Civic Committee

State Finance Updates

March 8, 2021

Introduction

The economic outlook for the State has improved compared to where it was a few months ago. When the Governor's Office of Management and Budget (GOMB) released budget projections last November, it showed a bleak outlook with budget deficits from FY22-FY26 hovering around $4-$5 billion a year (the projected deficit for FY22 was $4.8 billion). However, State revenues, like those of many states, have outperformed expectations, and the projected budget deficit for FY22 has been revised downward to approximately $3 billion. Despite that improvement, it will be a difficult task to close a $3 billion budget gap.

On February 17th, Governor Pritzker delivered his State of the State Address and outlined his proposed General Funds budget for FY22. If enacted as-is, the Governor's proposed budget would close that gap and produce a small surplus, but it would not set the State up for long-term success. The proposed budget does not represent a comprehensive fiscal plan, and instead relies on short-term measures to provide enough cash to get through the fiscal year without enacting major structural reforms to expenditures or revenues.

Governor Pritzker's Proposed FY22 Budget

Expenditures

Proposed FY22 expenditures total $41.6 billion. Although some expenditure lines will see increases and some will see decreases, total discretionary spending will be held flat to FY21 levels. Important expenditure highlights include:

- Holding K-12 education spending flat for the second year in a row;[1]
- Increasing Human Service funding by $300 million;
- Reducing General Funds Medicaid spending by $638 million;[2]

[1] The Evidence Based Funding law enacted in 2017 calls for $350 million in year-over-year increases for K-12 education funding. Keeping spending flat for two years in a row puts K-12 education funding $700 million behind the funding goal laid out in law.

[2] The reduction is due to a combination of lower-than-anticipated liabilities in FY20 and FY21 as well as an increased federal match percentage for State Medicaid spending through December 2021.

- Full payment of certified FY22 pension contributions of $9.4 billion,[3] an increase of $742 million over FY21;
- Eliminating $690 million of Municipal Liquidity Facility (MLF) borrowing repayment due to pre-payment in FY21;[4] and
- The continuation of $700 million in expenditure reductions the Governor identified in FY21.[5]

The $700 million in expenditure reductions continued by the Governor include $75 million for "personnel cost adjustments" for State employees; the nature of these adjustments and final savings have yet to be negotiated with AFSCME. However, other states, including New York, New Jersey, and Washington, have been more aggressive in their personnel cost-cutting measures in the face of budget shortfalls and have instituted furlough days and cancelations or deferrals of scheduled raises. [6] If Illinois were to defer raises, it could potentially save the State $313 million this fiscal year.[7]

Revenues

Projected FY22 revenues will total $41.7 billion if the Governor's proposed revenue raisers are enacted. This is a decrease of approximately $1.8 billion compared to FY21.[8]

As part of this revenue total, the FY22 budget plans to raise $932 million through policy changes that the Governor describes as "closing corporate loopholes." These proposed changes include:

- Capping Net Operating Losses (NOLs) for corporate income taxpayers at $100,000 for three years ($314 million);[9]

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[3] $9.4 billion is the portion of pension contributions that comes out of the General Funds. The total pension contribution across all state funds is estimated to be $10.5 billion. Source: Special Pension Briefing, Commission on Government Forecasting and Accountability, https://cgfa.ilga.gov/Upload/1120%20SPECIAL%20PENSION%20BRIEFING.pdf.

[4] The State borrowed a total of $3.2 billion through the MLF. By pre-paying $690 million in FY21, the State eliminated the $690 million required debt service payment for FY22.

[5] This list of spending cuts only included items the Governor could change without legislative involvement. A full list of these cuts is available here.

[6] In New York, Governor Cuomo has delayed scheduled pay increases for two years, but it is expected the raises will be made up in 2023. In New Jersey, Governor Murphy negotiated furloughs and a delay in scheduled pay increases until December 2021. Governor Inslee of Washington canceled scheduled pay raises under the previous budget and negotiated furlough days and no pay increases for the 2021-2023 biennial budget.

[7] Mailee Smith, "While Pritzker Talks State Worker Furloughs, New York Delays Raises," Illinois Policy Institute, January 14, 2021.https://www.illinoispolicy.org/while-pritzker-talks-state-worker-furloughs-new-york-delays-raises/

[8] Although revenues have recovered somewhat, they will be down year-over-year because of one-time infusions of cash that happened in FY21 (due to the delayed federal tax deadline and MLF borrowing), as well as a projected reduction in federal receipts due to an increased Medicaid match percentage applying through the end of the calendar year, therefore only half of the fiscal year.

[9] It is important to note that this provision would not take away the ability to use NOLs completely. The NOL cap is temporary, and affected businesses will only be delayed in when they are able to use their NOL deductions.

- Rolling back federal Tax Cuts and Jobs Act (TCJA) provisions for foreign-source dividends and treating those dividends the same as domestic-source dividends ($107 million);
- Rolling back TCJA provisions allowing for 100% accelerated depreciation ($214 million);
- Accelerating the expiration of biodiesel exemptions ($107 million);
- Capping the retailer's discount at $1,000 a month ($73 million);
- Reversing the repeal of the Corporate Franchise Tax ($30 million);
- Reducing the tax credit for private school scholarships ($14 million);
- Eliminating a tax credit for construction job payroll expenditures ($16 million); and
- Removing production-related tangible personal property from the Manufacturing, Machinery, and Equipment (MME) sales tax exemption ($56 million).

There is plenty of disagreement over the potential impact of the Governor's proposed changes and how they may impact the business climate. Some business groups, including the Illinois Chamber of Commerce and the Illinois Manufacturer's Association, have argued that making these changes during the middle of a recession is ill-advised and will make it less attractive to do business in Illinois compared to other states.[10] On the other hand, the Pritzker administration has said that some of these policies (e.g., capping NOLs and capping the retailer's discount) will only impact a small share of businesses – for example, the NOL cap would not impact 80% of corporate taxpayers claiming losses and the cap on the retailer's discount would leave 99% of retailers unaffected.[11]

One policy on this list that would clearly make Illinois an outlier is reversing the repeal of the Corporate Franchise Tax, which is a tax on capital stock. The majority of states do not have capital stock taxes, and of the 16 states that do, four states are currently in the process of phasing it out or will begin phasing it out this year.[12] We advocated for the repeal of the Corporate Franchise Tax in our *Bringing Illinois Back* and *Restore Illinois* reports.

In addition to raising revenue through the changes above, the Governor's budget proposes redirecting revenue from Other State Funds (including the Capital Projects Fund, among others) to the General Funds, reducing local government revenue sharing, and extending the repayment period for interfund borrowing. Reductions in revenue sharing will result in an approximately $200 million increase to the General Funds; sweeping some revenue streams and eliminating the requirement to pay back interfund borrowing within 48 months will result in an additional $456 million increase to the General Funds. Repurposing existing revenue streams in this manner will provide a temporary cash flow boost to the General Funds, but will

[10] "Pritzker SOTS/Budget react," Capitol Fax, https://capitolfax.com/2021/02/17/pritzker-sotsbudget-address-react/

[11] "Illinois State Budget: Fiscal Year 2022," Governor JB Pritzker, February 17, 2021, pp.49-50. https://www2.illinois.gov/sites/budget/Documents/Budget%20Book/FY2022-Budget-Book/Fiscal-Year-2022-Operating-Budget.pdf.

[12] The four states phasing out the tax include Illinois. Source: Janelle Cammenga, "Does your State Levy a Capital Stock Tax?" April 29, 2020. https://taxfoundation.org/state-capital-stock-tax-2020/#:~:text=As%20such%2C%20the%20tax%20tends,types%20of%20taxes%20as%20well).

not provide long-term budget solutions, and it will pull funding away from other important priorities, including transportation and capital funding.

Another potential cash flow boost that could occur soon is if Congress passes President Biden's $1.9 trillion economic recovery proposal, which includes $350 billion in unrestricted aid for state, local, and tribal governments. If the bill passes as-is, Illinois is projected to receive $7.5 billion and local governments in Illinois would collectively receive $5.7 billion.[13] It is important to note that the Governor's FY22 budget proposal does not assume new federal aid.

Next Steps

As we have consistently stated, the State needs a comprehensive fiscal plan to put itself on the right path and change the negative narrative about Illinois. While the proposed FY22 budget achieves balance if all elements are enacted as proposed, it does not provide the long-term solutions the State needs to address its finances and it will not change the perception that Illinois will not make the difficult choices necessary to put itself back onto firm fiscal footing. Illinois continues to have the worst credit rating in the country.

Given the political landscape and the challenges it presents, we are focusing our efforts on educating stakeholders through meetings about why it is so important to have a comprehensive fiscal plan in place and emphasizing the real-world consequences of continued inaction. Our goal is to emphasize that the lack of a comprehensive fiscal plan is not an abstract problem, and that it is likely contributing to the State's underperformance on a number of economic indicators. For example:

- From 2000-2019, Illinois' nonfarm employment grew only 2.3%, which ranks 46th out of the 50 states and Washington, DC.
- During that same period, Illinois' gross state product (GSP) maintained its position as the fifth largest in the United States, but its GSP growth was ranked 43rd out of all states and Washington, DC.
- From 2010-2020, Illinois' population declined by approximately 240,000 people, or almost 2%. Only West Virginia experienced a larger decline as a share of population.
- Since 2000, real dollar spending on core government services such as education, human services, and healthcare has declined by 23%.

The Illinois Economic Indicators document included in the State Finance Materials includes a fuller explanation of these metrics and how Illinois performs compared to other states.

We are working to schedule meetings with members of the Governor's administration and legislators in the coming months to see what opportunities there may be for a comprehensive plan going forward.

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[13] Yvette Shields, "Midwest State Budgets Take Shape with Eye to Pandemic Recovery," The Bond Buyer, February 16, 2021. https://www.bondbuyer.com/news/midwest-state-budgets-take-shape-with-eye-to-pandemic-recovery

City Budget Summary

The outlook for the City budget remains gloomy. The City of Chicago is facing some of its most difficult fiscal challenges in history, with a two-year budget deficit of $2 billion (almost $800 million for 2020 and $1.2 billion for 2021).

To close the budget gap, the FY21 budget included some tax increases (property tax levy, gas tax, and tax on cloud computing) and relied heavily on new debt as well as scoop and toss debt restructuring.

Since the budget was passed, there have been new developments related to the City's budget.

- The passage of HB 2451 during the General Assembly's recent lame-duck session, which creates a 3% annual benefit increase for certain participants in the City's Firemen's Annuity and Benefit Fund of Chicago (FABF), could add $18-$30 million a year to the City's pension costs if signed into law.
- There is also concern that if the firefighters' pension bill is signed into law, companion legislation extending these benefit increases to the Chicago Policemen's Annuity Benefit Fund of Chicago (PABF) will be passed as well (a companion bill has already been filed). If passed, it would boost costs to the City for police pensions by an additional $50 to $90 million a year, or $2.6 billion through 2055.
- If President Biden's $1.9 trillion economic recovery proposal passes as-is, the City would get $1.8 billion of the total $5.7 billion in local government funding allocated to Illinois.
- While the City struggles to deal with its budget shortfall, some of its sister agencies are benefitting from the COVID-19 stimulus bill approved by Congress on December 21, 2020.
    - Chicago Public Schools anticipates an overall allocation of $800 million to support students in FY21 and FY22.
    - That same stimulus package will also provide the Chicago region with approximately $450 million of the $14 billion for transit agencies nationwide. The CTA is expected to get $361 million from the funding.

We oppose the Firefighter's pension bill and sent two letters to the Governor requesting a veto. The first letter we sent independently; on the second we were co-signers with the Civic Federation, BOMA, the Chicagoland Chamber of Commerce, and the Illinois Municipal League.

We will continue to monitor the budget situation of the City and its sister agencies as it unfolds.