Institute for Illinois' Fiscal Sustainability at the Civic Federation

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CIVIC FEDERATION PROPOSES FIVE-YEAR PLAN TO BALANCE STATE BUDGET, ELIMINATE BILL BACKLOG & REDUCE INCOME TAX RATES

(CHICAGO) – In a report released today, the Civic Federation's Institute for Illinois' Fiscal Sustainability proposes a comprehensive plan for achieving long-term fiscal sustainability for the State of Illinois. The five-year plan would fully pay down the State's $5.4 billion backlog of unpaid bills while gradually reducing income tax rates by 20%, broadening the tax base and building a reserve fund as protection against future economic downturns. The full 47-page report is available at www.civicfed.org.

"This comprehensive approach, combined with the implementation of major pension reform legislation, would finally allow the State to move beyond what has become a perpetual fiscal crisis," said Laurence Msall, president of the Civic Federation. "Revenue enhancements alone are not enough to provide long-term stability for the State's finances while over-reliance on expenditure reductions could cripple essential services."

After examining the effectiveness of multiple State budget scenarios through FY2019 based on a series of long-term financial goals, the Civic Federation proposes the following recommendations:

1. **Completely Pay Down Bill Backlog**: The State should pay off its $5.4 billion backlog of unpaid bills over the next five years by establishing spending controls that limit the growth in net agency spending and create annual operating surpluses to fund bill backlog payments.
2. **Gradually Reduce Income Tax Rates by 20%**: Income tax rate increases that took effect in January 2011 are currently scheduled to be partially phased out in January 2015, leading to a dramatic reduction in State revenues. The State should eliminate the pending revenue cliff by extending income tax rate increases for one additional year in FY2015 and then gradually reducing the rates over the next three years (to 4.0% from 5.0% for individuals and to 5.6% from 7.0% for corporations by FY2019.)
3. **Broaden Income Tax Base to Include Federally Taxable Amounts of Retirement Income**: Out of the 41 states that impose an income tax, Illinois is one of only three that exempt all pension income and one of 27 that exclude all federally taxable Social Security income. The State should broaden its income tax base to create greater equity among taxpayers and facilitate the gradual rollback of the income tax rates. The broader base will also ensure greater long-term sustainability of the State's resources by accessing a growing portion of the Illinois economy.
4. **Build a Rainy Day Fund:** The State should work toward building a rainy day fund totaling at least 5.0% of General Funds revenues to help cope with the next economic downturn.
5. **Restore Full Share of Income Tax Revenues to Local Governments**: Municipalities did not share in the additional revenue generated by the 2011 tax increase, which reduced their share of total collections. In light of the pension funding crises and other financial pressures the State has imposed on Illinois municipalities, the State should restore the full 10.0% share.

The Civic Federation's comprehensive plan limits the growth in net agency spending to the target inflation rate established by the Federal Reserve Board of Governors. This ensures that operating surpluses are available to eliminate the State's backlog of unpaid bills. With a gradual income tax rollback and broadened tax base, the State would be able to fully pay down its bill backlog by FY2017. By FY2019, the State would also build a reserve fund of more than 6% of General Funds revenues available for future fiscal emergencies.

Three other budget scenarios are examined in the report. **Benchmark projections** based on Governor Quinn's recent three-year budget projection show a $3.9 billion revenue drop by FY2016 due to the scheduled rollback of income tax rates. This kind of fiscal cliff is unsustainable for a government that has not been able to pay off a mountain of unpaid bills left over from the recession. Under this scenario, the State's backlog of unpaid bills could climb from $5.4 billion at the end of FY2014 to $23.0 billion at the end of FY2019. Annual General Funds deficits would also increase dramatically due to continued expenditure growth and the scheduled reduction in income tax rates.

A **spending reductions only proposal** eliminates the State's backlog of unpaid bills but would require reducing net agency appropriations by $4.7 billion or 29.6% through FY2019. Cuts of this size could involve the elimination of large portions of government services widely regarded as essential. A proposal to **extend current income tax rates** could provide enough revenue to pay down the bill backlog by FY2019. However, this proposal offers no tax relief and does not allow for the creation of a rainy day fund. It also fails to provide additional funding to local governments, neglecting the State's responsibility to these financially distressed municipalities.

In contrast to the three other scenarios examined, the Civic Federation's proposal provides a roadmap for a sustainable fiscal future. The recommendations discussed above should be considered by the State as part of a formal five-year financial plan that is updated annually to reflect actual budget results and changes in economic condition.

The Institute for Illinois' Fiscal Sustainability at the Civic Federation is made possible by a generous grant from the John D. and Catherine T. MacArthur Foundation. The Institute's mission is to improve the State's decision-making process by providing timely fiscal policy analysis and recommendations to State officials, the media and the public through education and digital outreach. Please visit www.civicfed.org/iifs for more information.