
**The Public Finance Articles of
the 1970 Illinois Constitution**

by
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**A Background Paper for the
Committee of 50 to Re-examine the Illinois Constitution**

Illinois Commission on Intergovernmental Cooperation
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THE PUBLIC FINANCE ARTICLES
OF THE 1970 ILLINOIS CONSTITUTION

Staff Introduction

Articles VIII and IX of the 1970 Constitution detail the ways in which Illinois administers public finances. The most important features are analyzed in this paper prepared for the Committee of 50 by University of Illinois Professor J. Fred Giertz.

The Illinois Constitution requires an annual budget that must be balanced. The income tax is nongraduated; corporate rates may not exceed individual rates at a ratio of more than 8 to 5. There is no personal property tax, but counties of more than 200,000 may classify and tax real property. The General Assembly has a great deal of control over the types of taxes local governments may impose, even on home rule governments.

One area that is likely to become a subject of controversy in the event that Illinois voters choose to convene another constitutional convention involves the State Mandates Act, which was passed in 1979 and became effective in 1981. The act states that the financial burden imposed on local governments by state mandates will be reimbursed by the state at rates from 50 to 100 percent. Reimbursement is not required when local governments request the mandate or when the financial impact is slight.

To date, no money has been appropriated by the state for the reimbursement of local governments affected by the cost of state mandates. Much of the legislation passed by the General Assembly contains provisions which state expressly that the State Mandates Act does not apply to the legislation in question, and in general the act's intent has been ignored. An attempt to grant constitutional status to the State Mandates Act will almost certainly be part of the debate at any future constitutional convention.

Another area which could come up for discussion is a limitation, either at the level of taxation or at the level of expenditures, on the state's fiscal activity. Although there is at present nothing similar to an Illinois version of California's Proposition 13, a desire to stop the growth of government is perennial and may affect debate at any constitutional convention.

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Introduction

A constitution establishes procedural rules for making decisions, and also imposes constraints that limit the substantive outcomes of the decisionmaking process. The requirement for a balanced budget and restrictions on the types of taxes available to local governments are examples. Both aspects of a constitution can contribute to a stable environment for conducting economic activity.

A stable fiscal environment allows individuals and businesses to make long-term decisions with some degree of certainty. For example, businesses, when considering location and expansion decisions, are often more concerned about unforeseen changes in tax policies than the actual existing rates or forms of taxation. This seemingly modest attribute of stability can be an important contribution to the state's economy.

In addition, reasonable constraints on the outcomes of the political process can reduce the range of conflict in the distributive decisions that governments must make in regard to taxation and expenditure activities. Political battles over the division of fixed resources are negative sum games -- that is, the gains to the winners in such distributive contests are less than the losses imposed on the losers because of the costs expended by both sides in political activities. A constitution prevents every issue (especially the most basic ones) from being debated every year.

In evaluating particular fiscal aspects of the Illinois Constitution, the primary question is whether a particular feature of, or omission from, the Constitution is serious enough to require a convention to correct the defect. To warrant a convention, the problem presumably should have major consequences that cannot be addressed through the normal legislative or amendment process. It must be remembered that use of the convention process to change the Constitution entails a risk of bringing to the fore a range of issues that may be highly divisive. There may also, however, be issues that are not important enough to necessitate a convention, but which might be profitably addressed if a convention is called for other reasons. The fiscal issues in the Illinois Constitution will be discussed in both contexts.

Fiscal Issues in the Illinois Constitution

The important fiscal components of the Illinois Constitution are contained in Articles VIII and IX, the finance and revenue articles. The Illinois Blue Book offers a summary of these articles:

Finance (Article VIII). Provides for an annual, balanced executive budget, a uniform system of accounting for local governments, and an Auditor General appointed by the General Assembly.

Revenue (Article IX). Provides any income tax must be at a non-graduated rate and (that the) rate for corporations cannot exceed the rate for individuals by more than 8 to 5 (ratio). Permits classification of real property for tax purposes in counties over 200,000. Abolishes personal property tax by 1979. Allows homestead exemptions, exemptions of food, etc. from the sales tax, etc. Requires a three-fifths vote of the legislature or voter approval for general obligation borrowing; only a simple legislative majority required for revenue bonds.

Of the nine amendments that have come before the voters since the adoption of the Constitution, five have been related to public finance issues. Only one of these issues was of substantial importance: the 1978 amendment that would have repealed the elimination of the corporate personal property tax. This amendment failed, leaving intact a constitutional requirement to eliminate the taxation of corporate personal property by 1979 and to replace the revenue lost to local governments with other taxes.

Three of the five proposed amendments (in 1978, 1984, and 1986) were substantially the same, allowing the General Assembly to exempt from property taxation the property used by veterans' organizations. These amendments all failed to win approval. The only fiscal amendment to be approved was a technical one submitted to the voters in 1980; it concerned the minimum length of time for redemption of property sold because of long-term delinquency in property tax payments.

An Annual Balanced Budget. The Constitution provides that the governor submit a budget for each fiscal year to the General Assembly. The budget is to be balanced in a prospective sense, with proposed expenditures not to exceed expected revenue. The General Assembly is not precluded from making multiyear commitments, but it has been suggested in an attorney general's opinion that converting to a biennial budgeting process for all appropriations is not permissible.

The Constitution of 1870 did not directly provide for a balanced budget. It seems clear, however, that the intent of the constitution was for the General Assembly to appropriate enough money to carry out all of the planned activities of the government. Although the language was less than precise, the governor was required at the beginning of each legislative session to present an estimate of the tax revenues needed to carry out the activities of the state government. In practice this meant a biennial budget, since a new session of the General Assembly met every two years.

There seems to be little or no interest now in departing from the principle of an annually balanced state budget. Contrasting the relative fiscal health of most state governments with the deficit problems at the federal level, the requirement for a balanced budget seems to have served most states well. Provisions that limit borrowing to meet revenue deficiencies are also found in the constitution. Even with this constraint, the state has considerable flexibility in responding to unforeseen shortfalls in revenues, as evidenced by actions taken during the recession period in 1982-3. During that period, the problem was dealt with through a combination of short-term borrowing, delaying of certain payments, and speeding up of collections.

In recent General Assemblies, consideration of budget issues has become virtually a year-round activity, beginning at the opening of each year's session in January and continuing through the veto session in the fall. Some observers have suggested that a biennial budget would limit these discussions, providing the General Assembly with more time to consider other issues without the constant press of budget matters. It would also encourage more cautious long-term planning for state activities.

However, a counter argument can be found in the uncertainty surrounding state government revenues. Revenue shortfalls, in most cases, require the action of the General Assembly in the near term -- for example, through new taxes or tax rate changes. This lends support to an annual budget process. Similarly, most programmatic changes to respond to unforeseen problems have budget implications that must be addressed when the programs are approved. A biennial budget would not eliminate the need for annual revisions in appropriations and revenues. It is quite likely that even with a biennial budget, the General Assembly would still be occupied with budget questions most of the time. In addition, the current use of annual budgets does not preclude multiyear planning; such planning has been a feature of the Build Illinois program and the 1985 education reforms.

Limitations on the State Income Tax. The Constitution of 1970 expressly allowed the taxation of both individual and corporate income. In doing so, it also required that rates be non-graduated and that the ratio of the corporate tax rate to the individual tax rate not exceed 8 to 5. Accordingly, the corporate rate cannot exceed the individual rate by more than 60 percent.

Until 1969, Illinois had no income tax. The status of the income tax under the Constitution of 1870 was cloudy. A graduated income tax was ruled unconstitutional in 1932, but in 1969 the Illinois Supreme Court overruled its 1932 decision, permitting a flat rate tax on income with a different rate for corporations and individuals. Therefore, when the convention was deliberating the 1970 Constitution, Illinois was making use of an income tax similar to the one now employed.

The debate over the inclusion of income tax limitations in the Constitution was a heated one. The proposal of the revenue committee was much like the one ultimately adopted, except that the limitation on the ratio of corporate to individual tax rates was set to expire in 1979. There were attempts to eliminate all limitations and to impose tighter restrictions. One group proposed no limitations whatsoever on the use of the income tax, while another group wanted to impose a maximum rate ceiling of 5 percent (to be exceeded only with the approval of a statewide referendum) on the individual rate, along with a permanent provision limiting the ratio of corporate to individual rates. After considerable debate, the only major change in the income section was to make the maximum corporate to individual rate ratio a permanent feature of the Constitution.

To a certain extent, the convention took the income law already in place in 1969 and gave constitutional status to several provisions. This may seem unusual, but in light of the long and heated struggle to bring the state income tax into existence, such a response is understandable. The income tax probably would never have been passed initially if assurances had not been given to the business community on limiting the taxation of corporations, as well as on the use of progressive rates. The 1970 Constitution simply gave more definite legal status to the promises made when the income tax was passed in 1969.

In evaluating the provisions concerning the income tax, there is widespread agreement that the current income tax system, based on a broad base and a low rate, is a good one. In a sense, the state's original income tax incorporated many of the desirable features that tax reformers have been striving for both at the national level and in other states. However, some observers question whether the characteristics of the tax need to be given special constitutional protection. In comparison with other states, Illinois' provisions for a flat rate and a maximum ratio of corporate to individual tax rates are very unusual.

These constitutional limitations do provide a considerable amount of underlying stability in tax matters, both for firms and individuals. They also limit the range of potentially divisive debate in regard to income tax questions. In addition, such limitations do not restrict the ability of the state to raise or lower tax rates to respond to changing revenue conditions. The question of eliminating both the restriction on graduated rates and the ratio of corporate to individual rates was addressed explicitly in the deliberations of the 1982 Illinois Tax Reform Commission. The Commission agreed (with only one negative vote) to recommend the continuation of these limitations in the Constitution.

Real Property Tax Rules. The Constitution of 1970 modified the requirement of the 1870 Constitution that all property be taxed at a uniform rate within a jurisdiction. It did so by explicitly permitting the classification of property for tax purposes in counties with more than 200,000 population. This provision was included to give de jure recognition to a de facto classification scheme that already existed in Cook County. Classification means that different types or classes of property are either assessed or taxed at different rates. The actual property tax system in Cook, as well as many other counties, was in violation of the 1870 constitutional requirement for uniformity. While classification was permitted, limits were placed on the ratio of assessed value among classes: the highest assessment class can be no more than two and one-half times that of the lowest category.

As of the 1980 census, nine counties met the population eligibility test to classify property for tax purposes. Only Cook County has chosen to do so. Most tax analysts do not favor the use of a classification scheme for property taxation. It is considered both inefficient and inequitable. However, the elimination of the long-standing practices in Cook County would have been (and would be now) highly disruptive. Many observers have recommended the gradual elimination, or at least a reduction in the degree of classification in Cook County. With much business property assessed at a rate two and one-half times that of residential property, it is argued that such practices put the county at a competitive disadvantage for business development.

However, a constitutional remedy is not necessarily required to correct this problem. Cook County itself can choose to reduce or eliminate its property classification system. In addition, the General Assembly is empowered to limit classification schemes as well. Therefore, this would not seem to be a major issue with regard to the question of holding a constitutional convention.

Personal Property Taxation. The taxation of personal property (for example, automobiles, household furnishings, business equipment and inventories) no longer exists in Illinois. The taxation of the personal property owned by individuals was eliminated by a 1970 amendment to the 1870 Constitution, and was validated in the new Constitution. The elimination of the taxation of business personal property required by the 1970 Constitution provided that the local revenue lost because of the elimination of the business personal property tax be returned to local governments by a system of statewide taxation (excluding the use of real property taxation) on those classes relieved of the personal property burden. The replacement taxes were not to be included in the calculation of the 8 to 5 limit on corporate to individual income tax rates.

The removal of the business personal property tax presented difficult transition problems, especially with regard to the choice of appropriate replacement taxes. As previously noted, a 1978 amendment to allow the continuation of business personal property taxation was narrowly rejected. Finally, a set of taxes, along with a formula for distributing the tax receipts, were agreed upon. The personal property tax ceased to exist.

There is virtually no discussion now of eliminating the constitutional provision banning personal property taxation. As the years go by, however, the relationship between the business personal property tax collected before 1980 and the replacement tax collected and distributed annually becomes increasingly tenuous, both for business taxpayers and for the local governments receiving the proceeds of the taxes. The distribution formula currently used is based on collections in the late 1970s. Growing areas are penalized under such a formula since their allocation is based on their share of collections almost a decade ago.

At some future time, it might be appropriate to "clean up" Article IX, Section 5 by simply banning the taxation of personal property in Illinois without specifying a definite mechanism for replacing the lost revenue. This is clearly not a pressing issue, however. Changing this section would create potential problems in determining how the existing replacement taxes would be dealt with under the section placing limits on income taxation in the state.

Limitations on Local Government Taxing Powers. The 1970 Constitution places few explicit limitations on the taxes local governments can use, aside from the ban on taxation of personal property. As with state taxes, however, any local taxes must comply with constitutional requirements, such as uniformity and the ban on graduated income tax rates.

Non-home rule local governments only have access to taxes that have been approved by the state, since these governments "have only the powers granted them by law." (It should be noted that the General Assembly can also place restrictions on home rule governments.) Therefore, the state can effectively ban certain taxes, such as the income tax, by not providing authorizing legislation. The state can also set rate limitations on other taxes, such as the property tax and local sales taxes, through legislative action. This means that in regard to tax matters, non-home rule local governments must operate within the constraints set by the General Assembly.

During the constitutional convention, there was considerable debate over the issue of a local income tax. An amendment to ban the use of a local income tax was defeated, as was an amendment to allow local income taxes, with rates up to 1 percent, without authorization by the General Assembly. There seemed to be an underlying fear of potential abuse of the income tax by some local governments.

Some local governments would like to have access to a broader range of tax sources than is presently available -- for example, a local income tax. This could be accomplished either by legislation or by changing the Constitution. At the present time, there seems to be no strong interest in providing local government with a constitutionally guaranteed revenue source. However, these issues might arise in the context of a constitutional convention.

Providing the State Mandates Act Constitutional Status. In the 1970s, local governments, including school districts, became increasingly concerned about the financial impact of state-imposed mandates on their operations. The state had imposed a wide array of rules affecting local governments, including the granting of property tax exemptions, the establishing of personnel and pension rules, and the mandating of various services (such as curriculum requirements in schools). To meet these mandates, local governments were often forced to increase spending or forego taxation with no reimbursement from the state for the added burden.

In response to this problem, the State Mandates Act (SMA) was passed in 1979 and became effective in 1981. The act required that the financial burden imposed on local governments by state mandates be reimbursed by the state, at rates from 50 to 100 percent. There were also exceptions: reimbursement was not required in cases where the mandates were requested by local governments or where the financial impact was slight. The SMA also provided for the estimation of the costs of mandates that were being considered by the General Assembly.

In the five years the bill has been in effect, no money has been appropriated by the state to reimburse local governments for the costs of mandates. Recent General Assemblies have in some cases simply ignored the intent of the act, while in other cases legislation has contained provisions that expressly grant exemptions from the impact of the SMA.

In response to this, a constitutional amendment has been proposed that gives certain elements of the SMA constitutional status. The amendment, introduced in both the 83rd and 84th General Assemblies, required that bills with provisions which contain potentially reimbursable mandates could be approved by a simple majority if funds are provided to local governments to cover the costs of the mandates, or by a three-fifths majority in each house if reimbursement is not included. This amendment has not yet been approved by the General Assembly, so it has not reached the voters.

It seems clear that the SMA has not been an effective mechanism to address the problem of state imposed costs on local government. It is likely that the use of a constitutional amendment to deal with the problem will continue to be discussed. The mandates problem would certainly be an issue in any constitutional convention in the foreseeable future.

Tax and Expenditure Limitations. The issue of constitutional limitations on tax and expenditure levels would almost certainly arise at a constitutional convention. However, this may have been more an issue of the 1970s than an issue for the 1980s and 1990s. From the end of World War II until the mid to late 1970s, state and local spending in the nation and in Illinois increased very rapidly. This was true whether spending was measured in terms of current or constant dollars, or as a percentage of personal income. In recent years, state and local spending in Illinois has risen at a more moderate rate and in some cases has actually declined as a percentage of income.

The current Constitution places no effective limits either on rates of taxation or on expenditure levels. Legislative actions have placed limits on both property tax rates and local sales taxes for home rule jurisdictions. The 1870 Constitution limited property taxes levied by counties to three-fourths of one percent. This was the only constitutional rate limitation.

In the late 1970s, in the wake of the passage of Proposition 13 in California, there was considerable interest throughout the country in various types of constitutional amendments to limit the fiscal actions of state and local governments. In 1978 Illinois voters approved, by a wide margin, a non-binding referendum promoted by Governor Thompson that read: "Shall legislation be enacted and the Illinois Constitution be amended to impose ceilings on taxes and spending by the state of Illinois, units of local government and school districts?"

At about this time, a constitutional amendment was proposed that called for limiting state taxes to 8 percent of the state's personal income, and prohibited local governments from increasing taxes by more than 3 percent per year without approval of the voters in the jurisdiction. The amendment never received legislative approval, and thus was never placed before the voters. The proposed amendment was opposed not only by liberals, but by many conservatives who believed that the ceiling of 8 percent was too high and might actually encourage more spending.

In retrospect, if the limitation on state taxation had been approved it would have been unimportant; state taxes as a percentage of personal income have generally declined during the 1980s. This is the dilemma faced by advocates of constitutional tax or expenditure limitation: how can a constitutional limitation be effective in limiting the size of government, while at the same time providing the flexibility necessary for state government to deal with unforeseen problems in a variety of fiscal environments?

There is little interest across Illinois at this time for amending the Constitution to limit either taxes or expenditures. However, if a constitutional convention were called, it seems quite likely that these issues would arise and have to be dealt with. They clearly have the potential for being quite divisive.

Summary

There are a number of important public finance issues related to the provisions of the Illinois Constitution. These include the requirement for an annual, balanced budget and the restriction which states that the income tax must be non-graduated, with corporate rates not to exceed individual rates at a ratio of more than 8 to 5. In regard to property taxation, the Constitution permits classification of real property in counties over 200,000 while prohibiting the taxation of personal property. The Constitution gives the General Assembly considerable power to control the types of taxes used by local governments (even those with home rule). While all of the features of the Constitution have important implications for public finance in Illinois, they are not particularly controversial at this time. They would likely be addressed at any future constitutional convention, but they probably are not a compelling reason for calling such a convention.

Two areas not addressed in the Constitution are the state's responsibility to local governments for costs imposed by state mandates, and effective limits on the fiscal actions of state and local governments (measured either by expenditure or tax levels). Both of these areas would very likely be major issues in any future convention.

In summary, fiscal issues would command a prominent place in the deliberations of any future constitutional convention in Illinois. At the present time, however, such issues are not likely to be a major reason for convening a constitutional convention.