Additionally, $5 million per month from cigarette taxes are deposited into the School Infrastructure Fund and the remaining revenues are deposited into the Long Term Care Provider Fund.

Figure 33: Historical Performance of the Illinois Cigarette Tax Revenue

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<tr>
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<td>$400</td>
<td>$400</td>
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<td>$400</td>
<td>$450</td>
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<td>$350</td>
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<tr>
<td>Prior Year Inflation Adjusted CPI</td>
<td>$406</td>
<td>$410</td>
<td>$408</td>
<td>$413</td>
<td>$414</td>
<td>$461</td>
<td>$410</td>
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<tr>
<td>Difference Actual / Inflation Adj</td>
<td>-$6</td>
<td>-$10</td>
<td>-$8</td>
<td>-$13</td>
<td>$36</td>
<td>-$61</td>
<td>-$60</td>
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</table>

Gaming Tax. The state imposes a graduated tax on gross gaming revenues (called “adjusted gross receipts” or “AGR”) generated by riverboat casinos. The revenue from these gaming taxes are deposited into the General Fund. Some of the revenues are distributed to local governments in which the casinos are located. Adjusted gross receipts are currently taxed 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

Figure 34: Historical Performance of Gaming Tax Transfers

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</thead>
<tbody>
<tr>
<td>Actual Revenues in Nominal Dollars</td>
<td>$330</td>
<td>$460</td>
<td>$470</td>
<td>$554</td>
<td>$661</td>
<td>$614</td>
<td>$670</td>
<td>$685</td>
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<tr>
<td>Prior Year Inflation Adjusted CPI</td>
<td>$341</td>
<td>$467</td>
<td>$481</td>
<td>$565</td>
<td>$683</td>
<td>$635</td>
<td>$687</td>
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<tr>
<td>Difference Actual / Inflation Adj</td>
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<td>$3</td>
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<td>$96</td>
<td>-$69</td>
<td>$35</td>
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</table>

Motor Fuel and Storage Tank Taxes. Illinois levies fuel excise taxes of 19 cents per gallon of gasoline and 21.5 cents per gallon of diesel fuel. These fuel tax receipts are transferred to the Motor Fuel Tax Fund, the State Construction Account, a special fund created under the State Boating Act and the Grade Crossing Protection Funds. Illinois also assess excise taxes on underground storage tanks at the rates of 0.003 cents per gallon tax designated for the Leaking Underground Storage Tax and a 0.008 cents per gallon for the Environmental Impact Fee. Revenues from these taxes are deposited into the Underground Storage Tank Fund.

Figure 35: Historical Performance of the Motor Fuel and Storage Tank Taxes

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<tbody>
<tr>
<td>Actual Revenues in Nominal Dollars</td>
<td>$1,390</td>
<td>$1,424</td>
<td>$1,435</td>
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<tr>
<td>Prior Year Inflation Adjusted CPI</td>
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<td>$1,471</td>
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<tr>
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<td>$8</td>
<td>-$36</td>
<td>-$34</td>
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</tbody>
</table>

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

Figure 36: Historical Federal Transfers to Illinois General Fund

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</thead>
<tbody>
<tr>
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<td>$4,320</td>
<td>$4,258</td>
<td>$3,940</td>
<td>$5,189</td>
<td>$4,691</td>
<td>$4,725</td>
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<td>$4,389</td>
<td>$4,360</td>
<td>$4,015</td>
<td>$5,360</td>
<td>$4,850</td>
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<tr>
<td>Difference Actual / Inflation Adj</td>
<td>$297</td>
<td>-$131</td>
<td>-$420</td>
<td>$1,174</td>
<td>-$669</td>
<td>-$125</td>
<td>-$140</td>
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</table>
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. Illinois is able to do this because it decoupled from the federal repeal of the estate tax in 2003.

- Data show the state’s inheritance tax is only paid the wealthiest 1.7 percent of all taxpayers making it the only progressive tax Illinois has.
- Revenue from the Inheritance Tax is primarily deposited into the General Fund. Six percent of the revenue from this tax is diverted to the Estate Tax Collection Distributive Fund for distribution to the county of residence of the descendent.

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</thead>
<tbody>
<tr>
<td>Actual Revenues in Nominal Dollars</td>
<td>$348</td>
<td>$361</td>
<td>$329</td>
<td>$237</td>
<td>$222</td>
<td>$310</td>
<td>$272</td>
<td>$264</td>
</tr>
<tr>
<td>Prior Year Inflation Adjusted CPI</td>
<td>$360</td>
<td>$367</td>
<td>$337</td>
<td>$242</td>
<td>$229</td>
<td>$321</td>
<td>$279</td>
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</tr>
<tr>
<td>Difference Actual / Inflation Adj</td>
<td>$1</td>
<td>-$38</td>
<td>-$100</td>
<td>-$20</td>
<td>$81</td>
<td>-$49</td>
<td>-$15</td>
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Liquor Taxes and Fees. The state levies excise taxes of 18.5 cents per gallon on beer, 73 cents per gallon on wine and $4.50 per gallon on hard liquor. Revenue from the state’s liquor taxes are deposited into the General Fund.

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</thead>
<tbody>
<tr>
<td>Actual Revenues in Nominal Dollars</td>
<td>$128</td>
<td>$124</td>
<td>$123</td>
<td>$123</td>
<td>$127</td>
<td>$147</td>
<td>$152</td>
<td>$156</td>
</tr>
<tr>
<td>Prior Year Inflation Adjusted CPI</td>
<td>$132</td>
<td>$126</td>
<td>$126</td>
<td>$125</td>
<td>$131</td>
<td>$152</td>
<td>$156</td>
<td></td>
</tr>
<tr>
<td>Difference Actual / Inflation Adj</td>
<td>-$8</td>
<td>-$3</td>
<td>-$3</td>
<td>$2</td>
<td>$16</td>
<td>$0</td>
<td>$0</td>
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</tbody>
</table>

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 percent and other lines of coverage are taxed at a 0.5 percent 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.

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</thead>
<tbody>
<tr>
<td>Actual Revenues in Nominal Dollars</td>
<td>$209</td>
<td>$246</td>
<td>$272</td>
<td>$313</td>
<td>$362</td>
<td>$342</td>
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<td>Prior Year Inflation Adjusted CPI</td>
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<td>$250</td>
<td>$279</td>
<td>$319</td>
<td>$374</td>
<td>$354</td>
<td>$325</td>
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<tr>
<td>Difference Actual / Inflation Adj</td>
<td>$30</td>
<td>$22</td>
<td>$34</td>
<td>$43</td>
<td>-$32</td>
<td>-$37</td>
<td>-$15</td>
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</table>

Corporate Franchise Taxes and Fees. Illinois assesses franchise taxes on corporations in an amount equal to: (i) 0.15 percent of a corporation’s reported paid-in capital for its initial year of doing business in the state; (ii) an additional 0.15 percent of any increase in paid-in capital during the corporation’s initial year; and (iii) 0.10 percent 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.

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</thead>
<tbody>
<tr>
<td>Actual Revenues in Nominal Dollars</td>
<td>$139</td>
<td>$146</td>
<td>$159</td>
<td>$142</td>
<td>$163</td>
<td>$181</td>
<td>$181</td>
<td>$193</td>
</tr>
<tr>
<td>Prior Year Inflation Adjusted CPI</td>
<td>$144</td>
<td>$148</td>
<td>$163</td>
<td>$145</td>
<td>$168</td>
<td>$187</td>
<td>$187</td>
<td>$186</td>
</tr>
<tr>
<td>Difference Actual / Inflation Adj</td>
<td>$2</td>
<td>$11</td>
<td>-$21</td>
<td>$18</td>
<td>$13</td>
<td>-$6</td>
<td>$7</td>
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</tbody>
</table>
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 41: Historical Performance of Illinois Investment Income

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</thead>
<tbody>
<tr>
<td>Actual Revenues in Nominal Dollars</td>
<td>$233</td>
<td>$274</td>
<td>$135</td>
<td>$66</td>
<td>$55</td>
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<td>$153</td>
<td>$204</td>
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<tr>
<td>Prior Year Inflation Adjusted CPI</td>
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<td>$67</td>
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<td>$75</td>
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</tr>
<tr>
<td>Difference Actual / Inflation Adj</td>
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<td>-$143</td>
<td>-$72</td>
<td>-$12</td>
<td>$16</td>
<td>$78</td>
<td>$47</td>
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</table>

Cook County Inter-Governmental Transfer (IGT). The state retains a portion of federal Medicaid reimbursements paid to Cook County for rendering health care 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, federal law has recently changed in a manner that severely curtails the practice. For a complete review of both how the IGT system works and the impact of the recent 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.

The new federal law appears to mandate that Cook County, as provider of the Medicaid services to poor patients, receive the full federal Medicaid match and State government no longer appears entitled to retain any. While this change in law becomes effective in 2008, the state and Cook County appear to still be operating under the terms of the old IGT agreement, pursuant to which state government is retaining 65 percent of the Medicaid reimbursement paid by the federal government.

Figure 42: Historical Performance of the Cook County Inter-Governmental Transfer

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<tbody>
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<td>$245</td>
<td>$245</td>
<td>$355</td>
<td>$428</td>
<td>$433</td>
<td>$350</td>
<td>$307</td>
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<td>$251</td>
<td>$362</td>
<td>$442</td>
<td>$448</td>
<td>$359</td>
<td></td>
</tr>
<tr>
<td>Difference Actual / Inflation Adj</td>
<td>-$8</td>
<td>-$4</td>
<td>$104</td>
<td>$66</td>
<td>-$9</td>
<td>-$98</td>
<td>-$52</td>
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</table>

Vehicle Use Tax. This tax is imposed on motor vehicles purchased (or acquired by gift or transfer) in Illinois, from another individual or private party. (Sales of motor vehicles from registered Illinois dealers are taxed under the Retailers’ Occupation Tax Act.)

The tax amount is determined by either the purchase price or fair market value of the motor vehicle depending on the type and dollar value of transfer involved. Fair market value is used when there is no stated purchase price (e.g., the motor vehicle is a gift). If the vehicle’s purchase price is less than $15,000, the tax is based on the age of the vehicle. If the vehicle’s purchase price is $15,000 or more, the tax is based on the purchase price. In addition, there is a flat rate tax of $25 for purchases of motorcycles and all-terrain vehicles (ATVs).

Figure 43: Historical Performance of the Illinois Vehicle Use Tax

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<tr>
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<td>$1</td>
<td>-$2</td>
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Local Government Revenue Sharing

Local governments care what the state does about revenue collection. Why? – In FY 2007 over $8 billion was distributed from the state to local governments through various revenue sharing structures built into state law.53

- The revenue from the state’s individual and corporate income taxes shared with local governments under the Local Government Distributive Fund accounted for over $1 billion of that total. As discussed previously, one-tenth of the net collections from state individual and corporate income taxes (gross collections minus the refunds fund set asides) are distributed from the state to municipal and county governments in proportion to the percentage of total state population residing in the respective units of local government that qualify to receive distributions—i.e. municipalities and counties.

Other state transfers to local governments include:

- **Sales tax revenue** - local governments generally receive 20 percent of total collections (1.25 percent of the 6.25 percent rate) although home rule entities can receive more. Local governments also receive 100 percent of collections from a one percent tax on qualifying food and drug purchases.

- **Replacement taxes**:
  - **Personal Property Replacement Income Tax** is imposed on the income of corporations at the rate of 2.5 percent; and the income of partnerships, trusts, and S corporations at the rate of 1.5 percent.
  - **The Electricity Distribution Tax** is imposed on electric utilities or alternative retail electric suppliers who 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 kilowatt-hours (kwhs) distributed at the following monthly rates:
    - $0.00031 for the first 500 million kwhs
    - $0.0005 for the next 1 billion kwhs
    - $0.0007 for the next 2.5 billion kwhs
    - $0.0014 for the next 4 billion kwhs
    - $0.0018 for the next 7 billion kwhs
    - $0.0014 for the next 3 billion kwhs
    - $0.00131 for all kwhs distributed in excess of 18 billion kwhs
  - **Invested Capital Tax** – A tax imposed at 0.8 percent 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.
  - **Telecommunications Infrastructure Maintenance Fee (TIMF)** - The state TIMF is imposed at the rate of 0.5 percent 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 replacement taxes are distributed to local taxing districts as follows:
- 51.65 percent is distributed to Cook County taxing districts, which is then distributed to the taxing districts in the county on the basis of each district’s share of personal property tax collection for the 1976 tax year
- 48.35 percent 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 share in the revenue from the motor fuel tax. The current total rates are 19 cents per gallon on motor fuel and 21.5 cents per gallon on diesel fuel. State tax revenues are shared with local governments to be used for the construction and maintenance of highways. To qualify for funding, municipalities must be incorporated. Allocation is based on population. Counties receive their allotment based on total license fees in the county. Townships must levy a 0.08 percent road and bridge tax to be eligible to receive the money. Their allotment is based on total township mileage.

- **Gaming taxes** - Revenues received from the operator license fees and the 3 percent 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 licenses issued in each municipality or county. Revenues received from the operator license fees and the 5 percent 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 licenses issued in each municipality or county.
According to the Illinois Comptroller’s Office and despite the constitutional requirement that the state balance its budget, Illinois ran a $3.1 billion GAAP deficit in Fiscal Year 2005, the largest such deficit of any state in the nation.

The state primarily uses the follow three stratagems to enable it to deficit spend while still technically complying with the balanced budget requirement:

- Deferring Medicaid payment obligations owed to providers of health services from one fiscal year to the next fiscal year, a process known as “lapse period spending”;
- Under-funding the employer contribution the state owes its five public employee pension systems; and
- Transferring revenue from special state funds into the General Fund.

These stratagems have allowed the state to maintain public service levels that it does not have the fiscal capacity to afford. If state government does not have the fiscal capacity to provide the current level of public services it delivers without deficit spending, it cannot satisfy growing demand for public services, cover the cost of maintaining service levels from one year to the next, nor make enhanced investments in education, healthcare, human services, transit or other infrastructure.

Results of a Revenue System that Does Not Grow With Inflation: Structural Deficit

Illinois’ deficit is not just a one-time aberration resulting from unforeseen economic conditions or the actions of any one administration or legislature. It is the result of a revenue system that has not grown with the economy for decades, even though the cost of providing services has. This fiscal mismatch is called a “structural deficit”.

It results when a tax system does not generate enough revenue to continue funding the current level of public services into the future, adjusting solely for inflation and population growth.

Having a structural deficit means, even if Illinois does not expand, enhance or increase any existing services or provide any new services and even if the state were starting with a balanced budget, the revenue system will still create a deficit over time.

Figure 44 isolates how the state’s tax system fails to generate enough revenue to maintain current service levels over time, by ignoring the current GAAP deficit that has accumulated over decades and instead starting with the assumption that the state actually had recurring revenues equivalent to its budgeted expenditures for Fiscal Year 2007.

The projection of ongoing revenue shortfalls in Figure 44 is a conservative estimate that assumes:

- the economy will grow by 4 percent per year through 2026; and
- no new programs and no program expansions are passed, only current services under existing laws are maintained.

The graph in Figure 44 then compares the projected costs of maintaining current services over time against projected state revenue growth, adjusting solely for inflation based on the Bureau of Labor Statistics Consumer Price Index and population growth. It does not include the state’s GAAP deficit accumulated to date.

As Figure 44 illustrates, even if Illinois started with a balanced budget and had an economy that grew at 4 percent annually, the state’s deficit would still increase by more than $3 billion dollars over the next five years, without adding or expanding programs.

24 Center for Tax and Budget Accountability
Deficit Spending

As discussed in Section 8 above, to close the gap between revenues and expenditures (the structural deficit), the state employs unsound fiscal tactics, which either generate one-time unsustainable revenues or defer current obligations to future fiscal years. In both cases, these tactics ultimately make the situation worse. In fact, rather than actually balance the state’s budget in any given fiscal year, utilization of these stratagems merely masks the inability of the state’s tax system to generate the revenue necessary to support ongoing services. As Figure 45 details, Illinois has used over $12.9 billion in one-time revenues, fund sweeps and expenditure deferrals over the past five years to close gaping deficits in the General Funds.

Figure 45: Unstable, Non-Recurring Tactics Used to Fund Current Services

<table>
<thead>
<tr>
<th></th>
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<tr>
<td>Fund Sweeps</td>
<td>$165</td>
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<td>$140</td>
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<td>Increased Fee Transfers</td>
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<td>$162</td>
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<td>Tax Amnesty</td>
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<td>Pension Bond Sale</td>
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<td>Cigarette Tax Adjustment 62</td>
<td>$50</td>
<td>$50</td>
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<td>Federal Fiscal Relief 63</td>
<td>$675</td>
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<td></td>
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<td>$675</td>
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<tr>
<td>Deferred Medical Payments to Next Fiscal Year</td>
<td>$1,348.0</td>
<td>$2,949</td>
<td>$2,300</td>
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<td>$4,949</td>
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<td>Restructure of ERI Pension Payment</td>
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<tr>
<td>Increase in State Pension Fund Approps</td>
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<td>$80</td>
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<tr>
<td>Increase in non-IDOT Road Fund Approps</td>
<td>$95</td>
<td>$145</td>
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<td>$385</td>
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<tr>
<td>Pension Underfunding</td>
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<td>$1,178</td>
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<tr>
<td>Total</td>
<td>$560</td>
<td>$3,492</td>
<td>$4,030</td>
<td>$1,483</td>
<td>$3,409</td>
<td>$12,973</td>
</tr>
</tbody>
</table>

Tax Expenditures

A “tax expenditure” is actually 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 taxpayers’ 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 the taxpayer delivering the desired public good.

- Collectively, corporate tax expenditures in Illinois total over $1 billion annually.

Figure 46

Business Tax Expenditures

FY 2006 by Category

$ in millions

- General Business 73%  ($1,075)
- Agricultural 26%  ($373)

Source: Illinois Comptroller FY 2006 Tax Expenditure Report
The State of Working Illinois is an annual report that details the state’s industry, job, wage and benefit changes over time prepared by Northern Illinois University and the Center for Tax and Budget Accountability. The most recent report documented a number of challenges for policymakers based on changes in the Illinois economy. Among other things, the report showed that:

- Real, median income in Illinois declined by 12.2 percent from 2000 through 2006, the second worst decline in the nation;
- Since 1980, the percentage of Illinois workers with employer-provided health insurance declined from 75.4 percent to 59.2 percent;
- Less than half of Illinois workers currently have any private, employer-provided retirement benefits;
- Illinois lost 239,000 high paying manufacturing jobs since 1990—this loss of 26 percent of in-state manufacturing jobs over 17 years was worse than the rate of loss for the Midwest (20.8 percent) and the nation (20.9 percent);
- Most job growth in Illinois occurred in the lower paying, reduced benefit, service sectors; and
- Almost 60 percent of all new jobs created in the state over the next 10 years are projected to pay less than the current average of occupational wages, indicating median income will continue to decline.

Certainly, the Illinois economy is experiencing a transition that has major implications for the workforce and employers alike. But these implications do not stop with the private sector; they also have significant consequences for state government, impacting both the revenue and expenditure sides of the budget. On the revenue side, wages that grow at rates that do not keep pace with inflation lead to declining incomes and concomitant negative consequences on tax revenue, which constrains the state’s capacity to provide public services. Although this is an obvious aspect of the relationship between wages and the state budget, it is not the most meaningful. That is because, to a significant degree, longstanding structural flaws in the state fiscal system limit Illinois’ ability to generate revenue that responds adequately to economic growth anyway.

From a demand for public services standpoint, wage and benefit trends are crucially important. To the extent that many workers are realizing a decline in income over time, or a loss of health and/or retirement benefits, the corresponding demand for the public sector to fill benefit gaps, provide access to health care, childcare, housing assistance or even income supports grows.
Declining wage and benefit levels for workers, coupled with the transition in the state’s economy away from its traditional manufacturing base and towards lower paying service sectors, can be anticipated to challenge Illinois state government’s ability to raise revenue and provide the public services that will increasingly be demanded. Meanwhile, the state’s regressive tax system has actually worsened growing income inequality in Illinois and made it more difficult for middle and low income working families to make ends meet. Figure 49 shows the severe nature of income inequality in Illinois today. However, even if Illinois were to create significantly more high paying jobs than currently projected, state government would still run a deficit. (See the CTBA report, *Private Sector Job Trends and the Illinois Structural Deficit* at [www.ctbaonline.org](http://www.ctbaonline.org)). Due to its poorly designed fiscal system that has created a structural imbalance between what revenues produce and the ongoing cost of public services, Illinois state government seems ill-equipped to meet the challenges posed by changes in the private economy.

**Figure 48**

*Shares of U.S. Household Income by Quintiles (1980 & 2005)*

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**Conclusion**

The only sustainable solution to the structural flaws in the state’s fiscal system requires modernizing the Illinois tax system so it grows with the economy and is not overly reliant on the poor and middle class, like the reforms proposed in SB/HB 750 submitted by Senator James Meeks (D-15) in the Illinois Senate and Representative David Miller (D-29) in the House. The fundamental tax reform approach contained in HB 750 was in material part also recommended by the conservative business organization, The Civic Committee of the Commercial Club of Chicago, which found that, “To avoid collapse, a tax increase may be inevitable. The state could increase its income tax rates and expand its sales tax base without jeopardizing its competitive status compared to other Midwestern or urban industrial states.” Notably, the Civic Committee endorsed the targeted tax relief for low and middle income families known as the "Family Tax Credit" which exists in HB/SB 750.

Eliminating the structural deficit and making the state solvent requires tax reform. Illinois can accomplish sustainable tax reform and maintain its overall, low-tax competitiveness by following the fundamental principles of sound, capitalist taxation; i.e., taxation should be fair, responsive to economic growth, stable during recessions and not over reliant on local property tax revenue.

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Ultimately, Illinois either will have to reduce the level of public services it provides or modernize how it taxes in order to eliminate its ongoing deficit problems. However, tax reform that raises revenue and taxes more fairly and sustainably is the only one of these two option that will allow Illinois to make the investments in infrastructure, transit and education needed to be competitive in a modern economy.
Endnotes

1. All appropriation data is based on the Illinois Commission on Government Forecasting and Accountability.
5. Ibid.
6. Ibid.
8. The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 created Temporary Assistance for Needy Families (TANF), which is the current, national welfare program.
12. 40 ILCS 5/1-103.3
15. 49 of the 50 states have balanced budget requirements.
16. Center for Tax and Budget Accountability (CTBA) analysis of Illinois final budget expenditure reports since 1995. For more information see CTBA’s special report, Illinois has Cut Real Spending on All Services Except Health Care, Pensions and Education Since 1995, available online at: www.ctbaonline.org
17. Most state employees receive an annual cost of living adjustment as negotiated in contracts between employees unions and the state.
18. Center for Tax and Budget Accountability analysis of Illinois Commission on Government Forecasting and Accountability data.
20. Illinois Commission on Government Forecasting and Accountability, Bonded Indebtedness Reports.
21. The fundamental idea behind the pension bonds is that the state can borrow at a lower rate than the state can earn in investing the funds. In this case, the estimated rate of investment return for the bond proceeds is around 8.5%. The state borrowed (and is repaying bondholders) at an average rate of around 5.05%. The difference between these amounts is the projected “savings.”
25. Ibid.
28. Ibid.
33. Ibid.
34. 35 ILCS 5/201
35. Illinois Constitution Article IX, Section 3.
37. Center for Tax and Budget Accountability analysis of historical Internal Revenue Service and United States Census Bureau data.
38. Institute on Taxation and Economic Policy.
40. Illinois Constitution Article IX, Section 3
41. 30 ILCS 115/12
42. 35 ILCS 120/1 to 120/14
43. 35 ILCS 120
44. Based on data from the Federation of Tax Administrators.
45. 35 ILCS 505/2
46. 415 ILCS 125/Art. 3
47. 35 ILCS 405
48. 235 ILCS 5/8-1 to 5/8-14
49. 215 ILCS 5/409
50. 805 ILCS 5/Art. 15
52. 625 ILCS 5/Ch. 3
53. State of Illinois Department of Revenue FY 2004 Payments to Local Governments. All local government revenue sharing data and information is from the Illinois Department of Revenue.
54. Generally Accepted Accounting Principles. A standard established by the Accounting Practices Board of the American Institute of Certified Public Accountants. These rules, conventions and procedures define accepted accounting practices.
56. A comparison of Comprehensive Annual Financial Reports for each state is available from the National Association of State Auditors, Comptrollers and Treasurers.
57. The state is able to defer Medicaid payments to health care providers from one fiscal year to the next under 30 ILCS 105/25.
59. Ibid.
60. Based on the modeling designed for CTBA by J. Fred Giertz, Professor of Economics, University of Illinois and faculty at the Institute of Government and Public Affairs. See the CTBA report, Private Sector Job Trends and the Illinois Structural Deficit.
61. Executive Order 2003-10 authorizes the consolidation and transfer of facilities management, internal audit and staff legal functions from agencies directly responsible to the Governor to Central Management Services. The savings from consolidation are transferred to GRF equal $5.5 million for FY 2004.
62. The estimate of cigarette tax is $450 million in FY 2005. The $50 million increase over the previous year is due to a one-time change in the tax distribution authorized under SB 2206 (P.A. 93-839).
63. As part of the federal Jobs and Growth Tax Relief Reconciliation Act of 2003, Illinois is scheduled to receive $422 million in federal flexible grants as well as benefit from a 2.95% increase in our Medicaid matching rate. Together, those items are anticipated to total $675 million.