INSTITUTE OF GOVERNMENT & PUBLIC AFFAIRS

Where is Illinois Headed?

IGPA's *Fiscal Futures Project*

June 17, 2010

Richard Dye, Nancy Hudspeth & David Merriman

UNIVERSITY OF ILLINOIS
URBANA-CHAMPAIGN • CHICAGO • SPRINGFIELD

I. The Why

- Illinois lacks sufficient capacity to project fiscal demands & revenue streams into future
  - But many current choices have multi-year impact
  - Like the effects on future budgets of
    - Borrowing against or obligating future tax revenues
    - Delaying payment for current obligations
    - Not funding pension liabilities
- Lack of transparency in budget information
- Threatening demographic & health-cost trends
  - More retirees and fewer worker-taxpayers
  - Increasing share of state budget to medical costs

II. The How

- Compile state budget data into meaningful and consistently measured categories
- Estimate relationship between budget components and “driver” variables
- Use projections of driver variables to project receipts and spending into future

III. Creates Improved Budget Measure:

"Consolidated" not "General Funds" Budget

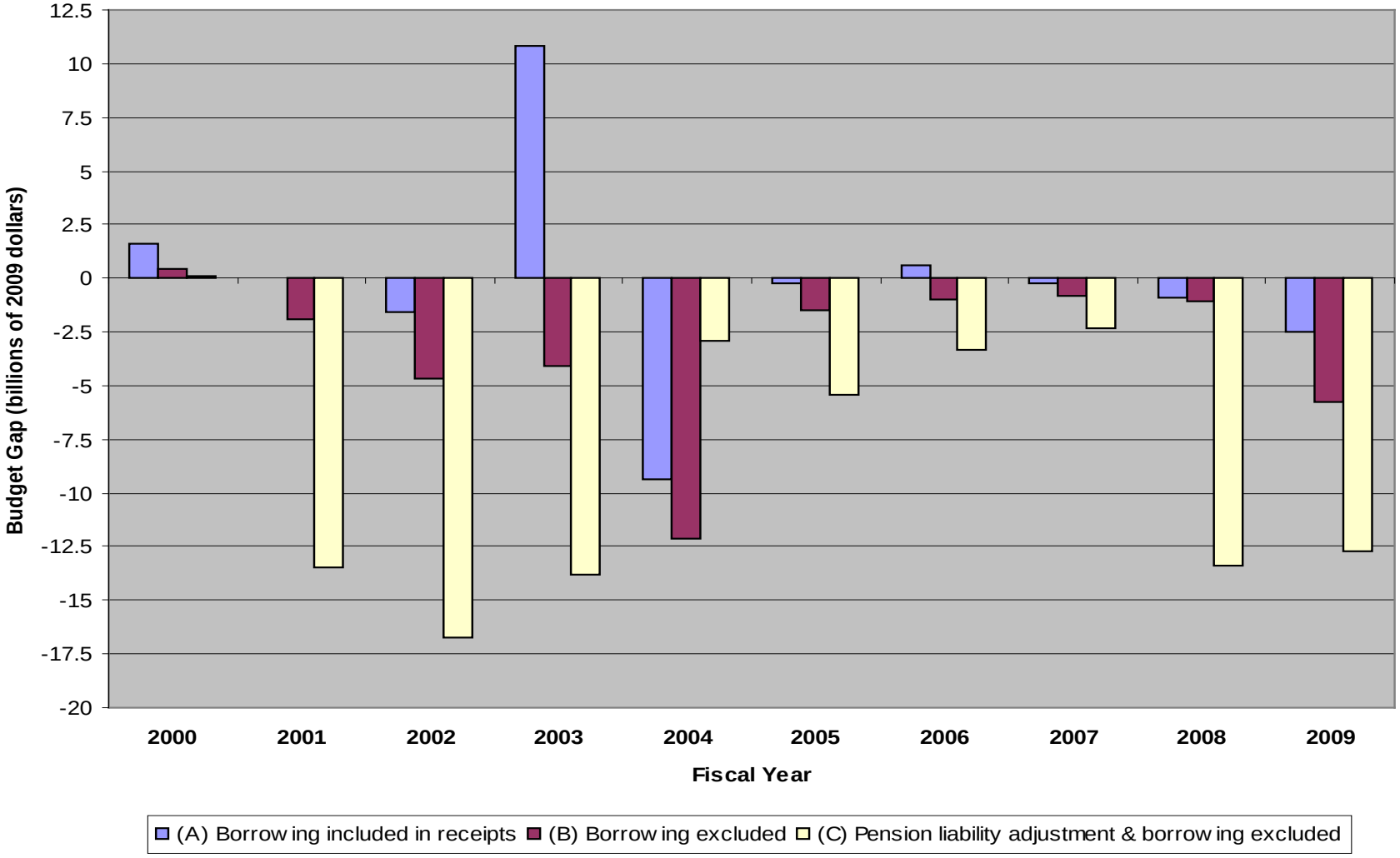
- More inclusive
  - Covers 380 v. 4 funds
  - Covers $61 billion v. $35 billion of spending in FY09
- More transparent
  - Brings major categories of state spending, like transportation, into the analysis
  - Inter-fund transfers don't obscure analysis
  - Re-assigning items won't obscure analysis

With consolidated funds have a consistent view of past budgets

- Budget gap = Receipts – Expenditures

  called “Surplus” if (+) or “Deficit” if (–)
- Budget gap under alternative measures
  - (A) Existing practice, which **counts new borrowing as a receipt**
  - (B) 1st alternative **excludes new borrowing**
  - (C) 2nd excludes borrowing and **adjusts for** cost of **new unfunded pension liability**

Figure 1: Surplus (+) or Deficit (-) in consolidated Illinois budget under alternative definitions



Source: Revised Table A.4.1

This look at 2000-09 budget gaps shows:

- Modest deficits or surpluses if (A) count borrowing and ignore new pension liability (exception: pension bonds sold in 2003, spent in 2004)
- Larger deficits and only one tiny surplus if (B) don't count borrowing as a receipt
- Large deficits in each of last 9 years if (C) also adjust for unfunded pension liability (but in 2000 was a tiny surplus, because stock market gains offset failure to fully fund new pension liabilities)

IV. Using model for budget projections

- Start with consolidated data for separate budget categories
- Supplement with data on economic and demographic “driver” variables
- Estimate relationship between budget components and driver variables
- Use projections of driver variables to project receipts and spending into future

Table 1: Expenditure Categories— Amounts and Projection Module Specification

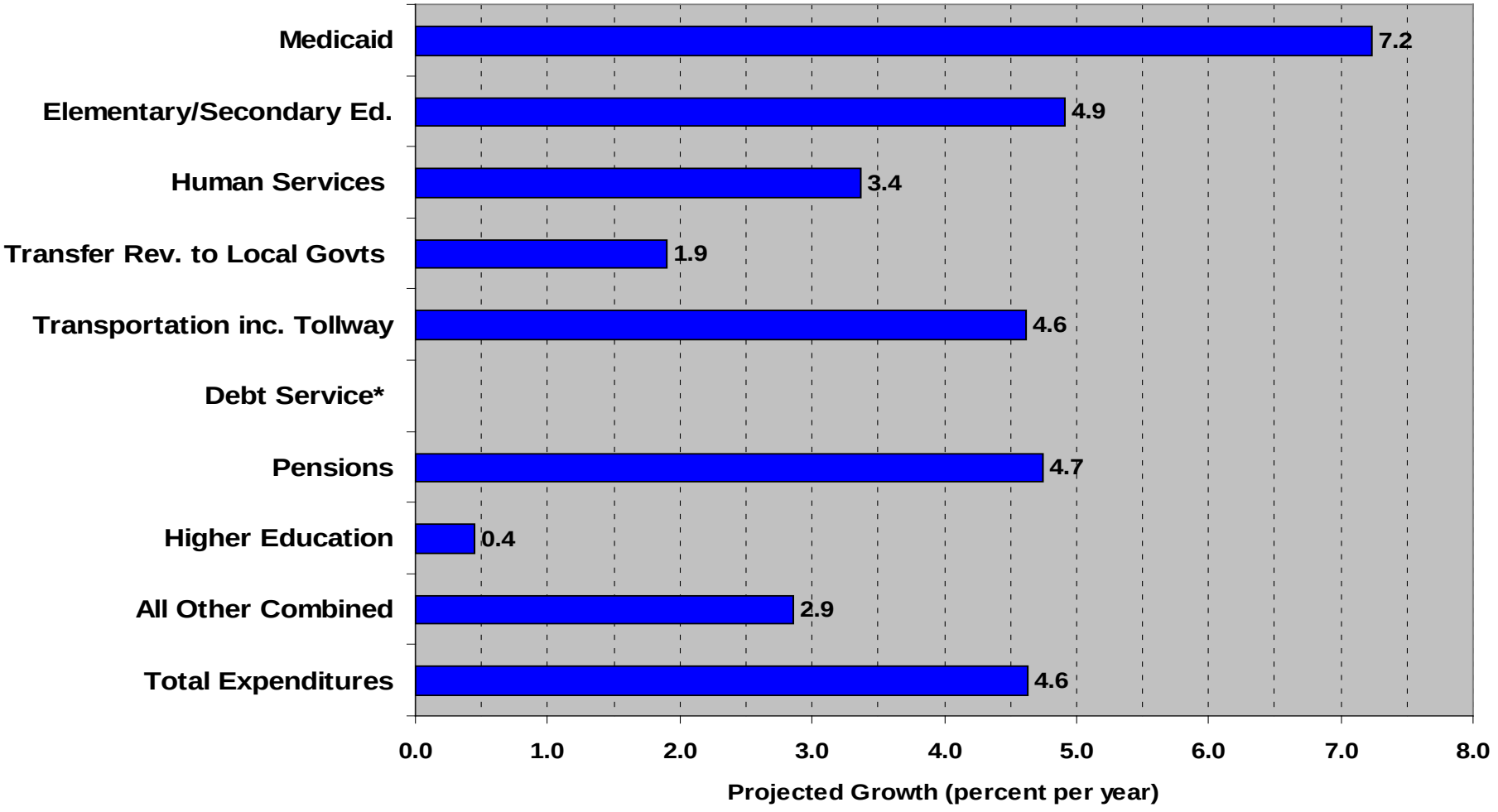
	$ Bil. FY'09	Predictors
Medicaid	**14.1**	**growth in personal income**
Elementary/Secondary Education	**9.4**	**growth in personal income & growth in population age 5-17**
Human Services	**9.0**	**growth in personal income**
Transfer Revenue to Local Govts	**5.4**	**same as "parent" revenue categories**
Transportation inc. Tollway	**4.6**	**growth in consumption of autos**
Debt Service	**3.4**	**as scheduled**
Pensions	**2.5**	**as scheduled**
Higher Education	**2.4**	**growth in population age 18-24**
All Other Combined	**10.2**	
Total Expenditures	**61.1**	

Table 2: Receipts Categories— Amounts and Projection Module Specification

	$ Bil. FY'09	Predictors
Federal Funds	**16.4**	**growth in population**
Personal Income Tax *	**9.2**	**Construct "anticipated revenue," given the tax rate, after personal exemptions, & after tax credits. Relate what's left to growth in personal income.**
General Sales Tax *	**9.0**	**growth in consumption net of services**
Bond Issue Proceeds	**3.3**	**assumed zero**
Business Income Tax *	**2.8**	**growth in personal income & growth in employment**
Motor Fuel/Vehicle/Operator *	**3.0**	**set to fixed amount in nominal dollars**
Short-Term Borrowing	**2.4**	**assumed zero**
Public Utility Tax *	**2.0**	**growth in personal income**
Smaller Categories Combined	**10.3**	
Total Receipts	**58.6**	

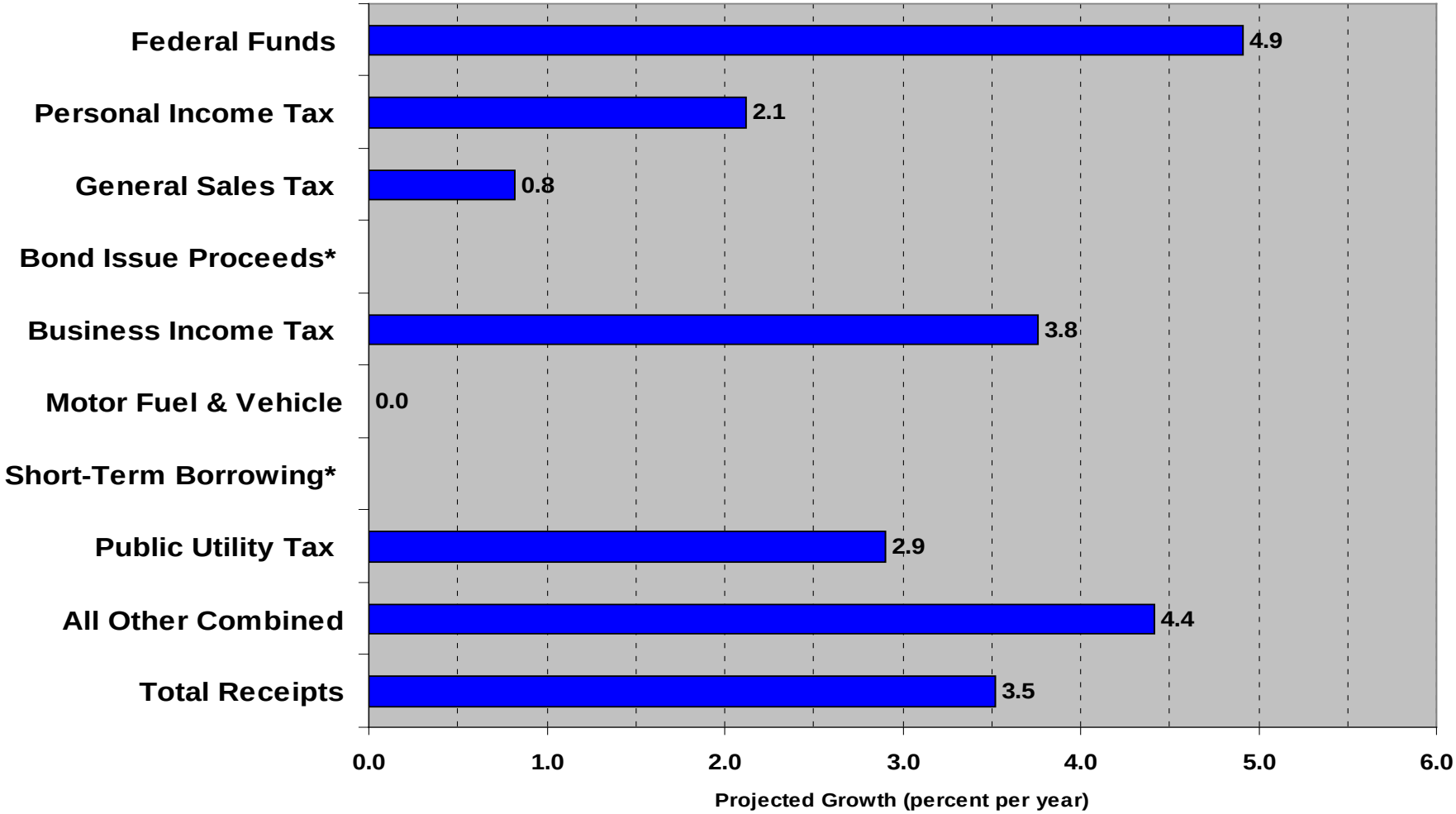
***Includes local govt. share**

Figure 2: Projected Growth for Consolidated Expenditure Categories
(annual average percentage rate for 2010 to 2024)



* Model assumes no new debt and only debt service currently obligated.

Figure 3: Projected Growth for Consolidated Receipt Categories
(annual average percentage rate for 2010 to 2024)

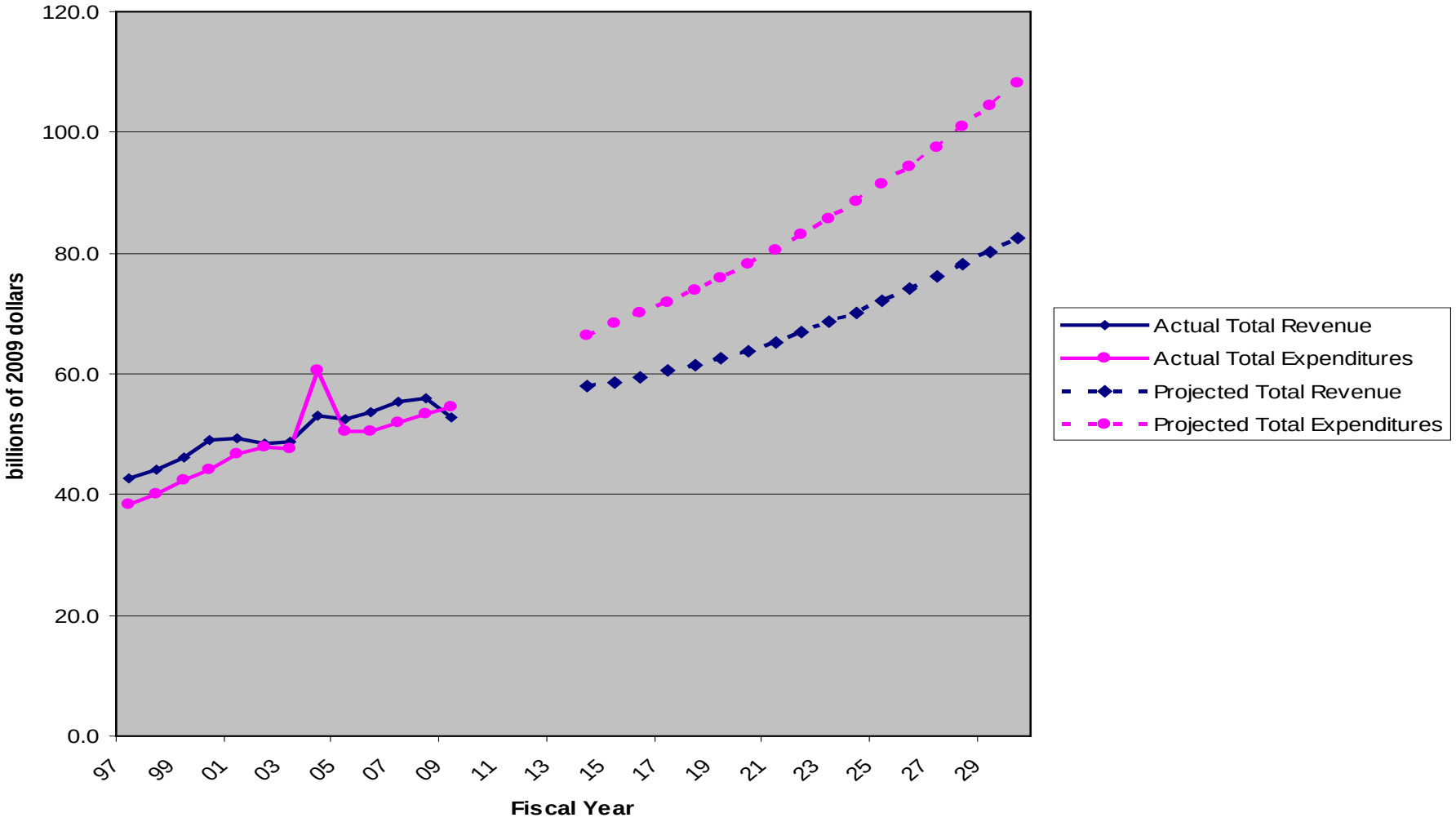


* Model assumes no new debt and only debt service currently obligated.

Budget projection results

- Expenditures
  - High projected growth for Medicaid, K12 education, transportation, and pension obligations
  - **Total outflow projected to grow 4.6 % per year**
- Receipts
  - Very low sales tax growth; modest income tax growth; federal aid (based on past experience) projected to be high growth
  - **Total inflow projected to grow 3.5 % per year**
- Projections by year (next slide)

Figure 4: Actual (FY 1997-2009) and Projected (FY 2014-2030)
Illinois Consolidated Total Receipts and Expenditures
with new borrowing **not** counted as a receipt (gap definition "B")



Model projects growing deficits

- This is because spending is projected to grow faster than receipts
  - Seemingly small 1 % per year difference, but
  - Difference compounds each year resulting in growing gap—a “structural deficit”
- Model makes “trend projections” not predictions of what will actually happen
  - Policymakers will be forced to decrease spending, increase taxes, or both

V. Using the model for “Scorekeeping”

- The model can simulate future budgets under alternative policy scenarios
- We’ve done initial simulations of increases in some major taxes. The bottom line:
  - There is no perceptible impact on **growth rate** of revenue in future, so
  - Even if tax change closes budget gap in one year, the **deficit will reemerge** in near future
- Can simulate different assumptions about economic or demographic trends

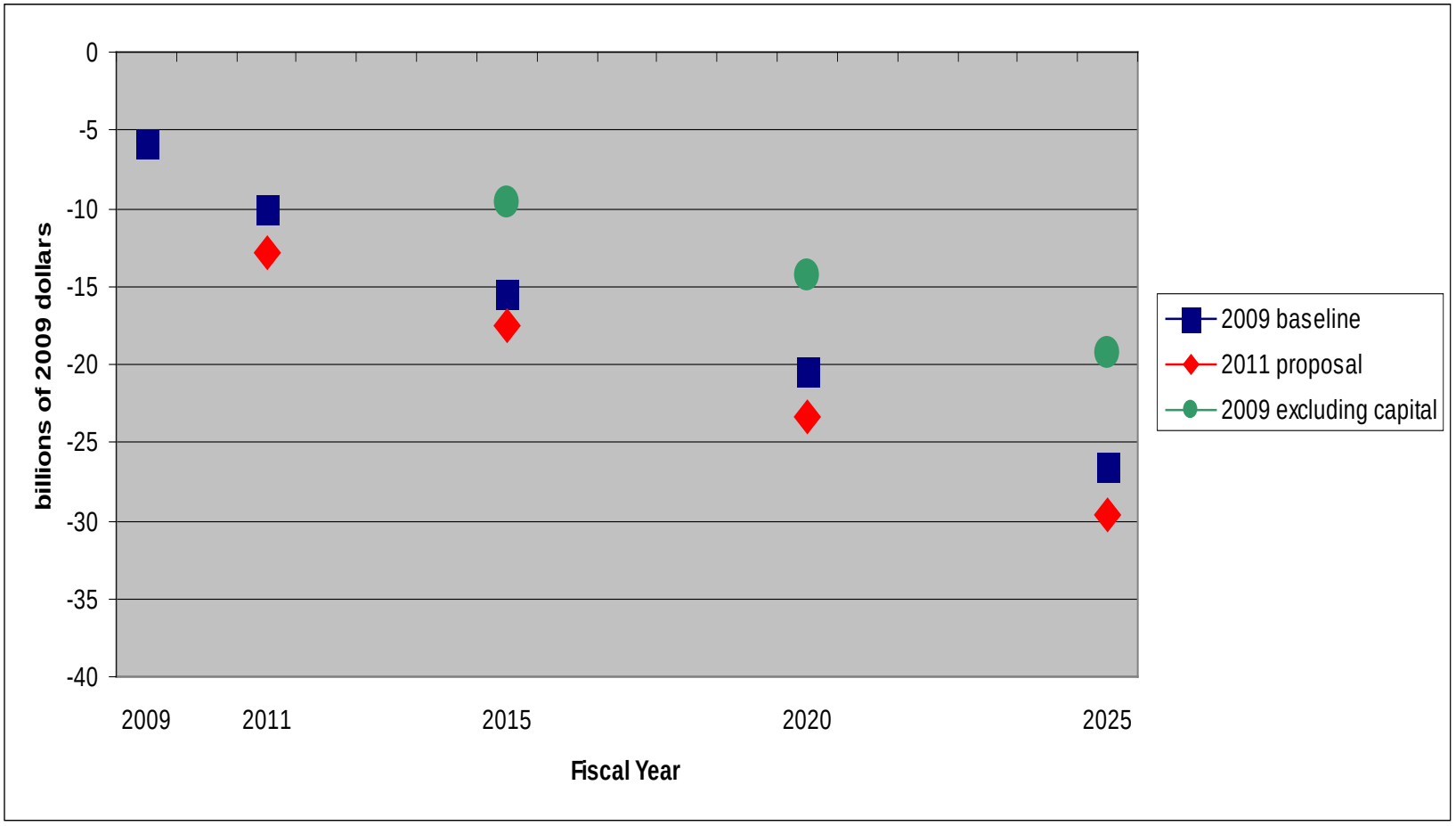
VI. The So What: Could change policy discussion

- Having projections will encourage explicit discussion of long- and short-run tradeoffs
- With projections, policymakers and media can better understand which policy elements merit the most attention
  - reducing the chance that the discussion gets sidetracked on less essential points

VII. Recent extensions of the model

- Separate capital spending from rest
  - Transportation, Natural Resources, Economic Development, and Capital Improvements
  - Link to specific revenues?
  - “Grants” for non-state capital projects
- Gov. Quinn’s Mar. 2010 proposal for FY11
  - Final budget adopted won’t be same, but
  - is more current baseline, especially revenues
  - Had to construct “consolidated” version

Figure 5: Budget Gap with Alternative Baselines
(all with new borrowing **not** counted as receipt—gap def. "B")



Source: Revised Table A.4.1 in May report (see notes to table)

VII. Summary Points

- Consolidated budget is more transparent
- Model can project current policy to future
- Model can estimate future budgetary impact of alternative policies

- Fiscal Futures Model is still a work in progress and we are seeking funding to continue

For reports or to contact us:

- Full report and other materials downloadable from http://igpa.uillinois.edu/content/fiscal-futures-project
- Institute of Government and Public Affairs
  815 West Van Buren Street, Suite 525
  Chicago, IL 60607-3525
- Richard Dye
  rfdye@uic.edu
  312-996-7644
- Nancy Hudspeth
  nwalla1@uic.edu
  312-996-6189