The Institute for Illinois' Fiscal Sustainability
AT THE CIVIC FEDERATION

STATE OF ILLINOIS FY2015 BUDGET ROADMAP:

State of Illinois Budget Overview, Projections and Recommendations for the Governor and the Illinois General Assembly

March 3, 2014

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The Civic Federation is an independent, non-partisan government research organization working to maximize the quality and cost-effectiveness of government services in the Chicago region and State of Illinois.

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EXECUTIVE SUMMARY

This report describes the State of Illinois' fiscal condition and presents the Civic Federation's proposed five-year plan to stabilize the State's finances. The report is published before the Governor's annual budget address in order to provide actionable recommendations to the Governor and General Assembly for the FY2015 budget year.[1]

Despite significant steps to improve its fiscal condition, the State continues to face severe budgetary pressures nearly five years after the official end of the national economic recession.[2] Due to legal challenges, major pension reform legislation enacted in December 2013 will not bring budgetary relief until FY2016 at the earliest.[3]

The State's backlog of unpaid bills has been reduced to an estimated $5.4 billion at the end of FY2014 from $8.9 billion at the end of FY2012, but further reductions seem unlikely under current law. Temporary income tax increases that took effect in January 2011 are scheduled to be partially phased out in January 2015, leading to a dramatic reduction in State revenues. Under current law, the rates will decline from 5.0% to 3.75% for individuals and from 7.0% to 5.25% for corporations.[4]

In analyzing the State's finances, the Civic Federation has concluded that the steep rollback in income tax rates would dramatically destabilize Illinois' already weak financial condition. Driven by the rollback, income tax revenues are expected to decline by $1.7 billion, or 8.7%, in FY2015.[5] In FY2016, the first full fiscal year affected by the lower rates, the projected drop in income tax revenues is $4.4 billion, or 22.6%, from FY2014.[6]

This kind of fiscal cliff is unsustainable for a government that still has not been able to pay off a mountain of unpaid bills left over from the recession. Dealing with the revenue loss through spending cuts, even without addressing the unpaid bills, would require that agency appropriations be reduced by $2.7 billion, or 17.1%, between FY2014 and FY2016.[7]

These spending reductions would necessarily be concentrated in the areas of education and human services because so many other State costs are determined by law, court order and legally binding contracts. To put this in perspective, it should be noted that net agency appropriations—not including pensions or group health insurance—declined by an estimated $992 million, or 4.1%, in the last five years. State General Funds spending on elementary and secondary education alone fell by 10.1% from $7.3 billion in FY2013 to an estimated $6.5 billion in FY2013.

In contrast, the Civic Federation's proposal provides a roadmap for a sustainable fiscal future. The five-year plan would restrain spending to pay down the backlog of bills and gradually reduce income tax rates by 20% while broadening the tax base and building a reserve fund as a cushion against future economic downturns.

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[1] The State of Illinois' fiscal year begins on July 1 and ends on June 30.
[2] The national economic recession began in December 2007 and officially lasted until June 2009, according to the National Bureau of Economic Research.
[3] Public Act 98-0599, enacted on December 5, 2013.
[4] Public Act 96-1496, enacted on January 13, 2011. Corporations also pay a Personal Property Replacement Tax of 2.5% that is collected by the State and passed on to local governments.
[5] Illinois Department of Revenue, *FY2015 Revenue Estimates*, February 4, 2014, p. 2.
[6] State of Illinois, Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY15-FY17*, January 1, 2014; Illinois Department of Revenue, *FY2015 Revenue Estimates*, February 4, 2014, p. 2.
[7] For more information on this Civic Federation calculation, see page 31 of this report. Healthcare, an approximation of Medicaid spending, is not included in this calculation.

Civic Federation Recommendations

- The State should pay off its $5.4 billion backlog of unpaid bills over the next five years by establishing spending controls that limit the growth in net agency spending and create annual operating surpluses to fund bill backlog payments.
- The State should eliminate the revenue cliff in FY2015 by extending the current income tax rates for one additional year and rolling them back gradually over the next three years. This would avoid a looming financial crisis and significantly reduce the State's unpaid bills by the end of FY2016.
- The current income tax rates should be gradually rolled back by 20% from the current levels. The individual income tax rate should be cut to 4.0% from 5.0%, with reductions of 0.25 percentage points on January 1, 2016 and January 1, 2017 and a further reduction of 0.5 percentage points on January 1, 2018. The corporate income tax rate should be reduced to 5.6% from 7.0%, with reductions of 0.5 percentage points on January 1, 2016 and January 1, 2017 and an additional reduction of 0.4 percentage points on January 1, 2018.
- The State should broaden its income tax base to include federally taxable amounts of retirement income to create greater equity among taxpayers and facilitate the gradual rollback of the income tax rates. The broader base will also ensure greater long-term sustainability of the State's resources by accessing a growing portion of the economy.
- In light of the financial pressures facing Illinois municipalities, the State should restore the full 10.0% share of income tax revenues to local governments. Municipalities did not share in the additional revenues generated by the 2011 tax increase, which reduced their share of total collections.
- The State should repeal the new statutory diversions of income tax revenues from the General Funds to fund human services and education that are scheduled to begin in FY2015. Any future efforts to shift resources outside of the scrutiny of the General Funds budgeting process should be rejected.
- The State should work toward building a rainy day fund totaling at least 5.0% of General Funds revenues to help cope with the next economic downturn. The fund should be governed by reasonable funding requirements and rigorous controls on withdrawals.
- The State should develop a formal five-year financial plan through a transparent process that allows for input from the public. Such a plan should be published prior to the release of the FY2016 budget. The plan should be updated annually to reflect actual budget results and changes in economic conditions.

Civic Federation Findings

- Although General Funds expenditures increased by $2.4 billion, or 7.4%, to an estimated $35.7 billion in FY2014 from $33.3 billion in FY2010, most of the additional spending was related to pension costs.
- Total pension costs, including State contributions and payments on previously issued pension bonds, increased by $3.6 billion, or 86.7%, to $7.7 billion in FY2014 from $4.2 billion in FY2010. Pension contributions in FY2010 and FY2011 were made by issuance of pension bonds.
- The State enacted landmark pension reform in December 2013 that is expected to reduce pension contributions by a total of $5.0 billion from FY2016 through FY2019.
- Between FY2010 and FY2014, net agency appropriations (not including pensions, group insurance or unspent appropriations) declined by $992 million, or 4.1%, from $24.2 billion to $23.2 billion.

- To deal with the drop in revenues caused by the recession, the State borrowed for operations in FY2010 and FY2011 and delayed bill payments. A temporary increase in individual and corporate income tax rates beginning in January 2011, from 3.0% to 5.0% for individual taxpayers and 4.8% to 7.0% for corporate taxpayers (9.5% including the Personal Property Replacement Tax), helped stabilize the State's finances.
- Since FY2012 the State has created budget surpluses by limiting growth in agency spending and is expected to reduce its unpaid bills to roughly $5.4 billion by the end of FY2014 from $8.9 billion at the end of FY2012.
- Total General Funds revenues decline by $1.6 billion in FY2015 to $35.2 billion from $36.7 billion in FY2014 and by an additional $2.4 billion to $32.8 billion in FY2016, due to the partial rollback of the income tax rates to 3.75% from 5.0% for individuals and to 5.25% from 7.0% for corporations. This amounts to an aggregate decline of $3.9 billion over two years or 10.7% of total General Funds Revenues.[8]
- Based on an extension of the Governor's three-year projection for two additional years, the State's unpaid bills would grow to $23.0 billion by FY2019 from $7.4 billion in FY2015.
- If spending reductions alone were used to eliminate the deficits and pay off the backlog of unpaid bills over the next five years, agency appropriations would have to be cut by $1.3 billion, or 8.4%, in FY2015 and an additional $1.4 billion in FY2016, or 9.6% from FY2015 levels. Agency budgets would need to be cut an additional $665 million, an average of 5.3% annually from FY2017 through FY2019, to completely pay off the remaining backlog of bills.
- If the income tax rates were extended at the current rates of 5.0% for individuals and 7.0% for corporations, it would take the State through FY2019 to completely pay down its backlog of bills.

[8] This projection differs slightly from the Governor's three-year projection because it is based on the most recent revenue numbers from the Illinois Department of Revenue. For more information, see page 19 of this report.

BUDGET OVERVIEW: FY2010 TO FY2014

Nearly five years after the official end of the national economic recession, the State of Illinois has taken significant steps to improve its fiscal condition.[9] Yet the State continues to face severe budgetary pressures.

A new pension law enacted in December 2013 is projected to result in major reductions in the State's unfunded liability and statutorily required contributions.[10] However, the law is being challenged in court and, even if eventually found constitutional, it is not expected to affect State pension contributions until FY2016.[11] In FY2014 State pension payments, including contributions and debt service on previously issued pension bonds, will total $7.7 billion and consume 23.8% of State-source general operating revenues.

This large pension expense has impeded efforts to reduce a backlog of unpaid bills that began to accumulate during the economic downturn. The backlog has declined from an estimated $8.9 billion at the end of FY2012 but is still expected to stand at roughly $5.4 billion at the end of FY2014.

Further progress in paying off bills appears unlikely under current law. Temporary income tax increases that took effect in January 2011 are scheduled to be partially phased out in January 2015, leading to a dramatic reduction in State revenues.[12]

This section summarizes major budget developments over the past five years and reviews recent changes in the State's credit ratings.

Revenues

General Funds revenues are projected to increase by $9.4 billion, or 34.2%, to $36.7 billion in FY2014 from $27.4 billion in FY2010.[13] Revenue growth was fueled by higher income tax rates, which spurred a 98.7% increase in income tax revenues to $19.6 billion in FY2014 from $9.9 billion in FY2010.

As of January 1, 2011, the personal income tax rate was raised to 5.0% from 3.0% and the corporate tax rate was raised to 7.0% from 4.8%.[14] The personal income tax rate is scheduled to decline to 3.75% on January 1, 2015 and to 3.25% on January 1, 2025. The corporate income tax

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[9] The national economic recession began in December 2007 and officially lasted until June 2009, according to the National Bureau of Economic Research.
[10] Public Act 98-0599, enacted on December 5, 2013.
[11] The State of Illinois' fiscal year begins on July 1 and ends on June 30.
[12] Public Act 96-1496, enacted on January 13, 2011.
[13] General Funds support the regular operating and administrative expenses of most State agencies and are the funds over which the State has the most control. The operating budget also includes Other State Funds, which are accounts for activities funded by specific revenue sources that may only be used for specific purposes, and Federal Funds (other than those designated for Other State Funds), which support a variety of State programs with federal revenues.
[14] Corporations also pay a Personal Property Replacement Tax of 2.5%, bringing the effective corporate tax rate after the increase to 9.5%. Replacement taxes are collected by the State and paid to local governments to replace revenues lost by local governments when their power to impose personal property taxes on businesses was rescinded by the 1970 Illinois Constitution.

rate falls to 5.25% in 2015 and returns to 4.8% in 2025. The first full budget year under lower rates will be FY2016.

In FY2013 individual income tax revenues grew by $1.0 billion from FY2012. [15] The increase was largely due to a surge in collections in April 2013, which occurred because wealthy taxpayers shifted income into 2012 to avoid higher federal tax rates.[16] The additional revenues were used to pay down outstanding bills and supplement appropriations for healthcare, human services and State group health insurance.

Federal revenues, which mainly consist of reimbursements for State Medicaid spending, decline by 30.5% from $5.9 billion in FY2010 to $4.1 billion in FY2014. The decrease reflects the expiration in FY2011 of the American Recovery and Reinvestment Act of 2009, the federal stimulus program designed to counteract the effects of the recession. Sales taxes increase by $1.3 billion, or 20.6%, to $7.6 billion in FY2014 from $6.3 billion in FY2010.

The following table shows General Funds revenues from FY2010 to FY2014.

State of Illinois General Funds Revenues by Source: FY2010-FY2014 (in $ millions)

	FY2010	FY2011	FY2012	FY2013	FY2014 Estimated	Five-Year $ Change	Five-Year % Change
Income Taxes	$ 9,871	$ 13,076	$ 17,973	$ 19,716	$ 19,618	$ 9,747	98.7%
Sales Taxes	$ 6,308	$ 6,833	$ 7,226	$ 7,354	$ 7,610	$ 1,302	20.6%
Other State Sources	$ 5,267	$ 4,868	$ 4,742	$ 5,104	$ 5,384	$ 117	2.2%
Total State-Source Revenue	**$ 21,446**	**$ 24,777**	**$ 29,941**	**$ 32,174**	**$ 32,612**	**$ 11,166**	**52.1%**
Federal Revenue	**$ 5,920**	**$ 5,386**	**$ 3,681**	**$ 4,154**	**$ 4,113**	**$ (1,807)**	**-30.5%**
Total	**$ 27,366**	**$ 30,163**	**$ 33,622**	**$ 36,328**	**$ 36,725**	**$ 9,359**	**34.2%**

Source: State of Illinois, General Obligation Bonds, Series of February 2014, *Preliminary Official Statement* , January 24, 2014, p. 13; Illinois Department of Revenue, *FY2015 Revenue Estimates* , February 4, 2014, p. 2.

Expenditures

General Funds expenditures are expected to increase by $2.4 billion, or 7.4%, to $35.7 billion in FY2014 from $33.3 billion in FY2010. The increase is mainly due to higher pension payments, which offset declines in agency spending.

Statutorily required pension contributions increase by $2.5 billion, or 69.9%, to $6.1 billion in FY2014 from $3.6 billion in FY2010. These are the contributions required under the State's existing pension funding law, which took effect in FY1996.[17]

Approximately 89% of total State pension contributions come from General Funds.[18] The General Funds pension contributions used in this report include certain additional pension and

[15] Illinois Department of Revenue, *FY2015 Revenue Estimates*, February 4, 2014, p. 2.
[16] Commission on Government Forecasting and Accountability, *Monthly Briefing for the Month Ended: April 2013*, p. 1.
[17] Public Act 88-0593, enacted on August 8, 1994.
[18] State of Illinois, General Obligation Bonds, Series of February 2014, *Preliminary Official Statement*, January 24, 2014, p. 18.

retiree health contributions by the State that amounted to $105.7 million in FY2014.[19] This is in line with Governor Pat Quinn's latest three-year budget projection, which was issued on January 1, 2014.[20]

In FY2010 and FY2011, the State issued bonds to make its General Funds pension contributions. In addition to pension contributions, State pension costs include debt service on these pension bonds and on pension bonds sold in 2003. Pension bond payments increase by $1.1 billion to $1.7 billion in FY2014 from $564 million in FY2010.

Total pension payments, including contributions and debt service, rise to $7.7 billion in FY2014, or 23.8% of projected State-source General Funds revenues of $32.6 billion. A comparison to FY2010 is not appropriate since contributions in FY2010 were made with bond proceeds rather than General Funds resources.

The increase in pension payments over the last five years has been accompanied by a decrease in net agency appropriations spent. Net agency appropriations spent (not including pension contributions, group insurance payments and unspent appropriations) decline by $992 million, or 4.1%, from $24.2 billion in FY2010 to $23.2 billion in FY2014. State General Funds spending on elementary and secondary education fell by 10.1% from $7.3 billion in FY2010 to an estimated $6.5 billion in FY2013.[21]

It should be noted that a growing share of Medicaid spending is appropriated from funds outside of the General Funds. These other State accounts are funded by transfers from General Funds and by a number of other sources, including proceeds from the settlement of tobacco-related litigation and rebates paid by prescription drug manufacturers. Legislatively required transfers out of General Funds rise by $871 million, or 43.4%, to $2.9 billion in FY2014 from $2.0 billion in FY2010 largely because of an increase in Medicaid transfers.

The FY2013 budget designated a total of $764 million for the payment of outstanding bills.[22] The total included an appropriation of $264 million to pay bills not related to Medicaid and a transfer from General Funds of $500 million for Medicaid bills. Through a cycle of State spending and federal reimbursement, this provided a total of $1 billion to pay Medicaid bills.[23]

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[19] The additional contributions are to the Teachers' Retirement Insurance Program (TRIP), College Insurance Program (CIP) and Public School Teachers' Pension and Retirement Fund of Chicago. Continuing appropriations for TRIP and CIP for FY2014 were not reflected in the Governor's projection.

[20] State of Illinois, Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY15-FY17*, January 1, 2014.

[21] Illinois State FY2012 Budget, p. 2-30; Illinois State FY2014 Budget, p. 2-33.

[22] State of Illinois, General Obligation Bonds, Series of February 2014, *Preliminary Official Statement*, January 24, 2014, p. 25.

[23] For more information on Medicaid spending and reimbursement, see the Institute for Illinois' Fiscal Sustainability at the Civic Federation blog at http://www.civicfed.org/iifs/blog/medicaid-101-how-3375-million-turns-675-million.

The next table shows General Funds expenditures from FY2010 to FY2014.

State of Illinois General Funds Expenditures: FY2010-FY2014 (in $ millions)							
	FY2010	FY2011	FY2012	FY2013	FY2014 Revised[1]	Five-Year $ Change	Five-Year % Change
Agency Appropriations	$ 25,087	$ 24,859	$ 23,909	$ 24,189	$ 23,732	$ (1,355)	-5.4%
Less Unspent Appropriations	$ (896)	$ (350)	$ (374)	$ (557)	$ (533)	$ 363	-40.5%
Net Agency Appropriations Spent	$ 24,191	$ 24,509	$ 23,535	$ 23,632	$ 23,199	$ (992)	-4.1%
Pension Contributions[2]	$ 3,587	$ 3,781	$ 4,238	$ 5,209	$ 6,094	$ 2,507	69.9%
Group Insurance	$ 1,146	$ 885	$ 1,436	$ 1,450	$ 1,346	$ 200	17.5%
Total Appropriations Spent	**$ 28,924**	**$ 29,175**	**$ 29,209**	**$ 30,291**	**$ 30,639**	**$ 1,715**	**5.9%**
Statutory Transfers Out							
Legislatively Required Transfers	$ 2,007	$ 2,399	$ 2,473	$ 2,840	$ 2,878	$ 871	43.4%
Debt Service on Pension Bonds	$ 564	$ 1,667	$ 1,607	$ 1,552	$ 1,655	$ 1,091	193.4%
Other Debt Service and Transfers Out[3]	$ 1,759	$ 729	$ 809	$ 683	$ 527	$ (1,232)	-70.0%
Total Transfers Out	**$ 4,330**	**$ 4,795**	**$ 4,889**	**$ 5,075**	**$ 5,060**	**$ 730**	**16.9%**
Total Expenditures	**$ 33,254**	**$ 33,970**	**$ 34,098**	**$ 35,366**	**$ 35,699**	**$ 2,445**	**7.4%**

[1]As of January 2014.

[2]Pension contributions in FY2010 and FY2011 were made by issuance of pension obligation bonds. All pension contributions include contributions to Teachers' Retirement Insurance Program, College Insurance Program and Public School Teachers' Pension and Retirement Fund of Chicago.

[3]Includes interfund borrowing repayment and Budget Stabilization Fund repayment. Interest on short-term borrowing in FY2010 includes $1.0 billion to repay failure of revenue borrowing in FY2009.

Source: State of Illinois, General Obligation Bonds, Series of February 2014, *Preliminary Official Statement* , January 24, 2014, pp. 13-16; State of Illinois, Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY15-FY17* , January 1, 2014; Illinois State FY2014 Budget, pp. 2-29, 6-269 and 6-294; Illinois State FY2013 Budget, pp. 2-31, 5-246 and 5-271; Illinois State FY2012 Budget, pp. 2-26, 6-8 and 6-39.

Deficit and Unpaid Bills

The State is expected to end FY2014 with a total General Funds deficit of $3.0 billion, compared with a deficit of $6.1 billion at the end of FY2010. The total deficit consists of the operating deficit or surplus and the accumulated deficit from prior years.

The State relied on borrowing to help close operating deficits in FY2010 and FY2011. As previously discussed, the borrowing included the sale of bonds to pay for General Funds pension contributions. For the past three years, the State has not borrowed to pay for operations.

Illinois has dealt with its General Funds deficits by delaying payments and transfers to vendors, social service agencies, local governments and other State funds. Those bills and other payables are paid from the next year's revenues. Beginning in FY2013, the State's lapse period—the period after the end of the fiscal year during which this year's bills can be paid from next year's revenues—was permanently extended to six months.[24]

[24] 30 ILCS 105/25(m).

The next table shows the General Funds deficit from FY2010 to FY2014. In FY2014, an operating surplus of $1.0 billion reduces the accumulated deficit to $3.0 billion from $4.0 billion at the end of FY2013.

State of Illinois General Funds Deficit: FY2010-FY2014 (in $ millions)					
	FY2010	FY2011	FY2012	FY2013	FY2014 Revised*
Operating Revenues	$ 27,366	$ 30,163	$ 33,622	$ 36,328	$ 36,725
Operating Expenditures	$ 33,254	$ 33,970	$ 34,098	$ 35,366	$ 35,699
Operating Surplus (Deficit)	**$ (5,888)**	**$ (3,807)**	**$ (476)**	**$ 962**	**$ 1,026**
Borrowing for Operations	$ 3,466	$ 5,394	$ -	$ -	$ -
Operating Surplus (Deficit) after Borrowing	$ (2,422)	$ 1,587	$ (476)	$ 962	$ 1,026
Accumulated Deficit from Prior Years	$ (3,673)	$ (6,095)	$ (4,508)	$ (4,984)	$ (4,022)
Total Deficit	**$ (6,095)**	**$ (4,508)**	**$ (4,984)**	**$ (4,022)**	**$ (2,996)**

*As of January 2014.

Source: State of Illinois, General Obligation Bonds, Series of February 2014, *Preliminary Official Statement* , January 24, 2014, pp. 13-16; Illinois Department of Revenue, *FY2015 Revenue Estimates* , February 4, 2014, p. 2.

Operating deficits can be funded by increasing accounts payable or reducing cash balances, and operating surpluses are used to decrease accounts payable or increase cash balances. At the end of FY2014, the State's General Funds payables are estimated at $3.2 billion and its cash balance is estimated at $154 million.[25]

Certain General Funds liabilities have piled up outside of the budget. These costs, generally related to Medicaid and group health insurance, may be incurred in a given fiscal year but paid from future appropriations under exceptions to Section 25 of the State Finance Act.[26] This has allowed the State to mask budget deficits by appropriating an insufficient amount to cover Medicaid and group health insurance costs in one year, knowing that remaining bills could be paid in the next year. These State costs are known as Section 25 liabilities.

The ability to defer Medicaid bills in this way was curtailed by legislation enacted in 2012.[27] The new law limited Section 25 liabilities incurred by the State's principal Medicaid agency, the Illinois Department of Healthcare and Family Services (HFS), to $700 million in FY2013 and $100 million thereafter, with certain exceptions.[28] Group health insurance liabilities were not limited by the new law.

Another General Funds liability that is not displayed in the budget involves the Community Care Program at the Illinois Department on Aging, which is designed to allow seniors to stay out of nursing homes. Community Care was not covered by the Section 25 exception, but in recent years annual appropriation bills have allowed the program's prior year costs to be paid from the

[25] State of Illinois, General Obligation Bonds, Series of February 2014, *Preliminary Official Statement*, January 24, 2014, p. 14. The accounts payable numbers shown in the bond document have been adjusted to reflect updated revenue estimates for FY2013 and FY2014. The year- end cash balance has not been changed.
[26] 30 ILCS 105/25.
[27] Public Act 97-0691, enacted on June 14, 2012.
[28] The main exception relates to bills incurred by the end of the fiscal year but not received until after June 30.

current year's funding. Although the FY2014 appropriation language did not include this provision, the State Finance Act was amended to allow payment of past bills up to $150 million from FY2014 appropriations.[29]

In recent years the State has also accumulated unpaid income tax refunds, an additional General Funds liability that is not included in the budget. Unpaid tax refunds, primarily owed to businesses, peaked at $735 million at the end of FY2010.

In addition, the State owes approximately $112 million in back wages to union employees as a result of a dispute over cancelled raises.[30] A Cook County Circuit Court judge in December 2012 ordered the State to pay the back wages when funds were available, and the Governor agreed to make the payments as part of contract negotiations with the American Federation of State, County and Municipal Employees (AFSCME).[31] The General Assembly has not taken action on a bill to provide supplemental appropriations to pay the back wages.[32]

The following table shows General Funds payables and other liabilities from FY2010 to FY2014. Most Medicaid Section 25 liabilities were paid off by the end of FY2013, but group health insurance bills are expected to remain at $1.5 billion at the end of FY2014. The total backlog is projected to decline from $8.9 billion at the end of FY2012 to $5.4 billion at the end of FY2014.

State of Illinois Estimated Unpaid Bills Backlog at Fiscal Year End: FY2010-FY2014 (in $ millions)

	FY2010	FY2011	FY2012	FY2013	FY2014
General Funds Payables	$ 6,224	$ 4,976	$ 5,024	$ 4,176	$ 3,150
Medicaid	$ 997	$ 792	$ 2,446	$ 607	$ 607
Community Care	-	$ 100	$ 173	$ -	$ -
Group Health Insurance	$ 524	$ 1,049	$ 1,183	$ 1,500	$ 1,500
Income Tax Refunds	$ 735	$ 646	$ 72	$ 45	na
Back Wages Owed	$ -	$ -	$ -	$ 112	$ 112
Total	**$ 8,480**	**$ 7,563**	**$ 8,898**	**$ 6,440**	**$ 5,369**

Source: State of Illinois, General Obligation Bonds, Series of February 2014, *Preliminary Official Statement* , January 24, 2014, pp. 14-16, 45-46; Communications between Civic Federation and Governor's Office of Management and Budget, January 28, 2014, September 12, 2013 and December 24, 2012; Civic Federation calculations.

Credit Ratings

Following numerous downgrades in the past five years, Illinois has the lowest credit rating of any state from all three of the major rating agencies. In lowering the State's ratings, the agencies recently cited its overwhelming unfunded pension liability and the legislature's apparent inability to enact significant pension changes. They have also pointed to Illinois' large backlog of bills and the impending rollback of the tax rate increases enacted in 2011.

After the General Assembly passed the new pension law, the rating agencies reacted positively but did not change the State's ratings. Moody's Investors Service said that Illinois' reforms

[29] Public Act 98-0024, enacted on June 19, 2013.
[30] State of Illinois, General Obligation Bonds, Series of February 2014, *Preliminary Official Statement*, January 24, 2014, p. 16.
[31] John O'Connor, "Quinn wants attorney general to drop back-pay lawsuit," *State Journal-Register*, April 25, 2013.
[32] 98th Illinois General Assembly, Senate Bill 2603, introduced on October 9, 2013.

appeared to be the largest reform package passed by any state but noted that implementation was likely to be delayed by litigation.[33] Standard & Poor's changed Illinois' outlook from negative to developing, meaning that the rating could be raised or lowered over the next two years.[34]

Fitch Ratings, in affirming its rating of A- for Illinois' planned sale of $1 billion of General Obligation bonds in February 2014, praised the action on pension reform.[35] However, Fitch also cited the imminent rollback of income tax increases, remaining backlog of unpaid bills and continued high level of unfunded pension liabilities, even if pension reform survives legal challenges.

The following table shows recent Illinois credit ratings by the three agencies.

State of Illinois General Obligation Bond Ratings FY2008-FY2014			
	Moody's Investors Service	**Standard & Poor's**	**Fitch Ratings**
FY2008	Aa3	AA	AA
FY2009	A1	AA-	A
FY2010	A1, Aa3*	A+	A-, A+*
FY2011	A1	A+	A
FY2012	A2	A+	A
FY2013	A2	A	A
FY2014	A3	A-	A-

*Moody's and Fitch increased Illinois' bond ratings in March 2010 due to recalibrations of their entire rating scales but this was not considered an upgrade.

Commission on Government Forecasting and Accountability, *State of Illinois Budget Summary Fiscal Year 2014* , August 2013, pp. 193-195.

Credit ratings are one of the factors considered by underwriters and investors in determining the interest rate the State must pay to issue debt. The declines in the State's rating have led to an overall increase in Illinois' debt service cost in recent years compared to other municipal bond issuers.[36] The difference between Illinois' borrowing costs and costs of other issuers has reportedly narrowed since the State enacted pension reform legislation.[37]

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[33] Moody's Investors Service, *Illinois Pension Reform Legislation is Credit Positive*, December 9, 2013, p. 2.
[34] Standard & Poor's Ratings Services, *Illinois Outlook Revised To Developing From Negative On Pension Consensus; Series 2013 GO Debt Rated 'A-,'* December 10, 2013.
[35] Fitch Ratings, *Fitch Rates $1 Billion Illinois GO Bonds 'A-;' Outlook Remains Negative*, January 31, 2014.
[36] Brian Chappatta, and Tim Jones, "Illinois Breaking Pension Logjam Saves 29% on Debt: Muni Credit," *Bloomberg.com*, December 12, 2013. For more information, see Institute for Illinois' Fiscal Sustainability at the Civic Federation, *Cost of the Crisis: An Analysis of the Additional Bond Costs Paid by the State of Illinois Due to the State's Ongoing Fiscal Crisis*, August 30, 2010.
[37] Brian Chappatta, "Illinois Cuts Yields in $1 Billion Sales as Penalty Drops 26%," *Bloomberg.com*, February 6, 2014.

GOVERNOR'S THREE-YEAR BUDGET PROJECTION

Each January the Governor's Office of Management and Budget (GOMB) is required to issue a three-year General Funds budget projection for the State.[38] The projection also includes updated figures for the current and prior fiscal years.

The projection for FY2015 to FY2017 is based on the assumption that income tax rate increases enacted in 2011 start to phase out in January 2015 as scheduled under existing law.[39] The projection also assumes that expenditures will increase to allow the State to continue to provide the same level of service as in FY2014.

With income tax rates reduced and expenditures increasing, the Governor's projection shows an operating deficit of $4.5 billion in FY2017.[40] It also shows the backlog of unpaid bills growing to $16.2 billion at the end of FY2017 from $5.6 billion at the end of FY2014.[41]

The budget projection sets the stage for the Governor's annual budget recommendation, which is scheduled to be released on March 26, 2014.[42] State law requires the Governor to present the budget proposal on the third Wednesday in February, but the date is frequently changed by the General Assembly.[43] The FY2015 budget recommendation will now be issued after the State's primary election on March 18. Along with the recommended budget, the Governor intends to present a five-year spending plan for the State.[44]

The Governor's budget proposal must be based only on existing sources of revenue.[45] Unlike the three-year projection, the Governor's budget recommendation must also be balanced, according to the Illinois Constitution and State law.[46]

The Civic Federation uses the Governor's projection as a starting point in developing its five-year forecasts. This section reviews the projection and accompanying economic and fiscal policy report.

It should be noted that the Illinois Department of Revenue published updated revenue numbers for FY2013 and FY2014 after the Governor's projection was issued. These updated estimates are used in the rest of this report.

Revenues

As previously discussed, Illinois temporarily raised income tax rates in January 2011 to 5.0% from 3.0% for individual taxpayers and to 7.0% from 4.8% for corporations (9.5% including the

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38 Public Act 96-1354, enacted on July 28, 2010.
39 State of Illinois, Governor's Office of Management and Budget, *Illinois' Economic and Fiscal Policy Report*, January 1, 2014, p. 3.
40 State of Illinois, Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY15-FY17*, January 1, 2014.
41 The FY2014 backlog total differs from the estimate in the previous section, which is based on an updated revenue estimate.
42 Public Act 98-0626, enacted on February 5, 2014.
43 15 ILCS 10/50-5(a).
44 Doug Finke, "$1.6 billion drop in Illinois revenue predicted next year," *State Journal-Register*, February 4, 2014.
45 Public Act 96-1529, enacted on February 16, 2011.
46 Illinois Constitution, Article VIII, Section 2; 15 ILCS 20/50-5(a).

Personal Property Replacement Tax or PPRT). On January 1, 2015, the individual income tax rate is scheduled to roll back to 3.75% and the corporate tax rate is scheduled to decline to 5.25% (not including the PPRT).

Since the State budget year begins on July 1, the first full-year impact of the partial rollbacks will be in FY2016. According to the Governor's projection, income tax revenues will drop by $1.4 billion in FY2015 and an additional $2.7 billion in FY2016. Personal income taxes decline by $1.3 billion in FY2015 and $2.3 billion in FY2016, while corporate income taxes decline by $135 million and $418 million in the same years.

General Funds income tax revenues are net of amounts diverted to pay income tax refunds to individuals and businesses. In the Governor's projection, the diversion rates applied to gross income tax collections are assumed to increase in FY2015. The higher diversion rates are needed to pay for refunds on taxes collected during years when tax rates were higher. The diversion rates are assumed to increase to 10.0% from 9.5% for individuals and to 14.0% from 13.4% for corporations and to stay at these levels through FY2017.

General Funds income tax revenues also decline due to a little-noticed provision of the 2011 tax increase law.[47] Beginning on February 1, 2015, the law requires that a specific share of individual income tax revenues be diverted from General Funds to provide additional funding for education and human services. After tax refund amounts are deducted, a portion of net collections goes to each of two new funds: the Fund for the Advancement of Education and the Commitment to Human Services Fund. Each fund will receive 1/30 (about 3.33%) of net individual income tax revenues annually through FY2024; in February 2025 the share increases to 1/26 (about 3.85%). According to GOMB, this diversion will reduce General Funds income tax revenues by $443 million in FY2015, $887 million in FY2016 and $904 million in FY2017.[48]

The impact of lower income tax rates and increased diversions is partially offset by projected underlying economic growth. GOMB assumes annual increases of 1.9% for personal income taxes and between 4.8% and 7.3% for corporate income taxes. By FY2017 income tax revenues start to rise due to economic growth. Sales taxes and federal revenues are projected to increase each year through FY2017.

Overall, the projection shows that General Funds revenues will decline by $3.6 billion to $32.8 billion from FY2014 to FY2016. General Funds revenues increase by $766 million to $33.6 billion in FY2017 due to natural growth.

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[47] Public Act 96-1496, enacted on January 13, 2011.

[48] After publication of the Governor's report, the Illinois Department of Revenue updated the FY2015 revenue diversion estimate to $449 million. For more information, see Illinois Department of Revenue, *FY2015 Revenue Estimates*, February 4, 2015, p.7.

The following table shows the Governor's projection of General Funds revenues through FY2017. Total General Funds revenues decline by $2.8 billion, or 7.7%, from $36.4 billion in FY2013 to $33.6 billion in FY2017.

State of Illinois Governor's Three-Year General Funds Budget Projection: Revenues FY2013-FY2017 (in $ millions)							
	FY2013 Actual	FY2014 Revised Enacted	FY2015 Forecast	FY2016 Forecast	FY2017 Forecast	Five-Year $ Change	Five-Year % Change
State Sources							
Individual Income Tax	$ 16,538	$ 16,030	$ 14,738	$ 12,418	$ 12,660	$ (3,878)	-23.4%
Corporate Income Tax	$ 3,177	$ 3,317	$ 3,182	$ 2,764	$ 2,967	$ (210)	-6.6%
Sales Taxes	$ 7,355	$ 7,610	$ 7,762	$ 7,917	$ 8,076	$ 721	9.8%
Other State Taxes and Fees	$ 3,151	$ 3,027	$ 3,000	$ 3,025	$ 3,008	$ (143)	-4.5%
Transfers In	$ 1,987	$ 2,223	$ 2,244	$ 2,265	$ 2,286	$ 299	15.0%
Total State Sources	**$ 32,208**	**$ 32,207**	**$ 30,926**	**$ 28,389**	**$ 28,997**	$ (3,211)	-10.0%
Federal Sources	**$ 4,154**	**$ 4,178**	**$ 4,273**	**$ 4,424**	**$ 4,582**	**$ 428**	**10.3%**
Total Revenues	**$ 36,362**	**$ 36,385**	**$ 35,199**	**$ 32,813**	**$ 33,579**	**$ (2,783)**	**-7.7%**

Source; State of Illinois, Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY15-FY17* , January 1, 2014.

In compiling the revenue forecast, the Governor's Office considered a number of indicators of economic growth. The next table shows economic forecasts provided to GOMB by the consulting firm IHS Global Insight, which expects Illinois' modest economic recovery to accelerate in the next three years.

State of Illinois Governor's Three-Year General Funds Budget Projection: Key Revenue Forecasting Indicators and Assumed Growth Rates FY2014-FY2017				
Economic Indicator	FY2014	FY2015	FY2016	FY2017
Illinois Real Gross Domestic Product	1.9%	2.3%	2.5%	2.7%
Illinois Unemployment	1.1%	1.5%	1.5%	1.4%
Illinois Wages and Salaries	3.1%	4.7%	7.8%	4.5%
Domestic Corporate Profits	6.0%	7.3%	5.4%	4.8%
Illinois Retail Sales	3.8%	3.2%	3.5%	3.8%

State of Illinois, Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY15-FY17* , January 1, 2014. Based on data from IHS Global Insight.

Expenditures

The Governor's projection assumes that General Funds agency appropriations show enough growth each year to maintain State services at the same level as in FY2014.[49] In FY2015 this includes costs and savings from a three-year contract with the American Federation of State, County and Municipal Employees (AFSCME) that took effect in FY2013. According to administration officials, wage increases of $222 million over the life of the contract are expected to be more than offset by savings of approximately $900 million on health insurance costs.[50]

[49] State of Illinois, Governor's Office of Management and Budget, *Illinois' Economic and Fiscal Policy Report*, January 1, 2014, p. 4.
[50] Illinois Department of Central Management Services, *AFSCME 2012-2015 Contract Summary*, Submission to General Assembly's Commission on Government Forecasting and Accountability, April 16, 2013.

Agency appropriations in the three-year projection are categorized by service areas. Service or result areas are an outgrowth of the State's Budgeting for Results initiative, which favors budgeting by program rather than by agency. Each State program is aligned to one of seven result areas; result areas include programs at different agencies.

The area of education, for example, includes programs at the State Board of Education, Board of Higher Education and public universities as well as programs at the Departments of Human Services, Military Affairs and Veterans' Affairs. Healthcare mainly consists of the Medical Assistance Program at the Department of Healthcare and Family Services (HFS), but the area also includes programs at the Departments of Human Services, Agriculture and Public Health.[51]

The next table shows projected agency appropriations spent (appropriations net of unspent appropriations) by service area, excluding pension contributions and group insurance, through FY2017. Agency appropriations are projected to increase by 3.8% in FY2015, 1.5% in FY2016 and 3.4% in FY2017. Total agency appropriations spent increase by $1.6 billion, or 6.6%, to $25.3 billion in FY2017 from $23.7 billion in FY2013.

State of Illinois Governor's Three-Year General Funds Projection: Agency Appropriations Spent FY2013-FY2017 (in $ millions)

Service Category	FY2013 Actual	FY2014 Revised Enacted	FY2015 Forecast	FY2016 Forecast	FY2017 Forecast	Five-Year $ Change	Five-Year % Change
Education*	$ 8,652	$ 8,807	$ 8,989	$ 8,994	$ 9,222	$ 570	6.6%
Healthcare	$ 7,111	$ 7,170	$ 7,396	$ 7,595	$ 7,799	$ 688	9.7%
Human Services	$ 5,132	$ 4,636	$ 4,917	$ 4,915	$ 5,142	$ 10	0.2%
Public Safety	$ 1,544	$ 1,613	$ 1,700	$ 1,833	$ 1,978	$ 434	28.1%
Government Services**	$ 1,333	$ 1,072	$ 1,115	$ 1,137	$ 1,160	$ (173)	-13.0%
Economic Development	$ 361	$ 371	$ 386	$ 394	$ 402	$ 41	11.4%
Environment and Culture	$ 56	$ 62	$ 65	$ 66	$ 67	$ 11	19.6%
Supplemental Appropriations***	$ -	$ 260	$ -	$ -	$ -	$ -	na
Total Agency Appropriations	**$ 24,189**	**$ 23,991**	**$ 24,568**	**$ 24,934**	**$ 25,770**	**$ 1,581**	**6.5%**
Less Unspent Appropriations	$ (485)	$ (533)	$ (500)	$ (500)	$ (500)	$ (15)	3.1%
Total Agency Appropriations Spent	**$ 23,704**	**$ 23,458**	**$ 24,068**	**$ 24,434**	**$ 25,270**	**$ 1,566**	**6.6%**

*Does not include pension contributions.

**Does not include pension contributions or group insurance.

***Proposed appropriations not yet enacted.

Source; State of Illinois, Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY15-FY17* , January 1, 2014.

It should be noted that GOMB reduced education and human services appropriations beginning in FY2015 to offset additional funding provided by the new income tax revenue diversions discussed above.[52] It is not clear whether this reduction is consistent with State law, which states that the diversions "shall supplement and not supplant" the existing level of funding.[53]

In the remaining months of FY2014, the Governor plans to seek supplemental appropriations of $260 million.[54] The total includes approximately $112 million in back wages owed to union

[51] HFS' Medical Assistance Program includes most of the State's Medicaid spending. However, the program also covers certain medical services that are not part of the Medicaid program. In addition, a significant share of Medicaid spending is done by other agencies, including the Departments of Human Services, Public Health and Children and Family Services and the Department on Aging.
[52] Communication between the Civic Federation and the Governor's Office of Management and Budget, January 15, 2014.
[53] 35 ILCS 5/901 (f) and (g).
[54] State of Illinois, Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY15-FY17*, January 1, 2014.

employees as a result of a dispute over cancelled raises.[55] A Cook County Circuit Court judge ordered the State to pay the back wages when funds were available, and the Governor agreed to make the payments as part of contract negotiations with the American Federation of State, County and Municipal Employees (AFSCME).[56] The General Assembly has not taken action on a bill to provide supplemental appropriations to pay the back wages.[57] The $260 million also includes additional funding for the Department of Corrections, child care and other purposes.

In addition to agency appropriations, expenditures include pension contributions, group insurance payments and transfers out of General Funds for debt service and for a wide range of other legislatively required purposes.

The pension contributions for FY2016 and FY2017 in the Governor's projection are based on the State's new pension law.[58] The numbers were compiled before the Teachers' Retirement System (TRS), the largest of the State's five pension funds, provided an actuarial review based on the final version of the law. [59] The latest TRS contribution estimates are significantly lower than previous estimates. As a result, the total pension contributions shown in the Governor's projection for FY2016 and FY2017 are higher than the current estimates shown in the rest of this report.[60]

It should also be noted that the pension contribution amounts in the Governor's projection include required contributions to three other funds: the Teachers' Retirement Insurance Program (TRIP), which provides health insurance for retired public school teachers outside of Chicago; the College Insurance Program (CIP), which provides health insurance for retired community college employees outside of Chicago; and the Public School Teachers' Pension and Retirement Fund of Chicago. The Governor's projection reflects the General Assembly's FY2014 appropriation for TRIP but not the full required contribution, which is covered by continuing appropriation.[61]

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[55] State of Illinois, General Obligation Bonds, Series of February 2014, *Preliminary Official Statement*, January 24, 2014, p. 16.
[56] John O'Connor, "Quinn wants attorney general to drop back-pay lawsuit," *State Journal-Register*, April 25, 2013.
[57] 98th Illinois General Assembly, Senate Bill 2603, introduced on October 9, 2013.
[58] Public Act 98-0599, enacted on December 5, 2013.
[59] State of Illinois, Governor's Office of Management and Budget, *Illinois' Economic and Fiscal Policy Report*, January 1, 2014, p. 4.
[60] For information on current pension contribution projections under the new law, see page 25 of this report. Projections could change if actuarial reports are revised.
[61] The Governor's projection understated required FY2014 TRIP and CIP contributions by about $32 million. The underestimation for TRIP was also reflected in the Governor's projection for pension contributions in FY2015 to FY2017.

The next table shows the Governor's projection of General Funds expenditures through FY2017. General Funds expenditures are projected to increase by $2.6 billion, or 7.4%, to $38.1 billion in FY2017 from $35.4 billion in FY2013.

State of Illinois Governor's Three-Year General Funds Projection: Expenditures FY2013-FY2017 (in $ millions)							
	FY2013 Actual	FY2014 Revised Enacted	FY2015 Forecast	FY2016 Forecast	FY2017 Forecast	Five-Year $ Change	Five-Year % Change
Net Agency Appropriations Spent	$ 23,704	$ 23,458	$ 24,068	$ 24,434	$ 25,270	$ 1,566	6.6%
Pension Contributions*	$ 5,209	$ 6,063	$ 6,177	$ 5,678	$ 5,804	$ 595	11.4%
Group Insurance Payments	$ 1,450	$ 1,346	$ 1,647	$ 1,730	$ 1,816	$ 366	25.2%
Total Appropriations Spent	**$ 30,363**	**$ 30,867**	**$ 31,892**	**$ 31,842**	**$ 32,890**	**$ 2,527**	**8.3%**
Transfers Out							
Statutory Transfers Out	$ 2,840	$ 2,878	$ 3,231	$ 3,137	$ 3,188	$ 348	12.3%
Debt Service on Pension Bonds	$ 1,552	$ 1,655	$ 1,501	$ 1,418	$ 1,603	$ 51	3.3%
Other Debt Service**	$ 683	$ 527	$ 477	$ 454	$ 395	$ (288)	-42.2%
Total Transfers Out	**$ 5,075**	**$ 5,060**	**$ 5,209**	**$ 5,009**	**$ 5,186**	**$ 111**	**2.2%**
Total Expenditures	**$ 35,438**	**$ 35,927**	**$ 37,101**	**$ 36,851**	**$ 38,076**	**$ 2,638**	**7.4%**

*Includes State contributions to Teachers' Retirement Insurance Program, College Insurance Program and Public School Teachers' Pension and Retirement Fund of Chicago.

**Includes interfund borrowing repayment of $132 million in FY2013.

Source: State of Illinois, Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY15-FY17* , January 1, 2014.

The Governor's projection of revenues and expenditures results in growing operating deficits from FY2015 to FY2017. These budgetary shortfalls are paid off using revenues from the next fiscal year. The backlog of payables increases to $16.2 billion at the end of FY2017 from $6.3 billion at the end of FY2013.

The next table summarizes the Governor's budget projection through FY2017.

State of Illinois Governor's Three-Year General Funds Budget Projection FY2013-FY2017 (in $ millions)					
	FY2013 Actual	FY2014 Revised Enacted	FY2015 Forecast	FY2016 Forecast	FY2017 Forecast
Total Revenues	$ 36,362	$ 36,385	$ 35,199	$ 32,813	$ 33,579
Total Expenditures	$ 35,438	$ 35,927	$ 37,101	$ 36,851	$ 38,076
Operating Surplus (Deficit)	**$ 924**	**$ 458**	**$ (1,902)**	**$ (4,038)**	**$ (4,497)**
Gross Bill Backlog at Year End	**$ (6,301)**	**$ (5,637)**	**$ (7,538)**	**$ (11,649)**	**$ (16,225)**

Source; State of Illinois, Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY15-FY17* , January 1, 2014.

FIVE-YEAR BUDGET PROJECTIONS

The following section presents multiple budget scenarios for the State of Illinois through FY2019. These five-year projections begin with a benchmark assessment of the State's financial condition as described in the Governor's three-year plan, which is then extended for an additional two years. Then various alternative spending and revenue proposals aimed at addressing the State's ongoing financial crisis are presented. The Civic Federation will examine the effectiveness of these scenarios based on a series of long-term financial goals for the State.

The Civic Federation includes these five-year projections as a possible basis for establishing a long-term financial plan for Illinois. As a government manages its budgets through a financial crisis and recovery, it is particularly important to undertake a long-term financial planning process.[62] A long-term financial plan highlights long-range financial issues and helps governments look beyond budget gap-bridging measures, such as one-time or temporary revenue sources, toward remedying structural problems.

A five-year time horizon for financial planning is recognized as a best practice by the Government Finance Officers Association.[63] Governments should formalize a long-term financial plan and update it annually to take into account actual budget results and changes in economic trends.

In order to achieve long-term sustainability in the State's finances, the Civic Federation proposes that the comprehensive long-term financial plan should meet the following goals:

- Ensure annual operating budgets are balanced;
- Eliminate the backlog of unpaid bills;
- Provide achievable spending limits;
- Set aside reserves for an adequate rainy day fund;
- Avoid drastic revenue cliffs;
- Provide a sustainable revenue base; and
- Include additional assistance for local governments.

The underlying assumptions used to develop the projections are based on data published in the Governor's three-year plan for revenues and expenditures through FY2017, which are then extended an additional two years to meet the five-year standard for long-term financial planning. However, the benchmark projections included in this section make some significant changes to the Governor's projections including:

- General Funds revenue estimates for FY2014 and FY2015 are updated to reflect preliminary revisions provided by the Illinois Department of Revenue on February 4, 2014; and[64]
- Estimated pension contributions reflect more recent actuarial reports on the effect of the new pension law enacted on December 5, 2013.[65]

[62] Shayne Kavanagh, *Fiscal First Aid and Financial Recovery*, (Chicago: GFOA, 2011), pp. 37-44.
[63] Government Finance Officers Association, *Best Practice: Long-Term Financial Planning*, February 22, 2008, http://www.gfoa.org/downloads/LongtermFinancialPlanningFINAL.pdf (last visited on February 3, 2014).
[64] Illinois Department of Revenue, *FY2015 Revenue Estimates*, February 4, 2014, p. 2
[65]Public Act 98-0599, enacted on December 5, 2013.

The spending and revenue projections suggested in the Governor's three-year plan are also used as a starting point for each of the alternative five-year scenarios. However, spending assumptions and revenue projections are altered to illustrate policy options that differ from those shown in the Governor's three-year projection.

The projections presented in this report are intended to provide an overview of the largest General Funds revenue sources and spending pressures through FY2019. Due to significant data limitations, these forecasts should not be viewed as precise predictions.

Benchmark Projection

In order to provide an initial analysis of the five-year outlook for the State of Illinois General Funds budget, the Civic Federation has extended the revenue and spending assumptions presented in the Governor's three-year projections with some adjustments as noted herein. This benchmark projection shows the depth of the financial crisis facing the State going into FY2015 and is the basis for the subsequent scenarios presented as balanced budget alternatives to the Governor's projection.

Revenues

Similar to the revenue forecasts in the Governor's three-year projection, as described earlier in this report, the five-year benchmark projections for General Funds revenues show the effects of current State tax policy, which creates a significant revenue cliff in FY2015 and FY2016. The five-year benchmark projections follow the underlying assumptions in the Governor's three-year projection but are updated to include preliminary revisions for FY2014 and FY2015 presented more recently by the Illinois Department of Revenue.[66]

The benchmark projection shows that even after two additional years of underlying growth in revenues, the State will still not have returned to current resource levels by FY2019. This is due to the size of the fiscal cliff created by the reduction of income tax rates as scheduled under current law. General Funds revenues are projected to be $1.9 billion lower in FY2019, totaling $34.9 billion compared to a total of $36.7 billion in FY2014.

Income taxes make up more than half of total General Funds revenues and are the State's largest source of operating revenue. The partial rollback of the increased individual income tax rate and corporate income tax rate lead to a dramatic loss of State operating resources beginning in FY2015.[67] The partial sunset of the income tax rate scheduled for January 1, 2015 reduces the individual income tax rate to 3.75% from 5.0% and the corporate income tax rate to 5.25% from 7.0%.

For the purpose of extending the Governor's three-year projection from FY2017 through FY2019, individual income taxes are assumed to grow at a rate of 1.9% annually and corporate income taxes grow at a rate of 4.8%. However, with two more years of growth, income taxes still total only $16.1 billion in FY2019, $3.5 billion less than the FY2014 estimate of $19.6 billion.

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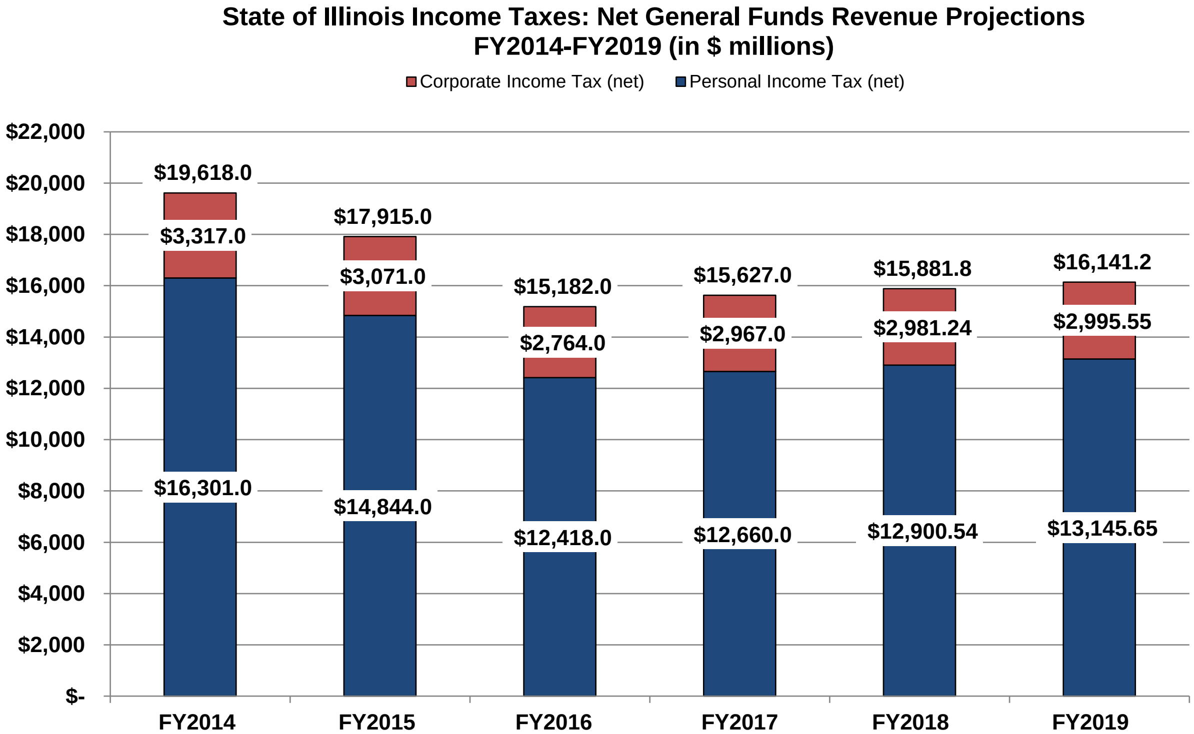
[66] Illinois Department of Revenue, *FY2015 Revenue Estimates*, February 4, 2014, p. 2.
[67] Public Act 96-1496, for more information on revenue growth between FY2010 and FY2014 see page 5 of this report.

The following chart shows the projected decline in income tax revenue in FY2015 and FY2016 as rates roll back halfway through FY2015. The projections then show moderate growth over the next several years.



Note: Income tax rates decline halfway through FY2015 to 3.75% from 5.0% for personal income and to 5.25% from 7.0% for corporate income.
Source: State of Illinois, Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY15-FY17*, January 1, 2014; Illinois Department of Revenue, *FY2015 Revenue Estimates*, February 4, 2014, p. 2; Civic Federation calculations for FY2018 and FY2019 based on 1.9% growth rate in personal income taxes and 4.8% in corporate income taxes.

State-source revenue projections for FY2015 through FY2019 show that the revenue decline from the income tax rate reductions is partially offset by growth in other sources. Sales taxes are the second largest contributor to State-source revenues, totaling $7.6 billion in FY2014, and are projected to increase by 2.0% annually through FY2019. The State collects sales taxes at a rate of 6.25%, of which 5.0-percentage points are revenues for the State while 1.25-percentage points are distributed to local and county governments.

The five-year projection shows a total State-source revenue decline of nearly $2.7 billion to $29.9 billion in FY2019 from $32.6 billion in FY2014. Driving this decline is an aggregate loss of $3.5 billion in income taxes, which is partially offset by an increase of $793.6 million in sales taxes. Other State-source revenues and transfers-in, which mostly consist of gaming revenues and the lottery proceeds, are not considered economically sensitive sources. These revenue categories are shown at relatively flat growth rates of 1.0% and 0.9%, respectively, in FY2018 and FY2019.

The following table shows projections for State-source revenues from FY2014 through FY2019.

State of Illinois Five-Year Projections: State-Source General Funds Revenue FY2014-FY2019 (in $ millions)								
Revenue Sources	**FY2014**	**FY2015**	**FY2016**	**FY2017**	**FY2018**	**FY2019**	**$ Change**	**% Change**
Income Taxes								
Individual Income Tax (net)	$ 16,301.0	$ 14,844.0	$ 12,418.0	$ 12,660.0	$ 12,900.54	$ 13,145.65	$ (3,155.3)	-19.4%
Corporate Income Tax (net)	$ 3,317.0	$ 3,071.0	$ 2,764.0	$ 2,967.0	$ 2,981.24	$ 2,995.55	$ (321.4)	-9.7%
Total Income Taxes	**$ 19,618.0**	**$ 17,915.0**	**$ 15,182.0**	**$ 15,627.0**	**$ 15,881.8**	**$ 16,141.2**	**$ (3,476.8)**	**-17.7%**
Sales Taxes	$ 7,610.0	$ 7,810.0	$ 7,917.0	$ 8,076.0	$ 8,238.19	$ 8,403.64	$ 793.6	10.4%
Other State Sources	$ 3,106.0	$ 3,020.0	$ 3,025.0	$ 3,008.0	$ 3,038.08	$ 3,068.46	$ (37.5)	-1.2%
Subtotal State Taxes & Fees	**$ 30,334.0**	**$ 28,745.0**	**$ 26,124.0**	**$ 26,711.0**	**$ 27,158.1**	**$ 27,613.3**	**$ (2,720.7)**	**-9.0%**
Transfers-In	$ 2,278.0	$ 1,934.0	$ 2,265.0	$ 2,286.0	$ 2,307.19	$ 2,328.59	$ 50.6	2.2%
Total State Sources	**$ 32,612.0**	**$ 30,679.0**	**$ 28,389.0**	**$ 28,997.0**	**$ 29,465.2**	**$ 29,941.9**	**$ (2,670.1)**	**-8.2%**

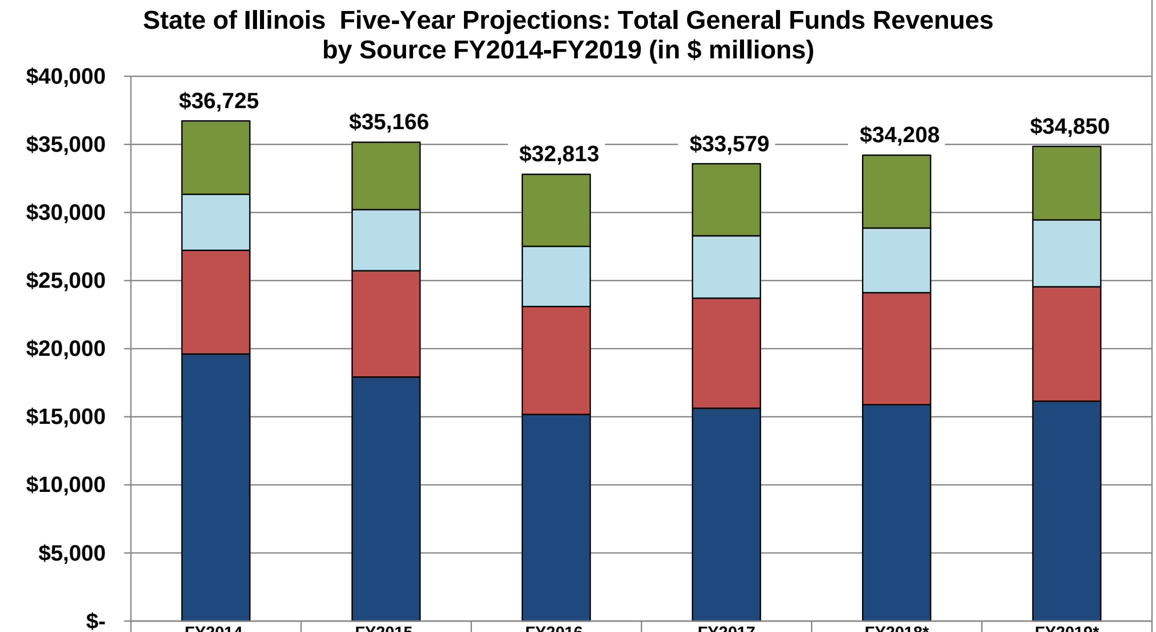
Source: State of Illinois, Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY15-FY17* , January 1, 2014; Illinois Department of Revenue, *FY2015 Revenue Estimates* , February 4, 2014, p. 2; Civic Federation calculations.

The final component of the State's General Funds revenue is federal resources. The federal government provides annual funding for a variety of State programs, including road and bridge improvements, education, economic development, public housing and environmental projects. However, most of the funds are appropriated outside the General Funds for designated purposes in Other State Funds. The majority of federally-provided General Funds revenues are reimbursements for Medicaid expenditures.

Federal revenue projections in the following chart are based on the Governor's three-year projection through FY2017. Federal revenue is assumed to grow at a rate of 3.5% for FY2018 and FY2019 to match projected increases from the prior three years. In all, federal revenues increase by $795.4 million to $4.9 billion in FY2019 from a total of $4.1 billion in FY2014.

Total General Funds revenues from State and federal sources are projected to decline by $1.9 billion, or 5.1%, to $34.9 billion in FY2019 from $36.7 billion in FY2014. This decline includes $3.5 billion in income tax losses partially offset by increases of $793.6 million in sales taxes and $795.4 million in increased federal revenues. It should be noted that within the five-year projection, from peak to trough, total General Funds revenues are expected to decline by $3.9 billion to $32.8 billion in FY2016 compared to $36.7 billion in FY2014.

The following chart shows total General Funds revenue projections by source for FY2014 through FY2019.



	FY2014	FY2015	FY2016	FY2017	FY2018*	FY2019*
Total	$36,725	$35,166	$32,813	$33,579	$34,208	$34,850
Other and Transfers In	$5,384	$4,954	$5,290	$5,294	$5,345	$5,397
Federal Revenues	$4,113	$4,487	$4,424	$4,582	$4,742	$4,908
Sales Taxes	$7,610	$7,810	$7,917	$8,076	$8,238	$8,404
Income Taxes	$19,618	$17,915	$15,182	$15,627	$15,882	$16,141

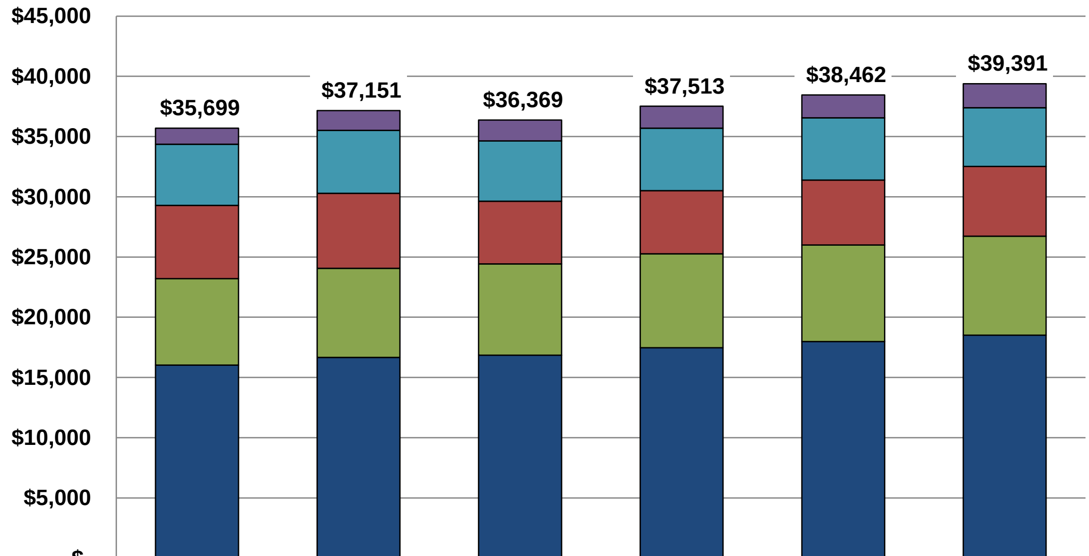
*Civic Federation projection for FY2018 and FY2019 based on growth rates used in Governor's three-year projection.
Source: State of Illinois, Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY15-FY17*, January 1, 2014; Illinois Department of Revenue, *FY2015 Revenue Estimates*, February 4, 2014, p. 2.

Expenditures

The benchmark expenditure projection extends the Governor's three-year spending projection through FY2019, with certain changes related to pension contributions and FY2014 supplemental appropriations. General Funds expenditures are projected to increase by $3.7 billion, or 10.30%, to $39.4 billion in FY2019 from $35.7 billion in FY2014.

The following chart shows total General Funds expenditure projections for FY2014 through FY2019. The decline in FY2016 mainly reflects the assumption that the State will be able to realize savings from the new pension reform law beginning in that fiscal year.

State of Illinois Five-Year Projections: Total General Funds Expenditures FY2014-FY2019 (in $ millions)



	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019
Total Expenditures	$35,699	$37,151	$36,369	$37,513	$38,462	$39,391
Group Insurance Payments	$1,346	$1,647	$1,730	$1,816	$1,907	$2,002
Debt Service and Transfers	$5,060	$5,209	$5,009	$5,186	$5,173	$4,870
Pension Contributions	$6,096	$6,227	$5,196	$5,241	$5,391	$5,787
Healthcare	$7,170	$7,396	$7,595	$7,799	$8,010	$8,226
Net Agency Appropriations	$16,028	$16,672	$16,839	$17,471	$17,981	$18,506

Source: State of Illinois, Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY15-FY17*, January 1, 2014; Illinois Department of Revenue, *FY2015 Revenue Estimates*, February 4, 2014, p. 2.

The chart shows net agency appropriations (appropriations net of unspent appropriations) separately from other spending categories because the State has the most control over these areas. Net agency appropriations grow by $2.5 billion to $18.5 billion in FY2019 from $16.0 billion in FY2014 based on the growth rates in the Governor's three-year projection, which assumes that services are maintained at FY2014 levels.[68] The Governor's projection shows increases of 4.0% in FY2015, 1.0% in FY2016 and 3.8% in FY2017; the average rate of 2.9% was used to extend the projection to FY2018 and FY2019. The net appropriation for FY2014

[68] State of Illinois, Governor's Office of Management and Budget, *Illinois' Economic and Fiscal Policy Report*, January 1, 2014, p. 4.

does not include the Governor's proposed supplemental appropriations of $260 million, which have not been enacted.

It should be noted that net agency appropriations in the Governor's projection are reduced to account for additional funding outside of General Funds. Beginning in February 2015, a share of individual income tax revenues will be diverted into two special funds to be used for education and human services.[69] If this additional funding were not diverted from General Funds, net appropriations would increase by $449 million in FY2015, $887 million in FY2016 and $904 million in FY2017, and the average growth rate of net appropriations in the Governor's projection would increase to 4.7% from 2.9%.[70]

Many other parts of the General Funds budget are regarded as non-discretionary, because spending levels are set by law, court order or legally binding contract.[71] State pension contributions are determined by statute, as discussed in more detail below. The General Assembly approved sweeping pension changes in December 2013 after nearly three years of debate about the State's pension problems.[72]

Healthcare, one of the government services categories in the Governor's projection, is used in this report as a rough approximation of the State's General Funds Medicaid budget.[73] Medicaid is an entitlement program that is partly financed by the federal government, which mandates certain coverage. In attempting to reduce annual Medicaid costs by $1.6 billion in FY2013, the State was hindered by resistance from State lawmakers, objections by federal regulators and patient-related lawsuits.[74]

General Funds spending on healthcare is projected to increase by $1.1 billion, or 14.7%, from $7.2 billion in FY2014 to $8.2 billion in FY2019. Spending in FY2018 and FY2019 is assumed to increase at an annual rate of 2.7%, the same rate used in the Governor's projection for FY2016 and FY2017.

Group health insurance coverage for employees and retirees is established by State law.[75] Governor Quinn's administration has maintained that retiree health insurance, like employee

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[69] For more information on the new revenue diversions, see page 13 of this report.
[70] State of Illinois, Governor's Office of Management and Budget, *Illinois' Economic and Fiscal Policy Report*, January 1, 2014, p. 3. The diversion estimate for FY2014 was increased to $449 million from $443 million in the Governor's report based on a new revenue forecast by the Illinois Department of Revenue.
[71] Illinois Senate Democrats, *Senate President previews budget options; Facing $3 billion budget hole, Cullerton calls for bipartisan solution*, February 17, 2014, http://www.senatedem.ilga.gov/index.php/caucus-news/blog-archive/3892-senate-president-previews-budget-options (last visited on February 18, 2014).
[72] Public Act 98-0599, enacted on December 5, 2013.
[73] The healthcare category mainly consists of the Medical Assistance Program at the Department of Healthcare and Family Services (HFS), but the area also includes programs at the Departments of Human Services, Agriculture and Public Health. Of the $7.2 billion in healthcare appropriations in the enacted FY2014 budget, only approximately $152 million are outside of HFS. HFS' Medical Assistance Program includes most of the State's Medicaid spending but also covers certain medical services that are not part of the Medicaid program. In addition, a significant share of Medicaid spending is done by other agencies, including the Departments of Human Services, Public Health and Children and Family Services and the Department on Aging.
[74] For more information on the State's Medicaid restructuring, see the Institute for Illinois' Fiscal Sustainability at the Civic Federation, *State of Illinois FY2014 Budget Roadmap: Budget Overview, Projections and Recommendations for the Governor and the Illinois General Assembly*, February 25, 2013, p. 28.
[75] 5 ILCS 375.

health insurance, must be negotiated as part of the collective bargaining process.[76] A law passed in 2012 that eliminates premium-free health insurance for retirees is on appeal to the Illinois Supreme Court.[77]

General Funds payments for group insurance are projected to increase by $656 million, or 48.7%, to $2.0 billion in FY2019 from $1.3 billion in FY2014. Spending in FY2018 and FY2019 is assumed to increase at an annual rate of 5%, the same rate used in the Governor's projection for FY2016 and FY2017.

Combined debt service and other transfers are expected to decline based on current bond payment schedules and the assumption that statutorily required transfers remain mostly flat, growing at a rate of 1.63% annually.

General Funds pension contributions are projected to decline by $309 million, or 5.1%, from $6.1 billion in FY2014 to $5.8 billion in FY2019. The projected decrease is based on the assumption that the State's new pension law, which was enacted in December 2013, will begin to generate savings in FY2016.[78] Litigation-related delays in implementing the new law could result in significantly higher pension costs.

Public Act 98-0599 reduces payments to retirees and employees and requires the State to pay off its unfunded pension obligations more quickly and completely than the existing funding plan.[79] The new law applies to four of the State's five retirement systems and affects employees hired before January 1, 2011, known as Tier 1 employees. Pension payments for new or Tier 2 employees were previously reduced by a law enacted in 2010.[80]

The new law represents the State's first actuarially-based pension funding plan, designed to result in 100% funding over 30 years. Illinois' existing pension law, which took effect in 1995, was designed to achieve 90% funding in 50 years.[81] That law and subsequently enacted changes deferred a large portion of required contributions to later years.

Due largely to decades of inadequate State contributions, Illinois has the most underfunded retirement systems of any state.[82] The State's total unfunded pension liability stood at $97.5 billion on June 30, 2013, based on the market value of assets, and pension assets covered only 41.1% of the pension liability.[83]

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[76]Communication between the Civic Federation and the Governor's Office of Management and Budget, March 6, 2013.
[77] Public Act 97-0695, enacted on June 21, 2012; Doug Finke, "State's high court hears case on retiree health premiums," *State Journal-Register*, September 18, 2013.
[78] Public Act 98-0599, enacted on December 5, 2013.
[79] A summary of the law's provisions can be found on the website of the Teachers' Retirement System, the State's largest pension fund, at http://trs.illinois.gov/press/reform/sb1.htm (last visited on February 4, 2014). For examples of how the annual benefit adjustment formula works for retirees and for current employees, see the Institute for Illinois' Fiscal Sustainability at the Civic Federation's blog at http://www.civicfed.org/iifs/blog/state-pension-overhaul-features-lower-benefit-increase and http://www.civicfed.org/iifs/blog/how-state-pension-plan%E2%80%99s-annual-benefit-increase-affects-current-employees.
[80] Public Act 96-0889, enacted on April 14, 2010.
[81] Public Act 88-0573, enacted on August 22, 1994.
[82] Pew Center on the States, *The Widening Gap Update*, June 2012, p. 5.
[83] Commission on Government Forecasting and Accountability, *Special Pension Briefing*, November 2013, p. 2.

The new pension law is expected to reduce total statutorily required State contributions by $144.9 million over 30 years, according to recent actuarial reports cited in documents related to the State's latest sale of General Obligation bonds.[84] Approximately 89% of total State pension contributions come from General Funds.[85] The new law is also expected to lower the projected unfunded pension liability as of June 30, 2014 by $21.7 billion, from $99.4 billion to $77.7 billion.[86]

The actuarial reports were prepared for the Teachers' Retirement System (TRS), the State Employees' Retirement System (SERS) and the State Universities Retirement System (SURS). An actuarial analysis was not available for the smallest system, the General Assembly Retirement System (GARS), and the fifth system, the Judges' Retirement System (JRS) is not affected by the new law.[87]

As noted above, projected pension contributions under the new law in this report are based on the data in recent bond documents. These contribution estimates are significantly lower than the pension contributions for FY2016 and FY2017 in the Governor's projection, which was compiled before TRS, the State's largest pension fund, provided an actuarial review based on the final version of the law. [88]

As in the Governor's projection, pension contributions in this report include required contributions to three other funds: the Teachers' Retirement Insurance Program (TRIP), which provides health insurance for retired public school teachers outside of Chicago; the College Insurance Program (CIP), which provides health insurance for retired community college employees outside of Chicago; and the Public School Teachers' Pension and Retirement Fund of Chicago. The Governor's projection underestimated contributions to CIP in FY2014 and to TRIP in FY2014 to FY2017 because it did not reflect amounts contributed under continuing appropriation.[89] Contributions to TRIP and CIP are set to continuing appropriation levels and assumed to grow by 5% a year and the contribution to the Chicago teachers' pension fund is held flat.[90]

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[84] State of Illinois, General Obligation Bonds, Series of February 2014, *Preliminary Official Statement*, January 24, 2014, pp. 88-89. Projections could change if actuarial reports are revised.

[85] State of Illinois, General Obligation Bonds, Series of February 2014, *Preliminary Official Statement*, January 24, 2014, p. 18. Approximately 34% of total State contributions to SERS come from Other State Funds and a portion of State contributions to SURS has come from the State Pensions Fund, which is funded from unclaimed property. As in the Governor's projection, the State Pensions Fund contribution is estimated at $150 million annually beginning in FY2015.

[86] State of Illinois, General Obligation Bonds, Series of February 2014, *Preliminary Official Statement*, January 24, 2014, p. 88. These figures are based on the actuarial, or smoothed, value of assets, under which unexpected gains or losses are recognized over five years. Based on the actuarial value of assets, the total unfunded liability was $100.5 billion at the end of FY2013 and the combined funded ratio was 39.3%.

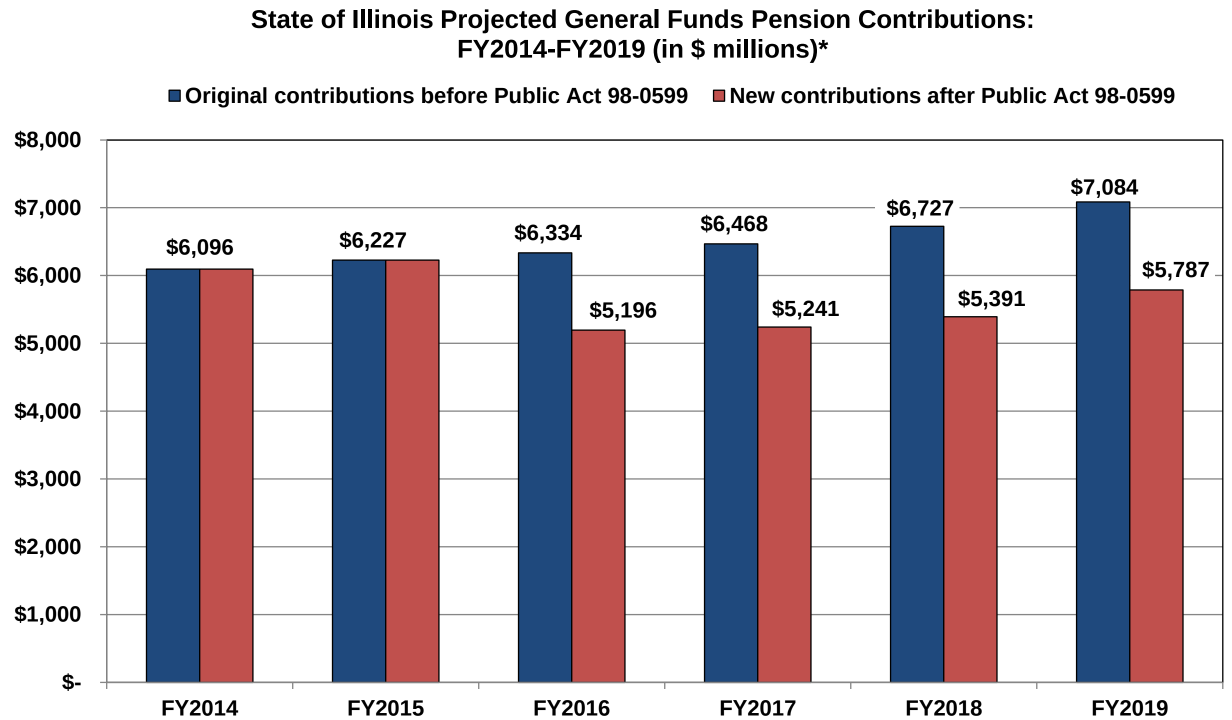
[87] JRS and GARS are relatively small, with statutorily required State contributions of $127 million and $14 million, respectively, in FY2014.

[88] State of Illinois, Governor's Office of Management and Budget, *Illinois' Economic and Fiscal Policy Report*, January 1, 2014, p. 4.

[89] For example, the Governor's projection understated required FY2014 TRIP and CIP contributions by about $32 million.

[90] Communication between the Civic Federation and the Governor's Office of Management and Budget, January 15, 2014.

The following chart shows the State's projected General Funds pension contributions before and after the new pension law. The chart is based on the State's assumption that the new law begins to reduce required contributions in FY2016.



*General Funds pension contributions include State contributions to Teachers' Retirement Insurance Program, College Insurance Program and Public School Teachers' Pension and Retirement Fund of Chicago and are net of payments funded by transfers from the State Pensions Fund ($198 million in FY2014 and an estimated $150 million in subsequent years).
Source: Actuarial impact analyses of Public Act 98-0599 by the Teachers', State Employees' and State Universities Retirement Systems; Judges' Retirement System, *Annual Actuarial Valuation as of June 30, 2013*, October 25, 2013, p. 24; General Assembly Retirement System, *Annual Actuarial Valuation Report as of June 30, 2013*, October 23, 2013, p. 24; Illinois State FY2014 Budget, pp. 6-269 and 6-294; Civic Federation calculations.

Although Public Act 98-0599 is scheduled to take effect on June 1, 2014, its implementation is expected to be delayed by legal challenges. The retirement systems certified FY2015 contribution amounts before the new law was enacted, and the legislation does not provide for revised certifications. Legislative leaders have said that savings will not be incorporated into the State's budget until the Illinois Supreme Court rules on the new law.[91]

Illinois is considered to have among the most stringent pension protections of any state. It is one of a handful of states, including New York and Arizona, with specific constitutional provisions barring benefit reductions.[92]

Illinois is facing several lawsuits from employees and retirees, who allege that the pension changes represent an illegal impairment of pension benefits under the pension protection clause.[93] Supporters of the new law rely mainly on a legal argument relating to the State's police power to preserve public safety, order and welfare.[94] According to this argument, Illinois can

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[91] Amanda Vinicky, "Speaker Madigan says Gov. shouldn't count on projected savings from passing pension reform," *Peoria Public Radio WCBU 89.9*, January 7, 2014.
[92] Amy Monahan, "Public Pension Reform: The Legal Framework," *Minnesota Legal Studies Research No. 10-13*, March 17, 2010, pp. 7-10.
[93] Doug Finke, "Illinois labor unions sue over plan to cut pensions," *State Journal-Register*, January 28, 2014.
[94] Karen Pierog, "Constitutional concerns cloud future of Illinois pension reform," *Reuters.com*, May 5, 3013.

impair contractual pension benefits if that action is reasonable and necessary to serve an important public purpose.[95]

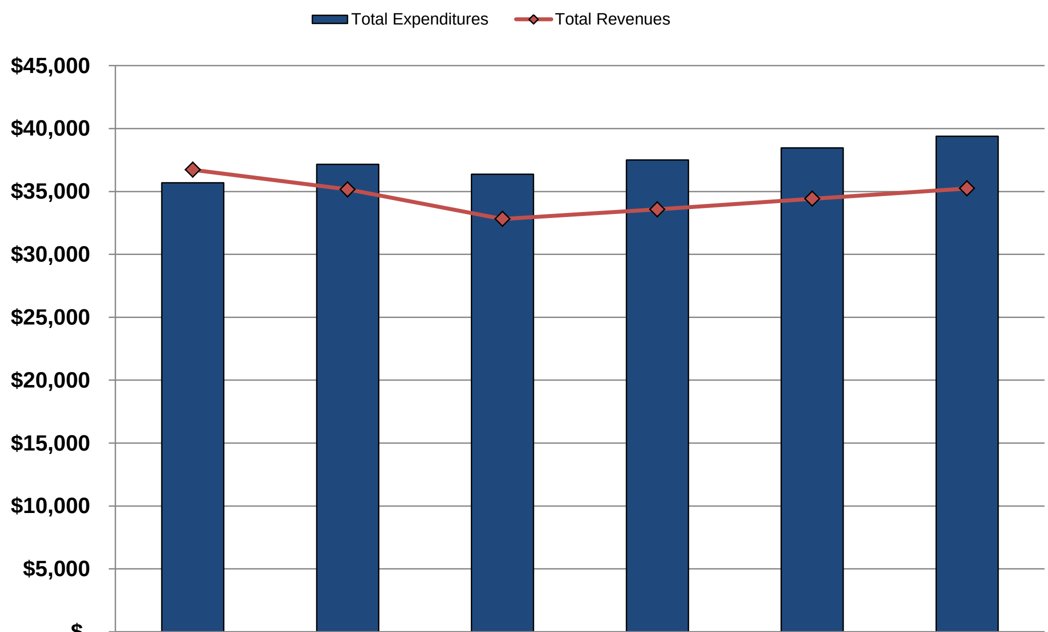
Deficit and Unpaid Bills

The five-year benchmark projection shows that the State's operating expenses will exceed revenues from FY2015 through FY2019. As a result, unpaid bills are projected to climb from $5.4 billion at the end of FY2014 to $23.0 billion at the end of FY2019.

This projection might understate the actual growth in unpaid bills. The forecast assumes a relatively modest increase of 2.7% a year in Medicaid costs. The expenditure projection also assumes that the State will realize savings in FY2016 based on the new pension legislation, which is in the early stages of litigation.

The following chart shows total projected General Funds revenues compared to total expenditures from FY2014 through FY2019.

State of Illinois Five-Year Projections: General Funds Revenues and Expenditures: FY2014-FY2019 (in $ millions)



	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019
Total Expenditures	$35,699	$37,151	$36,369	$37,513	$38,462	$39,391
Total Revenues	$36,725	$35,166	$32,813	$33,579	$34,417	$35,239

Source: State of Illinois, Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY15-FY17*, January 1, 2014; Illinois Department of Revenue, *FY2015 Revenue Estimates*, February 4, 2014, p. 2.

Although the projections show a small surplus in FY2014, annual General Funds deficits increase dramatically from FY2015 through FY2019 due to the scheduled reduction in income tax rates and continued expenditure growth.[96]

[95] Ronald A. Wirtz, "Public pension benefits and the law," *fedgazette*, January 1, 2011.
[96] Under Public Act 96-1496, the personal income tax rate will decline from 5.0% to 3.75% on January 1, 2015 and the corporate income tax rate will decline from 7.0% to 5.25%.

The General Funds operating deficit is projected to total $4.2 billion by FY2019 compared to a surplus of $1.0 billion in FY2014. The following table shows major revenue sources and spending categories that contribute to operating deficits from FY2015 to FY2019.

State of Illinois Five-Year Projections: General Funds Operating Surplus (Deficit) Benchmark Projections FY2014-FY2019 (in $ millions)								
	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	$ Change	% Change
Revenues								
State Source Revenues	$ 32,612	$ 30,679	$ 28,389	$ 28,997	$ 29,675	$ 30,330	$ (2,282)	-7.0%
Federal Revenues	$ 4,113	$ 4,487	$ 4,424	$ 4,582	$ 4,742	$ 4,908	$ 795	19.3%
Total Revenues	**$ 36,725**	**$ 35,166**	**$ 32,813**	**$ 33,579**	**$ 34,417**	**$ 35,239**	$ (1,486)	-4.0%
Expenditures								
Net Agency Appropriations	$ 16,028	$ 16,672	$ 16,839	$ 17,471	$ 17,981	$ 18,506	$ 2,478	15.5%
Original Pension Contributions	**$ 6,094**	**$ 6,227**	**$ 6,334**	**$ 6,468**	**$ 6,727**	**$ 7,084**	$ 990	16.2%
Reduction Due to Reform	$ -	$ -	$ (1,138)	$ (1,227)	$ (1,336)	$ (1,297)	$ (1,297)	na
New Pension Contributions*	**$ 6,094**	**$ 6,227**	**$ 5,196**	**$ 5,241**	**$ 5,391**	**$ 5,787**	$ (307)	-5.0%
Healthcare	$ 7,170	$ 7,396	$ 7,595	$ 7,799	$ 8,010	$ 8,226	$ 1,056	14.7%
Group Insurance Payments	$ 1,346	$ 1,647	$ 1,730	$ 1,816	$ 1,907	$ 2,002	$ 656	48.7%
Debt Service and Transfers	$ 5,060	$ 5,209	$ 5,009	$ 5,186	$ 5,173	$ 4,870	$ (190)	-3.8%
Total Expenditures	**$ 35,699**	**$ 37,151**	**$ 36,369**	**$ 37,513**	**$ 38,462**	**$ 39,391**	$ 3,692	10.3%
Operating Surplus (Deficit)	**$ 1,026**	**$ (1,985)**	**$ (3,556)**	**$ (3,934)**	**$ (4,045)**	**$ (4,153)**	**$ (5,179)**	**-504.8%**

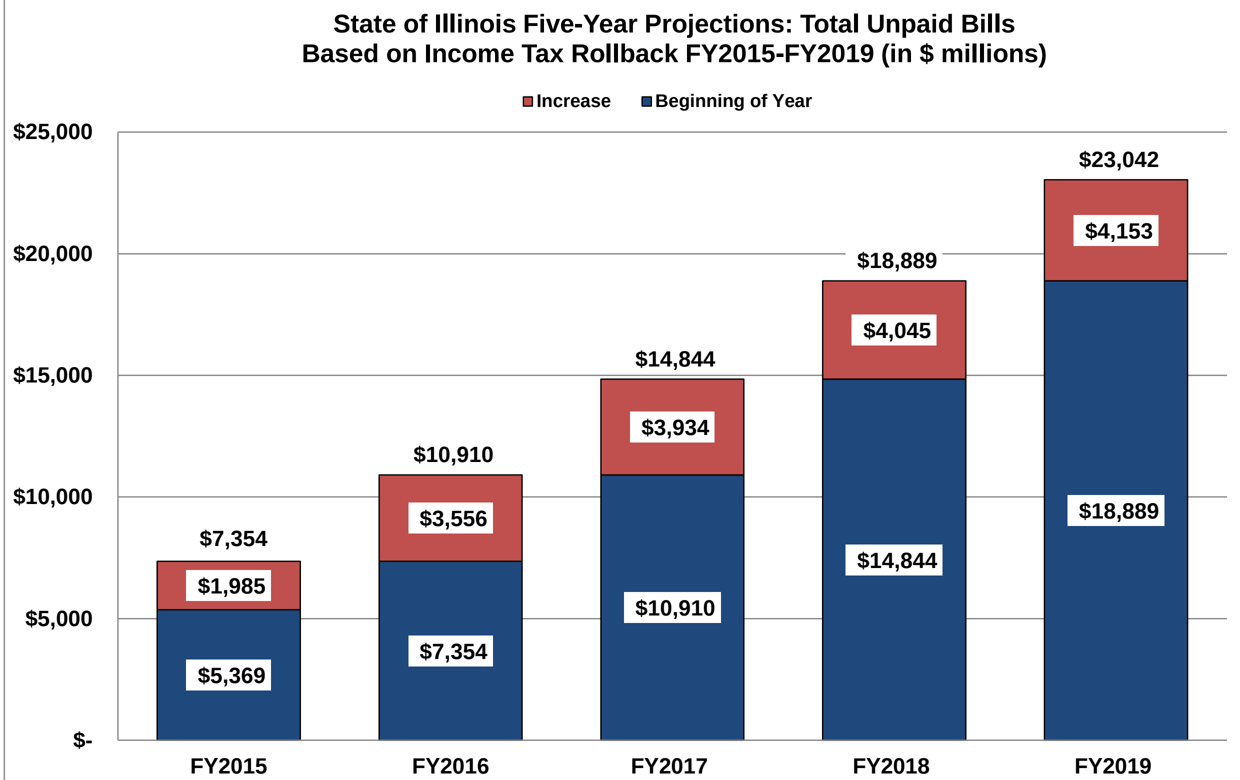
*Includes updated estimates for pension contributions available after January 1, 2014 and total estimated amounts attributable to the continuing appropriation for the Teachers Retirement Insurance Program.

Source: State of Illinois, Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds)* , *FY15-FY17* , January 1, 2014; Illinois Department of Revenue, *FY2015 Revenue Estimates* , February 4, 2014, p. 2.

Illinois has dealt with its General Funds deficits by delaying payments to vendors, social service agencies and local governments in order to pay those bills from the next year's revenue. Beginning in FY2013, the State's lapse period—the period after the end of the fiscal year during which this year's bills can be paid from next year's revenues—was permanently extended from two to six months.[97]

[97] 30 ILCS 105/25(m).

The following table shows the General Funds backlog of unpaid bills projected in the benchmark scenario from FY2015 to FY2019. Total unpaid bills could increase to $23.0 billion in FY2019 from $7.4 billion in FY2015 if nothing is done to curb expenditures or increase revenues.



Source: State of Illinois, Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY15-FY17*, January 1, 2014; Illinois Department of Revenue, *FY2015 Revenue Estimates*, February 4, 2014, p. 2.

It is unclear how the State could continue to provide basic government services if unpaid bills were allowed to grow to the levels shown in the chart above. The State would need to use more than half of projected FY2019 General Funds revenues of $35.2 billion to pay off the FY2018 backlog of $18.9 billion, significantly draining FY2019 resources and creating unsustainable payment delays.

Balanced Budget Alternatives

Considering the severe financial consequences of the FY2015 revenue cliff as described above, the Governor and General Assembly must take action to close the projected operating deficits and avoid a devastating growth in unpaid bills through FY2019.

Two approaches are commonly discussed to address the problem: reducing expenditures or extending the increased income tax rates. However, neither proposal on its own presents a comprehensive solution that meets all of the goals for a long-term financial plan proposed by the Civic Federation.[98]

The following alternative five-year budget projections will discuss the implications of these proposals and consider a more comprehensive approach to balancing the State's budget while providing for its long-term financial stability.

Spending Reductions

Based on the benchmark five-year projections, if the State were to balance its operating budgets and eliminate its backlog of unpaid bills between FY2014 and FY2019 through spending reductions alone, net agency appropriations would need to be reduced by approximately $4.7 billion. This would reduce net agency appropriations to $11.3 billion in FY2019 from the current total of $16.0 billion in FY2014, amounting to a 29.6% cut in net agency operating budgets over the next five years.

The reductions would begin in FY2015, when agency appropriations would need to decline by $1.3 billion to $14.7 billion or 8.4% below the FY2014 total of $16.0 billion. To balance the FY2016 budget, the State would need to make cuts of similar magnitude in net agency appropriations of $1.4 billion or 9.6% from the reduced levels in FY2015. Combined, the cuts necessary to balance the budget in FY2015 and FY2016 total $2.7 billion or a decline of 17.1% from FY2014 levels.

Additional reductions would be needed to address the backlog of unpaid bills. From FY2017 through FY2019, the State would need to cut an additional $665 million annually from net agency appropriations to pay down the backlog of bills. This would amount to cuts of 5.0% in FY2017, 5.3% in FY2018 and 5.6% in FY2019.

[98] For more information on the Civic Federation's goals, see page 18 of this report.

The following table shows the five-year projection of the necessary reductions in net agency appropriations to balance the General Funds budget and eliminate the State's backlog of bills between FY2015 and FY2019.

State of Illinois Five-Year Projections: Eliminate General Funds Deficit and Unpaid Bills Based on Spending Reductions Only FY2014-FY2019 (in $ millions)

	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	$ change	% change
Revenues								
State Source Revenues	$ 32,612	$ 30,679	$ 28,389	$ 28,997	$ 29,465	$ 29,942	$ (2,670)	-8.2%
Federal Revenues	$ 4,113	$ 4,487	$ 4,424	$ 4,582	$ 4,742	$ 4,908	$ 795	19.3%
Total Revenues	**$ 36,725**	**$ 35,166**	**$ 32,813**	**$ 33,579**	**$ 34,208**	**$ 34,850**	$ (1,875)	-5.1%
Expenditures								
Net Agency Appropriations	$ 16,028	$ 16,028	$ 14,687	$ 13,284	$ 12,618	$ 11,953	$ (4,075)	-25.4%
Cut Appropriations	$ -	$ (1,341)	$ (1,404)	(665)	$ (665)	$ (665)	$ -	na
Reduced Appropriations	**$ 16,028**	**$ 14,687**	**$ 13,284**	**$ 12,618**	**$ 11,953**	**$ 11,288**	**$ (4,740)**	**-29.6%**
Original Pension Contributions	**$ 6,094**	**$ 6,227**	**$ 6,334**	**$ 6,468**	**$ 6,727**	**$ 7,084**	**$ 990**	**16.2%**
Reduction Due to Reform	$ -	$ -	$ (1,138)	$ (1,227)	$ (1,336)	$ (1,297)	na	na
New Pension Contributions	**$ 6,094**	**$ 6,227**	**$ 5,196**	**$ 5,241**	**$ 5,391**	**$ 5,787**	**$ (307)**	**-5.1%**
Healthcare	$ 7,170	$ 7,396	$ 7,595	$ 7,799	$ 8,010	$ 8,226	$ 1,056	14.7%
Group Insurance Payments	$ 1,346	$ 1,647	$ 1,730	$ 1,816	$ 1,907	$ 2,002	$ 656	48.7%
Debt Service and Transfers	$ 5,060	$ 5,209	$ 5,009	$ 5,186	$ 5,173	$ 4,870	$ (190)	-3.8%
Total Expenditures	**$ 35,699**	**$ 35,166**	**$ 32,813**	**$ 32,661**	**$ 32,434**	**$ 32,173**	$ (3,526)	-9.9%
Operating Surplus (Deficit)	**$ 1,026**	**$ (0)**	**$ (0)**	**$ 918**	**$ 1,774**	**$ 2,677**	**$ 1,651**	**160.9%**
Backlog of Unpaid Bills	$ (6,440)	$ (5,369)	$ (5,369)	$ (5,369)	$ (4,451)	$ (2,677)	$ 3,763	na
Decrease in Unpaid Bills	$ 1,026	$ -	$ -	$ 918	$ 1,774	$ 2,677	$ 1,651	na
Unpaid Bills End of Year*	**$ (5,369)**	**$ (5,369)**	**$ (5,369)**	**$ (4,451)**	**$ (2,677)**	**$ (0)**	**$ 5,369**	**-100.0%**

*Data on projected unpaid income tax refunds at the end of FY2014 were not available; unpaid income tax refunds at the end of FY2013 were $45 million.

Source: State of Illinois, Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds)* , *FY15-FY17* , January 1, 2014; Actuarial impact analyses of Public Act 98-0599 by the Teachers', Employees' and Universities Retirement systems; Illinois Department of Revenue, *FY2015 Revenue Estimates* , February 4, 2014, p. 2; Civic Federation calculations.

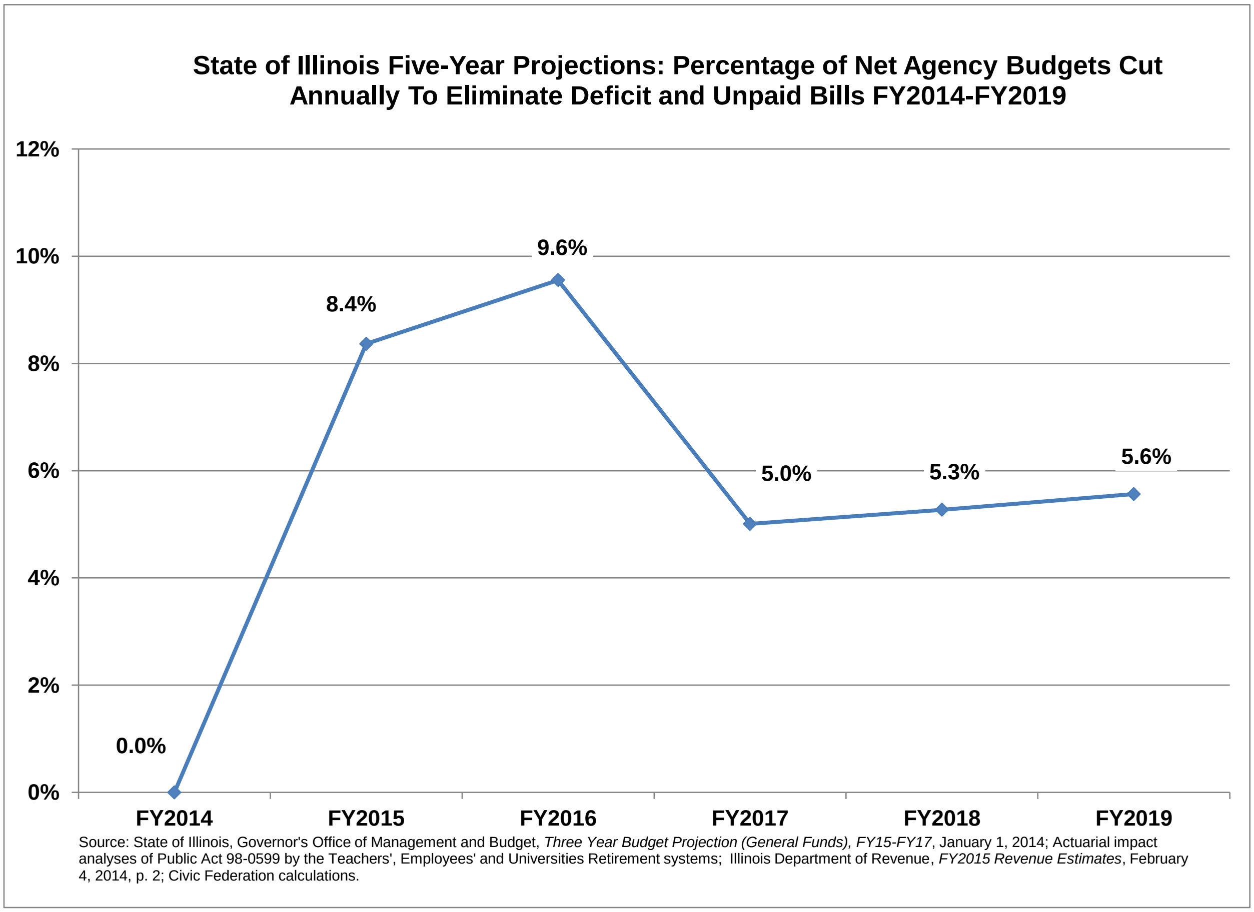
The prospect of reducing net agency appropriations by $4.7 billion or 29.6% through FY2019 is both unlikely and imprudent. After removing elements of the budget that are difficult to change due to law, contract or court order, most of the cuts would likely be centered on education and human services programs that are not federally reimbursed under Medicaid. Cuts of this size could involve the elimination of large portions of government services widely regarded as essential.

If the State could achieve the extraordinarily austere spending limits included in the five-year projection above, it would balance its operating budgets and eliminate the backlog of unpaid bills. However, the reductions-only budget scenario does not serve enough of the broader goals of a long-term financial plan proposed by the Civic Federation.

The State would be especially exposed to additional financial stress from an economic downturn or the possibility that the savings from the new pension law are eliminated or delayed by an adverse court ruling. Without the availability of reserves in a rainy day fund, the State will remain vulnerable to any major changes in revenues or spending requirements.

Similarly, there is no room in the reductions-only proposal to provide additional funding for local governments without imposing even deeper cuts.

The following chart shows the percentage of net appropriations that would need to be cut year to year in order to achieve budget plan above.



Simply reducing appropriations has an additional drawback: it does not allow the State to significantly reduce its unpaid bills until FY2018 and FY2019. Such a delay would extend the crisis that began in FY2009 for an additional three fiscal years. Although a long-term financial plan based on budget cuts alone does allow for significant tax relief to individuals and corporations in the near term, it also continues the cycle of annual financial crises and the resulting negative impact on service providers and local governments for the majority of the five-year horizon of the projection.

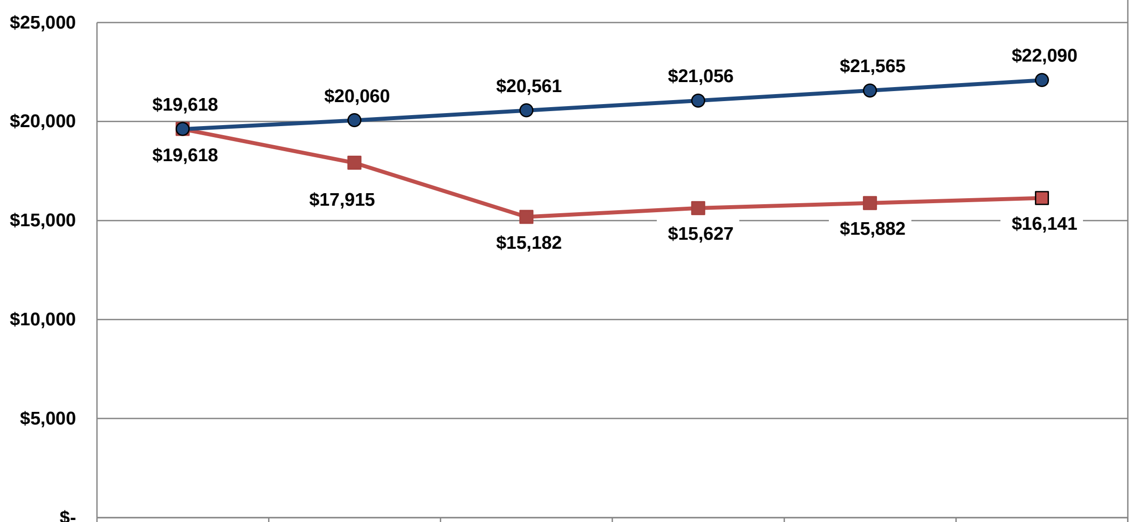
Extension of Income Tax Rates

Another commonly discussed alternative to the revenue cliff in FY2015 is to extend or make permanent the higher income tax rate of 5.0% for individuals and 7.0% for corporations.[99]

If the income tax rates were extended rather than allowed to partially sunset, General Funds revenues would grow by $3.7 billion over the next five fiscal years, totaling $40.5 billion in FY2019 compared to $36.7 billion in FY2014. This projection includes additional revenue from maintaining the current diversion rates to pay refunds at 9.5% for the individual income tax and 13.4% for the corporate income tax. The revenue projections for rolling back the income tax rates discussed earlier in this report included increasing the diversion rates to 10.0% for the individual income tax and 14.0% for corporations. The increase in the diversion rate was necessary to meet the demands for refunds from a higher tax rate while collecting taxes at the lower rate. Maintaining the lower diversion adds more than $100 million to the FY2015 projection, which then grows at the same rates as the individual and corporate income tax revenues through FY2019.

The following chart shows net income tax revenues from the extension of the higher income tax rates compared to the rollback under current law.

State of Illinois Net Income Tax Revenues: Rate Rollback Under Current Law Compared to Extension of Increased Rates FY2014-FY2019 (in$ millions)



	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019
IIT at 3.75%	$16,301	$14,844	$12,418	$12,660	$12,901	$13,146
CIT at 5.25%	$3,317	$3,071	$2,764	$2,967	$2,981	$2,996
Total Rollback	$19,618	$17,915	$15,182	$15,627	$15,882	$16,141
IIT at 5.0%	$16,301	$16,644	$16,960	$17,282	$17,611	$17,945
CIT at 7.0%	$3,317	$3,416	$3,601	$3,774	$3,955	$4,145
Total Extension	$19,618	$20,060	$20,561	$21,056	$21,565	$22,090

Note: Shows income tax rates rolled back on January 1, 2015 to 3.75% from 5.0% for individuals and to 5.25% from 7.0% for corporations compared to extension of higher rates.
Source: State of Illinois, Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds)*, FY15-FY17, January 1, 2014; Illinois Department of Revenue, *FY2015 Revenue Estimates*, February 4, 2014, p. 2; Civic Federation calculations.

[99] The State also collects the Personal Property Replacement Tax on behalf of local governments at a rate of 2.5% on corporate income, making the current effective corporate tax rate in Illinois 9.5%.

The following table shows the five-year projections for the State budget if the higher income tax rates were extended through FY2019.

State of Illinois Five-Year Projections: General Funds Budget Including Extension of the Income Tax Rates (5.0% IIT and 7.0% CIT) FY2014-FY2019 (in $ millions)								
	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	$ change	% change
Revenues								
State Source Revenues	$ 32,612	$ 32,776	$ 33,768	$ 34,426	$ 34,987	$ 35,563	$ 2,951	9.0%
Federal Revenues	$ 4,113	$ 4,487	$ 4,424	$ 4,582	$ 4,742	$ 4,908	$ 795	19.3%
Total Revenues	**$ 36,725**	**$ 37,263**	**$ 38,192**	**$ 39,008**	**$ 39,729**	**$ 40,471**	**$ 3,746**	**10.2%**
Expenditures								
Net Agency Appropriations*	$ 16,028	$ 16,672	$ 16,839	$ 17,471	$ 17,981	$ 18,506	$ 2,478	15.5%
Original Pension Contributions	**$ 6,094**	**$ 6,227**	**$ 6,334**	**$ 6,468**	**$ 6,727**	**$ 7,084**	**$ 990**	**16.2%**
Reduction Due to Reform	$ -	$ -	$ (1,138)	$ (1,227)	$ (1,336)	$ (1,297)	na	na
New Pension Contributions	**$ 6,094**	**$ 6,227**	**$ 5,196**	**$ 5,241**	**$ 5,391**	**$ 5,787**	**$ (307)**	**-5.1%**
Healthcare	$ 7,170	$ 7,396	$ 7,595	$ 7,799	$ 8,010	$ 8,226	$ 1,056	14.7%
Group Insurance Payments	$ 1,346	$ 1,647	$ 1,730	$ 1,816	$ 1,907	$ 2,002	$ 656	48.7%
Debt Service and Transfers	$ 5,060	$ 5,209	$ 5,009	$ 5,186	$ 5,173	$ 4,870	$ (190)	-3.8%
Total Expenditures	**$ 35,699**	**$ 37,151**	**$ 36,369**	**$ 37,513**	**$ 38,462**	**$ 39,391**	$ 3,692	10.3%
Operating Surplus (Deficit)	**$ 1,026**	**$ 112**	**$ 1,823**	**$ 1,495**	**$ 1,267**	**$ 1,080**	**$ 54**	**5.3%**
Backlog of Unpaid Bills	$ (6,440)	$ (5,369)	$ (5,257)	$ (3,434)	$ (1,939)	$ (672)	$ 5,768	na
Decrease in Unpaid Bills	$ 1,026	$ 112	$ 1,823	$ 1,495	$ 1,267	$ 1,080	$ 54	na
Unpaid Bills End of Year**	**$ (5,369)**	**$ (5,257)**	**$ (3,434)**	**$ (1,939)**	**$ (672)**	**$ -**	**$ 5,369**	**-100.0%**

*Assumes Net Agency Appropriations grow at 2.9% for FY2018 and FY2019 based on average rate of increase included in the Governor's three-year projections.

**Data on projected unpaid income tax refunds at the end of FY2014 were not available; unpaid income tax refunds at the end of FY2013 were $45 million.

Source: State of Illinois, Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY15-FY17*, January 1, 2014; Actuarial impact analyses of Public Act 98-0599 by the Teachers', Employees' and Universities Retirement systems; Illinois Department of Revenue, *FY2015 Revenue Estimates*, February 4, 2014, p. 2; Civic Federation calculations.

Extending current income tax rates could provide enough revenue to pay down the State's backlog of bills by the end of FY2019. This alternative has several shortcomings when compared to the Civic Federation's proposed goals for a long-term financial plan, however. The backlog of bills remains substantial until FY2018. In addition, the State makes little progress toward building a rainy day fund, with only $408 million available in FY2019, or 1.0% of total General Funds Revenues. A General Funds reserve of at least 5.0% of revenues could provide a substantial financial cushion in the event of an economic downturn or an adverse court ruling that eliminates or delays the savings from the new pension law. Additionally, there is no room in the five-year projections above for additional funding for local governments.

Finally, extending the higher income tax rates through FY2019 fails to provide tax relief, as originally intended when the rate increases were approved in 2011.

Comprehensive Alternative

As discussed above, neither the option of spending reductions alone nor only extending the current income tax rates meet the Civic Federation's goals for a comprehensive long-term financial plan for the State. It is evident that both reduced growth in spending and revenue changes are necessary in order to balance the State's operating budget and eliminate its backlog of unpaid bills though FY2019. When considering the broader picture of the State's finances, it is also important to start planning for future economic downturns or financial emergencies by providing significant funding to the State's rainy day fund. Such a reserve would not be possible under either of the previously considered scenarios.

To improve the long-term financial sustainability of the State's budget, it must control spending so that it does not exceed expected revenues. However, as shown in the chart related to the spending reductions only, it is unlikely that the State would be able to reduce net agency appropriations to meet the revenue losses caused by the revenue cliff in FY2015 and FY2016. It would also be difficult for lawmakers to justify the rollback of tax rates while still coping with $5.4 billion in unpaid bills and without a plan to mitigate the aggregate two-year loss of $3.9 billion in General Funds revenues.

Alternatively, the State could combine a lower level of spending with an extension of the increased tax rates for at least one year. In order to facilitate a reduction of the income tax rates without causing a fiscal cliff in any single budget year, rates could then be gradually reduced over time. The extension of the tax rates and gradual roll back could lead to a dramatic reduction in the State's backlog of unpaid bills beginning in FY2015 and FY2016, provide achievable spending limits for the State's operating budget through FY2019 and provide for reduced tax rates in future years.

However, to produce the combined outcomes of achieving tax relief, eliminating the unpaid bills and building an adequate rainy day fund, the State would also need to broaden its tax base. Unlike the federal government, which taxes certain levels of Social Security and other retirement income, Illinois exempts all retirement income from its income tax base.[100] Out of the 41 states that impose an income tax, Illinois is one of only three that exempts all pension income and one of 27 that excludes all federally taxable Social Security income.[101] The Illinois Comptroller reports that this exemption of federally taxable retirement income reduced individual income tax revenues by $2.0 billion in FY2012.[102] According to the Comptroller, the cost of this exemption is expected to increase over time due to a population shift in Illinois, in which the number of senior citizens is expected to grow from 1.7 million in 2010 to 2.7 million by 2030.

Based on data for 2011 from the Internal Revenue Service, even if the State of Illinois exempted federally taxed disbursements from individual retirement arrangements, pension income and Social Security income for all taxpayers earning below $50,000, the additional retirement income tax base would total more than $33.5 billion.[103] Dating back to 1999, this tax base has grown at an average rate of 6.5% annually, far outpacing the expected growth of the broader income tax base. Thus, the State could take steps to limit the taxation of lower income retirees while still sufficiently broadening the base. By adding a growing portion of the economy to the tax base, the State would ensure a more sustainable revenue source over time and allow for the gradual rollback of income tax rates.

In order to limit a shift of current operating spending outside the General Funds, the State should forgo the additional income tax diversions that are scheduled to begin in FY2015 to fund human services and education spending.[104] Each of these diversions reduces State's resources by 1/30 of the individual income tax receipts and allows for a significant amount of operating expenditures to be shifted outside of the scrutiny of the annual budget process.

Finally, if the current income tax rates are extended, the State should consider restoring the full share of income tax revenues to local governments. As part of the law enacting the temporary tax

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[100] 35 ILCS 5/203.
[101] Chicago Metropolitan Agency for Planning, Charting Progress Toward a More Efficient Regional and State Tax System via Indicators, July 18, 2013. http://www.cmap.illinois.gov/about/updates/-/asset_publisher/UIMfSLnFfMB6/content/charting-progress-toward-a-more-efficient-regional-and-state-tax-system-via-indicators (last visited on February 12, 2014)
[102] Illinois Comptroller, *Tax Expenditure Report*, *Fiscal Year 2012*, p. 6.
[103] Internal Revenue Service, SOI Tax Stats – Historic Tables, Illinois 1999-2011. http://www.irs.gov/uac/SOI-Tax-Stats---Historic-Table-2 (last visited on February 12, 2014)
[104] Public Act 96-1496, enacted on January 13, 2011.

increase in FY2011, the State limited the 10% share of the income taxes distributed to local governments through the Local Government Distributive Fund (LGDF) to only the original 3.0 percentage points of the individual income tax and 4.8 percentage points of the corporate income tax. Although this change maximized the revenues available to the State during its financial crisis, over the next five years the additional funding could provide critical resources to improve the finances of local governments, while still allowing the State to improve its own financial outlook.

The following table shows the five year budget General Funds budget projections based on the elements discussed above.

State of Illinois Five-Year Projections: General Funds Budget Including Gradual Income Tax Rollback, Restored LGDF, Tax on Retirement Income and Elimination of Diversions FY2014-FY2019 (in $ millions)

	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	$ change	%
Revenues								
State Source Revenues[1]	$ 32,612	$ 32,721	$ 33,112	$ 32,626	$ 31,573	$ 31,054	$ (1,558)	-4.8%
Retirement Income	$ -	1,039	$ 2,157	$ 2,179	$ 2,133	$ 2,138	$ 2,138	na
Elimination of Diversions	$ -	$ 449	$ 887	$ 904	$ 921	$ 939	$ 939	na
Federal Revenues	$ 4,113	$ 4,273	$ 4,424	$ 4,582	$ 4,742	$ 4,908	$ 795	19.3%
Total Revenues	**$ 36,725**	**$ 38,482**	**$ 40,580**	**$ 40,291**	**$ 39,369**	**$ 39,038**	$ 2,313	**6.3%**
Expenditures								
Net Agency Appropriations[2]	$ 16,028	$ 16,349	$ 16,676	$ 17,009	$ 17,349	$ 17,696	$ 1,668	10.4%
Original Pension Contributions	**$ 6,096**	**$ 6,227**	**$ 6,334**	**$ 6,468**	**$ 6,727**	**$ 7,084**	**$ 988**	**16.2%**
Reduction Due to Reform	$ -	$ -	$ (1,138)	$ (1,227)	$ (1,336)	$ (1,297)	na	na
New Pension Contributions	**$ 6,096**	**$ 6,227**	**$ 5,196**	**$ 5,241**	**$ 5,391**	**$ 5,787**	**$ (309)**	**-5.1%**
Restored LGDF		$ 852	$ 815	$ 713	$ 551	$ 446	$ 446	na
Healthcare	$ 7,170	$ 7,396	$ 7,595	$ 7,799	$ 8,010	$ 8,226	$ 1,056	14.7%
Group Insurance Payments	$ 1,346	$ 1,647	$ 1,730	$ 1,816	$ 1,907	$ 2,002	$ 656	48.7%
Debt Service and Transfers	$ 5,060	$ 5,209	$ 5,009	$ 5,186	$ 5,173	$ 4,870	$ (190)	-3.8%
Total Expenditures	**$ 35,699**	**$ 37,680**	**$ 37,021**	**$ 37,764**	**$ 38,381**	**$ 39,027**	$ 3,328	**9.3%**
Operating Surplus (Deficit)	**$ 1,026**	**$ 801**	**$ 3,559**	**$ 2,527**	**$ 988**	**$ 11**	**$ (1,015)**	**-98.9%**
Backlog of Unpaid Bills	$ (6,440)	$ (5,369)	$ (4,568)	$ (1,008)	$ -	$ -	$ 6,440	na
Decrease in Unpaid Bills	$ 1,026	$ 801	$ 3,559	$ 2,527			$ (1,026)	na
Unpaid Bills End of Year[3]	**$ (5,369)**	**$ (4,568)**	**$ (1,008)**	**$ -**	**$ -**	**$ -**	**$ 5,369**	**-100.0%**
Reserve Deposit	$ -	$ -	$ -	$ 1,518	$ 988	$ 11	$ 11	na
Rainy Day Fund Balance	**$ -**	**$ -**	**$ -**	**$ 1,518**	**$ 2,506**	**$ 2,517**	**$ 2,517**	**na**
Reserves % of General Funds	**0.0%**	**0.0%**	**0.0%**	**3.8%**	**6.4%**	**6.4%**	**na**	**na**

[1]Includes a phase out of the current income tax rates beginning in FY2016. The individual income tax rates are reduced by 0.25 percentage points per year on January 1, 2016 and 2017 and by an additional 0.5% on January 1, 2018 to a final rate of 4.0%. The corporate income tax rate is reduced by 0.5% per year on January 1, 2016 and 2017 and an addition .4% on January 1, 2018 for a final rate of 5.6%.

[2]Assumes growth limit for Net Agency Appropriations based on the Federal Reserve Board's long-term target inflation rate of 2.0%.

[3]Data on projected unpaid income tax refunds at the end of FY2014 were not available; unpaid income tax refunds at the end of FY2013 were $45 million.

Source: State of Illinois, Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY15-FY17*, January 1, 2014; Actuarial impact analyses of Public Act 98-0599 by the Teachers', Employees' and Universities Retirement Systems; Illinois Department of Revenue, *FY2015 Revenue Estimates*, February 4, 2014, p. 2; Civic Federation calculations.

An essential element of the comprehensive plan is limiting the growth in net agency appropriations in order to ensure that operating surpluses are available to eliminate the State's backlog of bills and to make deposits into a rainy day fund. In the table shown above, the annual growth in net agency appropriations is limited to 2.0%, which reflects the target inflation rate established by the Federal Reserve Board.[105] This is reduced from the 2.9% growth in net agency appropriations used to produce the benchmark five-year projection base on the average growth rate shown in the Governor's three-year projection. The 2.0% spending limit is used for illustrative purposes based on available data and should be reevaluated annually after taking into account actual economic trends and available resources.

[105] Federal Reserve Chair Janet L. Yellen, *Semiannual Monetary Policy Report to the Congress*, February 11, 2014. http://www.federalreserve.gov/newsevents/testimony/yellen20140211a.htm (last visited February 21, 2014)

The current income tax rates are extended for one year and then gradually rolled back. Both the individual income tax rate and the corporate income tax rate are reduced by 20% from the current levels. The individual income tax rate is cut to 4.0% from 5.0%, with reductions of 0.25 percentage points on January 1, 2016 and January 1, 2017 and a further reduction of 0.5 percentage points on January 1, 2018. The corporate income tax rate is reduced to 5.6% from 7.0%, with reductions of 0.5 percentage points on January 1, 2016 and January 1, 2017 and an additional reduction of 0.4 percentage points on January 1, 2018.[106]

The projection includes repealing the income tax exemption for all federally taxable retirement income in Illinois; eliminating the new income tax diversions; and restoring the full 10% share of the income taxes to the LGDF. The table shows the amounts that would be available to deposit in the State's rainy day fund from FY2017 though FY2019 based on this five-year plan.

By eliminating the diversions, which are intended to fund spending on human services and education outside of the General Funds budget, the comprehensive plan reduces total spending over the five-year projection by an aggregate total of $4.1 billion from the amount that would be otherwise made available under current law. In FY2019 net agency appropriations included in the comprehensive plan are $810 million less than the benchmark projection based on the Governor's three-year plan, totaling $17.7 billion compared to $18.5 billion.

Under the comprehensive plan, the State would be able to transition from a backlog of unpaid bills totaling 14.6% of its General Funds revenues to a reserve fund of more than 6% of General Funds revenues. Reserves in the rainy day fund should be protected by extensive restrictions on access to the funds to ensure they will be used only to help the State weather future fiscal emergencies.

Illinois has not maintained a functional rainy day fund, although a law was enacted in 2004 to build such a fund.[107] The law established a goal of maintaining 5% of General Funds revenues in an existing account called the Budget Stabilization Fund. According to the law, the fund would be used to reduce the need for future tax increases or short-term borrowing, maintain high credit ratings and address budgetary shortfalls. In authorizing withdrawals from the fund, priority was to be given to services for children. Deposits into the fund would be triggered by projected revenue growth of more than 4% from the prior year.

Transfers based on the statutory formula have not occurred, apparently because annual revenue projections did not meet the threshold requirement.[108] The Budget Stabilization Fund had $276 million at the end of FY2013—less than 1% of General Funds revenues of $36.4 billion.[109]

Instead of being used to withstand fiscal emergencies, the fund is used for cash flow problems resulting from timing variations between receipt and disbursement of funds in a given fiscal year.[110] By law, any cash flow borrowings transferred during a fiscal year from the Budget Stabilization Fund to the General Funds are to be reimbursed by a transfer back by the end of

[106] Diversion rates to pay for income tax refunds are assumed to increase to 10.0% from 9.5% for the individual income tax and to 14.0% from 13.4% for the corporate income tax in FY2015 through FY2019.
[107] Public Act 93-660, enacted on February 2, 2004.
[108] The law was amended to prohibit any deposits into the fund in FY2008.
[109] State of Illinois, General Obligation Bonds, Series of February 2014, Preliminary Official Statement, January 24, 2014, p. 14. The State also had a cash balance of $154.0 million.
[110] State of Illinois, General Obligation Bonds, Series of February 2014, Preliminary Official Statement, January 24, 2014, pp. 14-15.

that fiscal year.[111] During the State's ongoing fiscal crisis, the fund has been used for short-term borrowing, with reserves depleted at the beginning of the fiscal year and repaid in at the end.[112]

Another advantage of the Civic Federation's comprehensive plan is its ability to absorb the financial impact of a delay or adverse court ruling on the State's new pension law. In the table above, the savings from the pension reforms do not take effect until FY2016. If the reduction is delayed or the law overturned, the State's contribution will increase by $1.1 billion in FY2016 and could increase by an additional $5.0 billion through FY2019. However, based on the comprehensive plan, the increase in required pension contribution under the old pension law would not cause a financial crisis as the State would still have a surplus of $2.1 billion available to pay down bills in FY2016. Neither of the previously discussed scenarios could avoid significant operating deficits if pension costs increase to the original levels without dramatic changes to spending or revenue.

In short, the comprehensive long-term financial plan shown above illustrates the possibility that with significant policy changes the State could achieve all of the goals proposed by the Civic Federation while also providing significant tax relief over the next five years.

[111] 30 ILCS 105/6z-51(b). The law was amended to defer cash repayment for FY2011 until July 15, 2011.
[112] Communication between the Civic Federation and the Governor's Office of Management and Budget, February 13, 2014.

CIVIC FEDERATION RECOMMENDATIONS

This section presents the Civic Federation's recommendations for the State of Illinois' FY2015 budget as well as long-term reforms to stabilize the State's financial condition. Based on the analysis in this report, the following steps should be taken by the Governor and General Assembly in developing the FY2015 budget and planning for the budget years through FY2019.

Issue 1: Backlog of Unpaid Bills

As shown in this report, the State of Illinois is expected to end FY2014 with a backlog of unpaid bills totaling $5.4 billion. Based on existing spending trends and expected revenue losses under current law, the backlog could grow to $23.0 billion by the end of FY2019. Although the current total of unpaid bills is significantly below the recent peak of $8.9 billion at the end of FY2012, the backlog still represents 14.6% of total FY2014 General Funds revenue.

Until the State eliminates this backlog, it will not have completed its recovery from the economic downturn, which occurred more than five years ago. As the State pushes these liabilities from one year to the next, it continues to delay payments to vendors and other service providers, transferring its financial distress to businesses, social service agencies and local governments agencies across the State.

By limiting spending increases and dedicating surpluses to paying down its bill backlog, the State has begun to catch up on its unpaid bills over the last two fiscal years. It is essential that the Governor and General Assembly focus on limiting the growth in agency budgets in order to continue this progress and not allow the backlog to grow in the future.[113]

Civic Federation Recommendation on Unpaid Bills

The Civic Federation recommends that the State of Illinois eliminate its backlog of unpaid bills within the next five years by establishing spending controls that limit the growth in net agency spending, creating annual operating surpluses to pay down the bill backlog.

[113] For an illustration of spending limits as part of a comprehensive long-term financial plan see page 35.

Issue 2: Rollback of Income Tax Rates
Current law creates a significant revenue cliff for the State of Illinois beginning in FY2015 and continuing through FY2016. State resources drop dramatically due to the partial rollback of the income tax increase passed in FY2011, which reduces the individual rate to 3.75% from 5.0% and the corporate rate to 5.25% from 7.0%. Total General Funds revenues decline by $1.6 billion in FY2015 to $35.2 billion and by $2.4 billion in FY2016 to $32.8 billion. This amounts to an aggregate decline of $3.9 billion over two years or 10.6% of total General Funds revenues of $36.7 billion in FY2014.

Even after several years of underlying growth, General Funds revenues are projected to total only $34.9 billion in FY2019, which is still $1.9 billion below FY2014.

In light of a $5.4 billion accumulated backlog of unpaid bills at the end of FY2014, the State is not in a position to abruptly reduce tax rates without a plan to balance its operating budget and to pay down its bills.

Based on the analysis of net agency appropriations in the previous section, reducing spending alone is not a practical solution. Net agency appropriations would need to be reduced by 8.4% in FY2015 and by an additional 9.6% in FY2016 for a total aggregate cut of $2.7 billion over two years. By FY2019 annual agency spending would need to be reduced by $4.7 billion or 29.6% from current FY2014 levels.

After removing elements of the budget that are difficult to change due to law, contract or court order, most of the cuts would likely be centered on education and human services programs that are not federally reimbursed under Medicaid. Cuts of this size could involve the elimination of large portions of government services widely regarded as essential.

In addition, the State does not expect to take savings from the new pension law until FY2016. The revenue cliff begins in FY2015, likely before the State will know the outcome of legal challenges to the law. The projections included in this report include $5.0 billion in savings from FY2016 through FY2019.

Although temporary taxes or one-time revenues may be used as part of a short-term reaction to a fiscal crisis, it is not sound public policy to engineer a large reduction in State resources without a plan to mitigate those revenue losses. By reducing the income tax rates gradually over the next five years, the State could avoid the dramatic losses in any one year caused by current tax policy, while providing significant tax relief. A gradual reduction allows for realistic spending adjustments to mitigate operating losses caused by the lower tax rates.

Civic Federation Recommendation on the Income Tax Rollback
The Civic Federation recommends the elimination of the revenue cliff in FY2015 by extending the current income tax rates for one additional year and then rolling them back gradually thereafter. The one year extension allows the State to avoid a financial crisis while at the same time paying down a larger portion of the State's unpaid bills in the near term giving relief to vendors and local governments. Both the individual income tax rate and the corporate income tax rate should be gradually reduced by 20.0%. The individual income tax rate should be cut to 4.0% from 5.0%, with reductions of 0.25 percentage points on January 1, 2016 and January 1, 2017 and a further reduction of 0.5 percentage points on January 1, 2018. The corporate income tax rate should be reduced to 5.6% from 7.0%,

with reductions of 0.5 percentage points on January 1, 2016 and January 1, 2017 and an additional reduction of 0.4 percentage points on January 1, 2018.

Issue 3: Retirement Income Exemption

Unlike the federal government, the State of Illinois exempts all retirement income from the individual income tax. Out of the 41 states that impose an income tax, Illinois is one of only three that exempt all pension income and one of 27 that exclude all federally taxed Social Security income.[114]

The Illinois Comptroller reports that this exemption of federally taxable retirement income reduced the State's individual income tax revenues by $2.0 billion in FY2012.[115] The cost of this exemption is also expected to increase over time due to a population shift in Illinois, with the number of senior citizens expected to grow from 1.7 million in 2010 to 2.7 million by 2030.[116]

The federal government provides some relief for lower income retirees by exempting Social Security benefits below a certain threshold. Individual senior citizens do not have to pay income taxes on their Social Security benefits if the sum of half of their Social Security benefits combined with all other income is less than $25,000 annually.[117] For couples the threshold is $34,000.

Based on data for 2011 from the Internal Revenue Service, even if the State of Illinois exempted federally taxed disbursements from individual retirement arrangements, pension income and Social Security income for all taxpayers earning below $50,000, the additional retirement income tax base would total more than $33.5 billion.[118] Dating back to 1999, this tax base has grown at an average rate of 6.5% annually, far outpacing the expected growth of the broader income tax base. By adding a growing portion of the economy to the tax base, the State would ensure a more sustainable revenue source over time and allow for the gradual rollback of income tax rates.

Civic Federation Recommendation on Taxing Retirement Income

The Civic Federation recommends that the State of Illinois broaden its income tax base to include federally taxable amounts of retirement income to create greater equity among taxpayers and facilitate the gradual rollback of the income tax rates for all. The broader base will also ensure greater long-term sustainability of the State's resources by accessing a growing portion of the economy.

Issue 4: Revenue Diversion from General Funds

Beginning on February 1, 2015, State law requires that a specific share of individual income tax revenues be diverted from General Funds to provide additional funding for education and human

[114] Chicago Metropolitan Agency for Planning, Charting Progress Toward a More Efficient Regional and State Tax System via Indicators, July 18, 2013. http://www.cmap.illinois.gov/about/updates/-/asset_publisher/UIMfSLnFfMB6/content/charting-progress-toward-a-more-efficient-regional-and-state-tax-system-via-indicators (last visited February 12, 2014)

[115] Illinois Comptroller, *Tax Expenditure Report, Fiscal Year 2012*, p. 6.

[116] Illinois Comptroller, *Tax Expenditure Report, Fiscal Year 2012*, p. 6.

[117] Internal Revenue Service, Social Security Benefits and Your Taxes, March 1, 2013. http://www.irs.gov/uac/Newsroom/Social-Security-Benefits-and-Your-Taxes (last visited February 13, 2014)

[118] Internal Revenue Service, SOI Tax Stats – Historic Tables, Illinois 1999-2011. http://www.irs.gov/uac/SOI-Tax-Stats---Historic-Table-2 (last visited on February 12, 2014)

services. This requirement is contained in a little-noticed provision of the 2011 law that temporarily increased income tax rates.[119]

Currently all of the individual income taxes collected by the State are deposited into General Funds, with one exception. A share of individual income tax revenues is diverted into a separate fund—the Income Tax Refund Fund—to pay income tax refunds. The remaining net revenues are deposited into General Funds.

Under the new requirement, a portion of net revenues will be diverted to two new funds: the Fund for the Advancement of Education and the Commitment to Human Services Fund. Each of the new funds will receive 1/30 (about 3.33%) of net individual income tax revenues annually through FY2024; in February 2025 the share increases to 1/26 (about 3.85%).

In January the Governor's Office of Management and Budget projected that this diversion would reduce General Funds income tax revenues by $443 million in FY2015, $887 million in FY2016 and $904 million in FY2017.[120]

The State's annual budget process is focused on the allocation of General Funds resources. Diverting revenues from General Funds essentially hides resources from public view, making the budget process less transparent. The statutory diversions also make it more difficult for lawmakers to ensure that resources are allocated each year to the most critical priorities.

Civic Federation Recommendation on Revenue Diversion from General Funds

The Civic Federation recommends repealing the new statutory diversions of income tax revenues from the General Funds to fund human services and education that are scheduled to begin in FY2015. Any future efforts to shift resources outside of the scrutiny of the General Funds budgeting process should be rejected.

Issue 5: Local Government Revenue Sharing

As part of the law enacting the temporary tax increase in FY2011, the State limited the previous 10% share of the income taxes that is distributed to local governments through the Local Government Distributive Fund (LGDF) to only the original 3.0 percentage points of the individual income tax and 4.8 percentage points of the corporate income tax. This change maximized the revenues available to the State during its financial crisis. As the State moves to stabilize its budgets over the next five years, restoring the full 10% share of the income tax could provide critical resources to improve the finances of local governments.

The City of Chicago, which faces a projected $1.0 billion deficit going into the next fiscal year, estimates that it would have received more than $400 million in revenues if local governments had not been excluded from sharing in the increased income tax revenues since 2011.[121] Chicago receives roughly 21% of the LGDF funding and like many other local governments is facing ongoing financial pressure due to its own pension funding crisis.

Civic Federation Recommendation on Local Government Revenue Sharing

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[119] Public Act 96-1496, enacted on January 13, 2011. The provision can be found at 35 ILCS 5/901 (f) and (g).
[120] State of Illinois, Governor's Office of Management and Budget, *Illinois' Economic and Fiscal Policy Report*, January 1, 2014, p. 3.
[121] City of Chicago, Annual Financial Analysis 2013, p. 16. The City of Chicago estimates that it would have received additional revenue of more than $50 per resident per year beginning in 2011.

The Civic Federation recommends that if the State of Illinois extends the income tax rates, the full 10% share distributed to local governments should be restored in light of the financial pressures facing Illinois municipalities.

Issue 6: Rainy Day Fund

All governments should place a portion of their general operating revenues in a general fund reserve or "rainy day" fund.[122] These rainy day funds are savings accounts that governments can use to address revenue shortfalls or unanticipated expenditures and to help stabilize tax rates. Governments that maintain adequate reserves are better positioned to deal with funding issues in bad times. Putting money into reserves is a more fiscally prudent action than spending surplus funds on new or expanded programs.

The Government Finance Officers Association (GFOA) recommends as a best practice that governments maintain at a minimum an unrestricted general fund balance of no less than two months, or 16.7%, of regular general fund operating revenues or regular general fund operating expenditures.[123] The GFOA notes that larger governments may require smaller reserves because they are better able to predict and plan for contingencies and because they often have a more diversified revenue base that mitigates revenue volatility.

Although there does not appear to be a consensus on what the size of a state's rainy day fund should be, state budget officials generally set a target of 5% of general fund expenditures.[124] A survey in the fall of 2013 by the National Association of State Budget Officers found that 34 states had reserves (including cash balances and rainy day funds) of 5% of expenditures or higher.[125] Many states require that withdrawals from the funds occur only after an economic trigger, such as a specific drop in personal income or increase in unemployment.[126]

The adequacy of reserves is one of the factors considered by credit rating agencies in assessing a state's financial condition.[127] Fitch Ratings noted in January 2012, for example, that Illinois' financial options were limited during the recession because it failed to build reserves prior to the economic downturn.[128]

Illinois has not maintained a functional rainy day fund, although a law was enacted in 2004 to build a fund containing 5% of General Funds revenues.[129] The fund has never received significant resources, however, apparently because annual revenue projections have not met the threshold requirement to trigger deposits into the fund.

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[122] Government Finance Officers Association, *Best Practice: Appropriate Level of Unrestricted Fund Balance in the General Fund (2002 and 2009) (Budget and CAFR)*, October 2009.
[123] Government Finance Officers Association, *Best Practice: Appropriate Level of Unrestricted Fund Balance in the General Fund (2002 and 2009) (Budget and CAFR)*, October 2009.
[124] National Association of State Budget Officers, *Fall 2013 Fiscal Survey of States*, December 10, 2013, p. 51.
[125] National Association of State Budget Officers, *Fall 2013 Fiscal Survey of States*, December 10, 2013, p. 55.
[126] Joseph Henchman, "Trend #8: Insufficient Rainy Day Funds," *Fiscal Fact*, Tax Foundation, June 6, 2012.
[127] Moody's Investors Service, "Outlook for US states revised to stable; local government outlook remains negative," *news release*, August 20, 2013.
[128] Fitch Ratings, "Fitch Affirms Illinois' GO Bonds at 'A'; Outlook Stable**,"** *news release,* January 5, 2012.
[129] Public Act 93-660, enacted on February 2, 2004.

The Budget Stabilization Fund had $276 million at the end of FY2013—less than 1% of General Funds revenues of $36.4 billion.[130] Instead of being used to withstand fiscal emergencies, the fund is used for cash flow problems resulting from timing variations between receipt and disbursement of funds in a given fiscal year.[131] During the State's fiscal crisis, the fund has recently been used for short-term borrowing, with reserves depleted at the beginning of the fiscal year and repaid in at the end.[132]

Civic Federation Recommendation on Rainy Day Fund

Illinois should work toward building a rainy day fund equal to 5% of General Funds revenues to cushion the budget from the next economic downturn. Like other states, Illinois should have stringent statutory restrictions on the use of the fund, relating to budgetary and economic factors such as projected revenue decreases and the declaration of a nationwide recession. Illinois must also establish reasonable requirements for rebuilding the fund over time when it is depleted.

Issue 7: Long-Term Financial Plan

As a government recovers from a financial crisis, it is particularly important to undertake a long-term financial planning process.[133] A long-term financial plan highlights long-range financial issues and helps governments look beyond budget gap-bridging measures, such as one-time or temporary revenue sources, toward remedying structural problems. A time horizon of at least five years for financial planning is recognized as a best practice by the Government Finance Officers Association (GFOA).[134]

Since 2011 the Governor's Office of Management and Budget (GOMB) has been required each January to issue an annual economic and fiscal policy report.[135] The report is required to provide budget projections for the next three fiscal years. It also must outline the State's long-term economic and fiscal policy objectives and its economic and fiscal policy intentions for the next three fiscal years.

The reports issued by GOMB in the last four years have significantly increased publicly available information about the State's fiscal condition. They have consistently provided useful data on the enacted budget and revenue and expenditure projections for future years. In the past two years, the reports have also shown year-end General Funds liabilities that are not displayed in the budget, giving a more comprehensive picture of the State's finances.

However, the reports over time have provided less information about the State's policy intentions. The report in January 2011, for example, outlined the Governor's plan to pay down the State's backlog of bills in two years by selling debt restructuring bonds.[136] The latest report,

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[130] State of Illinois, General Obligation Bonds, Series of February 2014, Preliminary Official Statement, January 24, 2014, p. 14. The State also had a cash balance of $154.0 million.
[131] State of Illinois, General Obligation Bonds, Series of February 2014, Preliminary Official Statement, January 24, 2014, pp. 14-15.
[132] Communication between the Civic Federation and the Governor's Office of Management and Budget, February 13, 2014.
[133] Shayne Kavanagh, *Fiscal First Aid and Financial Recovery,* (Chicago: GFOA, 2011), pp. 37-44.
[134] Government Finance Officers Association, *Best Practice: Long-Term Financial Planning*, February 22, 2008, http://www.gfoa.org/downloads/LongtermFinancialPlanningFINAL.pdf (last visited on February 3, 2014).
[135] Public Act 96-1354, enacted on July 28, 2010.
[136] State of Illinois, Governor's Office of Management and Budget, *Illinois' Economic and Fiscal Policy Report*, January 20, 2011, p. 2. The proposal was not passed by the General Assembly.

which covers a period during which the State faces a dramatic loss of revenue due to the scheduled rollback of income tax rate increases, does not address policy intentions.[137] Instead, it shows the financial impact of the rate rollback and the budget deficits and bill backlogs that would be generated if expenditures were permitted to increase to keep government services at FY2014 levels.

A long-term financial plan takes a step beyond financial forecasting and develops strategies to achieve the financial stability necessary to achieve a government's goals.[138] The long-term financial plan is then implemented and revisited through the annual budget and revised as necessary.

The Governor's proposed budget for FY2015 is scheduled to be released on March 26, 2014.[139] State law requires the Governor to present the budget proposal on the third Wednesday in February, but the date is frequently changed by the General Assembly.[140] The FY2015 budget recommendation will now be issued after the State's primary election on March 18. The Governor's budget proposal must be based only on existing sources of revenue.[141] Unlike the three-year projection, the Governor's budget recommendation must also be balanced, according to the Illinois Constitution and State law.[142]

When the budget delay was announced, it was also disclosed that the Governor intended to present a five-year spending plan for the State along with the budget.[143] Details about the five-year plan have not been made available, but the limited time remaining before March 26 could preclude the development of a comprehensive financial plan.

The GFOA and the National Advisory Council on State and Local Budgeting (NACSLB) both consider long-term financial planning to be a pillar of proper financial management. The NACSLB defines the financial planning process as an assessment of the long-term financial implications of current and proposed policies, programs and assumptions with development of appropriate strategies to achieve the plan's goals.[144] The GFOA and the NACSLB have developed best practices in long-term financial planning. Recommended elements of a long-term financial plan include:[145]

1. An analysis of historic financial trends.
2. An assessment of problems and opportunities facing the jurisdiction including an analysis of the financial environment.
3. A description of financial policies, service level preferences and financial goals.

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[137] State of Illinois, Governor's Office of Management and Budget, *Illinois' Economic and Fiscal Policy Report*, January 1, 2014.
[138] Government Finance Officers Association, "Long-Term Financial Planning for Governments," (http://www.gfoa.org/downloads/LTFPbrochure.pdf (last visited on February 14, 2014).
[139] Public Act 98-0626, enacted on February 5, 2014.
[140] 15 ILCS 10/50-5(a).
[141] Public Act 96-1529, enacted on February 16, 2011.
[142] Illinois Constitution, Article VIII, Section 2; 15 ILCS 20/50-5(a).
[143] Ray Long, "Quinn wants to delay budget speech," *Chicago Tribune*, February 3, 2014.
[144] National Advisory Council on State and Local Budgeting, *Recommended Budget Practices, (*Chicago: GFOA, 1998).
[145] See Shayne Kavanagh, *Financing the Future: Long-Term Financial Planning for Local Government* (Chicago: GFOA, 2007) and National Advisory Council on State and Local Budgeting, *Recommended Budget Practices,* (Chicago: GFOA, 1998), pp. 37-44.

4. A long-term (five-year) forecast of revenues and expenditures that uses alternative economic, planning and policy assumptions.
5. Narrative that discusses strategies, actions and scenarios needed to address financial imbalances and other long-term issues.
6. The identification of key assumptions used to develop the plan.
7. An analysis of liabilities and fund balance.

An essential element of the long-term financial planning process is that it be an open and public process. All stakeholders should be engaged in the planning process. The GFOA describes the long-term financial planning process as "not just a staff-driven process. It is consensus-driven and inclusive, involving elected officials, staff and the public."[146]

Civic Federation Recommendation on Long-Term Financial Plan

The Civic Federation recommends that the State work on a formal, public five-year financial plan to be published prior to the release of the FY2016 budget. The plan should be updated annually to reflect actual budget results and changes in economic conditions.

[146] Government Finance Officers Association, "Long-Term Financial Planning for Governments," (http://www.gfoa.org/downloads/LTFPbrochure.pdf (last visited on July 3, 2013).