



STATE OF ILLINOIS
EXECUTIVE OFFICE OF THE GOVERNOR
GOVERNOR'S OFFICE OF MANAGEMENT AND BUDGET
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Illinois Economic and Fiscal Policy Report

The Governor's Office of Management and Budget (GOMB), pursuant to 20 ILCS 3005/7.3, annually submits an Economic and Fiscal Policy Report to the General Assembly outlining the long-term economic and fiscal policy objectives of the state, along with the economic and fiscal policy intentions for the upcoming fiscal year and for the subsequent four fiscal years. The report also includes a review of the current fiscal year's enacted budget compared with the current outlook for the fiscal year along with fiscal and policy options that GOMB recommends for consideration by the General Assembly and the Governor to remedy any budgetary shortfalls in the current year or the five following fiscal years.

ECONOMIC REVIEW

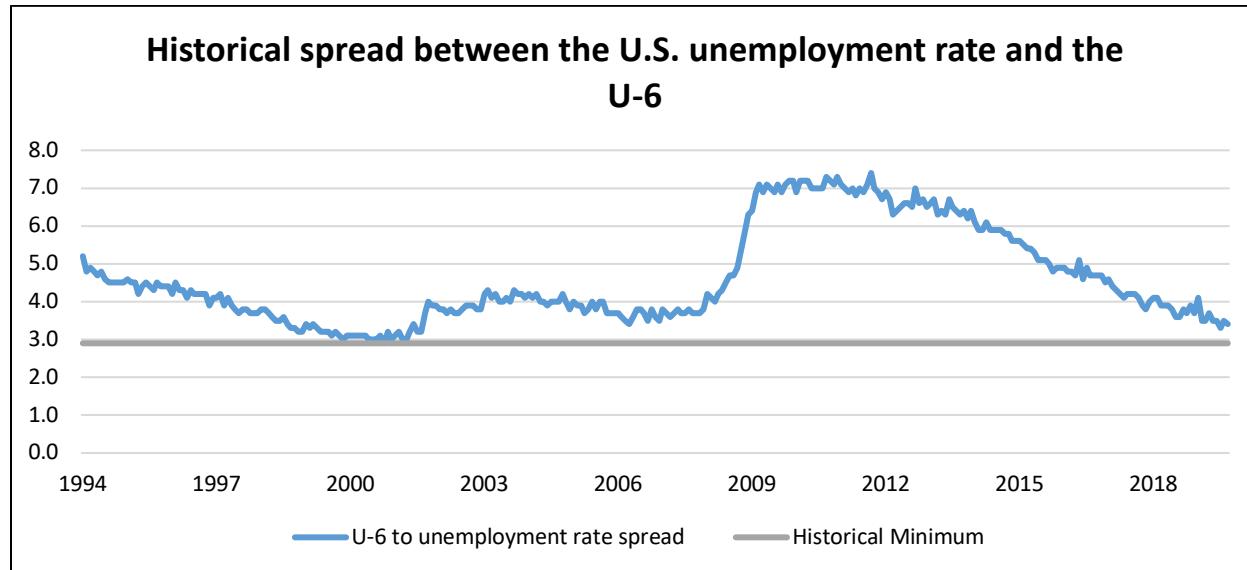
NATIONAL ECONOMIC CONDITIONS

In July 2019, the current U.S. economic expansion became the longest on record, reaching 121 consecutive months and surpassing the prior record of 120 months seen in the economic expansion between 1991 and 2001. The unemployment rate is at a near 50-year low and wages are near historic highs in real terms. However, sustainable economic growth is uncertain in the face of the U.S.'s trade war with China, decelerating domestic and global growth and warning signs from the bond market. In response to these headwinds and persistently low inflation, the Federal Reserve cut its Federal Funds rate for the first time since the Great Recession at the end of July and did so again in September.

A Tight Labor Market is Beginning to Bear Fruit for Workers

After a record 108 consecutive months of job growth, several indicators point to a tight labor market, or a low capacity for further job growth. The national unemployment rate has hovered near a 50-year low for about a year and fell to 3.5 percent in September, its lowest level since December 1969. The U-6, which is a broader measure of unemployment that also captures individuals too discouraged to continue searching for work and part-time workers who are seeking full-time employment, stood at 6.9 percent in September, just 0.1 percent above its lowest level on record. Additionally, the spread between the U-6 and the unemployment rate was just 0.5 percent above the historical minimum (see chart below).¹ According to the Federal Reserve's July 2019 Beige Book, which surveys business contacts of the central

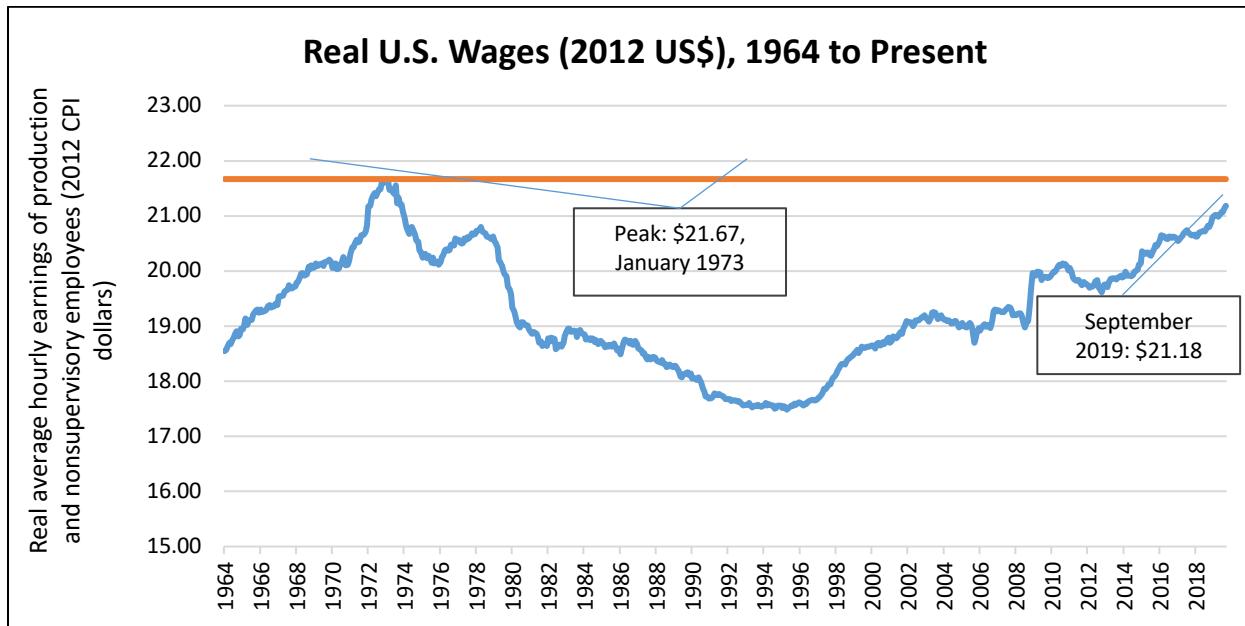
bank's 12 regional banks, "contacts across the country [are] experiencing difficulties filling open positions ... especially in construction, information technology, and health care." Furthermore, a few bank regions "highlighted concerns about securing and renewing work visas, flagging this as a source of uncertainty for continued employment growth."²



Source: Bureau of Labor Statistics

Typically, a tight labor market forces employers to raise wages to attract workers. Wage growth during the current economic expansion has been relatively low. Year-over-year growth in average hourly earnings of production and nonsupervisory employees has averaged 2.3 percent since the end of the last recession compared to 3.1 percent in the prior economic expansion of the 2000s. While wage growth began accelerating in late 2017, it has stalled in the past 11 months holding around 3.4 percent compared to the 3.9 percent average seen in the two years prior to the start of the Great Recession.³

Relatively low productivity growth could be holding back wage growth: since the end of the last recession annualized productivity growth has averaged 1.2 percent, which underperforms the 1947 to 2009 average of 2.4 percent. However, productivity growth has picked up in 2019, reaching annualized rates of 3.5 percent and 2.4 percent in the first and second quarters respectively.⁴ Historically low inflation could also be a factor, limiting the ability of employers to raise wages.⁵ Technology, automation, the declining share of workers who are in unions and consolidation in certain industries also gives firms more leverage in setting wages.⁶ Nominal wage growth and low inflation have brought real wages to their highest levels in 45 years, though this also means that workers' wages are no better than they were 45 years ago in real terms.⁷ Despite relatively low inflation and productivity, it is expected that the tight labor market will cause wage growth to quicken over the next several years (see Economic Forecasts section).



Low inflation has puzzled experts given historically low unemployment. Federal Reserve Chairman Jerome Powell testified to Congress in early July that “we really have learned that the economy can sustain much lower unemployment than we thought without troubling levels of inflation.” Economists point to downward price pressures such as globalization, which has enabled companies to produce goods more cheaply in lower wage countries, as well as the “Amazon effect” of online shopping, which allows consumers to compare prices from different vendors more easily.⁸

Recession Risks: U.S. Trade War with China, Global and Domestic Growth Concerns

Though the economy is strong, the Trump administration’s trade war with China is threatening to derail the economy’s momentum. On July 6, 2018, the United States imposed tariffs of 25 percent on \$34 billion worth of Chinese goods, mainly industrial products. China retaliated by imposing \$34 billion in tariffs on U.S. agricultural products, thus beginning a trade war that has now lasted over a year.⁹ Following a year of a series of failed talks and additional tariffs, the Trump administration recently announced on August 1, 2019 that it would extend tariffs to virtually all remaining untouched Chinese imports, which would go into effect on September 1, 2019. Such tariffs would, unlike prior iterations, affect consumer products that have thus far been avoided such as smartphones, apparel and toys and would affect \$300 billion in Chinese goods.¹⁰ Two weeks later, the Trump administration announced it would delay imposing tariffs on about half of these goods until December 15 in response to concerns about the impact of the tariffs on the holiday shopping season.¹¹ On August 5, 2019, China responded to the initial tariff announcement by letting its currency depreciate to a historic low of 7.11 yuan to the U.S. dollar, which makes Chinese exports cheaper.¹² A day later, China announced it would cease imports of all U.S. agricultural goods,¹³ though China announced in mid-September it would reverse this policy on U.S. soybeans, pork and other agricultural products.¹⁴

According to *The Economist*, uncertainty, and “not tariffs, is the greatest harm from the trade war between America and China ... Because big investments are hard to reverse, firms are disinclined to press ahead with them.”¹⁵ Indeed, growth in business investment has trended downward since the fourth quarter of 2017 and business investment declined in the second quarter of 2019 by 0.8 percent.¹⁶

According to a monthly survey of 670 small companies conducted by The Wall Street Journal, economic confidence among small U.S. companies fell in August to the lowest reading since November 2012.¹⁷

The trade war's effects are being seen elsewhere and are sparking fears of a global economic downturn and a recession in the U.S. Germany, an "export-driven economy," saw its economy shrink by 0.1 percent in the second quarter of 2019, with "economists and government leaders largely blaming ... the uncertainty caused by the U.S.-China trade war and the prospect of an abrupt Brexit." In China, the jobless rate in urban areas in July hit a record high,¹⁸ while Chinese year-over-year industrial production growth was 4.8 percent in July, the worst rate of growth in 17 years.¹⁹

Another warning sign of a recession is being seen in the bond market's inverted yield curve. Since May, the yield on the 3-month Treasury bill has been higher than the yield on the 10-year Treasury note.²⁰ This event has happened prior to every U.S. recession since 1975. While the Federal Reserve focuses on the spread between these two yields, the investor community tends to prefer to look at the spread between the yields on the 10 and two-year Treasury notes, since "moves in two-year debt can reflect expectations for Fed policy over a longer period than just the next meeting or two."²¹ The yield on the two year Treasury note was briefly higher than the 10 year Treasury note yield on August 14, sending the S&P 500 index down 2.9 percent that day.²²

In the face of "global developments ... as well as muted inflation pressures," the Federal Reserve cut the federal funds rate by 25 basis points at the end of July for the first time since 2008. The Federal Reserve also announced that it would cease the gradual reduction of its securities portfolio in August, "two months earlier than previously indicated."²³ The Federal Reserve significantly increased the size of its securities holdings after the last recession as a way to stimulate the economy.²⁴ The Federal Reserve cut the federal funds rate by 25 basis points again in September.²⁵

Economic Forecasts

This report will discuss the baseline economic forecast provided by IHS Markit (IHS), a national economic forecasting firm. The baseline forecast, which IHS Markit gives a 55 percent probability, does not project a recession in the forecast horizon, but does project slower economic growth. It anticipates U.S. real GDP growth to slow from 2.9 percent in 2018 to 2.6 percent in 2019, 1.8 percent in 2020, 1.7 percent in 2021 and 1.6 percent in 2022 and 2023, before rising to 1.9 percent in 2024. This projected slowdown in economic growth is attributed to slowing global growth, the dwindling effects of the 2017 federal stimulus, the trade war, a reversal of the Federal Reserve's recent rate cuts and additional rate tightening in 2023, and slowing wealth growth due to a plateauing stock and housing market. However, the forecast expects that the labor market will remain tight, translating into faster wage growth, stable consumption and inflation near the Federal Reserve's target of 2 percent.

The baseline forecast assumes that the labor market will see further tightening in the short term, with the unemployment rate beginning to slowly climb in early 2020. Monthly employment growth is expected to also exceed the growth in the labor force in the short term, pushing the unemployment rate down to 3.5 percent in late 2019. Growth in the labor force is expected to begin exceeding employment growth in mid-2020. Still, the forecast assumes that the unemployment rate will reach 4.5 percent in 2024 – just 0.1 percent higher than the pre-recession's minimum.

While wage growth has been slow to respond to the tightness of the labor market, it is expected to accelerate in 2020 and remain above 2019 levels through 2024. The Employment Cost Index is expected to grow by 2.8 percent in 2019 compared to 2.9 percent in 2018, but is then expected to grow by 3.2

percent in 2020 and reach 3.6 percent in 2022, remaining essentially flat through 2024. The strong labor market and wage growth are expected to keep consumption growth at current levels through 2024. Wage growth and stable consumption are expected to boost inflation up to 2.2 percent in 2020 from 1.9 percent in 2019, remaining steady at 2.2 percent through 2024.

IHS's forecast does not find that Federal Reserve rate cuts are necessary to maintain economic growth, and thus it expects that the Federal Reserve will return to rate hikes in 2020. The Federal Funds rate, currently at a range of 1.75 percent to 2 percent, is expected to rise to an average of 2.2 percent in 2020, 2.38 percent in 2021 and 2022, and 2.61 percent in 2023 and 2024.

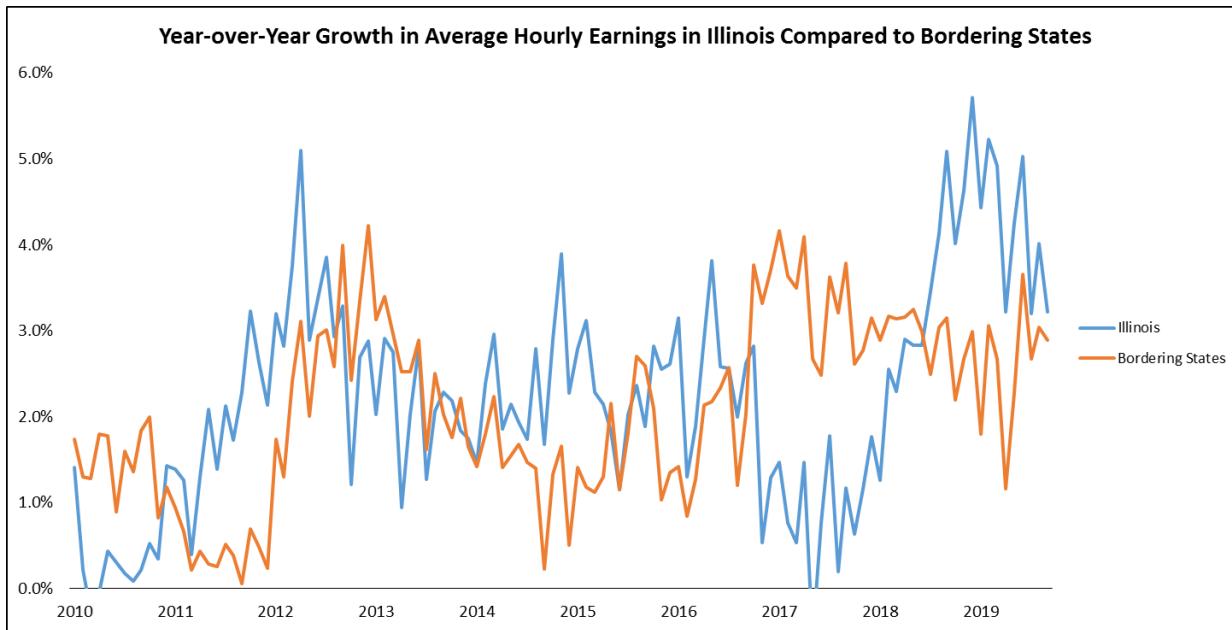
Variables	FY19	FY20	FY21	FY22	FY23	FY24	FY25
U.S. Real Gross Domestic Product	3.0%	2.0%	1.8%	1.6%	1.6%	1.7%	2.0%
Illinois Real Gross Domestic Product	2.4%	1.5%	1.3%	1.0%	0.8%	0.9%	1.4%
Illinois Non-Farm Employment	1.0%	0.8%	0.3%	0.2%	0.1%	(0.0%)	0.1%
Illinois Wage Disbursements	2.7%	3.5%	4.0%	4.0%	4.0%	3.9%	4.2%
Domestic U.S. Corporate Profits	7.4%	(2.7%)	4.0%	3.6%	3.8%	3.5%	4.0%
Illinois Retail Sales	3.1%	2.7%	3.0%	3.2%	2.8%	2.9%	3.2%

Source: IHS Markit July 2019 Forecast

ILLINOIS' ECONOMIC CONDITIONS AND FORECAST

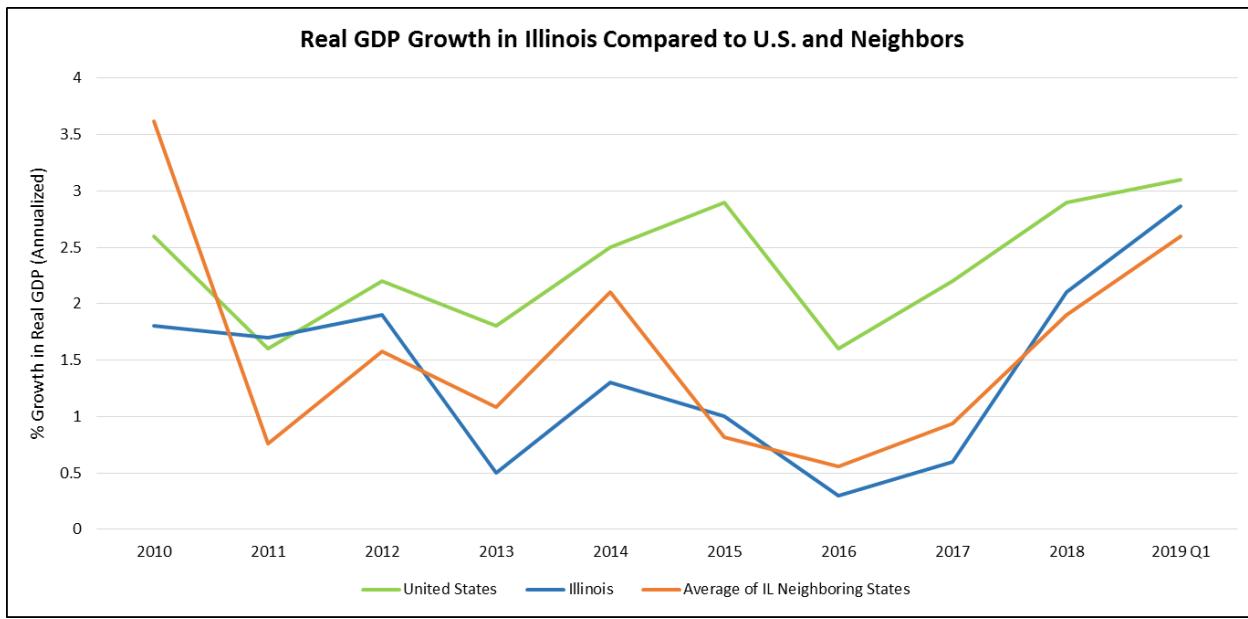
While Illinois has by some measures underperformed the U.S. during the current economic expansion, it also appears to be benefitting from a tight labor market and accelerating economic growth. According to the Bureau of Labor Statistics' preliminary September 2019 reading, Illinois' September unemployment rate was the lowest on record at 3.9 percent. Illinois' unemployment rate has hovered between 4.2 percent and 4.4 percent since January 2018.²⁶ While Illinois' unemployment rate has been higher than that of the U.S., (as has been the case in the last two decades), part of the gap between the Illinois unemployment rate and the U.S. unemployment rate can be attributed to Illinois' higher labor force participation rate: Illinois' currently stands at 64.9 percent, while the U.S.'s stands at 63.2 percent.²⁷

During this same time period that Illinois' unemployment rate has hovered around this historic low, Illinois' wage growth has accelerated above average growth seen in bordering states (see chart below). Wage growth in Illinois has exceeded its neighbors and the U.S. over the last 15 months.²⁸ Illinois' real GDP growth has also recently outperformed its neighbors and has been catching up with growth seen in the nation as a whole after underperforming the nation and its neighbors for most of the current economic expansion (see chart below).²⁹



Source: Bureau of Labor Statistics

Illinois industries that have seen the most job growth since the last recession are Professional and Business Services (2.2 percent annualized growth), Leisure and Hospitality (2.0 percent annualized growth) and Education and Health Services (1.4 percent annualized growth). Industries that have seen the most declines are Mining (-2.2 percent annualized growth), Information (-1.4 percent annualized growth) and Government (-0.3 percent annualized growth).³⁰



Source: Bureau of Economic Analysis

A REVIEW OF THE ENACTED FISCAL YEAR 2020 BUDGET

On June 5, 2019, Governor Pritzker signed the state's fiscal year 2020 budget into law. The fiscal year 2020 general funds budget agreement was based on estimated general funds operating revenues and transfers in from other state funds to be \$40.3 billion, including a projected \$100 million from interfund borrowing. Total fiscal year 2020 base expenditures were estimated at \$40.1 billion, resulting in an estimated \$151 million surplus. In the Economic and Fiscal Policy Report released in November 2018, the fiscal year 2020 budget deficit was estimated to total \$2.765 billion – this deficit was eliminated and converted to a surplus by the time of enactment.

A Balanced Bipartisan Budget Marks a New Era of Fiscal Stability

The enacted \$40.1 billion fiscal year 2020 budget begins to pay down Illinois' debt and return the state to fiscal stability. Highlights of the new investments from the operating budget include:

- Increases Evidence-Based Funding for K-12 education by \$378.6 million, historic funding for K-12 students across the state.
- Increases Early Childhood Education funding by \$50 million, record high funding that moves Illinois toward the goal of enrolling every low-income child in a high-quality early childhood program.
- Increases funding for public universities by \$52.8 million and community colleges by \$13.9 million, a 5 percent increase that will help hold down tuition and build a competitive workforce.
- Increases the Monetary Award Program (MAP) funding by \$50 million, a 12.5 percent increase and part of the Governor's four-year goal to increase MAP funding for low income students by 50 percent.
- Includes \$35 million for the second year of the bipartisan AIM HIGH grant pilot program to help stem the outmigration of Illinois' high achieving students.
- Expands child care assistance eligibility through the Child Care Assistance Program at DHS, providing quality care to an additional 10,000 children. The threshold increases from 185 percent to 200 percent of the Federal Poverty Level (FPL) starting in October 2019. Once in the program, families will be allowed to remain eligible up to 225 percent FPL.
- Includes the full appropriations to the state retirement systems, funding the January 2019 certified requests from the systems.

In addition to making key investments in long-term programs that will improve the state's health, the budget was balanced with several bipartisan revenue initiatives – some of which will improve the state's structural deficit going forward. The budget plan also provided several tools to manage and reduce the state's continued backlog of unpaid bills.

- Extends the ability for the Comptroller to do interfund borrowing to the general funds of balances in other state funds in excess of additional cash needs. Estimated to generate approximately \$100 million in liquidity in fiscal year 2020.
- \$500 million from MCO assessment. This produces General Revenue Fund budget relief by reducing the transfer required from GRF to the Healthcare Provider Relief Fund.
- \$175 million from a tax amnesty program, with most of the funds coming from corporate and sales taxes.
- \$94 million from decoupling from the federal deduction for repatriated income for corporate income taxes.

- Authorizes \$1.2 billion in general obligation bonds to be issued to address bills that are over 90 days old (i.e. accruing interest). The size and timing of the issuance will depend on cash flow needs at the Comptroller's office.

In addition, a historic commitment to the state's infrastructure was enacted through Rebuild Illinois, a six year, \$45 billion capital investment in infrastructure and economic development. Rebuild Illinois utilizes state bonded and pay-as-you-go funding, as well as federal, local and private funds to support an estimated \$33.2 billion in transportation capital projects and nearly \$11.6 billion in non-transportation capital projects. Major components of the plan include \$25.3 billion for roads and bridges; \$4.7 billion for mass transit projects; \$3.3 billion for other transportation projects including rail, ports and aeronautics; \$3.5 billion for educational facilities; \$4.4 billion for state facilities; \$1 billion for environment and conservation; and \$2.7 billion for economic and community development, healthcare and human services, and statewide broadband deployment. The total share of Rebuild Illinois funded by the state is expected to total \$31.2 billion, while federal sources are expected to support \$10.0 billion, and local contributions \$3.6 billion.

Updated Fiscal Year 2020 Projections

Following a review of fiscal year 2019 final revenue collections and revenue performance year-to-date, GOMB is identifying several revisions to the baseline budget forecast. Revisions in this report to fiscal year 2020 projected revenues and expenditures change the fiscal year end result to an estimated surplus of \$184 million based on current appropriation levels (see chart below).

Changes to FY 2020 Projections			
(\$ in Millions)			
Revenues		Expenditures	
Income Taxes	\$ (126)	SERS Prior Year Underpayment	
Sales Taxes	197	Continuing Appropriation	\$ 100
Transfers In*	287	Debt Issuance Timing	(109)
Federal Sources	(200)	Investment Borrowing Repayment	400
Investment Borrowing	400	All Other Changes	44
All Other Changes	(90)		
Total Changes		Total Changes	\$ 436
Total Changes			
Revision to Forecast			
Initial Surplus/(Deficit)		\$ 151	
Increase to Revenue Forecast		468	
Increase in Projected Expenditures		(436)	
Revised Surplus/(Deficit)		\$ 184	

*Includes revision to the total Income Tax Refund Fund transfer.

Based on year-to-date revenue collections and the economic indicators discussed in the Economic Review, fiscal year 2020 estimated revenues, including \$400 million of non-base revenues from the Treasurer's Investment Borrowing, are now projected to total almost \$40.8 billion. The state's three largest revenue sources - individual income tax, corporate income tax and sales tax - are estimated to total \$30.8 billion, a net increase of approximately \$727 million or 2.4 percent when compared to fiscal year 2019 final collections. The general funds estimate excludes approximately \$1.8 billion from income and sales tax receipts deposited directly into the Local Government Distributive Fund, Public Transportation Fund and Downstate Public Transportation Fund.

The fiscal year 2020 general funds budget projects that federal revenues will total \$3.5 billion, a decrease of \$103 million, or 2.9 percent from fiscal year 2019 federal revenues. Federal revenue collections are dependent on the release of reimbursable payments by the Comptroller's office, and due to additional payments released prior to the end of fiscal year 2019, GOMB estimates that fiscal year 2020 federal revenues will fall below original estimates.

Budgeted transfers in for fiscal year 2020 are projected to be \$2.5 billion, an increase of \$448 million, or 22.0 percent above fiscal year 2019. This amount includes \$616 million in transfers from the end-of-year surplus balance in the Income Tax Refund Fund. Also included in fiscal year 2020 revenue estimates is \$100 million in estimated amounts available through interfund borrowing and \$400 million for Treasurer's Investment Borrowing processed as of the time of this report.

The fiscal year 2020 general funds revised budget estimates include projected expenditures and transfers from the general funds of \$40.6 billion. The fiscal year 2020 general funds budget projects transfers out to other state funds, including debt service, to total \$2.9 billion, a decrease of \$964 million from fiscal year 2019. The state estimates that debt service for GO Bonds, which includes pension, capital, pension buyout and backlog borrowing bonds, will total \$2.1 billion from the general funds.

The fiscal year 2020 general funds budget is projected to result in a revised budgetary surplus of \$184 million.

A potential allocation of \$300 million to the General Revenue Fund from the sale of up to \$1.2 billion in a Spring 2020 issuance of backlog borrowing bonds (with the balance of \$900 million deposited into the Health Insurance Reserve Fund, pursuant to the Comptroller's discretion) would increase to \$484 million the projected amount available to reduce the state's continued backlog of unpaid bills as intended by the authorization for the bonds. Estimated debt service costs for this borrowing are included in above totals.

FIVE YEAR BUDGETARY FORECAST

Pursuant to 20 ILCS 3005/7.3, attached to this report is a financial walk down of the budgetary outlook for fiscal year 2020 through fiscal year 2025.

The projections assume baseline growth in revenues under existing law and expenditures are driven by increases in pension payments, projected debt service amounts, and moderate increases in other spending. The revenue forecast does not reflect revenue from the Fair Income Tax or recent legalization of adult use cannabis. However the state anticipates substantial revenues during the budget forecast period. All projections assume no significant reforms or spending controls aside from what is in current statute. While agency directors have been asked to include in their budget requests options to potentially

achieve a 6.5 percent reduction from what would otherwise be fiscal year 2021 maintenance level agency operations funding, those potential budget cuts have not been included in the projections.

Estimated Resources

GOMB estimates that under current statutes, general funds revenues for fiscal year 2020 will total \$40,756 million. The general funds revenue projection includes one-time revenues from authorized interfund borrowing and investment borrowing.

Revenue estimates going forward are based on projections provided by the Illinois Department of Revenue economists using the IHS's baseline forecast.

The diversion rate of 9.5 percent of total individual income tax revenues in fiscal year 2020 to the Income Tax Refund Fund is assumed to remain at that level in fiscal year 2021 and the remainder of the forecast. The corporate income tax forecast assumes a refund fund diversion rate of 14.25 percent in fiscal year 2020 that will fall to 14.0 percent in fiscal year 2021 and the remainder of the forecast.

Fiscal year 2020 estimated base general funds receipts for federal sources total \$3,497 million based on appropriations that are expected to generate federal match if payments are released timely. Federal reimbursements for Medicaid spending generally are returned to the same fund that was used for the original expenditure. It is assumed that the Department of Healthcare and Family Services will continue to maximize use of general funds for Medicaid spending, which will produce moderate growth over the forecast horizon.

Estimated Expenditures

Fiscal year 2020 estimated general funds spending in the financial walk down totals \$40,571 million. Future-year spending estimates are based on increasing evidence-based funding for education by \$350 million a year, moderate growth rates in the various categories of state spending from fiscal year 2020 appropriations, pension spending growth consistent with end of fiscal year 2018 projections, and no significant changes to base programs.

GOMB estimates fiscal year 2020 revenues will exceed current spending projections by \$184 million. This reflects the underlying surplus of the general funds budget, excluding any additional revenues that may flow into the general funds from backlog borrowing proceeds to reduce the state's backlog of unpaid bills³¹.

Fiscal Year Results

The projected fiscal year 2020 surplus, plus the impact from the issuance of \$1.2 billion of backlog borrowing, would cause the state's outstanding accounts payable to decrease from approximately \$7.3 billion³² at the end of fiscal year 2019 to an estimated \$5.9 billion at the end of fiscal year 2020.

However, even with the balanced budget for fiscal year 2020, the underlying structural deficit of the state's budget has not been addressed. Sizeable deficits in the general funds budget are projected for fiscal years 2021 through 2025. Without changes to the current trajectory of the state's finances, year-end accounts payable will continue to grow year by year throughout the reporting period. Options (such as the Fair Tax) have been proposed and others are being considered (such as agency budget cuts) to balance the state's budget and resolve the budget shortfalls projected in this report.

POLICY OBJECTIVES AND INTENTIONS

The Plan to Achieve Fiscal Stability

The Governor is committed to achieving fiscal stability in Illinois' budget and spurring statewide economic growth while investing in the people of Illinois, the state's educational system, its programs to assist the most vulnerable and its infrastructure. Investing in Illinois' people and its infrastructure will strengthen the economy and ready the state to compete in the global marketplace.

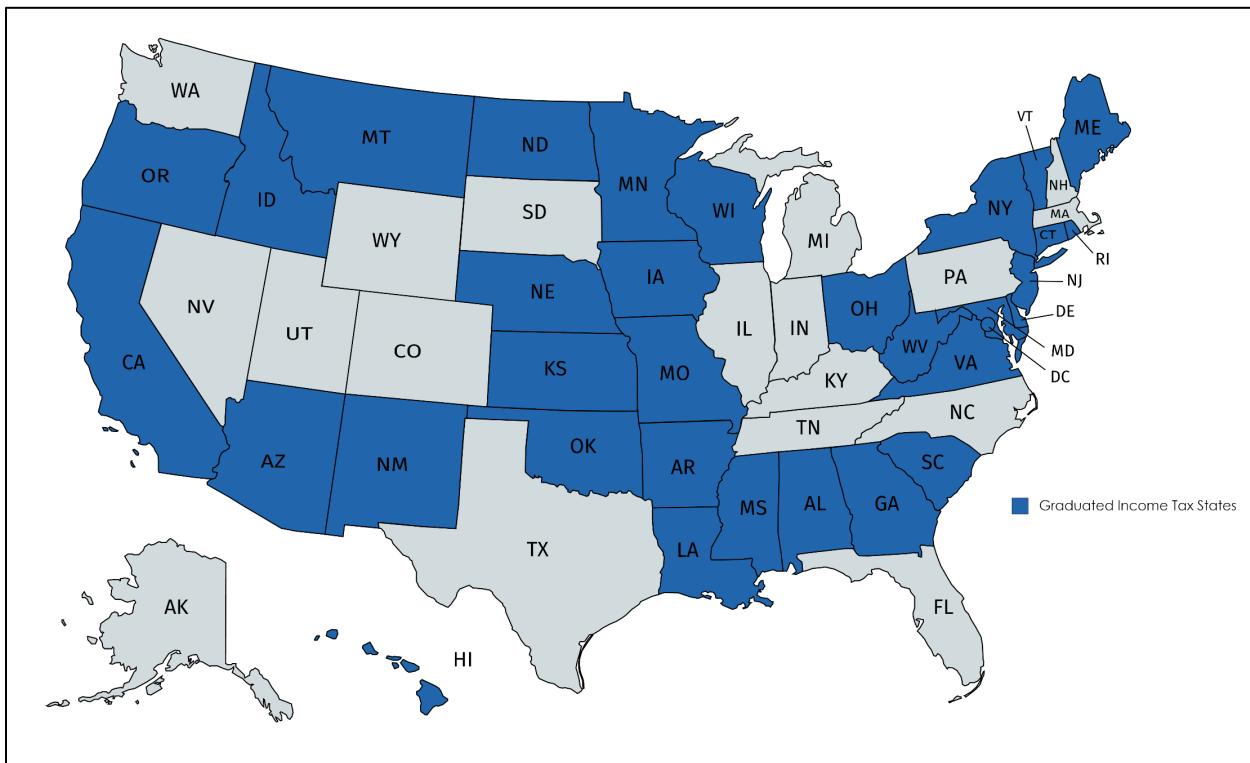
Looking ahead to the fiscal year 2021 budget and recognizing that Illinois continues to face significant financial challenges, the Governor is asking agency directors to continue to responsibly manage the limited resources of State government. He believes the people of Illinois expect the best programs and services, as well as the most efficient and effective use of their tax dollars. Agency directors have been asked to include in their budget requests options to potentially achieve a 6.5 percent reduction from what would otherwise be fiscal year 2021 maintenance level agency operations funding. Agencies also have been asked to identify significant efficiency and savings ideas including elimination or consolidation of duplicative programs, reduction in funding for underutilized or inefficient services, or improvements in service delivery that streamline costs.

However, the structural deficit cannot be addressed by spending cuts alone. Dramatic cuts in state services would stifle long-term economic growth for Illinois. Investments in early childhood education, K-12 education, higher education, our social safety net, economic development and infrastructure will reap dividends long into the future. Draconian cuts to services is not the answer to balancing the budget.

Fair Income Tax Proposal

Illinois' current tax structure is unsustainable. Governor Pritzker believes our future depends on the passage of a fair income tax, one that will help us meet our growing needs that will sustain us into the future. Illinois is one of just nine states that assess all taxpayers at the same income tax rate. Most of our Midwest neighbors have a graduated income tax structure. Thirty-three states have progressive tax systems based on varying tax rates at varying income levels. It is long past time for Illinois to adopt a fair income tax system to replace the current flat tax income tax that over burdens the middle class and those striving to get there.

According to the Institute on Taxation and Economic Policy (ITEP), Illinois has the eighth most regressive tax system in the country.³³ This means the tax impact falls more heavily on those with lower levels of income. The state mainly relies on three forms of taxation: income taxes, consumption taxes and excise taxes. Consumption taxes and excise taxes are inherently regressive. The sales tax is the largest of these taxes. Lower income people, by necessity, spend a larger share of their income on sales taxed items than higher earners. In fact, the lowest 20 percent of earners pay 6.8 percent of their income in sales and excise taxes while the top one percent of earners pay just 0.8 percent of their income in sales and excise taxes.



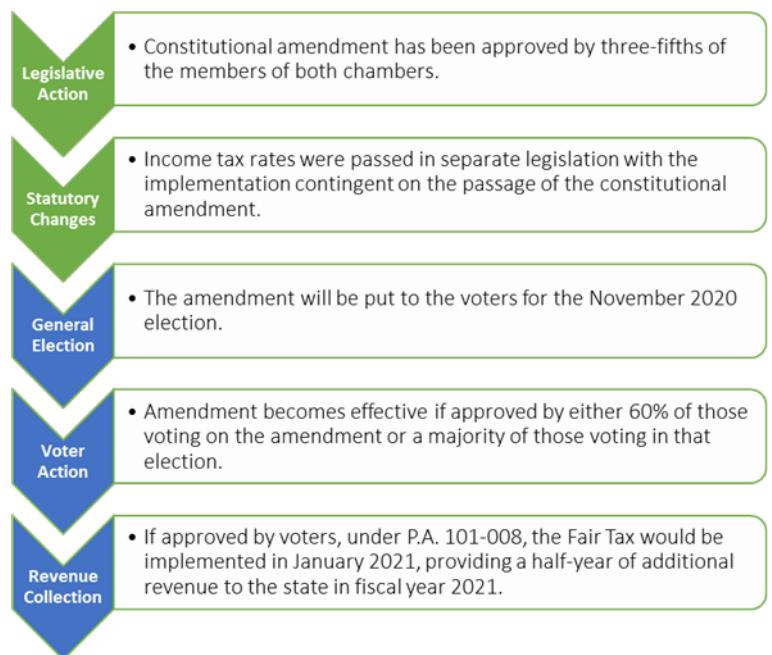
Source: Governor's Office of Management and Budget

On the income tax side, the personal exemption and earned income tax credit (EITC) are mildly progressive, but are not enough to offset the regressive nature of the sales tax and other consumption taxes. Both personal and business income taxes are levied at a single rate for all taxpayers regardless of the level of income.

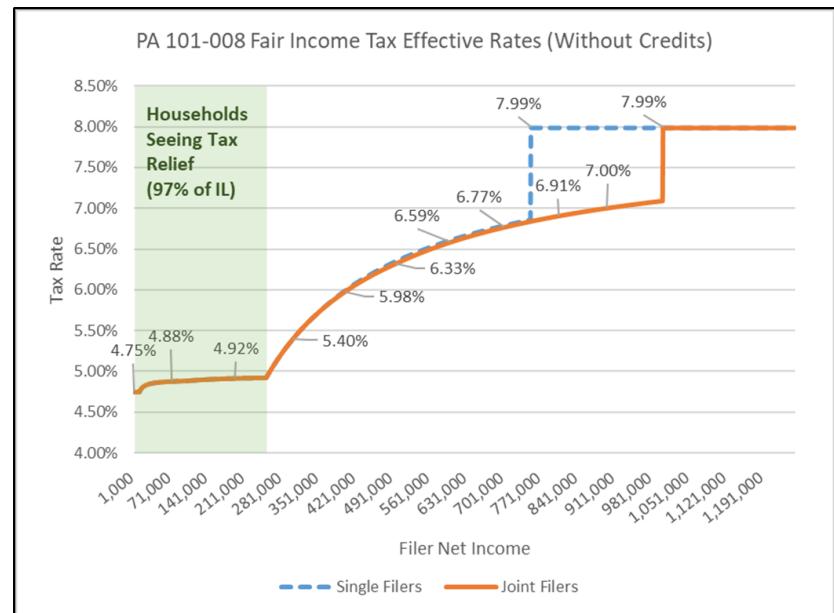
Spring 2019 Actions on a Fair Income Tax

Under Illinois' constitution, an income tax must be levied at a flat rate. In order to enable the state to change the income tax structure, the Illinois Constitution must be amended. To that end, the General Assembly adopted SJRCA 0001 which would remove the flat rate from the Constitution. The amendment will be voted on in the November 2020 general election and will become effective if approved by either 60 percent of those voting on the question or a majority of those voting in the election.

To clarify the rates that would go into effect upon enactment of the constitutional amendment, the legislature passed and the Governor signed into law Public Act 101-008. The Act enacts the following changes to Illinois' income tax rates, effective January 1, 2021, contingent on the passage of the amendment.



- Filers at or below \$250,000 – 97 percent of taxpayers – will have lower tax bill due to a lowering of the effective tax rate for those households (see chart to the right)
- Creation of six separate tax brackets (see table below)
- Top rate of 7.99 percent for net income over \$750K for single filers and \$1.0 million for married/joint filers
- Once income reaches this threshold, *entire* income is taxed at 7.99 percent rate
- Corporate Income Tax rate to match top Fair Income Tax rate (7.99 percent)
- 20 percent increase in current Property Tax Credit from the current 5 percent rate to 6 percent of property taxes paid³⁴
- Up to \$100 per child Child Tax Credit³⁵ for lower and middle income families (single filers under \$80,000 and joint filers under \$100,000)



In total, the changes would be estimated to generate approximately \$3.6 billion in the first year following implementation, after allocations to local governments and the increase in credits.

Public Act 101-008 Fair Income Tax		
Marginal Rates ¹	Net Income Level, Single Filers	Net Income Level, Joint Filers
4.75%	\$0 - \$10,000	\$0 - \$10,000
4.90%	\$10,001 - \$100,000	\$10,001 - \$100,000
4.95%	\$100,001 - \$250,000	\$100,001 - \$250,000
7.75%	\$250,001 - \$350,000	\$250,001 - \$500,000
7.85%	\$350,001 - \$750,000	\$500,001 - \$1,000,000
7.99%	Over \$750,000	Over \$1,000,000

The increased revenue following the rate changes set forth in Public Act 101-0008, and the growth in that base amount, would be utilized to eliminate the structural deficit outlined earlier in the report and reduce the amount of the bill backlog, switching the projected budget deficits to surpluses over the forecast horizon. Additionally the Governor proposes dedicating \$100 million a year of the fair income tax revenues towards the state's unfunded pension liabilities and \$100 million a year to building up the state's Budget Stabilization Fund.

Governor Pritzker believes that the fair tax proposal outlined here is an important element of the path forward for Illinois to return to fiscal stability. There are few alternatives if the Fair Tax amendment is not enacted. Illinois would need to consider dramatic budget cuts of approximately 15 percent to many essential services such as education funding and public safety, or the state would need to consider revenue enhancements equivalent to a 1 percent increase in the individual income tax for all households under this existing flat tax. Either of these alternatives would require legislative approval.

Incremental FIT Dollars (in Millions)	
IIT Net Refunds	\$ 3,574
CIT Net Refunds	\$ 345
Property & Child Tax Credit	\$ (230)
LGDF	\$ (100)
Annualized New FIT Revenue	\$ 3,589

Building up the Budget Stabilization Fund for a "Rainy Day"

Looking ahead, keeping Illinois on a future path for fiscal stability requires a reinvestment in the Budget Stabilization Fund. Illinois created the Budget Stabilization Fund in 2001 with the intent to use it as a "rainy day fund" for future fiscal emergencies or economic downturns. After that original funding, very little was contributed to the fund and it was used as a tool to assist with cash flow until it

was nearly drained in fiscal year 2017. The Volcker Alliance December 2018 report "Truth and Integrity in State Budgeting" graded Illinois a D in reserve fund balances over the past three years. According to the Alliance, "States should enact clear policies for deposits into and withdrawals from rainy day and other reserves...Without rules for replenishing rainy day funds, it can be too easy for legislatures to leave them empty or with minimal assets."³⁶ With that in mind, Governor Pritzker has proposed that upon the enactment of a fair tax, \$100 million annually from the new revenues will be directed to building up the Budget Stabilization Fund so that it may be used in the manner for which it was established.

The Governor's 5-Year Economic Plan

Illinois has struggled in recent years to achieve growth in its economy at levels seen in other parts of the country. As part of the Governor's comprehensive approach to fiscal stability and economic development, his Department of Commerce and Economic Opportunity issued a 5-year economic plan earlier this month that outlines a vision to reinvigorate the economy and spur equitable growth. It focuses on fostering job creation, improving wages, building greater equity, and attracting and supporting businesses.

The plan sets out three priorities: laying the foundations for long-term growth by investing in and fostering research, entrepreneurship and innovation; reducing the equity gap by investing in, providing support to and taking down barriers for economically disadvantaged populations; and attracting more workers and businesses to Illinois by aggressively marketing the state and providing a solid foundation for business growth and attraction.

The initiatives outlined in the report focus on key growth industries with a broad reach, such as technology, manufacturing, life sciences and healthcare, and transportation and logistics.

In addition to industry-specific strategies, the plan includes initiatives that will help spur investments in communities of color, revitalize downstate communities, attract businesses and retain young talent.

Rebuild Illinois Capital Plan

As part of the Governor's plan to revitalize the Illinois economy, he worked with the legislature to enact Rebuild Illinois, a \$45 billion bipartisan investment plan to build new roads, bridges and other transportation infrastructure, creating good jobs, repairing long-neglected infrastructure and constructing major projects that are essential to the state's economic future.

Rebuild Illinois is making investments to fix Illinois' crumbling roads and bridges and commit to major projects that are essential to Illinois' future, like robust mass transit, a modern state crime lab, high quality veterans' homes and world class universities. Every part of Illinois will see investment from Rebuild Illinois, which will put \$33.2 billion into our aging transportation system alone. Rebuild Illinois addresses the unique assets and needs of each region of the state, ensuring Northern, Central, and Southern Illinois

receive funding to begin to make significant infrastructure improvements and upgrades. As part of this plan, local governments will receive \$4 billion in direct transportation funds to meet their specific needs – their first increase in 20 years.

Among the plan's significant investments beyond transportation, Rebuild Illinois creates comprehensive improvements in education, the state crime lab, state parks and historic sites, clean water infrastructure, and conservation of natural resources. Initiatives like statewide broadband deployment, affordable housing, hospital and healthcare transformation, and economic and community development will create growth in communities across every region of Illinois, and strengthen our state for generations to come. The plan provides capital for small businesses, invests in our community colleges and public universities, and supports large industries like agriculture and manufacturing.

Adult Use Cannabis

Beginning in fiscal year 2020, 45 percent of tax revenues and license fees related to adult use cannabis that are deposited into the Cannabis Regulation Fund, net of state agencies' operational costs, will be transferred into the general funds. Ten percent (from that 45 percent) of the tax revenues, scheduled to be deposited into the Budget Stabilization Fund, will be directed solely towards pay down of the backlog of bills.

The financial walk down forecast does not reflect these revenues at this time, as the estimates and timing forecasts for growth have a wide range. Variables such as number of licenses issued, amount of time it takes to fully establish the growth and distribution pipelines, amount of demand, and costs to the state to regulate cultivators and dispensaries will all affect out-year projections of receipts to the general funds. However, potentially \$25 - \$150 million a year increase to the general funds revenue estimate will be available as the adult use cannabis market develops over the forecast horizon.

ESTIMATED INTEREST EXPENSES

The State Prompt Payment Act (30 ILCS 540/3-2) establishes a specified time-frame in which bills for goods and services shall be paid. In the event that the bills are not paid within the specified time frame, an interest penalty is applied for each month, or portion thereof, until final payment is made. Similarly, the Illinois Insurance Code (215 ILCS 5/368a and 5/370a) establishes timely pay for healthcare services under the State Employees Group Health Insurance Program. In the event that healthcare services bills are not paid within the specified time frame, the healthcare service provider is entitled to interest for each month, or portion thereof, until final payment is made.

In order to calculate the interest due to an eligible vendor or provider, an agency must know two critical dates: the date the proper bill or invoice was received by the agency and the date the payment to the eligible vendor or provider was issued by the Illinois Office of the Comptroller. With that information, agencies can then calculate the amount of days that passed beyond the established payment time-frames and the appropriate interest due to the vendor or provider. Until such time as a bill is paid, the agencies are not able to calculate interest. The Comptroller's office determines which bills get paid and when, making it difficult for the agencies to project an interest amount.

With respect to the State Employees Group Health Insurance Program, the Department of Central Management Services (CMS) has been able to estimate that the program will incur approximately \$224 million in interest expense in fiscal year 2020 from delayed payments in fiscal year 2019 and prior years. In this instance, CMS is able to project its fiscal year 2020 interest costs due to known fiscal year 2019

interest carry-over. Future interest expense estimates cannot be made due to fluctuations in when invoices are received and the payment timing decisions made by the Comptroller, but until a further reduction in unpaid bills occurs, the state is likely to continue accruing interest penalties.

NOTE: The projections assume baseline growth in revenues under existing law. The revenue forecast does not reflect revenue from the recent legalization of adult use cannabis. **However, the state anticipates substantial revenues during the budget forecast period, particularly from the Fair Tax.** All projections assume no significant reforms or spending controls aside from what is in current statute. Agency directors have been asked to include in their budget requests options to potentially achieve a 6.5 percent reduction from what would otherwise be fiscal year 2021 maintenance level agency operations funding, those potential budget cuts have not been included in the projections.

STATE OF ILLINOIS GENERAL FUNDS FINANCIAL WALK DOWN						
Governor's Office of Management and Budget						
(\$ in millions)	FY 2020 Estimated	FY 2021 Projected	FY 2022 Projected	FY 2023 Projected	FY 2024 Projected	FY 2025 Projected
RESOURCES						
State Sources: Revenues						
Net Individual Income Taxes	19,561	20,150	20,757	21,382	22,016	22,717
Net Corporate Income Taxes	2,460	2,511	2,543	2,593	2,653	2,712
Net Sales Taxes	8,740	9,012	9,177	9,309	9,454	9,624
Public Utility Taxes	846	828	811	793	776	759
All Other Sources	2,669	2,383	2,318	2,188	2,115	2,082
Total State Sources: Revenues	34,276	34,885	35,605	36,265	37,014	37,895
State Sources: Transfers In						
Lottery	745	760	775	791	806	823
Riverboat Gaming	258	258	258	258	258	258
Other Transfers	1,480	864	864	864	864	864
Total State Sources	36,759	36,766	37,502	38,177	38,942	39,839
Federal Sources	3,497	3,710	3,828	3,950	4,076	4,205
SUBTOTAL, RESOURCES	40,256	40,476	41,330	42,128	43,018	44,044
Interfund Borrowing/Fund Reallocations	100	-	-	-	-	-
Treasurer's Investment Borrowing	400	-	-	-	-	-
TOTAL RESOURCES	40,756	40,476	41,330	42,128	43,018	44,044
EXPENDITURES						
1. Education	10,826	11,372	11,851	12,331	12,775	13,219
PreK-12 Education	8,883	9,350	9,750	10,150	10,550	10,950
Higher Education	1,943	2,022	2,101	2,181	2,225	2,269
2. Economic Development	68	69	69	70	71	72
3. Public Safety	1,867	1,922	1,976	2,031	2,088	2,147
4. Human Services	6,565	7,005	7,212	7,425	7,645	7,871
5. Healthcare	7,464	7,890	8,127	8,371	8,622	8,881
6. Environment and Culture	61	63	64	65	66	68
7. Government Services	3,596	3,587	3,681	3,778	3,877	3,978
Group Health Insurance	2,028	2,099	2,172	2,248	2,327	2,409
Chicago Teachers' Pension System	257	262	267	272	276	279
Government Services	1,311	1,226	1,242	1,258	1,274	1,290
8. Pensions¹	8,113	8,611	9,004	9,197	9,423	9,650
K-12 Education Pensions	4,814	5,141	5,377	5,488	5,613	5,769
State Universities' Pensions	1,640	1,729	1,807	1,867	1,938	1,981
State Employees' Pensions	1,659	1,741	1,820	1,842	1,871	1,900
9. Unspent Appropriations	(932)	(979)	(1,015)	(1,046)	(1,077)	(1,109)
Total Operating Budget	37,629	39,540	40,969	42,223	43,491	44,777
Statutory Transfers Out	365	407	414	421	429	436
Debt Service: Capital and Pension Bonds	1,235	1,222	1,207	1,191	1,194	1,192
Debt Service: Backlog Borrowing ²	811	891	861	831	801	771
Debt Service: Pension Acceleration Bonds	47	84	82	81	80	78
Interfund Borrowing Repayment	85	100	221	240	100	-
Treasurer's Investment Borrowing Repayment	400	-	-	-	-	-
Total Additional Expenditures	2,942	2,704	2,784	2,764	2,603	2,476
TOTAL EXPENDITURES	40,571	42,244	43,754	44,987	46,094	47,253
General Funds Surplus/(Deficit)	184	(1,768)	(2,424)	(2,860)	(3,076)	(3,209)
Backlog Borrowing Proceeds²	300	-	-	-	-	-
Adjusted General Funds Surplus/(Deficit)	484	(1,768)	(2,424)	(2,860)	(3,076)	(3,209)
End of Fiscal Year Backlog of Bills	(5,894)	(7,661)	(10,085)	(12,945)	(16,021)	(19,230)

¹ Pension estimates based on end of FY18 certifications. Revised numbers available by November.

² An additional \$1.2 billion was authorized to be issued to address interest accruing bills. Timing of issuance to be determined. FY21 numbers reflect an estimated allocation of \$300 million to the General Funds, with the \$900 million balance deposited into the Health Insurance Reserve Fund to reduce the backlog of bills on hold in that fund.

Key to Agencies by Outcome	
1. Education PreK-12 Education State Board of Education Higher Education Board of Higher Education Chicago State University Eastern Illinois University Governors State University Northeastern Illinois University Western Illinois University Illinois State University Northern Illinois University Southern Illinois University University of Illinois Illinois Community College Board Illinois Student Assistance Commission Illinois Math and Science Academy University Civil Service System	5. Healthcare Healthcare and Family Services 6. Environment and Culture Natural Resources Illinois Arts Council Abraham Lincoln Presidential Library and Museum 7. Government Services (including employees health insurance) General Assembly and Legislative Agencies Auditor General Supreme Court, Supreme Court Historic Preservation Commission Judicial Inquiry Board State Appellate Defender State's Attorneys Appellate Prosecutor Court of Claims Governor Lieutenant Governor Attorney General Secretary of State State Comptroller State Treasurer State Board of Elections Central Management Services Lottery Revenue Innovation and Technology Management and Budget Office of the Executive Inspector General Executive Ethics Commission Capital Development Board Civil Service Commission Drycleaner Environmental Response Trust Fund Council Procurement Policy Board Independent Tax Tribunal Gaming Board Liquor Control Commission Racing Board Other Retiree Health Insurance Payments Chicago Teachers' Pension and Retirement System
2. Economic Development Agriculture Commerce and Economic Opportunity Illinois Power Authority Labor Transportation Illinois Commerce Commission Human Rights Commission Illinois Sports Facilities Authority Metropolitan Pier and Exposition Authority Southwestern Illinois Development Authority	8. Pensions Teachers' Retirement State Universities' Retirement GA Retirement System Judges Retirement System State Employees' Retirement
3. Public Safety Corrections Financial and Professional Regulation Insurance Military Affairs State Police Environmental Protection Criminal Justice Information Authority Educational Labor Relations Board Workers' Compensation Commission Law Enforcement Training and Standards Board Prisoner Review Board Property Tax Appeal Board Emergency Management Agency Labor Relations Board State Police Merit Board State Fire Marshal	
4. Human Services Aging Children and Family Services Juvenile Justice Employment Security Human Rights Human Services Public Health Veterans' Affairs Deaf and Hard of Hearing Commission CHIP Guardianship and Advocacy Illinois Coroner Training Board Council on Developmental Disabilities	

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- ³² Estimated value of General Funds and Health Insurance Reserve Fund bills pending on June 30, 2019 per the Illinois Office of the Comptroller's Debt Transparency Report. <https://illinoisc comptroller.gov/comptroller/assets/File/DTA/ReportSummary/ReportSummaryPeriodEnding201906.pdf>
- ³³ <https://itep.org/whopays/illinois/>
- ³⁴ Income thresholds for property tax credits remain unchanged from current law.
- ³⁵ For Child Tax Credit, single filers eligible up to \$80,000 in net income and married/joint filers eligible up to \$100,000 in net income, with credit phase-out starting at \$40,000 and \$60,000, respectively.
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