



THE FISCAL FUTURES PROJECT

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TOOLS TO ASSESS BUDGETARY CONCERNS: THE U OF ILLINOIS FISCAL FUTURES PROJECT

PRESENTED AT

*ILLINOIS FINANCIAL FORECAST FORUM: PRIVATE SECTOR VIEWS THAT WILL IMPACT THE PUBLIC
SECTOR*

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Lombard, IL

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IGPA'S FISCAL FUTURES PROJECT

- Mission: Conduct and promote objective, non-partisan, broad-based, long-term analysis of Illinois' budget
- Began in 2008 with goal of estimating trajectory of gap in state budget
- Recognized need for broad-based budget data consistently defined & categorized over time
- We now work closely with Illinois Comptroller to get detailed official data

METHODOLOGY AND GOALS

- We obtain raw data by FOIAing the Illinois Comptroller for a very detailed (more than 7,500 item) record of fiscal year revenues and expenditures as of October 1
- We clean the data and match it with previous years
- We aggregate the data to meaningful categories of revenues and expenditures

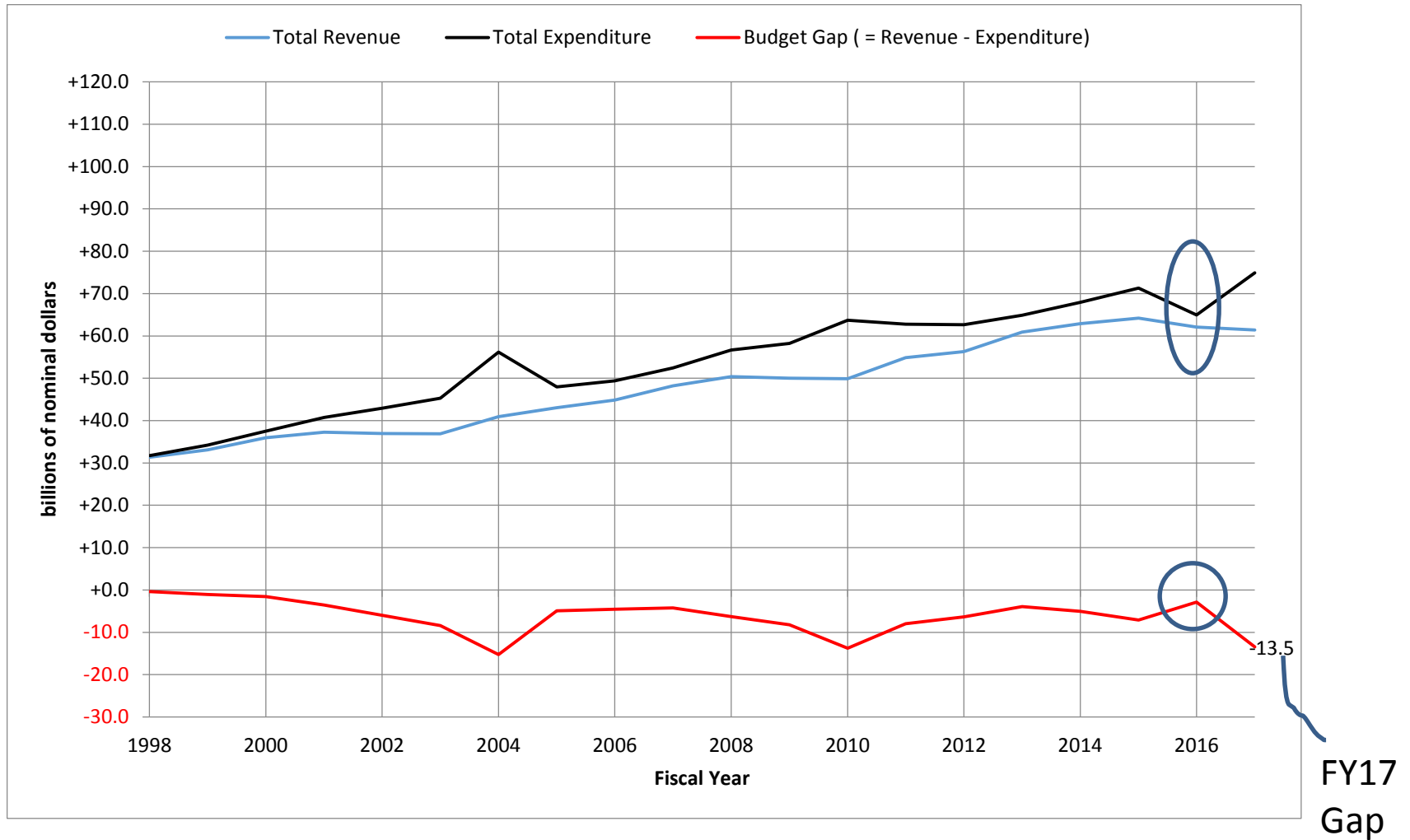
FISCAL FUTURES PROJECT

- **Broad-based:** “All Funds” budget measure, avoids distortions from General Funds alone
- Focus on ***Budget Gap***
$$= \textit{Total Revenue} - \textit{Total Spending}$$

Sustainable Total Revenue *excludes* new borrowing, decreased fund balances, or other one-time sources
- Analysis of potential options to improve Illinois’ fiscal outlook

WHAT IS ILLINOIS' CURRENT FISCAL SITUATION?

Illinois Revenue, Expenditure and Budget Gap (FY 1989 to 2017)

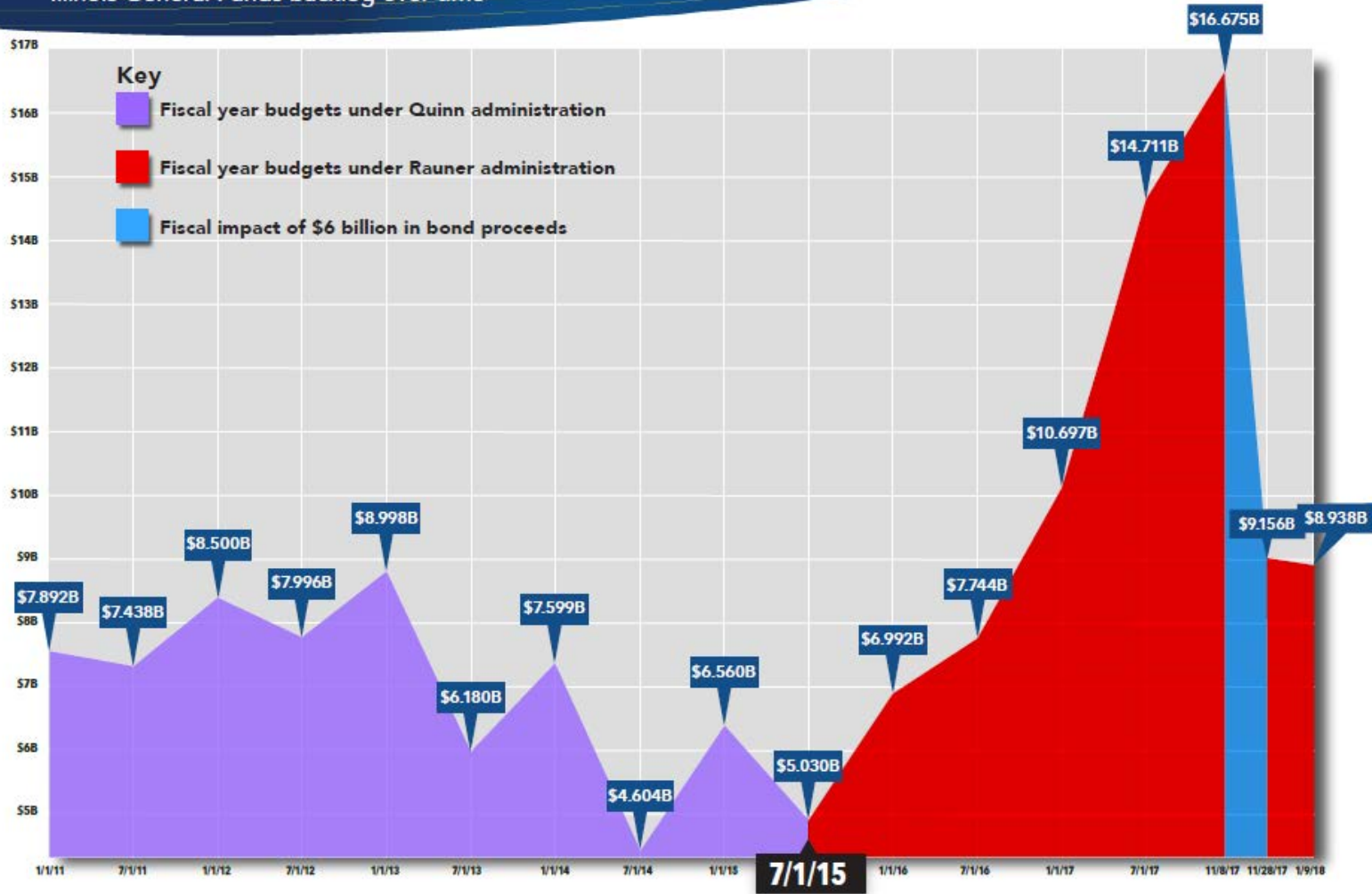


Detailed categories of spending in FY 2015, 16 and 17 (in millions of \$)

Fiscal Year	2015	2016	2017
Aging	1,032	710	1,256
Agriculture	68	54	67
Central Management	720	583	1,012
Children & Family Services	1,118	1,087	1,076
Commerce & Community Affairs	994	513	649
Natural Resources	289	154	211
Corrections	1,380	949	1,274
Employment Security	218	205	194
Human Services	5,854	5,017	5,364
Healthcare & Family Services (Net of Medicaid)	373	299	332
Public Health	396	337	363
Revenue	433	423	505
Transportation	4,343	4,142	3,998
Environmental Protect Agency	617	793	902
Toll Highway Authority	1,894	2,246	1,764
Community College Board	381	116	431
Student Assistance Commission	560	363	693
State Pension Contribution	6,719	7,309	7,519
Debt Service	4,050	3,536	5,603
State Employee Healthcare	2,070	118	2,974
Legislative	91	88	89
Judicial	397	387	421
Elected Officers	797	685	725
Public Safety	768	721	812
Business & Profession Regulation	256	175	146
Medicaid	16,914	17,035	17,853
Capital Improvement	747	88	251
Other Departments	1,085	669	731
Other Boards & Commissions	239	202	208
K-12 Education	8,903	9,331	9,755
University Education	1,308	386	1,265
Local Government Revenue Share	6,283	6,232	6,460
Total Expenditure	71,297	64,953	74,903
Decomposition of "Local Government Revenue Share"			
	2015	2016	2017
INCOME TAX 1/10 TO LOCAL	1,316	1,301	1,216
PPRT TRANSFER TO LOCAL	1,434	1,320	1,469
MFT TO LOCAL	534	583	582
GST TO LOCAL	2,998	3,028	3,192

BACKLOG VOUCHER REPORT (BVR)

Illinois General Funds backlog over time



STATE OF ILLINOIS
COMPTROLLER
SUSANA A. MENDOZA

All dates as of 8 A.M.
Source: Office of the Illinois Comptroller
Bills are not processed on non-business days and state holidays.

Illinois Bond Ratings

ILLINOIS' GENERAL OBLIGATION RATINGS HISTORY						
Date of Rating Action	Fitch		S&P		Moody's	
	Rating	up/down	Rating	up/down	Rating	up/down
February 2017	BBB	↓1x				
September 2016			BBB	↓1x		
June 2016			BBB+	↓1x	<i>Baa2</i>	↓1x
October 2015	BBB+	↓1x			<i>Baa1</i>	↓1x
June 2013	A-	↓1x			A3	↓1x
Jan 2013			A-	↓1x		
Aug 2012			A	↓1x		
Jan 2012					A2	↓1x
Jun 2010	A	↓1x			A1	↓1x

Agency Ratings Comparison	
Fitch/S&P	Moody's
AAA	Aaa
AA+	AA+
AA	Aa2
AA-	Aa3
A+	A1
A	A2
A-	A3
BBB+	Baa1
BBB	Baa2
BBB-	Baa3
BB+	Ba1
BB	Ba2
BB-	Ba3
B+	B1
B	B2
B-	B3
CCC+	Caa1
CCC	Caa2
CCC-	Caa3
CC	Ca
C	C

As of January 2017 Illinois had the lowest general obligation bond rating of any state in the country by all three rating agencies.

Source: Illinois Commission on Gov't Forecasting and Accounting March 2017. 3-Year Budget Forecast FY 2018-FY2020 <http://cgfa.ilga.gov/Upload/3YearBudgetForecastFY2018-FY2020.pdf>

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Bond Ratings

When debt is issued by the government, independent credit rating agencies attach a rating to the issue. The ratings attached to all bonds associated with the State of Illinois affect interest payments and the cost to Illinois taxpayers. Individual bond ratings will vary, but the general and special obligation bond ratings are directly related to financial condition of the state government.

General Obligation

MOODY'S	S&P	FITCH
Baa3 negative outlook	BBB- stable outlook	BBB negative outlook

Special Obligation

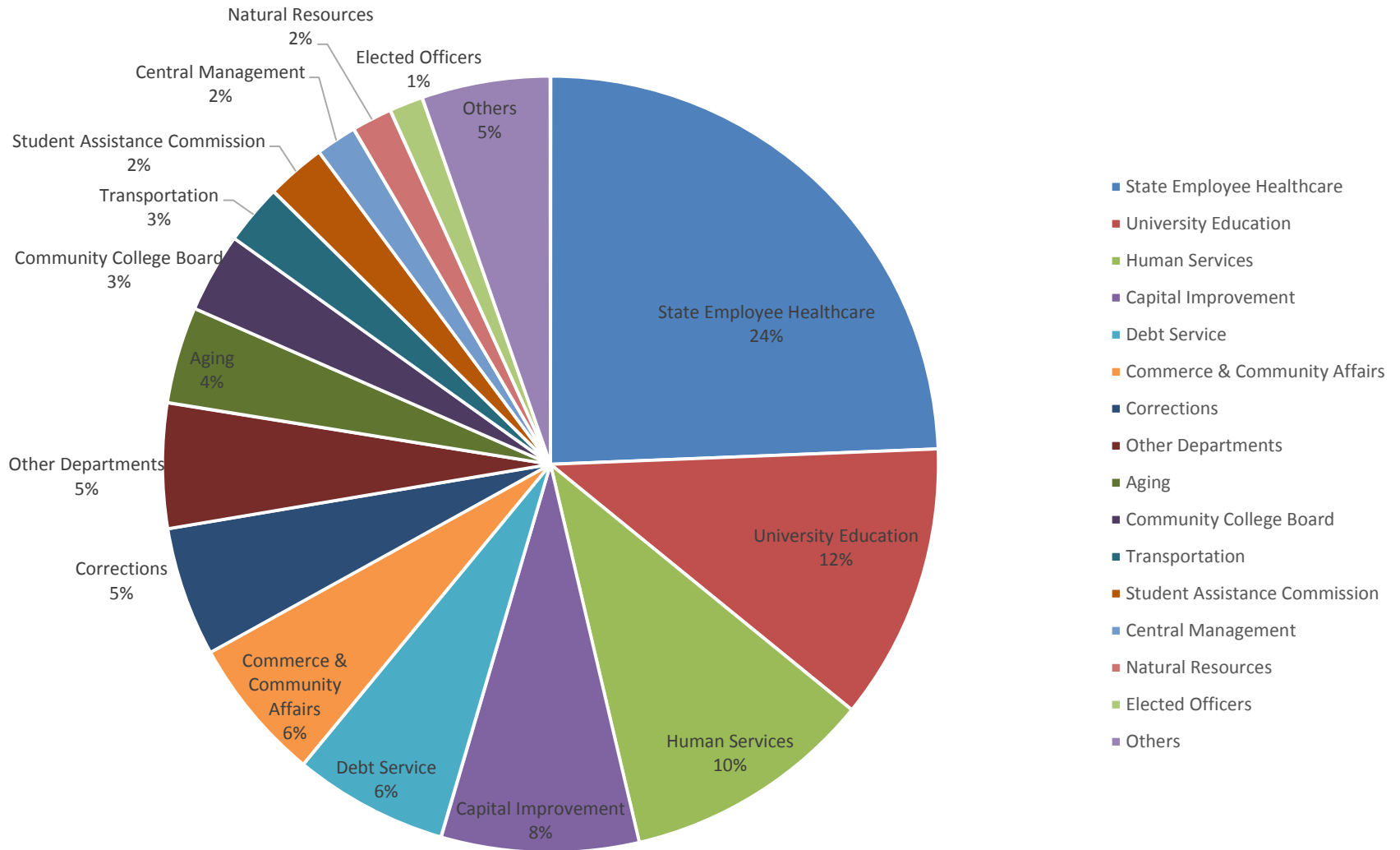
MOODY'S	S&P	FITCH
Baa3 negative outlook	AA- stable outlook	AA+ stable outlook

This table shows the most recent bond ratings from three credit rating bureaus for the two major State of Illinois bond programs.

As of January 9, 2018

Source: <https://ledger.illinoiscomptroller.com/fiscal-condition/bond-ratings/>

Proportion of Cuts in Expenditure (FY2015-FY2016)



HOW DID WE GET HERE?

Expenditures grew faster than
revenues for a long time
(and two years of budget chaos did
not help)

Level and growth rates of Illinois' revenue sources

Fiscal Year	FY2017 (\$ millions)	Share of Revenue (FY2017)	Compound Annual Growth Rate (FY1998-FY2015)	Growth Rate (FY2016)	Compound Annual Growth Rate (FY2015-FY2017)
Individual Income Taxes	11,738	19.1%	4.8%	-14.6%	-8.4%
Sales Taxes	11,385	18.5%	2.6%	1.4%	1.1%
Federal Medicaid	10,448	17.0%	7.0%	7.2%	-0.2%
Federal Other	5,934	9.7%	3.0%	-5.0%	-2.3%
Corporate Income Taxes	2,389	3.9%	4.7%	-17.6%	-17.8%
Receipts From Revenue Producing Activities	2,221	3.6%	6.5%	3.8%	2.5%
Medical Provider Assessments	2,138	3.5%	7.8%	-0.5%	4.4%
Federal Transportation	2,105	3.4%	5.4%	-9.2%	1.8%
All Other Sources	1,885	3.1%	4.2%	-17.2%	-3.4%
Motor Vehicle & Operators	1,585	2.6%	4.3%	0.8%	1.5%
Total Revenue	61,423	100.0%	4.3%	-3.3%	-2.2%

	Compound Annual Growth Rate (FY1998-FY2015)	Growth Rate (FY2016)	Compound Annual Growth Rate (FY2015-FY2017)
CPI	2.3%	1.0%	1.5%

Level and growth rates of Illinois' expenditures

Fiscal Year	FY2017 (\$ millions)	Share of Revenue (FY2017)	Compound Annual Growth Rate (FY1998-FY2015)	Growth Rate (FY2016)	Compound Annual Growth Rate (FY2015-FY2017)
Medicaid	17,853	23.8%	7.1%	0.7%	2.7%
K-12 Education	9,755	13.0%	3.4%	4.8%	4.7%
State Pension Contribution	7,519	10.0%	12.3%	8.8%	5.8%
Local Government Revenue Share	6,460	8.6%	3.5%	-0.8%	1.4%
Debt Service	5,603	7.5%	7.3%	-12.7%	17.6%
Human Services	5,364	7.2%	2.4%	-14.3%	-4.3%
Transportation	3,998	5.3%	4.8%	-4.6%	-4.1%
State Employee Healthcare	2,974	4.0%	7.5%	-94.3%	19.9%
Toll Highway Authority	1,764	2.4%	10.1%	18.6%	-3.5%
Corrections	1,274	1.7%	2.2%	-31.2%	-3.9%
University Education	1,265	1.7%	0.0%	-70.5%	-1.7%
Aging	1,256	1.7%	9.7%	-31.2%	10.3%
Children & Family Services	1,076	1.4%	-0.8%	-2.8%	-1.9%
Central Management	1,012	1.4%	4.3%	-19.0%	18.6%
Total Expenditure	74,903	100.0%	4.9%	-8.9%	2.5%

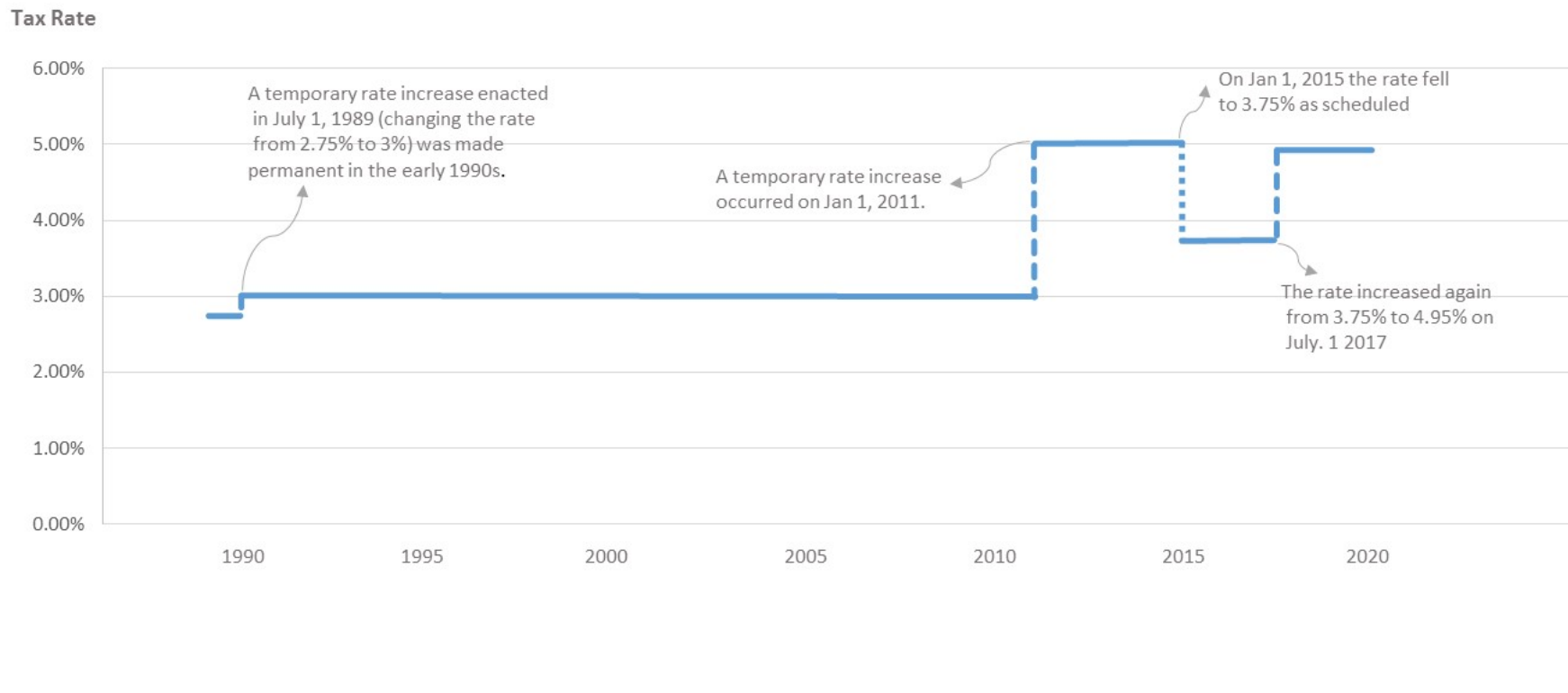
			Compound Annual Growth Rate (FY1998-FY2015)	Growth Rate (FY2016)	Compound Annual Growth Rate (FY2015-FY2017)
CPI			2.3%	1.0%	1.5%

Decomposition of "Local Government Revenue Share"	FY2017 (\$ millions)	Share of Revenue (FY2017)	Compound Annual Growth Rate (FY1998-FY2015)	Growth Rate (FY2016)	Compound Annual Growth Rate (FY2015-FY2017)
INCOME TAX 1/10 TO LOCAL	1,216	18.8%	3.6%	-1.1%	-3.9%
PPRT TRANSFER TO LOCAL	1,469	22.7%	4.0%	-7.9%	1.2%
MFT TO LOCAL	582	9.0%	0.6%	9.2%	4.4%
GST TO LOCAL	3,192	49.4%	4.0%	1.0%	3.2%

HOW DID WE GET HERE?

Tax policy did very little to offset this trend

Illinois Personal Income Tax Rate (1989-2020)



Source: Tax Rate Data Base from the Department of Revenue: <http://www.revenue.state.il.us/TaxRates/IndividualPriorYears.htm> ; <http://www.revenue.state.il.us/TaxRates/Income.htm>
 2017 Illinois tax hand book: <http://www.ilga.gov/commission/lru/2017taxhandbook.pdf>

Table 1. HISTORICAL ILLINOIS SALES TAX RATES

Effective Date	Rate
July 1, 1933	2.00%
July 1, 1935	3.00%
July 1, 1941	2.00%
July 1, 1955	2.50%
July 1, 1959	3.00%
July 1, 1961	3.50%
July 1, 1967	4.25%
October 1, 1969	4.00%
January 1, 1984	5.00%
January 1, 1990 - Current	6.25%

Source: Illinois Department of Revenue

An earlier income tax increase would have helped a little but, by itself would not have been nearly enough.

Analysis for the revenue amount if there were tax increase:			
	Fiscal Year	2016	2017
Current Income Tax Revenue		14,865	14,127
Income Tax Rate:		3.75%	3.75%
If Instead:		4.95%	4.95%
Then the Income Tax Revenue should have been:		19,622	18,648
So there would be extra tax revenue for FY2016 and FY2017 :		4,757	4,521
Current budget gaps for FY2016 and FY2017 are: (See Sheet "Figure1_Rev, Exp, Deficit")		-2,896	-13,480
The ratio of these extra revenue to current budget gaps:		164.3%	33.5%

What will happen to Illinois' Future Fiscal Balance?

“It's tough to make **predictions**, especially about the future”
attributed to philosopher, **Yogi Berra**,

WHAT WILL HAPPEN TO FUTURE REVENUES?

- Illinois state gov't revenues will be driven by three things
 - Federal policies on grants
 - State tax policies (recent income tax rate increase will raise roughly \$4.5 billion more per year)
 - Economic activity

Federal policies on grants

There is a significant chance that there will be dramatic changes in federal government policy about intergovernmental grants

From the 2016 Republican platform “We applaud the Republican governors and state legislators who have undertaken the hard work of modernizing Medicaid. ***We will give them a free hand to do so by block-granting the program without strings.***” (emphasis added)

Source: Republican Platform 2016

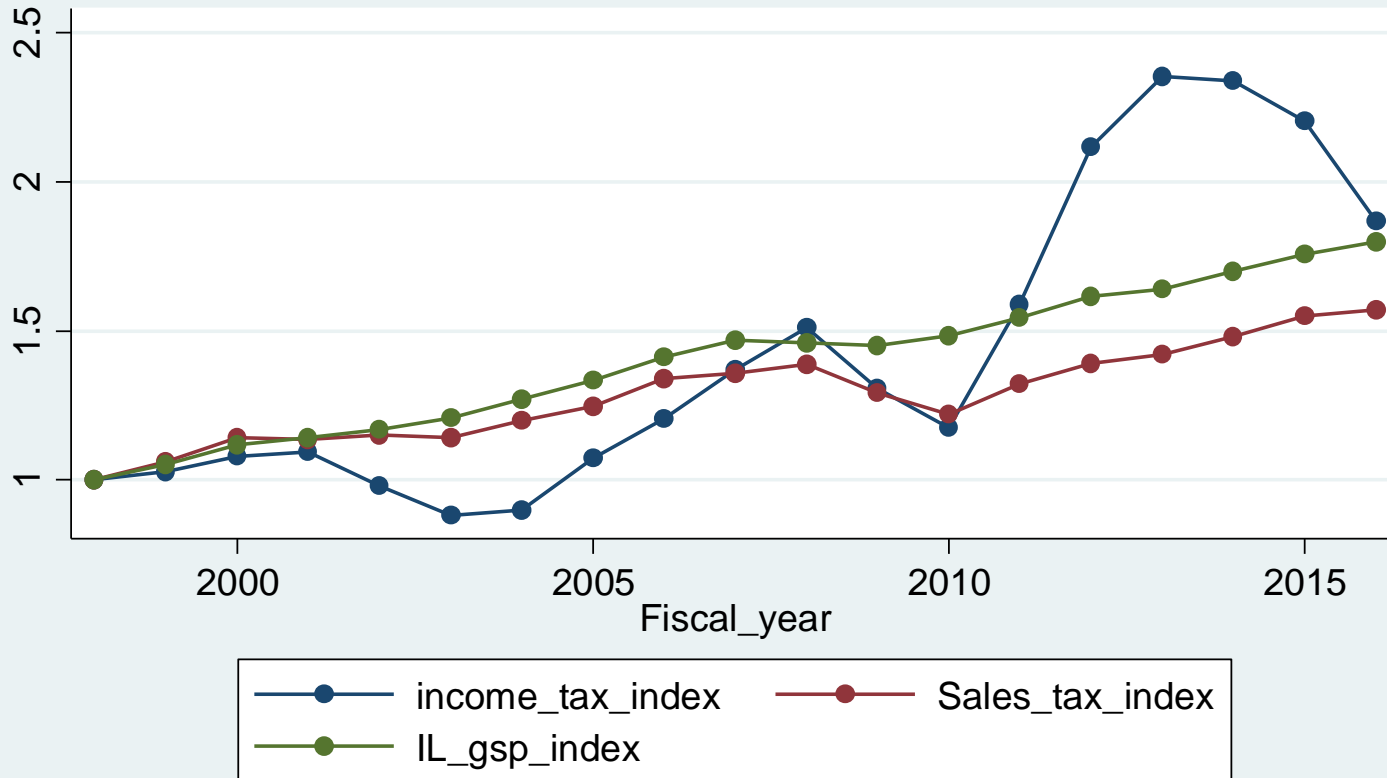
<https://prod-cdn-static.gop.com/static/home/data/platform.pdf>

State Tax Policy

- Election for governor
- Federal tax changes (limits on state and local tax deductibility) are expected to make it more challenging to increase state and local taxes

ECONOMIC ACTIVITY

Indicies of Illinois GSP, income tax revenue
and sales tax revenue
FY 1998 to 2016



Source: U of I Fiscal Futures Project. Based on data from Illinois Comptroller.

WHAT WILL HAPPEN TO FUTURE EXPENDITURES?

Illinois state gov't expenditures will be driven by

- Past commitments

 - Debt including infrastructure deficit

 - Unpaid bills

 - Pension

- State expenditure policy

- Economic activity

WHAT WILL HAPPEN TO FUTURE EXPENDITURES?

- \$2 billion of additional annual spending is necessary to maintain Illinois' infrastructure. (estimate of Fiscal Future's Martin Luby)
- \$17 billion of unpaid bills (some converted to longterm debt).
- \$350 million annual increase in pension spending over the next decade.
- What will happen to Medicaid?
- What will happen to K-12 education?

ILLINOIS HAS LARGE, CHRONIC, STRUCTURAL FISCAL PROBLEMS AND THERE IS NO SINGLE SOLUTION

- Additional borrowing, increased unfunded liabilities, or decreased asset balances will only make things worse
- Increases in economic growth—alone—are insufficient
- Increases in taxes—alone—are insufficient
- Cuts in spending—alone—are insufficient
- Aggressive pension changes—alone—are insufficient

- **No** quick fix



- **No** magic bullet



Virtually any remedy for Illinois' structural imbalance will require **sustained discipline** on both the expenditure and revenue side.