VOICES FOR ILLINOIS CHILDREN

BUDGET & TAX POLICY INITIATIVE

ISSUE BRIEF

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GENERAL FUNDS REVENUE ESTIMATES FOR FY 2012

IMPLICATIONS FOR FISCAL AND SOCIAL RESPONSIBILITY

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The Illinois State Constitution requires adoption of a balanced budget: "Appropriations for a fiscal year shall not exceed funds estimated by the General Assembly to be available during that year." For many years, however, the legislature has passed appropriations bills without addressing the revenue side of the budget. The House of Representatives has adopted a new process for FY 2012 that could lead to enactment of an *actual state budget*, including both revenue and spending determinations. The Committee on Revenue and Finance recently approved a set of General Funds revenue estimates (House Resolution 110), which was subsequently approved unanimously by the full House. The House Revenue Committee will now consider another resolution (HR156), which will allocate a share of available resources to each of five appropriations committees: elementary and secondary education, higher education, human services, public safety, and general services.

Different Revenue Estimates

The House Revenue Committee considered two sets of revenue estimates — one from the Governor's Office of Management and Budget (GOMB) and one from the Commission on Government Forecasting and Accountability (CGFA), a legislative agency with responsibility for monitoring state revenues and developing revenue projections. In the aggregate, CGFA estimates are $132 million lower than GOMB's for FY 2011 but $950 million higher for FY 2012 (see Table 1).

For FY 2011 and FY 2012 combined, the biggest differences between the GOMB and CGFA estimates involve sales taxes ($335 million) and the individual income tax ($507 million). Regarding sales tax revenue, GOMB and CGFA have very different growth estimates. Through February, actual FY 2011 sales tax receipts were 9.3 percent higher than the previous year. (Some of this reflects revenue from the tax amnesty program in fall 2010.) CGFA assumes 6.2 percent growth for FY 2011, but GOMB assumes only 3.3 percent (see Table 1).

The two agencies make similar assumptions about the impact of increasing the individual income tax from 3 percent to 5 percent. However, they have different overall estimates for income tax revenue — largely because of their projections for "natural" revenue growth (i.e., growth resulting from economic recovery rather than from the tax increase). GOMB estimates that natural growth for the individual income tax will average 3.1 percent in FY 2011 and FY 2012. The CGFA estimate is somewhat higher but still modest — 4.1 percent (see Table 2).[1]

[1] Another difference between the two estimates is that CGFA makes an adjustment for delayed implementation of the income tax increase, which was enacted on January 13, 2011, but was retroactive to the first of the year. For the most part, income tax withholding in January did not reflect the higher tax rate. As a result, some of the taxes owed from January will not be paid until tax returns are filed next year. In the CGFA estimates, $500 million is shifted from FY 2011 to FY 2012 (see Table 2).

TABLE 1: General Funds Revenue Estimates from the Governor's Office of Management and Budget (GOMB) and the Commission on Government Forecasting and Accountability (CGFA), FY 2011 and FY 2012 (in $ millions)

	Actual FY 2010	GOMB FY 2011	CGFA FY 2011	Diff.	GOMB FY 2012	CGFA FY 2012	Diff.
Individual income tax	8,511	11,466	11,142	-324	14,955	15,785	830
Corporate income tax	1,360	1,885	1,969	84	2,768	2,770	2
Sales taxes	6,308	6,514	6,696	182	6,586	6,739	153
Public utility taxes	1,089	1,101	1,125	24	1,082	1,136	54
Other state taxes, fees, etc.	2,018	1,833	1,825	-8	1,886	1,916	30
Transfers from other funds	1,884	2,308	2,218	-90	1,811	1,691	-120
Total state sources	21,170	25,107	24,975	-132	29,088	30,038	950
Federal sources	5,920	5,506	5,506	0	4,844	4,844	0
Total	**27,090**	**30,613**	**30,481**	**-132**	**33,932**	**34,882**	**950**

TABLE 2: GOMB and CGFA Estimates for the Individual Income Tax (in $ millions)

	Actual FY 2010	GOMB FY 2011	CGFA FY 2011	Diff.	GOMB FY 2012	CGFA FY 2012	Diff.
Base estimate (3% rate)	8,511	8,811	8,943	131	9,048	9,216	168
Impact of tax increase	------	2,632	2,676	44	5,907	6,089	182
Implementation timing	------	0	-500	-500	0	500	500
Tax amnesty adjustment	------	23	23	0	0	-20	-20
Total	**8,511**	**11,466**	**11,142**	**-324**	**14,955**	**15,785**	**830**

Even though CGFA is the legislature's own support agency — with a good track record in revenue forecasting — the House Revenue Committee chose to incorporate most of the GOMB revenue estimates into HR110. One exception involves corporate income tax refunds. CGFA assumes that 17.5 percent of gross receipts will be set aside for the Income Tax Refund Fund — the same rate used in FY 2011. GOMB's estimate assumes a refund rate of 12.5 percent for the corporate income tax. HR110 uses the higher refund rate, which reduces the GOMB estimate by $159 million.

The only other difference between the GOMB and HR110 revenue estimates involves the federal "bonus depreciation." A recent change in federal law allows businesses to immediately deduct the entire cost of capital investments from their federal gross income. This bonus depreciation applies to purchases made between September 2010 and December 2011. Illinois, like many other states, uses the federal definition of income as the starting point for its income taxes. Consequently, federal bonus depreciation would result in a loss of state revenue. Both GOMB and CGFA assume that Illinois will "decouple" its tax code from the depreciation changes in federal law. HR110 does not assume decoupling and therefore includes an estimated revenue loss of $600 million.

Policy Implications and Next Steps

The Governor's FY 2012 budget proposes $8.75 billion in debt structuring bonds. The proceeds of these bonds would be used to pay down the state's backlog of outstanding bills, as well as medical expenses incurred by state health plans, corporate income tax refunds, and other unspecified operating expenses. Without debt structuring bonds, the Governor's budget would leave a $4.4 billion carryover deficit from FY 2011 and a $1 billion operating deficit for FY 2012 (see Table 3). GOMB also estimates that actual spending in FY 2012 will be about $800 million less than appropriations. Without that assumption, the fiscal year operating deficit would be more than $1.8 billion.

The HR110 revenue estimate would increase the projected deficit by about $760 million. Using CGFA's revenue assumptions would marginally increase the carryover deficit but substantially reduce the FY 2012 operating deficit. The CGFA revenue estimate for FY 2011 is about $130 million less than the GOMB estimate. (HR110 does not include any revenue estimates for FY 2011.) However, CGFA's FY 2012 revenue estimate, even after adjusting for the revenue loss from federal bonus depreciation, is about $1.1 billion higher than HR110.

TABLE 3: General Funds Deficit under the Governor's Proposed Budget (in $ millions)

	FY 2011	FY 2012
Fiscal year operating surplus/deficit	**+1,959**	**-1,047**
Carryover deficit from prior year	-6,314	-4,355
Cumulative deficit	**-4,355**	**-5,402**

Note: Estimates exclude proposed debt restructuring bonds. FY 2012 operating deficit assumes unspent appropriations of $802 million.

Source: Governor's Office of Management and Budget

The next phase of the budget process in the House of Representatives will be HR156 — the allocation of available revenue to various appropriations committees. After adoption of HR156, the relevant committees will recommend appropriations for specific agencies and programs. Although the total General Funds revenue estimate in HR110 is $33.2 billion, not all of this amount would be available for allocation to state agencies. Presumably, HR156 will subtract the costs of mandated pension contributions, debt service, and statutory transfers ($9.1 billion). This would leave $24.1 billion in resources for state agencies, compared to $26.7 billion in the Governor's proposed budget. In order to create a balanced budget under HR110, the appropriations committees would have to *cut $2.6 billion* from the Governor's aggregate recommendation for state agencies (see Table 4). Under the CGFA revenue estimates (adjusted for the revenue loss from federal bonus depreciation), there would be a shortfall of $1.5 billion. If the state decoupled from the federal bonus depreciation, the projected shortfall could be reduced to about $900 million.

TABLE 4: FY 2012 Revenue Available for State Agency Appropriations under HR110 (in $ millions)

HR110 revenue estimate	**33,173**
Subtractions for mandated spending	
Pension contributions	-4,594
Pension-related debt service	-1,559
Capital projects debt service	- 578
Statutory transfers	-2,317
Revenue available for agency appropriations	**24,125**
Recommended appropriations in Governor's FY12 budget	26,733
Shortfall (required budget cuts)	**2,608**

Neither existing FY 2011 appropriations nor the Governor's proposed FY 2012 budget should be taken as given for allocating resources across or within state agencies. Although the Governor's recommended FY 2012 appropriations are somewhat higher than the FY 2011 level, the proposed budget continues to place a disproportionate burden on human services, which have already been hit by deep budget cuts in the past two fiscal years. In the Department of Human Services (DHS), grants to community-based providers would be reduced to a level 27 percent below FY 2009. Funding for some DHS programs would be eliminated entirely. A budget based on HR110 would put human services in even greater jeopardy.

The state budget must reflect both fiscal and social responsibility. As both the House and Senate move forward with their budget plans for FY 2012, several critical issues should be kept in mind:

- The FY 2012 budget process in the Senate is not yet clear, but members of that chamber should carefully examine CGFA's estimates as a credible alternative to HR110.
- Regardless of the revenue estimates used, the General Assembly should avoid a $600 million revenue loss by decoupling state tax law from the federal bonus depreciation — a legislative effort that should begin as soon as possible.
- The final FY 2012 budget must involve *shared sacrifice* among state agencies and across the various functions of state government. The General Assembly should not allow the continued erosion of human services in Illinois.
- Aside from the FY 2012 operating budget, the state must still address the carryover deficit from FY 2011. The General Assembly should authorize at least $4.5 billion in debt restructuring bonds to cover the remaining backlog of unpaid bills to school districts, state universities, community colleges, human service providers, and local governments.

About the Budget & Tax Policy Initiative

The Budget & Tax Policy Initiative (BTPI) at Voices for Illinois Children provides timely, credible, and accessible information and analysis on fiscal issues that affect children, families, and communities in Illinois. BTPI is a member of the State Fiscal Analysis Initiative (SFAI), a network of nonprofit organizations in more than 35 states. SFAI is coordinated by the Center on Budget and Policy Priorities, a Washington, D.C.-based research organization and strategic policy institute that works on a range of federal and state issues.

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