The Institute for Illinois' Fiscal Sustainability

AT THE CIVIC FEDERATION

# STATE OF ILLINOIS FY2013 RECOMMENDED OPERATING AND CAPITAL BUDGETS:

## *Analysis and Recommendations*

**May 1, 2012**

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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

The Civic Federation **supports** Governor Pat Quinn's FY2013 recommended $57.4 billion budget for the State of Illinois because it acknowledges the depth of the State's financial problems and advocates major structural reforms to put Illinois finances on the road to recovery.

The Civic Federation is **encouraged** that Governor Quinn has made a reasonable proposal to restructure the State's retirement systems by reducing unfunded liabilities and establishing an actuarially sound funding plan. The Civic Federation is also **encouraged** that the Governor has made a sensible proposal to reorganize the Medicaid program, in keeping with the magnitude of the program's fiscal challenges and the State's deteriorating fiscal condition.

After years of mismanagement, the State is left with no easy answers for either pensions or Medicaid. The Governor's recommended changes will be painful and difficult to implement. However, the State **cannot afford continued inaction**. The Civic Federation calls on the General Assembly to adopt the Governor's plans or identify reasonable alternatives of a similar magnitude that will not make the State's fiscal condition worse.

The Civic Federation offers the following key findings on the Governor's proposed FY2013 budget:

- The budget results in an operating surplus of $163 million at the end of FY2013, but this result is based on underfunding projected Medicaid costs by $2.7 billion;
- The Governor has proposed closing the $2.7 billion Medicaid funding gap by $1.38 billion of program changes, $675 million of reimbursement rate reductions for all healthcare providers (except doctors) and a $1 per pack cigarette tax increase that would raise $675 million (including federal reimbursements);
- General Funds pension-related costs, including State contributions and debt payments, total $6.6 billion in FY2013, or 22.1% of projected State-source General Funds revenues, and are expected to rise to 27.8% in FY2033;
- The Governor has proposed pension reforms designed to reduce the State's unfunded liability, reduce State contributions significantly over time and establish an actuarially sound funding plan;
- Unpaid bills accumulated from prior years are expected to total $9.1 billion at the end of FY2013, including General Funds bills ($5.5 billion), Medicaid bills ($1.9 billion), State group health insurance bills ($1.1 billion) and unpaid business tax refunds ($643 million);
- Net agency appropriations spent are projected at $24.3 billion in FY2013, virtually unchanged from FY2012;
- The FY2013 budget assumes reductions of $250 million in State group health insurance costs and does not provide for retiree health payments—totaling $90.9 and covered by continuing appropriations—for teachers and community college employees; and
- General operating revenues are expected to grow by $719 million, or 2.2%, to $33.9 billion in FY2013 but would have increased more if not for State tax incentives enacted in 2011 and federal tax changes that together reduced total revenues by $542 million.

The Civic Federation **supports** the following aspects of the Governor's FY2013 budget:

- The proposal to improve the financial stability of the State's five pension funds that is actuarially-based and includes shared sacrifice by taxpayers and employees;
- The proposal to reorganize the Medicaid program that is reasonable given the magnitude of the program's $2.7 billion shortfall for FY2013;

- The Governor's plans to close two State residential centers for the developmentally disabled and move willing residents to community settings, in line with federal law and the State's strategic plan; and
- Not relying on borrowing for operating costs, which the State cannot afford, as was proposed by the Governor in FY2012 and used to fund operations in FY2011 and FY2010.

The Federation has **concerns** about the following components of the Governor's spending plan:

- More detailed information is needed about the actuarial assumptions on which the savings projections of the Governor's pension proposal are based and the affordability of future contributions;
- More information is needed about the phase-in periods for various aspects of the Governor's pension plan, especially the transfer of pension normal costs for teachers and university employees to their employers;
- The savings projections for some aspects of the Governor's Medicaid proposal may be overly aggressive, particularly in light of the State's recent implementation history;
- In reducing reimbursement rates, special consideration should be given to safety net hospitals, which serve a large portion of uninsured and underinsured patients and rely heavily on Medicaid funding;
- The Governor's proposed budget is not expected to significantly reduce the State's backlog of unpaid bills from $9.2 billion projected for the end of FY2012; and
- The FY2013 capital budget book has not been published on the State's website and is not widely available for public review as of the date of this report.

The Civic Federation offers the following **recommendations** intended to improve the State's financial condition, institute sound management practices and reduce costs:

- The State should grant local school districts, universities and community colleges the authority to determine benefit levels for their employees;
- The State should conduct a six-month review of actual savings due to changes in the Medicaid program and make additional changes to the program if projected savings are not achieved;
- The State should require all retirees to pay premiums for health insurance, starting with members of the Judges' and General Assembly Retirement System, and should abolish any law or rule that allows retirees who live outside Illinois to pay lower premiums than retirees who live in Illinois for the same insurance coverage;
- Before further expansion of its capital program, the State should prepare and make publicly available a comprehensive capital improvement plan utilizing a needs-based prioritization for all capital investments to ensure effective and appropriate use is made of long-term capital funding resources; and
- The State should work to make similar reforms to the retirement systems that cover employees of the City of Chicago, its coordinate units of government and Cook County as those proposed by Governor Quinn for the five State funds.

## CIVIC FEDERATION POSITION

The Civic Federation **supports** Governor Pat Quinn's recommended FY2013 budget for the State of Illinois because it acknowledges the depth of the State's financial problems and advocates major structural reforms to put Illinois finances on the road to recovery.

The Civic Federation is **encouraged** that Governor Quinn has made a reasonable proposal to restructure the State's retirement systems by reducing unfunded liabilities and establishing an actuarially sound funding plan. The Civic Federation is also **encouraged** that the Governor has made a sensible proposal to reorganize the Medicaid program, in keeping with the magnitude of the program's problems.

After years of mismanagement, including borrowing to prop up operating spending and ignoring liabilities, the State is left with no easy answers for either pensions or Medicaid. The Governor's recommended changes will be painful and difficult to implement. However, the State **cannot afford continued inaction**. The Civic Federation calls on the General Assembly to adopt the Governor's plans or identify reasonable alternatives.

The Governor's recommended $57.4 billion operating budget for FY2013, including a general operating funds budget of $33.8 billion, results in a modest operating surplus, does not rely on borrowing and makes the State's full statutorily required pension contributions from General Funds.

It should be noted, however, that the operating surplus is based on underfunding the projected costs of the Medicaid program. It also is based on cost reductions in employee and retiree health insurance that have not yet been fully detailed. The Governor's reform proposal addresses Medicaid costs, but the Civic Federation is **concerned** that some of the estimated savings might be overly optimistic. Consideration should also be given to safety net hospitals, which serve the State's uninsured and underinsured citizens and might not be able to absorb the full brunt of the proposed rate cuts.

The Civic Federation is further **concerned** about the lack of information that has been made available about the Governor's pension reform proposal. More data are needed to confirm the projected savings estimates, understand the impact on annual State contributions and evaluate the phase-in periods for various changes.

Although the Governor's recommended FY2013 budget, combined with the plan to eliminate the $2.7 billion of underfunded Medicaid costs, would keep the State's backlog of bills from growing, the Civic Federation is **concerned** that the State will again end the year with a daunting total of approximately $9 billion in unpaid bills accumulated from previous years.

## Issues the Civic Federation Supports

The Civic Federation supports the following aspects of the Governor's FY2013 State of Illinois budget.

### *Governor's Pension Reform Proposal*

The State has underfunded its pension funds for decades, promising employees future benefits that it cannot afford to pay. The State's obligations under its current pension funding law, combined with debt payments on past borrowing for pensions, will consume more than 22% of State-source General Funds revenues in FY2013 and approximately 28% by FY2033. Yet if the State scales back its contributions and devotes more resources to current services, the pension funds face insolvency.

Public pensions should offer retirement security to employees and be affordable for taxpayers. The Governor's proposal for pension reform is designed to stabilize the State's retirement systems over the long term and includes shared sacrifice by both current employees and taxpayers. It appears to be a strong plan based on actuarial reality.

The proposal includes a 100% funding goal and follows actuarially-based best practices for pension funding. It includes a common sense rollback of an unaffordable benefit enhancement—the compounded automatic annual increase of 3%—as well as a phased-in increase in the retirement age to 67 and a three percentage point increase in workers' contributions.

The proposal offers employees a choice: those who decide to keep their current benefits would not be able to count future salary increases toward their pension benefits and would not receive a State subsidy for retiree health insurance. Currently, State retirees with 20 or more years of service do not have to pay any health insurance premiums; this generous benefit is currently enjoyed by approximately 91% of the State's retirees. Employees who choose the new plan can include future raises in their pension calculations and will continue to receive some State subsidy for their healthcare after retirement.

The proposal also includes a phased-in shifting of the normal cost (current service cost) for teachers and university employees to their employers: school districts, community colleges and universities. The Civic Federation agrees that the responsibility for contributing to a worker's pension should rest with the employer who determines the worker's salary. Our concern is how the transition will be achieved. Under the proposal, the State will continue to pay for reducing the unfunded pension liability relating to these workers.

### *Governor's Plan to Eliminate Medicaid Funding Gap*

The Governor's FY2013 budget recommendation leaves General Funds appropriations for Medicaid unchanged at the FY2012 level of $6.6 billion. This level is $2.7 billion below projected Medicaid costs. If the funding gap is not closed, unpaid Medicaid bills are expected to increase to $4.5 billion by the end of FY2013. Such a backlog of unpaid bills would increase payment delays to Medicaid service providers to 300 days. Facing such a long wait to be paid, healthcare providers would be unlikely to participate in the program.

Although it is unfortunate that the State allowed the Medicaid program to deteriorate to the brink of collapse, the Governor's proposal is a reasonable effort to restructure the program given the magnitude of the crisis. The State cannot simply accept the Governor's proposed FY2013 appropriation without cutting costs or increasing funding. Medicaid is an entitlement program, and insufficient appropriations do not reduce actual program costs. As the State learned in FY2012, budgeting too little for Medicaid simply causes unpaid bills to pile up.

The Governor's proposal eliminates the funding gap through a combination of program changes, reimbursement rate decreases for healthcare providers (excluding doctors) and resources from an increase in the State's cigarette tax. It would be unreasonable and would likely have unintended adverse consequences to cut $2.7 billion from the program in a single year. That amount represents nearly 23% of the $11.5 billion projected cost of the program in FY2013, excluding special funding agreements that are not subject to the cuts. Even the proposed level of program reductions will be painful and difficult to implement, although many represent cost control measures that should have been incorporated into the program years ago.

The Civic Federation calls on the General Assembly to adopt the Governor's proposal for Medicaid or identify other comparable combinations of cuts and revenues that are reasonable.

### *Governor's Initiatives to Move Disabled from Institutions to Community Settings*

The Civic Federation supports the Governor's plans to close two State residential centers for the developmentally disabled (one in FY2013 and the other in FY2014) and move willing residents to community settings. These plans are in line with federal law and with the Department of Human Services' strategic plan which calls for an acceleration of the State's placement of residents in community care settings to meet national benchmarks.[1]

Similarly, the Civic Federation supports the Governor's settlement of three federal lawsuits against the State for excessive use of institutions in caring for individuals who are developmentally disabled, physically disabled and mentally ill.[2] The FY2013 budget proposal includes appropriations to implement two of the settlement agreements.

## Civic Federation Concerns

The Civic Federation has the following concerns about the Governor's recommended FY2013 budget and related reform proposals.

### *Governor's Pension Reform Proposal*

Although the Civic Federation supports the direction of the Governor's pension reform proposal, more information is needed about the actuarial assumptions on which the proposal's savings projections are based. It is important to understand why the range of projected savings—$65 billion to $85 billion—is so wide and how projected savings are affected by employees' decisions on whether to stay in the existing benefit program.

[1] Illinois Department of Human Services, Division of Developmental Disabilities, *Strategic Plan FY2011-2017*, June 11, 2010.

[2] Williams v. Quinn, No. 05-4673 (N.D. Ill. filed August 15, 2005); Colbert v. Quinn, No. 07-4737 (N.D. Ill. filed August 22, 2007); Ligas v. Hamos, No. 05-4331 (N.D. Ill. filed July 28, 2005).

A comprehensive analysis of the proposal's affordability would require information on what the State's contributions would be under an actuarially sound framework. Other details that are not determined or publicly available include how the increased retirement age will be phased in over time and whether employees who choose the new plan will have the same retiree health insurance benefits as current retirees or reduced benefits.

Another concern involves shifting the normal costs for teachers and university employees to their employers. Although the Civic Federation supports this concept, any proposal should provide an adequate transition period to allow local school districts to handle the additional costs. Many school districts are in counties where property tax caps are in effect, limiting their ability to pay the additional pension costs from property tax increases.

The Governor's proposal does not affect existing retirees. It remains unclear, however, whether pension reform that does not reduce benefits for existing retirees can result in a plan that is affordable over the long term for the State. This question is particularly important in light of reports of a significant increase in State employee retirements in FY2012. [3]

### *Governor's Proposal to Eliminate the Medicaid Funding Gap*

While supporting the Governor's Medicaid proposal, the Civic Federation is concerned that some of the savings projections might be overly optimistic. For example, the largest single projected program saving, at $250 million, comes from shifting coverage for children with complex medical conditions to private insurers. This is a large cost shift that will likely face strong opposition and be difficult to implement. Due to lack of data, it remains to be seen whether savings of $120 million can be realized by removing ineligible recipients from the Medicaid rolls.

In reducing reimbursement rates, special consideration should be given to safety net hospitals, which serve a large portion of uninsured and underinsured patients. Hospitals with many commercially-insured patients are able to shift costs to private insurers, but safety net hospitals rely on Medicaid to help cover their costs.

### *Backlog of Unpaid Bills from Previous Years*

Due to Medicaid appropriations lower than actual program costs in previous years, the State is expected to have a total of $1.9 billion in unpaid Medicaid bills at the end of FY2012. If the Governor's Medicaid proposal successfully eliminates the $2.7 billion in underfunded program costs in FY2013, it would prevent the backlog of Medicaid bills from growing. However, the Medicaid proposal does not include provisions to pay down the existing $1.9 billion backlog of Medicaid related bills, which would cost the State approximately $930 million after accounting for federal reimbursements.

The State is expected to have a backlog of bills from previous years totaling $9.2 billion at the end of FY2012, including $1.9 billion in Medicaid bills, $5.7 billion in unpaid General Funds bills, approximately $643 million in unpaid tax refunds and $1.1 billion in State group health bills.

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[3] Kurt Erickson, "Big spike seen in Illinois worker retirements," *Quad-City Times*, April 12, 2012.

The Governor's recommended budget for FY2013 results in a surplus of $163 million to be applied to the accumulated General Funds deficit. This is less than a 2% reduction in the backlog of bills. If used for Medicaid bills, this surplus could pay down the backlog by $326 million, after accounting for federal reimbursements, but would still amount to a reduction in unpaid bills of less than 4% by the end of FY2013.

Because of the bill backlog, the delay in State payments to vendors, local governments and other service providers has been over 100 days for more than three fiscal years and ballooned to up to 6 months in the start of FY2011 and FY2012 as the lapse period was extended to cope with the accumulated deficits. The delay in Medicaid payments related to the backlog of unpaid bills is expected to grow to 120 days by the end of FY2012.

If the State wishes to reduce its backlog of unpaid bills, it has two options: additional budget cuts or revenue increases. Borrowing to pay down these bills is not a viable option due to 1) the lack of available resources in the budget to pay for debt service and 2) the fact that State revenues will fall sharply in just a year and a half after the end of FY2013 due to the partial sunset of the State's income tax increases. Significant additional budget cuts would be difficult, given the spending reductions already under consideration.

Eliminating the State's existing exclusion of most retirement income from taxation is a revenue source of the magnitude required to reduce this backlog significantly. In the past, the Civic Federation has urged Illinois to bring its policy with respect to the taxation of retirement income in line with that of other states. Among the 41 states with individual income taxes, Illinois is one of only three that broadly exempts retirement income from taxation.[4] Illinois excludes from taxation virtually all retirement income, including Social Security benefits, government disability payments and income from qualified employee benefit plans and Individual Retirement Accounts.[5]

Revenue forgone by not taxing retirement income was Illinois' second largest tax expenditure in FY2010.[6] Illinois' population of senior citizens is expected to reach 2.9 million in 2030, up 73.9% from 1.7 million in 2010, leading to a continued increase in the expense of providing this tax exemption.[7] If the State taxed retirement income in the same manner as the federal government, it would collect an additional $1.7 billion to $1.8 billion at the current personal income tax rate of 5.0%, according to estimates by the Illinois Department of Revenue.[8]

If these additional revenues were available in FY2013, the State could eliminate the backlog of Medicaid bills, which are expected to total $1.9 billion and would cost the State roughly $930 million to pay down after accounting for federal reimbursements. Additional reduction in

[4] Ronald Snell, National Conference of State Legislatures, *State Personal Income Taxes on Pensions & Retirement Income: Tax Year 2010*, February 2011. Ten states offer exclusions for all state and local government pension income: Alabama, Hawaii, Illinois, Kansas, Louisiana, Massachusetts, Michigan, Mississippi, New York and Pennsylvania. Two of the ten—Kansas and Massachusetts—do not exclude any private-sector income. Louisiana, Michigan and New York cap the private-sector exclusion. Alabama excludes income from defined benefit plans and Hawaii excludes income from contributory plans. Of the remaining three, Illinois and Mississippi exclude income from all plans defined by the Internal Revenue Service as qualified plans and Pennsylvania allows a full exclusion.

[5] Illinois Department of Revenue, *Publication 120: Retirement Income*, October 2005. A qualified employee benefit plan is defined in Internal Revenue Code Sections 402 through 408.

[6] Illinois State Comptroller, *FY2010 Tax Expenditure Report*, August, 2011, p. 7.

[7] Illinois State Comptroller, *FY2010 Tax Expenditure Report*, August, 2011, p. 7.

[8] Email communication between the Civic Federation and the Illinois Department of Revenue, April 11, 2012.

General Funds bills of nearly $1 billion in FY2013 could also be achieved. In all the total backlog of bills could be reduced by more than 30% with the addition of these revenues.

To achieve the same result through cuts alone would require an across-the-board reduction of nearly 11% in agency budgets, excluding Medicaid and State group insurance.

### *Reauthorizing and Expanding the Capital Budget*

The Governor's FY2013 capital budget recommends total appropriations of $24.9 billion. This includes the reauthorization of $19.8 billion in spending approved in previous years and $5.0 billion in new project funding.

However, the FY2013 capital budget book has not been published on the Governor's website or the State's budget website as of the publication of this report. A list of nearly 5,000 capital expenditures has been posted online and a capital budget book for FY2013 was circulated on compact disk the day of the Governor's budget address but it has not been made widely available to the public through online publication like the operating budget and may still be subject to change.

The Civic Federation opposed the Governor's proposed $31-billion *Illinois Jobs Now!* capital spending program prior to its enactment in FY2010 because it was not based on a comprehensive capital improvement plan (CIP) and was unaffordable over time. However, the General Assembly passed a capital budget in FY2010 based on the Governor's proposal. In FY2012 the State reauthorized the capital budget totaling $24.2 billion in unspent appropriations but did not approve an additional $2.6 billion in new spending proposed by the Governor.

In FY2013 the Governor proposes $3.0 billion in new bond-funded capital programs for additional school projects, waste water and State facilities. These new projects are bond financed with no new source of revenue to support the borrowing costs.

The Civic Federation recognizes the need for infrastructure investment in Illinois to maintain State-owned assets for the safety of residents and to ensure a vital state economy. However, the Federation cannot support capital spending that is not directly linked to a comprehensive CIP and supported by reliable revenue resources. The Civic Federation opposes the reauthorization of the debt-funded portion of the capital budget and the increase in debt-funded spending until the State establishes a transparent and needs-based CIP for all capital spending.

The Governor's recommendation does not indicate a prioritization of projects or articulate when projects approved will receive funding. The largest portion of the capital funding, totaling $20.6 billion, is designated by purpose and is not tied to specific projects goals, cost estimates or completion timelines.

Additionally, the revenues passed in FY2010 to support the new capital borrowing appear insufficient to support long-term debt service needs. The revenue for the capital bill included an increase in vehicle and license fees, expanding the sales tax to candy, sweetened beverages and some personal hygiene products, a lease of the marketing operations for the state lottery, increased taxes on alcoholic beverages and taxing legalized video poker.

Without the proper planning and transparency provided by a CIP, the residents of Illinois cannot be assured that the *Illinois Jobs Now!* program will properly address the capital needs of the State. At the same time, the new proposed capital debt levels combined with the recent sizable increases in pension-related debt will severely limit any further capital borrowing for decades to come. Citizens of Illinois deserve a concrete multi-year plan before being asked to support a capital plan that is based on an extremely high level of indebtedness and higher fees and taxes.

## Civic Federation Recommendations

The Civic Federation also offers the following recommendations for the FY2013 budget.

### *Additional Pension Reforms*

In addition to developing a reasonable plan for dealing with the transition of normal costs for non-State employees to their actual employers, the Civic Federation recommends that the General Assembly grant local school districts, universities and community colleges the authority to determine benefit levels for their employees. Employers should have responsibility for both pension funding and benefit decisions.

The Civic Federation also recommends that the General Assembly make similar reforms to the retirement systems that cover employees of the City of Chicago, its coordinate units of government and Cook County as those proposed by Governor Quinn for the five State funds. Recent events show that these reforms are essential. On April 26, 2012, Moody's Investor Services revised the outlook on the City's credit rating to negative from stable, citing the lack of a plan for improving funding levels and current inadequate pension contributions. [9] In response, Mayor Rahm Emanuel wrote a letter to General Assembly leaders urging quick action by the State to fix the City's pension problems.[10] Emanuel stated that without reforms Chicago would have to triple its current pension payments and impose a $1.4 billion property tax hike.

### *Medicaid Proposal Implementation Oversight*

The Civic Federation recommends that actual savings due to changes in the Medicaid program be closely monitored and that additional spending reductions be made if projected savings are not achieved. A review of the program changes by the Illinois Auditor General or another financial oversight body should be conducted halfway through the fiscal year.

A review is needed due to uncertainty surrounding the savings projections in the Governor's proposal. It remains to be seen, for example, how much the State can save by removing ineligible recipients from the Medicaid rolls. If savings projections are overly optimistic, then the proposed changes will not close the funding gap and unpaid Medicaid bills will continue to grow.

### *State Retiree Health Insurance*

The Civic Federation has repeatedly recommended that all State retirees be required to share the cost of their health insurance premiums. The Federation also supports abolishing any law or rule that allows retirees who live outside Illinois to pay lower premiums than retirees who live in Illinois for the same insurance coverage.

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[9] Reuters, "Pension issues cloud Moody's outlook for Chicago," *Chicago Tribune*, April 26, 2012.
[10] Yvette Shields, "Pensions Risk Chicago's Aa3 Rating, Moody's Says," *Bond Buyer*, April 27, 2012.

The State pays the entire bill for health insurance premiums for approximately 91% of retirees in the State group health insurance program.[11] Under Illinois law, employees who retired before January 1, 1998 and those who retired after that date with at least 20 years of service do not pay healthcare premiums. Exceptions include General Assembly members, who can retire with as few as four years of service and not pay any premiums, and judges, who can retire with as few as six years of service and not pay premiums.

In FY2012 64.9% of retirees participated in the State's traditional insurance plan, rather than in a less costly managed care plans.[12] The State's cost for retiree health insurance coverage in FY2012 was estimated at $684.3 million, while retirees' contribution was estimated at $25.8 million.[13]

The State also makes contributions for retiree health insurance to separate programs that cover retired teachers outside Chicago and downstate retired community college employees. Unlike most retirees in the State group health program, these retirees are required to pay premiums.

The proposed FY2013 budget assumes a reduction of approximately $250 million in the State's General Funds costs for state group health insurance. The budget includes no health insurance funding for retired teachers and community college employees, although these payments are covered by continuing appropriations.

The Governor has provided few details on his plans for retiree health insurance, except to indicate that retiree health costs are under discussion in ongoing labor negotiations and discussions about pension reform. Under the Governor's pension reform proposal, employees who do not choose a new, reduced benefit plan would no longer receive a State subsidy for retiree health insurance. It is not clear whether employees who choose the new plan would receive the existing subsidy or a lower subsidy.

### *Capital Improvement Plan*

Before reauthorizing or expanding the State's capital budget, the Civic Federation urges the State to establish a comprehensive capital improvement plan (CIP) that is updated and published annually. The citizens of Illinois deserve to know the overall condition and maintenance needs of all State-owned assets and how projects in the capital budget are prioritized to meet those needs.

Although a list of 5,000 appropriations accompanies the capital budget document, no planning documents are available to explain the prioritization of projects or estimates of total capital needs for the State. Very little has been publicized about the selection of projects approved in FY2010 or the new projects added in FY2012. Although the capital budget book describes a process coordinated by the Capital Development Board and the Governor's Office of Management and Budget to assemble and prioritize the projects in the capital program, no documentation of the process or final ranking of projects was included the budget. Some of the important elements of a CIP missing from the Governor's proposed capital budget include:

[11] Commission on Government Forecasting and Accountability, *Request for Proposals to Provide Consulting Services*, February 17, 2011, p. 2.
[12] Commission on Government Forecasting and Accountability, *Liabilities of the State Employees' Group Health Insurance Program FY2013*, March 2012, p. 8.
[13] Commission on Government Forecasting and Accountability, *Liabilities of the State Employees' Group Health Insurance Program FY2013*, March 2012, p. 13.

- A comprehensive inventory of all state owned assets, with description of useful life and current condition;
- A five-year summary list of all projects and expenditures per project as well as funding sources per project;
- Criteria for projects to earn funding in the capital budget, including a description of an objective and needs-based prioritization process;
- Information about the impact of capital spending on the annual operating budget of each project;
- Brief narrative descriptions of individual projects, including the purpose, need, history, and current status of each project; and
- Expected timeframe for completing each project and a plan for fulfilling overall capital priorities.

A well-organized and annually updated CIP ensures efficient and predictable execution of capital projects. The State's capital budgeting process should use a more transparent process of determining the specific goals of infrastructure investments and the availability of pay-as-you-go funding versus leveraging the bonding authority to complete projects.

### *Budget Document Improvements*

The State's annual budget document contains many useful features, but the Civic Federation recommends that its content be improved to provide readers with more information on the overall Medicaid budget, General Funds liabilities not included in the budget and personnel.

The budget document format provides a user guide for the reader, as well as a budget summary that outlines the policy goals and objectives for the fiscal plan. Both of these sections are well done and provide the public and policymakers with useful knowledge regarding the State's finances.

In FY2013 the budget document also includes a Budgeting for Results table, which shows all State appropriations organized by outcome and goals, rather than by agency. The table is intended to convey the State's policy priorities and objectives, the goals that are critical to achieving those outcomes and how agencies and programs fit into this framework. Although the State is still in the early stages of implementing outcome-based budgeting, this new table provides helpful information on how resources are used.

However, the budget is lacking in other critical areas, including its presentation of the overall Medicaid program. Medicaid involves several State agencies and has no single programmatic appropriation in the State budget. The Medicaid program in Illinois is administered primarily by the Illinois Department of Healthcare and Family Services (HFS), and the Medical Assistance program at HFS is often used as the best available approximation to the Medicaid program. Roughly $2 billion a year in Medicaid expenditures are made by other agencies, and a portion of the appropriations for HFS Medical Assistance program are outside of the Medicaid program. The Governor's Medicaid proposal actually involves only activities at HFS and not those in other agencies. The new Budgeting for Results table includes a healthcare-related outcome that approximates the overall Medicaid program, but more detailed information is needed.

The State's General Funds accounts payable are shown in budget tables, but other General Funds liabilities are not presented in any detail. These liabilities include Medicaid and employee group health bills that are paid from future years' appropriations and unpaid income tax refunds that accumulate in the Income Tax Refund Fund. These liabilities, which must be paid from future appropriations, represent a significant aspect of the State's financial condition and should be included in the budget. The State has begun to present detailed information about these other General Funds liabilities in documents issued in connection with bond sales; similar information should be provided in the budget.

The budget provides minimal information with regard to personnel. The only aggregate information on state personnel in the FY2013 budget document consists of a chart depicting employee headcount and an accompanying descriptive paragraph. Although the chart only contains headcount information for agencies under the Governor, it is not labeled to explain that personnel related to the constitutional offices, the General Assembly, the judicial branch and certain other agencies are excluded. The Governor's Office of Management and Budget (GOMB) does not include headcount for agencies not under the Governor because those headcounts reflect budget requests to the Governor and not the Governor's recommendations. The budget does not include any aggregate information on salary costs. As a result, it was necessary for the Civic Federation to base the personnel cost calculations in this report on data provided by the State in response to a request. The budget has no information on headcount or salary costs for General Assembly staff because this is not made available to Governor's Office of Management and Budget.

Personnel data should be aggregated in one section of the budget and include positions across all funds and for all departments. If necessary, separate tables should be provided for agencies under the Governor and agencies not under the Governor. The General Assembly should make headcount and salary cost information available to GOMB for inclusion in the budget.

### *Special Funds Consolidation*

The vast majority of the State's more than 600 Special State Funds were created to receive earmarked revenues that are only used for a designated purpose. Over time the number of special funds has increased, consuming ever larger portions of the state budget. In most cases, segregating revenues into special purpose funds is a practice that should only be adopted for certain high priority or mandatory programs. The Civic Federation recommends that the State's Special Funds be consolidated and/or eliminated except in those cases. The State should be afforded maximum flexibility in allocating resources to meet policy priorities.

## INTRODUCTION

The State of Illinois faces grave challenges as it prepares an operating budget for Fiscal Year 2013.[14] Temporary income tax increases enacted in January 2011[15] averted financial disaster, but major underlying problems continue to threaten the State's financial stability.

One of those problems—a staggering backlog of unpaid bills—stems directly from the national economic recession that began in December 2007 and officially ended in June 2009.[16] Confronted with sharply reduced revenues due to the recession, the State managed its cash shortages by delaying payments to vendors, local governments, school districts and universities. Billions of dollars of unpaid bills are still being rolled from one fiscal year to the next, and the tax increases have not provided enough resources to reduce the backlog.

Illinois' biggest financial problems, however, cannot be attributed to the recent economic downturn. Long before the recession began, the State had set the stage for unsustainable growth in pension and Medicaid expenses. Illinois did not properly fund the pension benefits that were promised to employees and expanded eligibility for the Medicaid program without regard to how the enrollment growth would be funded.

Unfortunately, the budget does not provide a complete picture of these costs.[17] The Illinois Constitution requires that the State enact a balanced budget, meaning that proposed spending should not exceed projected resources.[18] Nevertheless, the State has developed techniques to defer pension and Medicaid payments, thus creating the appearance of budgetary balance despite the existence of liabilities that will have to be addressed in the future.

In his budget speech on February 22, 2012, Governor Pat Quinn acknowledged that the State's most pressing challenges involved pension and Medicaid liabilities not fully reflected in the budget.[19] The Governor subsequently announced proposals designed to reduce pension and Medicaid costs.[20]

[14] The State's fiscal year begins on July 1 and ends on June 30.
[15] Public Act 96-1496.
[16] National Bureau of Economic Research, "US Business Cycle Expansions and Contractions," September 20, 2010.
[17] For a detailed analysis of the State's fiscal crisis, see Illinois State Comptroller, "The State Fiscal Crisis—How Did We Get Here," *Fiscal Focus*, September 2011, pp. 4-12.
[18] Illinois Constitution, Article VIII, Section 2.
[19] Office of Governor Pat Quinn, *Fiscal Year 2013 Budget Address*, February 22, 2012, http://www2.illinois.gov/budget/Documents/Budget%20Book/FY%202013/FINAL%20FY13%20BUDGET%20SPEECH.pdf (last visited on April 22, 2012).
[20] Office of Governor Pat Quinn, "Governor Quinn Proposes Bold Plan to Stabilize the Public Pension System," *news release*, April 20, 2012, http://www.illinois.gov/PressReleases/ShowPressRelease.cfm?SubjectID=1&RecNum=10188 (last visited on April 20, 2012); Office of Governor Pat Quinn, *FY13 Medicaid Liability and Spending Reductions: Governor's Proposal to General Assembly*, April 19, 2012, http://www2.illinois.gov/gov/Documents/Medicaid/Medicaid%20Spending%20Reductions.pdf (last visited on April 19, 2012).

When he issued the pension proposal, the Governor referred to concerns by credit rating agencies about the size of the State's unfunded pension liability.[21] Rating agencies have also raised alarms about the State's backlog of unpaid bills.

Illinois currently has the lowest rated credit of all 50 states by Moody's Investor Services and is the second lowest rated state by Fitch and Standard & Poor's, ahead of California. Standard & Poor's has warned that it could downgrade Illinois' rating by more than one notch if the State does not address its financial problems.[22]

### Underfunded Pensions

The State's pension problems are relatively well known and longstanding.[23] State contributions to the five retirement systems declined sharply in FY1982 and FY1983 and increased only moderately through FY1995. At the end of FY1995, the total unfunded liability—pension obligations not covered by pension assets—totaled approximately $19.5 billion.[24]

The pension shortfall led the State to enact a 50-year pension funding plan that took effect in FY1996.[25] After a 15-year phase in period, the law required State contributions at a level percentage of payroll sufficient to achieve 90% funding by FY2045.

However, the funding plan and subsequently enacted changes deferred a large portion of the required contributions to later years. For most of the funding period, the law required contributions that were insufficient to keep the unfunded liability from growing.[26] As of June 30, 2011, the total unfunded liability was estimated at $83.1 billion.[27]

Most of the additional tax revenues due to the income tax increases in January 2011 were used to pay pension costs.[28] These costs include statutorily required State contributions and debt service on bonds issued in previous years to pay for pension contributions.

### Deferred Medicaid Bills

The total annual costs of Medicaid are not reflected in the State budget due to a provision of Section 25 of the State Finance Act that allows Medicaid costs to be paid from future years' appropriations.[29] In simple terms, this allows the State to hold down Medicaid appropriations

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[21] Office of Governor Pat Quinn, *What the Rating Agencies Say About Illinois*, April 20, 2012, http://www2.illinois.gov/gov/Documents/Pensions/What%20the%20Ratings%20Agencies%20Say%20About%20Illinois.pdf (last visited on April 27, 2012).

[22] Doug Finke, "Illinois faces financial struggle, S&P Suggests," *State Journal-Register*, March 12, 2012.

[23] See p. 52 of this report for more information on the State's retirement systems. For a detailed analysis of the State's pension problems, see Illinois State Comptroller, "Illinois State Pension Systems: A Challenging Position," *Fiscal Focus*, May 2011, pp. 4-9.

[24] Commission on Government Forecasting and Accountability, *Report on the 90% Funding Target of Public Act 88-0593*, January 2006, p. i. This statistic is based on the market value of assets.

[25] Public Act 88-0593.

[26] Governor's Office of Management and Budget, *Letter Concerning 90% Funding Ratio*, in Commission on Government Forecasting and Accountability, *Report on the 90% Funding Target of Public Act 88-0593*, January 2006, p. 25.

[27] Commission on Government Forecasting and Accountability, *Report on the Financial Condition of the Illinois State Retirement Systems as of June 30, 2011*, March 2012, p. 25.

[28] Illinois State FY2013 Budget, p. 2-3. Another $500 million was used to provide full funding for State group health insurance.

[29] 30 ILCS 105/25 (b-4).

below expected costs in order to help balance the budget. Meanwhile, Medicaid bills pile up outside the budget.

Deferring Medicaid bills does not appear to be a common practice among other states. In his budget speech, the Governor said that Illinois "is the only State that intentionally kicks its current Medicaid bills into future fiscal years."[30] The practice in Illinois goes back at least 20 years, according to the Illinois Department of Healthcare and Family Services.[31] In the current fiscal year, which ends on June 30, 2012, Medicaid costs in the general operating budget were underfunded by roughly $1.5 billion. The Governor's FY2013 budget leaves general operating funds appropriations for Medicaid unchanged from FY2012 at $6.6 billion, leading to a funding gap of $2.7 billion unless costs are reduced or revenues increased.[32]

In general, Section 25 of the State Finance Act requires that State bills from a given fiscal year must be paid with that same year's appropriations. The State has an additional period after the end of the fiscal year, known as the lapse period, during which bills can be processed and revenues from the next fiscal year may be used to pay for the current fiscal year's appropriations. The lapse period is usually two months but was extended to six months for FY2010 and FY2011 because of the large amount of unpaid bills.

However, that deadline does not apply to Medicaid bills, State employee health insurance claims and certain other State bills.[33] Under exceptions to Section 25, these liabilities can be paid from subsequent years' appropriations.

According to the Illinois Comptroller's Office, the Section 25 exception for Medicaid was initially used to help healthcare providers by allowing the State to pay bills that arrived or were processed after the end of the lapse period.[34] The provision then became a budgeting tool, allowing the State to mask budget deficits by appropriating an insufficient amount to cover Medicaid costs in one year, knowing that remaining bills could be paid in the next year.[35]

It is important to understand that simply reducing Medicaid appropriations will not reduce Medicaid costs. Medicaid is an entitlement program under which certain categories of low-income people who meet eligibility requirements are entitled to specified medical services. To reduce Medicaid costs would require reductions in program eligibility, benefits or reimbursement rates paid to healthcare providers such as hospitals, nursing homes and pharmacies.

[30] Office of Governor Pat Quinn, *Fiscal Year 2013 Budget Address*, February 22, 2012, http://www2.illinois.gov/budget/Documents/Budget%20Book/FY%202013/FINAL%20FY13%20BUDGET%20SPEECH.pdf (last visited on April 22, 2012).
[31] Illinois Department of Healthcare and Family Services (HFS), *Menu of Possible Options for Medicaid Liability and Spending Reductions*, February 22, 2012, p. 4.
[32] HFS, *Five Year Medical Assistance Budget Outlook*, March 2012.
[33] See p. 60 of this report for a discussion of State group health insurance.
[34] Illinois State Comptroller, "State Medicaid Programs Face Funding Challenges," *Fiscal Focus*, July 2008, p. 7.
[35] Medicaid reform legislation (Public Act 96-1501) enacted in January 2011 phases out the Section 25 by FY2021.

## REVENUES

Governor Pat Quinn's recommended FY2013 budget is based on total State revenues of $55.6 billion.[36] This includes $33.9 billion in General Funds revenues, which are the sources of funding that the Governor and General Assembly have the most discretion over during the annual appropriation process.[37] The remaining revenues are made up of designated funding used to support spending in the Other State Funds or federal grants for specific purposes outside of the General Funds budget.

The FY2013 revenue projections included in the Governor's budget are based on economic analysis from two private firms, IHS Global Insight and Moody's Economy.com. These firms provide an overview of national economic trends compared to Illinois' economy. The research is then reviewed by the Governor's Council of Economic Advisors, the Illinois Department of Revenue (IDOR), The Illinois Department of Employment Security (IDES) and the Governor's Office of Management and Budget (GOMB). Together these advisors and agencies use the projections for economic activity in the coming year to formulate State revenue projections. IDOR provides its own analysis of growth in wages and salaries and IDES provides an analysis of expected employment trends for the coming year.

In general, the FY2013 projections show marginal growth and are based on expectations of relatively slow economic recovery compared to the dramatic losses experienced during the recent global recession. Two of the key economic indicators used to project future State revenues include the State's unemployment outlook and more directly the anticipated change in total wages and salaries earned by workers in the State. IDES projections for total non-farm workforce anticipate growth of 1.3% for FY2012 and 1.5% in FY2013. IDOR projects that wages and salaries in Illinois will grow a total of 2.8% in FY2012 and 3.0% in FY2013. [38]

This section reviews and compares estimated FY2012 revenue and the Governor's projections for FY2013 revenue, focused primarily on General Funds revenues.

### General Funds Revenues

The majority of General Funds revenue sources that are used to pay for the State's regular operations are made up of personal income tax, corporate income tax and sales taxes. Together these sources make up 88% of total General Funds revenues.[39] Both income taxes and sales taxes are economically sensitive and declined dramatically during the recession that began in December 2007 and lasted until June 2009.[40] Total General Funds revenues declined by $2.3 billion from $29.7 billion in FY2008 to $27.4 billion in FY2010.[41] Although revenues began to stabilize and show marginal growth in FY2011, overall revenue projections remained weak when the State enacted its FY2011 budget. Total General Funds revenue in FY2011 was originally estimated to increase by approximately $268 million from FY2010 or just less than 1.0%.

[36] Illinois State FY2013 Budget, p. 2-62.
[37] Illinois State FY2013 Budget, p. 2-63.
[38] Illinois State FY2013 Budget, p. 3-4.
[39] Illinois State FY2013 Budget, p. 3-7.
[40] National Bureau of Economic Research, "US Business Cycle Expansions and Contractions," September 20, 2010.
[41] Illinois State Budgets: FY2009-FY2012.

### *Income Taxes*

On January 13, 2011, the State enacted temporary increases for both the personal and corporate income tax rates.[42] The corporate income tax rate was increased from 4.8% to 7.0% and the personal income tax rate was increased from 3.0% to 5.0%.[43] The rate increases, as enacted, are temporary and will partially sunset on January 1, 2015. The personal income tax rate declines from 5.0% to 3.75% and the corporate income tax rate will be reduced from 7.0% to 5.25%. Under the current law, the rates roll back again on January 1, 2025, when the personal income tax rate declines to 3.25% and the corporate rate returns to 4.8%.

Although total gross income tax receipts are well above the peak FY2008 level, this is only due to the higher rate. The gross receipts expected from the first 3 percentage points of the projected FY2013 personal income taxes total $10.3 billion compared to gross revenues of $11.2 billion in FY2008. The corporate income taxes anticipated from the first 4.8 percentage points are expected to bring in $2.0 billion in FY2013, compared to $2.2 billion in FY2008.

The following table shows the gross income tax receipts attributable to the original rates from FY2008 through FY2013 and the amounts due to the increased rates since FY2011.

**State of Illinois Gross Income Tax Receipts: FY2008-FY2013 (in $ millions)**

| Income Tax Increment | FY2008 | FY2009 | FY2010 | FY2011 | FY2012 (Est.) | FY2013 (Proj.) |
|---|---|---|---|---|---|---|
| Personal Base (3.0%) | $ 11,187 | $ 10,219 | $ 9,430 | $ 9,795 | $ 9,916 | $ 10,312 |
| Personal Increase (2.0%) | | | | $ 2,507 | $ 6,473 | $ 6,875 |
| **Total Personal Income Taxes** | **$ 11,187** | **$ 10,219** | **$ 9,430** | **$ 12,302** | **$ 16,389** | **$ 17,187** |
| Corporate Base (4.8%) | $ 2,201 | $ 2,073 | $ 1,649 | $ 2,106 | $ 1,971 | $ 2,030 |
| Corporate Increase (2.2%) | | | | $ 180 | $ 917 | $ 940 |
| **Total Corporate Income Taxes** | **$ 2,201** | **$ 2,073** | **$ 1,649** | **$ 2,286** | **$ 2,888** | **$ 2,970** |
| **Total Income Taxes (Gross)** | **$ 13,388** | **$ 12,292** | **$ 11,079** | **$ 14,588** | **$ 19,277** | **$ 20,157** |

Source: Illinois State FY2011 Budget, pp. 4-8, 9; Illinois State FY2013 Budget pp. 3-10, 3-11.

The breakdown of gross income tax revenues by rate in the table provides a clearer picture of the loss of income tax revenue the State experienced due to the economic downturn from FY2008 through FY2010 and the amount of State income tax revenues that are due to economic recovery versus the increased rate.

All gross income tax revenues are not available for General Funds expenditures. Income tax receipts are reduced by a transfer set aside to pay anticipated refunds owed by the State.[44] The gross income tax revenues estimated for FY2012 and projected for FY2013 are also affected by recent tax policy changes at the State and federal levels.

The State enacted a package of tax reductions for businesses and individuals in December 2011 that take effect in FY2013.[45] The tax changes include a reduction in corporate income tax liabilities for the CME Group, which operates the Chicago Mercantile Exchange and the Chicago Board of Trade. The legislation reduces the sales factors for the exchanges to 63.77% during FY2013 and will further reduce the rate to 27.54% during FY2014.[46] Previously all of the trades

[42] Public Act 96-1496.
[43] The State also collects Personal Property Replacement Tax from businesses in Illinois on behalf of local governments of 2.5%, which increases the total effective corporate tax rate to 9.5%.
[44] See page 10 for more details on the Income Tax Refund Fund.
[45] Public Acts 97-0636 and 97-0652.
[46] Public Act 97-0636.

made at the exchanges were considered Illinois sales and taxed at the full corporate tax rate of 7.0% by the State. By reducing the sales factor percentage, the State reduces the corporate income tax liability for CME. The Governor's recommended FY2013 budget reduces anticipated corporate income taxes by $43 million to account for this change.[47]

The State also granted the Sears Holdings Corporation an EDGE tax credit[48] expected to cost the State $15 million annually in order to ensure the company's headquarters remain in Illinois.[49] This loss is included in the FY2013 income tax projections. The General Assembly also approved the renewal of a special taxing district to reduce Sears' local property tax burden, but this provision does not affect State revenues.

The tax changes enacted include a partial reinstatement of the net operating loss (NOL) deduction for Illinois businesses. The State suspended the net operating loss deduction for businesses, other than Subchapter S corporations, through December 31, 2014 as part of the income tax increase in January 2011.[50] The NOL deduction allows businesses reporting a loss in total annual income to reduce future tax liabilities by their losses and spread the amounts out for up to 12 years. The deduction was reinstated but capped at $100,000 per year in the legislation enacted in December 2011.[51] The reinstatement of the rule does not take place until December 31, 2012 and is not expected to reduce State revenues in FY2012. The increase in corporate tax revenue attributed to the suspension of NOL is now projected to decline from $275 million in FY2012 to $232 million in FY2013 for a total loss in revenues of $43 million.

The Earned Income Tax Credit (EITC) is a federal program that allows low and moderate income workers to reduce their tax burden and receive tax refunds. Since January 1, 2000, Illinois has allowed individuals who qualify for the program to claim 5% of the federal credit toward their State income tax returns. The State increased this credit in Illinois to 7.5% in FY2012 and 10% in FY2013. The Governor's FY2013 budget does not include a loss of revenue for the FY2012 change but does reduce FY2013 income tax revenues by $56 million.[52]

The standard personal income tax deduction in Illinois was set at $2,000 on December 31, 2000. Public Act 97-0652 increases that amount to $2,050 in FY2013 and increases the exemption each year thereafter by the change in the Consumer Price Index for All Urban Areas to account for inflation. The increase in personal tax exemption is expected to cost the State an additional $30 million in FY2013.

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[47] Illinois State FY2013 Budget, p. 3-10.
[48] Illinois Department of Commerce and Economic Opportunity, "Economic Development For A Growing Economy Tax Credit Program (EDGE)," http://www.ildceo.net/dceo/Bureaus/Business_Development/Tax+Assistance/EDGE.htm (last visited April 15, 2012).
[49] Public Act 97-0636.
[50] Public Act 96-1496.
[51] Public Act 97-0636.
[52] Illinois State FY2013 Budget, p. 3-10.

The following table shows the effect of the tax policy changes enacted at the end of the fall veto session in December 2011 and the estimated reduction in revenues due to a change in federal rules for depreciation of capital assets.

| State of Illinois FY2013 Tax Policy Changes (in $ millions) | |
|---|---|
| **Public Act 97-0636** | |
| **Description** | **FY2013** |
| CME Sales Factor Change* | $ (43) |
| Live Theater Production Credit | $ (2) |
| Net Operating Loss Deduction** | $ (43) |
| EDGE Tax Credits | $ (15) |
| **Subtotal Public Act 97-0636** | **$ (103)** |
| **Public Act 97-0652** | |
| EITC | $ (56) |
| Personal Exemption Increase | $ (30) |
| **Subtotal Public Act 97-0652** | **$ (86)** |
| **Other** | |
| **Federal Bonus Depreciation** | **$ (353)** |
| **Total Changes** | **$ (542)** |

*CME Sales Factor is reduced to 63.77% for the 2013 calendar year and then 27.54% thereafter.

**Net Operating Loss Deduction was suspended completely by Public Act 96-1496 but is now capped at $100,000 through December 31, 2014 and then is fully reinstated under Public Act 97-0636.

Source: Illinois State FY2013 Budget, pp. 3-10, 3-11.

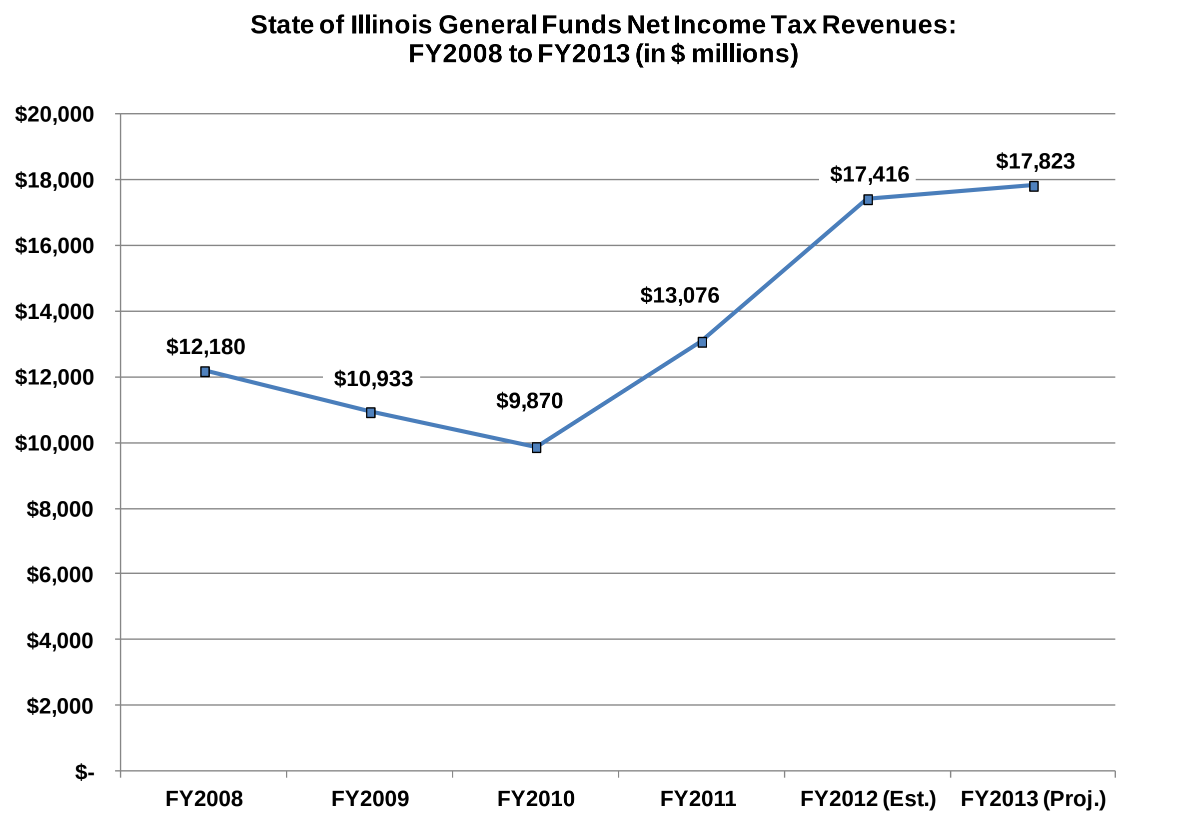
The largest loss of revenue due to tax policy changes in FY2012 and FY2013 is attributable to federal bonus depreciation, also referred to as 100% expensing. The U.S. Congress enacted a change to federal corporate tax depreciation provisions at the end of calendar year 2010 that is expected to offset a significant amount of the growth in State income tax revenues for FY2012 and FY2013.[53] This federal tax incentive allows an upfront deduction from annual taxable income for the cost of capital investments in machinery or equipment used for business purposes. The amount of income that is taxable in Illinois conforms to the federal tax code, so the State also experiences reduced income taxes associated with the change in this rule. The bonus depreciation benefit was included as part of a package of tax cuts added to a bill to extend unemployment payments for individuals whose benefits were set to expire at the end of 2010.[54] The change allows businesses to deduct 100% of the cost of equipment and machinery purchased and put into operation between September 8, 2010 and December 31, 2011. In the 2012 calendar year, the law allows businesses to continue to reduce their taxable income but only by 50% of the cost of capital equipment purchases. Normally businesses must spread out depreciation of their capital investments incrementally over the entire useable life of the equipment. Bonus depreciation was previously enacted at the federal level in 2003 for 30% of the cost of capital equipment investments and in 2005 and subsequent years for 50% of the cost.

Illinois enacted legislation decoupling from both the 30% and the 50% bonus depreciation. However, as written the decoupling statute does not apply to the 100% bonus depreciation because it specifically instructs only corporations that have taken the 50% bonus depreciation

[53] Illinois State FY2012 Budget, p. 5-15.
[54] Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, House Resolution 4853, 111th Congress (2009-2010).

deduction to add the amounts back into their taxable income for their Illinois tax filing.[55] Although the Governor recommended decoupling from the 100% bonus depreciation as part of the FY2012 budget, the legislature did not take action on the change. State income tax receipts are expected to decline by $570 million in FY2012 and $353 million in FY2013 due to this federal incentive.[56]

After accounting for these tax policy changes and subtracting amounts set aside to pay for refunds, total net income tax revenues are $17.8 billion in FY2013, compared to the gross total of $20.2 billion. Total net revenues from income taxes in FY2013 are expected to grow by 2.3% from FY2012. The following chart shows net income tax revenues from the peak in FY2008 prior to the recession through the projected FY2013 budget.



Source: Illinois State FY2013 Budget, pp. 3-10, 3-11; Illinois State FY2012 Budget p. 5-13, 5-14.

### *Sales Taxes*

The second largest source of General Funds revenues collected by the State on an annual basis are sales taxes. The State taxes the sale of tangible personal property at a rate of 6.25%; however the State keeps only 5.0% of the purchase price while 1.25% is passed on to local governments.[57]

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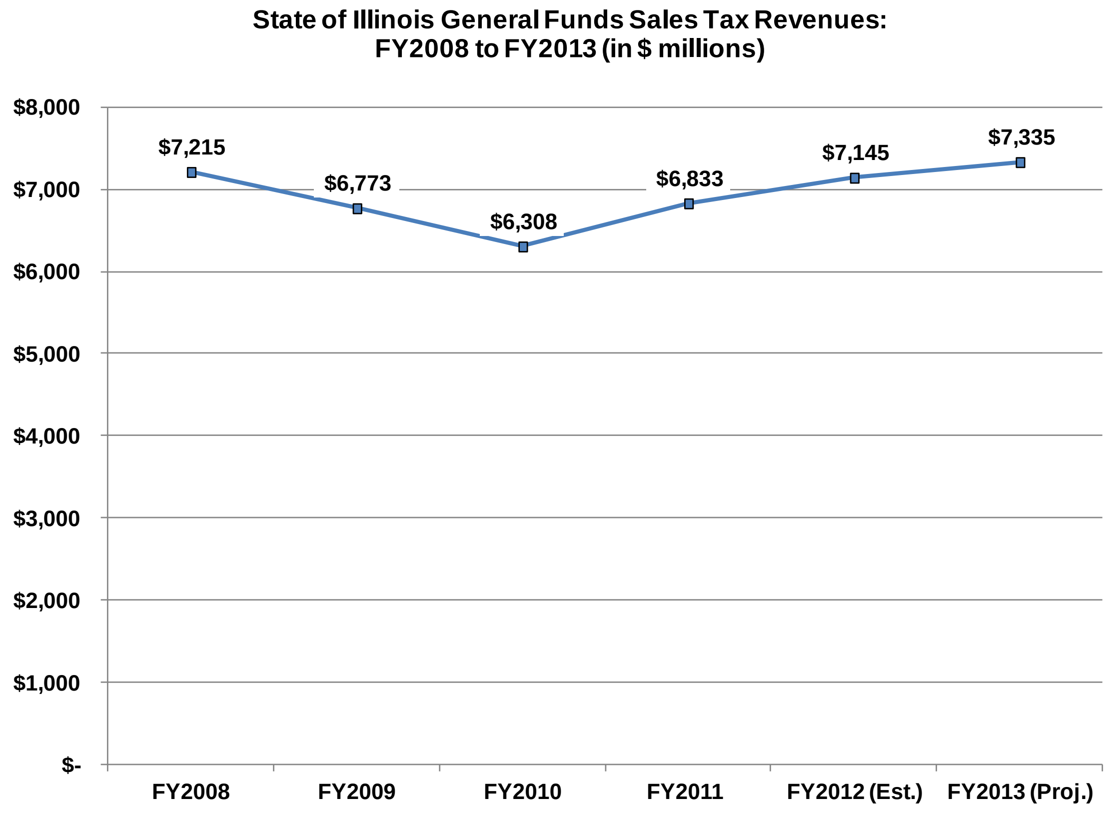
[55] Public Act 96-932.
[56] Illinois State FY2013 Budget, pp. 3-10, 3-11.
[57] For goods other than food and drugs, Illinois law also authorizes local governments to impose sales taxes, subject to certain limits on rates. Home rule units may tax in increments of 0.25% with no statutory limit. Non-home rule municipalities may impose sales taxes of 0.25%, 0.50%, 0.75% or 1.0% for property tax relief or public infrastructure. The State collects a 1% tax on sales of food for consumption off the premises, drugs and medical appliances; the tax is distributed to counties and municipalities. Chicago is authorized to levy a tax on soft drinks,

The State sales tax rate has remained the same since 1990, when the additional share for local governments was added to the State rate of 5.0%.[58]

Despite significant revenue losses during the economic downturn the State did not alter the sales tax rate. Total sales tax revenues declined from $7.2 billion in FY2008 to $6.3 billion FY2010. In FY2013 sales taxes are projected to total $7.3 billion, an increase of $190 million, or 2.7%, from the estimated FY2012 total of $7.1 billion. The FY2013 projections mark the first year since the recession that sales tax revenues are expected to exceed FY2008 levels.[59]

The following chart shows General Funds sales tax revenues from FY2008 through the budget projections for FY2013.



Source: Illinois State FY2013 Budget, p. 3-12; Illinois State FY2012 Budget p. 5-15.

which the State collects, and the State collects sales taxes on food and drugs for three transit districts across the State, including the Regional Transportation Authority in Northeast Illinois.

[58] Commission on Government Forecasting and Accountability, *Sales Taxes in Illinois*, May 2010, p. 2.

[59] Illinois State FY3013 Budget p. 5-15.

### *Total FY2012 Estimates and FY2013 Projections*

The Governor's proposed budget for FY2013 projects that total General Funds revenues will increase by $719 million, or 2.2%, to $33.9 billion from $33.2 billion in FY2012.[60] The majority of this increase takes place in projected State taxes, which increase by $618 million to $28.2 billion in FY2013 from $27.6 billion in FY2012.

Transfers to the General Funds from other State sources including lottery, riverboat gaming and other proceeds are expected to decline slightly by $29 million to $1.8 billion. The decline in State transfers is mostly due to the FY2012 transfer from the sale of the State's 10th casino license, which provided $73 million. The license sale proceeds only amount to $10 million in FY2013.[61]

Federal revenues that support General Funds spending increase by $130 million, or 3.4%, to $3.9 billion in FY2013 from $3.8 billion in FY2012.[62] The increase is attributable to additional reimbursements for the State's Medicaid program, which increase from $3.3 billion to $3.4 billion.[63] The federal government generally reimburses State Medicaid spending at a rate of 50%.

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[60] Illinois State FY2013 Budget, p. 2-63.
[61] Illinois State FY2013 Budget, p. 2-63.
[62] Illinois State FY2013 Budget, p. 3-19.
[63] See page 43 of this report for more details on Medicaid.

The following table shows total General Fund revenue estimates for FY2012 compared to the Governor's projections for FY2013.

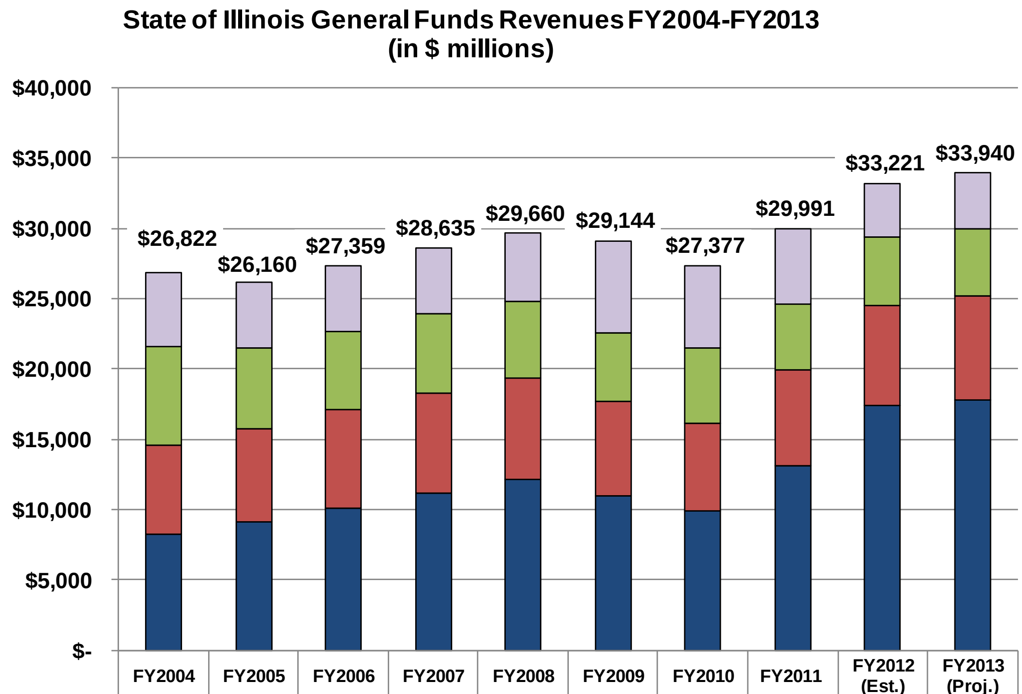
| State of Illinois General Funds Revenues: Estimated FY2012 and Projected FY2013 (in $ millions) | FY2012 (Est.) | FY2013 (Proj.) | $ Change | % Change |
|---|---|---|---|---|
| **State Taxes** | | | | |
| Income Taxes (net) | $ 17,416 | $ 17,823 | $ 407 | 2.3% |
| Personal Income Tax (net) | $ 15,062 | $ 15,273 | $ 211 | 1.4% |
| Corporate Income Tax (net) | $ 2,354 | $ 2,550 | $ 196 | 8.3% |
| Sales Taxes | $ 7,145 | $ 7,335 | $ 190 | 2.7% |
| Public Utility Taxes | $ 1,082 | $ 1,101 | $ 19 | 1.8% |
| Cigarette Tax | $ 355 | $ 355 | $ - | 0.0% |
| Liquor Gallonage Taxes | $ 162 | $ 163 | $ 1 | 0.6% |
| Vehicle Use Tax | $ 31 | $ 29 | $ (2) | -6.5% |
| Inheritance Tax | $ 215 | $ 242 | $ 27 | 12.6% |
| Insurance Taxes & Fees | $ 302 | $ 285 | $ (17) | -5.6% |
| Corporate Franchise Tax & Fees | $ 204 | $ 203 | $ (1) | -0.5% |
| Interest on State Funds & Investments | $ 20 | $ 20 | $ - | 0.0% |
| Cook County Intergovernmental Transfer | $ 244 | $ 244 | $ - | 0.0% |
| Other Sources | $ 411 | $ 405 | $ (6) | -1.5% |
| **Total State Taxes** | **$ 27,587** | **$ 28,205** | **$ 618** | **2.2%** |
| **Transfers** | | | $ - | |
| Lottery | $ 639 | $ 649 | $ 10 | 1.6% |
| Riverboat Transfers & Receipts | $ 339 | $ 350 | $ 11 | 3.2% |
| Proceeds From 10th Gaming License | $ 73 | $ 10 | $ (63) | -86.3% |
| Other | $ 778 | $ 791 | $ 13 | 1.7% |
| **Total Transfers** | **$ 1,829** | **$ 1,800** | **$ (29)** | **-1.6%** |
| **Federal Sources** | **$ 3,805** | **$ 3,935** | **$ 130** | **3.4%** |
| **Total Revenue** | **$ 33,221** | **$ 33,940** | **$ 719** | **2.2%** |

Source: Illinois State FY2013 Budget, p. 2-63.

Since the midyear enactment of the temporary State income tax increase in FY2011, total General Funds revenues have exceeded the level in FY2008, the last year prior to the economic recession.[64] The estimates in the Governor's proposed FY2013 budget show General Funds revenues increasing by $7.1 billion, or 26.5%, over the last 10 years. In FY2004 General Funds revenues totaled $26.8 billion, compared to the FY2013 projection of $33.9 billion.

[64] National Bureau of Economic Research, "Determination of the December 2007 Peak in Economic Activity," December 1, 2008.

The following chart shows General Funds revenues in nominal dollars by source of revenue between FY2004 and FY2013.




| | FY2004 | FY2005 | FY2006 | FY2007 | FY2008 | FY2009 | FY2010 | FY2011 | FY2012 (Est.) | FY2013 (Proj.) |
|---|---|---|---|---|---|---|---|---|---|---|
| Total | $26,822 | $26,160 | $27,359 | $28,635 | $29,660 | $29,144 | $27,377 | $29,991 | $33,221 | $33,940 |
| Federal | $5,189 | $4,691 | $4,725 | $4,702 | $4,815 | $6,567 | $5,920 | $5,386 | $3,805 | $3,935 |
| Other State Taxes and Transfers | $7,094 | $5,723 | $5,479 | $5,638 | $5,450 | $4,871 | $5,279 | $4,696 | $4,855 | $4,847 |
| Sales Taxes | $6,331 | $6,595 | $7,092 | $7,136 | $7,215 | $6,773 | $6,308 | $6,833 | $7,145 | $7,335 |
| Income Taxes | $8,208 | $9,151 | $10,063 | $11,159 | $12,180 | $10,933 | $9,870 | $13,076 | $17,416 | $17,823 |

Source: Illinois State Budgets FY2005-FY2013.

However, inflation as measured by the Consumer Price Index for all urban areas has grown by 22.4% between January 2004 and January 2012.[65] After adjusting for inflation, FY2004 General Funds revenue totaled $32.8 billion in 2012 dollars. This reduces the 10-year revenue increase in real dollars to $1.1 billion, or 3.4%.

## General Assembly Revenue Estimate

Since the publication of the Governor's budget on February 22, 2012, two other prominent revenue estimates have been published for FY2013. Each year the Commission on Government Forecasting and Accountability (COGFA), which serves as the General Assembly's bipartisan financial oversight body, releases its own revenue estimates for the coming fiscal year after the Governor's recommended budget is released. Also for the second year in a row the General Assembly has approved resolutions on the available General Funds resources as a first step in its budget deliberations.

The legislative projection for FY2013 was adopted by both chambers of the General Assembly in House Joint Resolution (HJR) 68. The measure states that the budget should be based on General Funds revenues totaling $33.7 billion in FY2013, which is $221 million less than the Governor's

[65] U.S. Department Of Labor, Bureau of Labor Statistics, CPI Detailed Report January 2012, p. 93, http://www.bls.gov/cpi/cpid1201.pdf (last visited on April 23, 2012).

projected total of $33.9 billion. The approved revenue projections are also $271 million less than the most recent projections published by COGFA. As shown in the table below, the estimate budgeted by COGFA totals $50 million more than the Governor's FY2013 projections.

In FY2012 the Senate and House based their appropriations on separate revenue projections, which were more than $1 billion apart, leading to some difficulty in consolidating their bills into one budget. The consensus revenue estimate between the chambers of the General Assembly is seen as an improvement over last year's budget process and was a recommendation of the Governor's Budgeting for Results Commission.[66]

The largest reduction in the revenue projections made by the General Assembly from the Governor's recommended FY2013 budget is a lower expectation for income taxes. Personal income tax revenues in the General Assembly's projections are $133 million lower than the Governor's and corporate income taxes revenues are $46 million lower.

The following table compares the revenue projections approved by the General Assembly (GA) to the estimates published by the Governor and COGFA for FY2013.

| State of Illinois FY2013 General Funds Revenue Projections (in $ millions) | | | |
|---|---|---|---|
| | **Governor** | **COGFA** | **GA** |
| **State Taxes** | | | |
| Personal Income Tax (net) | $ 15,273 | $ 15,233 | $ 15,140 |
| Corporate Income Tax (net) | $ 2,550 | $ 2,640 | $ 2,504 |
| Sales Taxes | $ 7,335 | $ 7,340 | $ 7,335 |
| Public Utility Taxes | $ 1,101 | $ 1,085 | $ 1,085 |
| Cigarette Tax | $ 355 | $ 355 | $ 355 |
| Liquor Gallonage Taxes | $ 163 | $ 162 | $ 162 |
| Vehicle Use Tax | $ 29 | $ 29 | $ 29 |
| Inheritance Tax | $ 242 | $ 230 | $ 230 |
| Insurance Taxes & Fees | $ 285 | $ 296 | $ 285 |
| Corporate Franchise Tax & Fees | $ 203 | $ 195 | $ 195 |
| Interest on State Funds & Investments | $ 20 | $ 20 | $ 20 |
| Cook County Intergovernmental Transfer | $ 244 | $ 244 | $ 244 |
| Other Sources | $ 405 | $ 400 | $ 400 |
| **Total State Taxes** | **$ 28,205** | **$ 28,229** | **$ 27,984** |
| **Transfers** | | | |
| Lottery | $ 649 | $ 655 | $ 649 |
| Riverboat Transfers & Receipts | $ 350 | $ 361 | $ 350 |
| Proceeds From 10th Gaming License | $ 10 | $ 10 | $ - |
| Other | $ 791 | $ 800 | $ 801 |
| **Total Transfers** | **$ 1,800** | **$ 1,826** | **$ 1,800** |
| **Federal Sources** | **$ 3,935** | **$ 3,935** | **$ 3,935** |
| **Total Revenue** | **$ 33,940** | **$ 33,990** | **$ 33,719** |

Source: Illinois State FY2013 Budget, p. 2-63; Commission on Government Forecasting and Accountability, *FY2013 Economic Forecast and Revenue Estimate and FY2012 Revenue Update* , February 28, 2012, p. 31; 97th Illinois General Assembly, House Joint Resolution 68.

According to the resolutions, both chambers will now proceed with crafting spending plans with expenditures that are not to exceed the approved revenue estimates.

[66] State of Illinois, *Budgeting for Results Commission Report*, November 2, 2011, p. 29.

The projections for FY2013 General Funds revenues approved by the General Assembly, although lower than COGFA and the Governor's budget, are $499 million more than the FY2012 total of $33.2 billion and represent a total increase of 1.5%. The largest year-to-year growth in State revenues is projected by the General Assembly for sales taxes, which increase by $190 million from $7.1 billion to $7.3 billion. As shown in the table above, the legislature's sales tax total matches the Governor's projection.

The General Assembly adopted a projection for personal income tax revenues totaling $15.1 billion, growing by only $79 million, or less than 1%, from FY2012. The legislature's projections for growth in corporate income tax revenues in FY2013 are more optimistic. Projections approved in the resolutions show an increase of $150 million, or 6.4%, from $2.3 billion in FY2012 to $2.5 billion in FY2013.

The following table compares the current projected revenues for FY2012 to the projections for FY2013 approved by the General Assembly.

| State of Illinois General Funds Revenue: FY2012 Estimates Compared to FY2013 General Assembly (GA) Projections (in $ millions) | | | | |
|---|---|---|---|---|
| | FY2012 (Est.) | FY2013 (GA Proj.) | $ Change | % Change |
| **State Taxes** | | | | |
| Personal Income Tax (net) | $ 15,061 | $ 15,140 | $ 79 | 0.5% |
| Corporate Income Tax (net) | $ 2,354 | $ 2,504 | $ 150 | 6.4% |
| Sales Taxes | $ 7,145 | $ 7,335 | $ 190 | 2.7% |
| Public Utility Taxes | $ 1,082 | $ 1,085 | $ 3 | 0.3% |
| Cigarette Tax | $ 355 | $ 355 | $ - | 0.0% |
| Liquor Gallonage Taxes | $ 162 | $ 162 | $ - | 0.0% |
| Vehicle Use Tax | $ 31 | $ 29 | $ (2) | -6.5% |
| Inheritance Tax | $ 215 | $ 230 | $ 15 | 7.0% |
| Insurance Taxes & Fees | $ 302 | $ 285 | $ (17) | -5.6% |
| Corporate Franchise Tax & Fees | $ 204 | $ 195 | $ (9) | -4.4% |
| Interest on State Funds & Investments | $ 20 | $ 20 | $ - | 0.0% |
| Cook County Intergovernmental Transfer | $ 244 | $ 244 | $ - | 0.0% |
| Other Sources | $ 411 | $ 400 | $ (11) | -2.7% |
| **Total State Taxes** | **$ 27,586** | **$ 27,984** | $ 398 | 1.4% |
| **Transfers** | | | $ - | |
| Lottery | $ 639 | $ 649 | $ 10 | 1.6% |
| Riverboat Transfers & Receipts | $ 339 | $ 350 | $ 11 | 3.2% |
| Proceeds From 10th Gaming License | $ 73 | $ - | $ (73) | -100.0% |
| Other | $ 778 | $ 801 | $ 23 | 3.0% |
| **Total Transfers** | **$ 1,829** | **$ 1,800** | $ (29) | -1.6% |
| **Federal Sources** | **$ 3,805** | **$ 3,935** | $ 130 | 3.4% |
| **Total Revenue** | **$ 33,220** | **$ 33,719** | **$ 499** | **1.5%** |

Source: Illinois State FY2013 Budget, p. 2-63; 97th Illinois General Assembly, House Joint Resolution 68.

## All Funds Revenues

General Funds revenues are the focus of State budget negotiations because they are the revenues over which the Governor and General Assembly have the most discretion. However, these funds make up just over half of the total All Funds revenues collected by the State. The Governor's FY2013 recommended budget projects total All Funds revenues in FY2013 of $55.6 billion. This is an increase of $899 billion, or 1.6%, over year-end estimates of All Funds revenues in FY2012 totaling $54.7 billion. The total revenues collected include state taxes, licensing fees, gaming revenues, lottery proceeds, intergovernmental transfers and federal funds. The funds that are outside of the General Funds budget are transfers to Special State Funds for designated purposes. These revenues represent earmarked funding for specific programs, capital projects, debt service and in some cases are collected on behalf of local governments.

State taxes account for $30.8 billion of the projected FY2013 All Funds revenues, which is an increase of $640 million over FY2012, or 2.1%. Other receipts from assessments and fees increase from $9.6 billion in FY2012 to $9.8 billion in FY2013. The State also receives significant funding from the federal government. Total Federal Funds, including amounts that are included in General Funds revenues, are projected to remain relatively flat, increasing by $94 million to $15.0 billion in FY2013 from $14.9 billion in FY2012.

The following chart compares All Funds revenue estimates for FY2012 to the projections for FY2013.

| State of Illinois Revenues for All Funds: Estimated FY2012 and Projected FY2013 (in $ millions) | | | | |
|---|---|---|---|---|
| | FY2012 (Est.) | FY2013 (Proj.) | $ Change | % Change |
| **State Taxes** | | | | |
| Income Taxes (net) | $ 17,416 | $ 17,823 | $ 407 | 2.3% |
| Individual | $ 15,062 | $ 15,273 | $ 211 | 1.4% |
| Corporate | $ 2,354 | $ 2,550 | $ 196 | 8.3% |
| Sales Taxes | $ 7,479 | $ 7,681 | $ 202 | 2.7% |
| Motor Fuel Tax (gross) | $ 1,315 | $ 1,325 | $ 10 | 0.8% |
| Public Utility Taxes | $ 1,791 | $ 1,823 | $ 32 | 1.8% |
| Cigarette Taxes and Tobacco Products Taxes | $ 553 | $ 543 | $ (10) | -1.8% |
| Liquor Gallonage Taxes | $ 277 | $ 279 | $ 2 | 0.7% |
| Inheritance Tax | $ 215 | $ 242 | $ 27 | 12.6% |
| Insurance Taxes and Fees | $ 414 | $ 384 | $ (30) | -7.2% |
| Corporate Franchise Taxes and Fees | $ 212 | $ 211 | $ (1) | -0.5% |
| Riverboat Gaming Taxes and Fees | $ 507 | $ 508 | $ 1 | 0.2% |
| **Subtotal State Taxes** | **$ 30,179** | **$ 30,819** | **$ 640** | **2.1%** |
| **Other Revenues** | | | | |
| Motor Vehicle and Operations License Fees | $ 817 | $ 820 | $ 3 | 0.4% |
| Interest Income | $ 34 | $ 34 | $ - | 0.0% |
| Revolving Fund Receipts | $ 583 | $ 575 | $ (8) | -1.4% |
| Lottery | $ 1,203 | $ 1,396 | $ 193 | 16.0% |
| Assessment Fund Receipts | $ 1,658 | $ 1,917 | $ 259 | 15.6% |
| Intergovernmental Receipts | $ 1,638 | $ 1,583 | $ (55) | -3.4% |
| Group Insurance Receipts | $ 1,878 | $ 1,365 | $ (513) | -27.3% |
| Tobacco Settlement Receipts | $ 141 | $ 120 | $ (21) | -14.9% |
| Other Taxes, Fees, Earnings and Net Transfers | $ 1,635 | $ 1,942 | $ 307 | 18.8% |
| **Subtotal Other Revenues** | **$ 9,587** | **$ 9,752** | **$ 165** | **1.7%** |
| **Federal Revenues** | **$ 14,943** | **$ 15,037** | **$ 94** | **0.6%** |
| **Total** | **$ 54,709** | **$ 55,608** | **$ 899** | **1.6%** |

Source: Illinois State FY2013 Budget, p. 2-62.

## Income Tax Refund Fund

Each year as part of the budget process the State sets aside a portion of business and personal income tax revenue to pay for anticipated refunds. These amounts are deposited into the Income Tax Refund Fund. To determine how much should be set aside each year, a separate Refund Fund rate is applied to personal income tax receipts and business income tax receipts.[67] Tax revenues are then reduced by this rate prior to the distribution of pass-through funding to local governments and the transfer of the remaining proceeds into the General Funds.

[67] The Refund Fund rate for businesses covers both the income tax and the Personal Property Replacement Tax (PPRT) on corporations and the PPRT on subchapter S corporations, partnerships and estates. Replacement taxes are revenues collected by the State and paid to local governments to replace money that was lost by local governments when their power to impose personal property taxes on corporations, partnerships and other business entities was rescinded pursuant to the 1970 Illinois Constitution.

All refunds, both personal and business, are paid out of the Income Tax Refund Fund. The Illinois Department of Revenue makes it a priority to pay personal income tax refunds to individuals, so when there is a shortfall in the fund, unpaid business refunds rise.

The higher the Refund Fund rate, the more money is deposited into the fund, resulting in less revenue available for the State's general operations. A higher rate also reduces the share of income taxes transferred to local governments. The rates are set by the Illinois General Assembly or can be set through a statutory formula that takes into account refunds from the prior year as well as income tax revenues from the prior year. The last time the rate was set using the formula was FY1998. Since then the rate has been specifically designated in budget legislation passed by the General Assembly and signed by the Governor.[68] If a high enough Refund Fund rate is not applied to the income tax receipts, then a backlog of unpaid refunds can occur.

The State experienced an increase in the backlog of unpaid refunds in FY2009 and FY2010. Approved but unpaid business refunds grew to $219.5 million at the end of FY2009 and increased to $734.5 million at the end of FY2010. Less than $1 million in business refunds were paid in FY2010; revenues deposited into the Refund Fund from business taxes were used to help pay personal refunds of $1.3 billion, according to revenue and expenditure data on the website of the Illinois Comptroller's Office.[69] Since then, the State has continued to carry a high level of unpaid refunds from year to year.

Despite the increased refund backlog in FY2010, the personal refund rate was reduced by statute to 8.75% in FY2011 from 9.75% in FY2010. The business refund rate remained unchanged at 17.5% in FY2011. Although the Governor's recommended FY2012 budget proposed reducing the business refund rate from 17.5% to 12.5%, the General Assembly continued to use the same rates as in FY2011. The backlog of unpaid business refunds had been expected to reach $1.4 billion by the end of FY2011.[70] However, the actual backlog ended up totaling only $645.5 million. It is believed that a change in behavior on the part of businesses that reduced income tax payments to avoid overpayment and used refunds owed to offset their future tax liabilities staved off much off that increase.[71]

As of April 24, 2012, the State reported the backlog of refunds totaled $642.5 million.[72] The Governor's proposed FY2013 budget includes an increase in the personal income tax refund rate from 8.75% to 9.75% and a decrease in the business income tax refund rate from 17.5% to 14.0%. This proposed change has been explained as a reaction to the tax policy changes made in December 2011, specifically to pay for additional refunds that are expected due to the increased personal exemption rate and the increase in the EITC.[73] The projected Refund Fund rates are not intended to address the current backlog of refunds and IDOR has not provided updated year-end projections for FY2012 or projections for the backlog in FY2013.[74]

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[68] Communication between the Civic Federation and the Department of Revenue's Senate legislative staff, April 25, 2011.

[69] Illinois State Comptroller's website, Expenditures Inquiry, https://www.wh1.ioc.state.il.us/?LINKSERVID=9BE42BFE-E0C7-3CE9-004A03EDB710F5B8 (last visited on April 26, 2012).

[70] State of Illinois $3.7 Billion General Obligation Bonds, *Preliminary Official Statement*, January 21, 2011, p. 30.

[71] Illinois State FY2012 Budget, pp. 3-11, 3-12.

[72] State of Illinois, General Obligation Refunding Bonds, Series May 2012, *Official Statement*, April 24, 2012, p. 41.

[73] See page Income Taxes for more information on the tax policy changes from December 2011.

[74] Testimony from IDOR before a joint meeting of the House Revenue and Finance Committee and Senate Revenue Committee, February 21, 2012.

The following chart shows the Refund Fund rates set by the General Assembly from FY2008 through FY2012 and the proposed rates in FY2013 compared to the known backlogs that occurred over the same period.

| State of Illinois Income Tax Refund Rates and Unpaid Tax Refunds: FY2008-FY2012 (in $ millions) | | | | |
|---|---|---|---|---|
| | **Personal Refund Rate** | **Unpaid Personal Refunds** | **Business Refund Rate** | **Unpaid Business Refunds*** |
| FY2008 | 7.75% | $ - | 15.50% | $ 3.5 |
| FY2009 | 9.75% | $ 5.0 | 17.50% | $ 214.0 |
| FY2010 | 9.75% | $ 44.0 | 17.50% | $ 691.0 |
| FY2011 | 8.75% | $ 19.0 | 17.50% | $ 627.0 |
| FY2012 | 8.75% | $ - | 17.50% | $ 642.5 |
| FY2013** | 9.75% | NA | 14.00% | NA |

*As of June 30 for FY2004-FY2011, as of April 24, 2012 for FY2012.

**FY2013 rates proposed by Governor.

Source: Illinois State FY2013 Budget, pp. 3-10 to 3-11; State of Illinois, General Obligation Refunding Bonds, Series of May 2012, *Preliminary Official Statement* , April 24, 2012, p. 41; Communication between Civic Federation and Illinois Department of Revenue, August 31, 2011.

## APPROPRIATIONS AND EXPENDITURES

Governor Quinn's FY2013 budget proposes total appropriations of $57.4 billion, including $29.9 billion in General Funds appropriations. Most discussion of the Illinois budget focuses on General Funds, which represent the largest component of the State budget. General Funds support the regular operating and administrative expenses of most agencies and are the funds over which the State has the most control and discretion. General Funds are funded by State revenues such as income and sales taxes, as well as federal revenues.

The budget also includes Other State Funds, which are accounts for activities funded by designated revenue sources that may only be used for specific purposes. The last broad category of state accounts is Federal Funds, which use federal revenues outside of the General Funds to support a variety of programs.

In addition to appropriations, this section also examines the Governor's proposed General Funds expenditures. Expenditures include appropriations and transfers out of General Funds to make debt payments and for other purposes.

### Appropriations by Fund

Total appropriations increase by $434 million, or 0.8%, to $57.4 billion in the Governor's proposed FY2013 budget from $57.0 billion in the FY2012 enacted budget. As shown in the table below, total appropriations increase by $3.6 billion, or 6.7% in the last five years, from $53.8 billion in FY2009.

| FY2009 Enacted - FY2013 Recommended (in $ millions) | | | | | | | |
|---|---|---|---|---|---|---|---|
| | FY2009 Enacted | FY2012 Enacted | FY2013 Rec. | 2-Year $ Change | 2-Year % Change | 5-Year $ Change | 5-Year % Change |
| General Funds | 30,283 | $ 29,353 | $ 29,918 | $ 565 | 1.9% | $ (365) | -1.2% |
| Other State Funds | 15,471 | $ 18,419 | $ 19,335 | $ 916 | 5.0% | $ 3,864 | 25.0% |
| Federal Funds | 8,037 | $ 9,204 | $ 8,157 | $ (1,047) | -11.4% | $ 120 | 1.5% |
| **Total** | **53,791** | **$ 56,976** | **$ 57,410** | **$ 434** | **0.8%** | **$ 3,619** | **6.7%** |

Source: Illinois State FY2013 Budget, p. 2-37; Illinois State FY2011 Budget, p. 2-26.

It is important to note that actual spending from Other State Funds and Federal Funds is often substantially below enacted appropriation levels. In FY2009, for example, actual spending from Other State Funds was $13.3 billion, compared with enacted appropriations of $15.5 billion; actual spending from Federal Funds was $4.5 billion, compared with enacted appropriations of $8.0 billion.[75] Expenditures may not reach the appropriated levels because the State enacts appropriation bills without knowing the precise level of funding that will be available or because the State must spend the money only for specific purposes and is not able to do so.

General Funds appropriations increase by 1.9% to $29.9 billion in the proposed FY2013 budget from $29.4 billion in FY2012. Over the five-year period, General Funds appropriations decline by 1.2% from $30.3 billion in FY2009.

[75] Illinois State FY2011 Budget, p. 2-26.

The next table highlights three components of General Funds appropriations: agency appropriations, pension contributions and state group insurance. Agency appropriations decline by $126 million, or 0.5%, from FY2012 and by 9.9%, or $2.6 billion, from FY2009. Agency appropriations were boosted in FY2009 by a supplemental appropriation designed to allow the State to take advantage of enhanced federal reimbursement for Medicaid spending available under the American Recovery and Reinvestment Act of 2009.[76] In contrast, the total cost of the Medicaid program is underfunded by an estimated $1.5 billion in FY2012 and $2.7 billion in FY2013.[77]

**State of Illinois General Funds Appropriations: FY2009 Enacted - FY2013 Recommended (in $ millions)**

| | FY2009 Enacted | FY2012 Enacted | FY2013 Rec. | 2-Year $ Change | 2-Year % Change | 5-Year $ Change | 5-Year % Change |
|---|---|---|---|---|---|---|---|
| Agency Appropriations | 26,244 | $ 23,783 | $ 23,657 | $ (126) | -0.5% | $ (2,587) | -9.9% |
| Pension Contributions | 2,486 | $ 4,134 | $ 5,090 | $ 956 | 23.1% | $ 2,604 | 104.7% |
| State Group Insurance | 1,058 | $ 1,436 | $ 1,171 | $ (265) | -18.5% | $ 113 | 10.7% |
| **Total** | **29,788** | **$ 29,353** | **$ 29,918** | **$ 565** | **1.9%** | **$ 130** | **0.4%** |

Source: Civic Federation calculations based on: Illinois State FY2013 Budget, pp. 2-18 to 2-19 and 2-29 to 2-37; Illinois State FY2011 Budget, pp. 2-10 and 2-17 to 2-26.

Despite lower agency appropriations, total General Funds appropriations increase due to higher pension contributions. Pension contributions increase by $956 million, or 23.1%, from FY2012 and by 104.7%, or $2.6 billion, from FY2009. Illinois' contributions to the five State retirement systems are determined by a law that requires 90% funding by FY2045.[78]

General Funds appropriations for State group insurance increase by $113 million, or 10.7%, from FY2009 but decline by $265 million, or 18.5%, from FY2012. The Governor's FY2013 budget assumes that State costs for group insurance will be reduced by roughly $250 million through labor negotiations and that unpaid insurance bills at the end of the year will increase by $71 million from FY2012.[79]

Actual General Funds agency appropriations are typically less than enacted agency appropriations because appropriations remain unspent at the end of the fiscal year. Appropriations remain unspent because insufficient funding is available or expenses do not reach budgeted levels. The level of unspent appropriations is not determined until the end of the fiscal year.

[76] State of Illinois, General Obligation Bonds, Taxable Series of February 2011, *Official Statement*, February 23, 2011, p. 15. The American Recovery and Reinvestment Act required that states pay bills owed to doctors, hospitals and nursing homes within 30 days. The supplemental appropriation was needed so that Illinois could pay off past-due bills.
[77] See p. 43 of this section for a detailed discussion of Medicaid.
[78] Public Act 88-0593. See p. 52 of this section for a detailed discussion of State pension systems.
[79] See p. 60 of this section for a detailed discussion of State group insurance.

The following table shows net agency appropriations, after deducting unspent appropriations. In this table, agency appropriations include group insurance and continuing appropriations.[80] Unspent appropriations are projected at $904 million in FY2012, compared with $500 million in FY2013. The increase in unspent appropriations in FY2012 is due to insufficient cash to fund authorized Medicaid spending.[81] Net agency appropriations spent are projected at $24.33 billion in FY2013, down $20 million from $24.35 billion in FY2012.

| State of Illinois General Funds Agency Appropriations Spent: FY2009- FY2013 (in $ millions) | | | | | | | |
|---|---|---|---|---|---|---|---|
| | FY2009 Actual | FY2012 Enacted | FY2013 Rec. | 2-Year $ Change | 2-Year % Change | 5-Year $ Change | 5-Year % Change |
| Agency Appropriations | $ 27,796 | $ 25,252 | $ 24,828 | $ (424) | -1.7% | $ (2,968) | -10.7% |
| Less Unspent Appropriations | $ (322) | $ (904) | $ (500) | $ 404 | -44.7% | $ (178) | 55.3% |
| **Net Agency Appropriations** | **$ 27,474** | **$ 24,348** | **$ 24,328** | **$ (20)** | **-0.1%** | **$ (3,146)** | **-11.5%** |

Source: Illinois State FY2013 Budget, pp. 2-18 to 2-19; Illinois State FY2011 Budget, p. 2-10.

[80] Continuing appropriations of $34 million are included in agency appropriations because the table is based on the Governor's spending plan, while previous tables are based on appropriations acted on by the General Assembly. Group insurance is included in agency appropriations for purposes of comparability with the Governor's spending plan.
[81] Email communication between the Civic Federation and the Governor's Office of Management and Budget, March 13, 2012.

## Appropriations by Agency

The following table shows enacted all funds appropriations for the ten largest state agencies, ranked according to the Governor's proposed FY2013 appropriations.

| State of Illinois All Funds Appropriations to Ten Largest Agencies: FY2009-FY2013 (in $ millions)* | | | | | | | |
|---|---|---|---|---|---|---|---|
| Agency | FY2009 Enacted | FY2012 Enacted | FY2013 Rec. | 2-Year $ Change | 2-Year % Change | 5-Year $ Change | 5-Year % Change |
| **Healthcare and Family Services** | **$ 14,149** | **$ 14,309** | **$ 14,688** | **$ 379** | **2.6%** | **$ 539** | **3.8%** |
| General Funds | $ 8,499 | $ 6,768 | $ 6,768 | $ - | 0.0% | $ (1,731) | -20.4% |
| Other State Funds | $ 5,514 | $ 7,191 | $ 7,571 | $ 380 | 5.3% | $ 2,057 | 37.3% |
| Federal Funds | $ 137 | $ 350 | $ 350 | $ - | 0.0% | $ 213 | 155.5% |
| **State Board of Education** | **$ 10,262** | **$ 10,398** | **$ 9,788** | **$ (610)** | **-5.9%** | **$ (474)** | **-4.6%** |
| General Funds | $ 7,445 | $ 6,750 | $ 6,782 | $ 32 | 0.5% | $ (663) | -8.9% |
| Other State Funds | $ 44 | $ 67 | $ 65 | $ (2) | -3.0% | $ 21 | 47.7% |
| Federal Funds | $ 2,774 | $ 3,581 | $ 2,941 | $ (640) | -17.9% | $ 167 | 6.0% |
| **Human Services** | **$ 6,029** | **$ 5,669** | **$ 5,864** | **$ 195** | **3.4%** | **$ (165)** | **-2.7%** |
| General Funds | $ 4,228 | $ 3,387 | $ 3,385 | $ (2) | -0.1% | $ (843) | -19.9% |
| Other State Funds | $ 520 | $ 562 | $ 808 | $ 246 | 43.8% | $ 288 | 55.4% |
| Federal Funds | $ 1,281 | $ 1,720 | $ 1,671 | $ (49) | -2.8% | $ 390 | 30.4% |
| **Transportation** | **$ 2,403** | **$ 2,670** | **$ 2,662** | **$ (8)** | **-0.3%** | **$ 259** | **10.8%** |
| General Funds | $ 32 | $ 21 | $ 19 | $ (2) | -9.5% | $ (13) | -40.6% |
| Other State Funds | $ 2,365 | $ 2,644 | $ 2,638 | $ (6) | -0.2% | $ 273 | 11.5% |
| Federal Funds | $ 5 | $ 5 | $ 5 | $ - | 0.0% | $ - | 0.0% |
| **Commerce and Economic Opportunity** | **$ 2,192** | **$ 1,983** | **$ 1,740** | **$ (243)** | **-12.3%** | **$ (452)** | **-20.6%** |
| General Funds | $ 63 | $ 32 | $ 31 | $ (1) | -3.1% | $ (32) | -50.8% |
| Other State Funds | $ 262 | $ 401 | $ 406 | $ 5 | 1.2% | $ 144 | 55.0% |
| Federal Funds | $ 1,868 | $ 1,550 | $ 1,302 | $ (248) | -16.0% | $ (566) | -30.3% |
| **Children and Family Services** | **$ 1,328** | **$ 1,260** | **$ 1,225** | **$ (35)** | **-2.8%** | **$ (103)** | **-7.8%** |
| General Funds | $ 865 | $ 813 | $ 768 | $ (45) | -5.5% | $ (97) | -11.2% |
| Other State Funds | $ 455 | $ 440 | $ 449 | $ 9 | 2.0% | $ (6) | -1.3% |
| Federal Funds | $ 8 | $ 8 | $ 8 | $ - | 0.0% | $ - | 0.0% |
| **Corrections** | **$ 1,464** | **$ 1,305** | **$ 1,196** | **$ (109)** | **-8.4%** | **$ (268)** | **-18.3%** |
| General Funds | $ 1,351 | $ 1,222 | $ 1,111 | $ (111) | -9.1% | $ (240) | -17.8% |
| Other State Funds | $ 113 | $ 83 | $ 86 | $ 3 | 3.6% | $ (27) | -23.9% |
| Federal Funds | $ - | $ - | $ - | $ - | na | $ - | na |
| **Lottery**** | **na** | **$ 949** | **$ 1,042** | **$ 93** | **9.8%** | **na** | **na** |
| General Funds | na | $ - | $ - | $ - | na | na | na |
| Other State Funds | na | $ 949 | $ 1,042 | $ 93 | 9.8% | na | na |
| Federal Funds | na | $ - | $ - | $ - | na | na | na |
| **Central Management Services** | **$ 938** | **$ 960** | **$ 977** | **$ 17** | **1.8%** | **$ 39** | **4.2%** |
| General Funds | $ 76 | $ 46 | $ 49 | $ 3 | 6.5% | $ (27) | -35.5% |
| Other State Funds | $ 862 | $ 894 | $ 928 | $ 34 | 3.8% | $ 66 | 7.7% |
| Federal Funds | $ - | $ 20 | $ - | $ (20) | -100.0% | $ - | na |
| **Aging** | **$ 628** | **$ 823** | **$ 908** | **$ 85** | **10.3%** | **$ 280** | **44.6%** |
| General Funds | $ 539 | $ 737 | $ 815 | $ 78 | 10.6% | $ 276 | 51.2% |
| Other State Funds | $ 9 | $ 8 | $ 8 | $ - | 0.0% | $ (1) | -11.1% |
| Federal Funds | $ 80 | $ 77 | $ 85 | $ 8 | 10.4% | $ 5 | 6.3% |

*Does not include appropriations for pension contributions, employee group insurance or debt service.

**The Lottery Department was created in August 2011, after the State agreed to have lottery operations managed by a private firm. The lottery was previously part of the Department of Revenue.

Source: Illinois State FY2013 Budget, pp. 2-29 to 2-37; Illinois State FY2011 Budget, pp. 2-17 to 2-27; Illinois State FY2010 Budget, p. 2-23.

The Department of Healthcare and Family Services (HFS), which runs the State's Medicaid program, is the largest agency with recommended total appropriations of $14.7 billion in

FY2013. It is important to understand, however, that State Medicaid spending is reimbursed by the federal government, generally at a rate of 50%. Total appropriations for HFS increase by $379 million, or 2.6%, to $14.7 billion in FY2013 from $14.3 billion in FY2012 due to higher Other State Funds appropriations. The increase stems partly from a new assessment on nursing homes, designed to bring in additional federal reimbursements and pay for legislatively required safety reforms.[82] As discussed above, however, actual spending from Other State Funds is typically well below appropriations.

Although most discussion of the State budget focuses on General Funds appropriations, several large agencies receive their main funding from other sources. The Department of Transportation is primarily supported by Other States Funds including the Road Fund, which is funded by motor fuel taxes and vehicle registrations, licenses and fees. The Department of Commerce and Economic Opportunity is mainly funded by federal grants.

The next table shows enacted General Funds appropriations for the ten largest state agency recipients of General Funds.

**State of Illinois General Funds Appropriations to 10 Largest Agencies: FY2009-FY2013 (in $ millions)***

| Agency | FY2009 Enacted | FY2012 Enacted | FY2013 Rec. | 2-Year $ Change | 2-Year % Change | 5-Year $ Change | 5-Year % Change |
|---|---|---|---|---|---|---|---|
| State Board of Education | $ 7,445 | $ 6,750 | $ 6,782 | $ 32 | 0.5% | $ (663) | -8.9% |
| Healthcare and Family Services | $ 8,584 | $ 6,768 | $ 6,768 | $ - | 0.0% | $ (1,816) | -21.2% |
| Human Services | $ 4,228 | $ 3,387 | $ 3,385 | $ (2) | -0.1% | $ (843) | -19.9% |
| Corrections | $ 1,351 | $ 1,222 | $ 1,111 | $ (111) | -9.1% | $ (240) | -17.8% |
| Aging | $ 539 | $ 737 | $ 815 | $ 78 | 10.6% | $ 276 | 51.2% |
| Children and Family Services | $ 865 | $ 813 | $ 768 | $ (45) | -5.5% | $ (97) | -11.2% |
| University of Illinois | $ 743 | $ 689 | $ 705 | $ 16 | 2.3% | $ (38) | -5.1% |
| Illinois Student Assistance Commission | $ 429 | $ 407 | $ 457 | $ 50 | 12.3% | $ 28 | 6.5% |
| Community College Board | $ 356 | $ 361 | $ 361 | $ - | 0.0% | $ 5 | 1.4% |
| Supreme Court | $ 291 | $ 288 | $ 288 | $ - | 0.0% | $ (3) | -1.0% |

*Does not include appropriations for pension contributions or employee group insurance.

Source: Illinois State FY2013 Budget, pp. 2-29 to 2-37; Illinois State FY2011 Budget, pp. 2-17 to 2-27; Illinois State FY2010 Budget, p. 2-23.

Many agency budgets decline in FY2013 from a year earlier, with the Department of Corrections experiencing the largest proposed reduction. General Funds appropriations for the Department of Corrections decline by $111 million, or 9.1%, from $1.2 billion in FY2012 to $1.1 billion in FY2013. The Governor's budget is based on the proposed closure of two prisons—the Tamms and Dwight Correctional Centers—and six adult transition centers in FY2013, resulting in estimated savings of $65.7 million.

In addition to correctional facilities, the FY2013 budget proposes closing other State facilities and consolidating agency offices for a total projected savings of approximately $100 million across several agencies. Plans had previously been announced for the closure of a state psychiatric hospital in Tinley Park and a residential center for the developmentally disabled in Jacksonville.[83] The FY2013 budget proposes the closure of a second state psychiatric hospital, in

[82] Public Act 96-1530.
[83] For more information on these plans, see the Civic Federation's Institute for Illinois' Fiscal Sustainability blog at http://www.civicfed.org/iifs/blog/two-state-facilities-close-2012.

Rockford.[84] Youth detention facilities in Joliet and Murphysboro would also be closed in FY2013. Planned office consolidations in FY2013 would affect the Departments of Human Services (DHS), Children and Family Services, Agriculture and State Police.

General Funds appropriations for HFS in FY2013 are unchanged from the enacted FY2012 level at $6.8 billion. At this appropriation level, expected Medicaid costs in FY2013 would be underfunded by roughly $2.7 billion.[85] The Governor's administration is working with the General Assembly to reduce FY2013 Medicaid costs by $2.7 billion.

The Governor proposed increases for certain agencies in FY2013. General Funds appropriations to the State Board of Education increase to $6.78 billion in FY2013 from $6.75 billion in FY2012 due largely to a $20 million increase in funding for early childhood education. General State Aid remains flat at $4.4 billion. General State Aid is designed to fill the gap between local funding resources available to school districts and the minimum per pupil expenditure (or Foundation Level) deemed to be adequate.

General Funds appropriations for the Student Assistance Commission increase by $50 million, or 12.3%, to $457 million in FY2013 from $407 million in FY2012. The increase reflects additional funding for the Monetary Award Program, which provides tuition grants to Illinois undergraduates who meet financial eligibility requirements.

The proposed budget for the Department on Aging increases by $78 million, or 10.6%, to $815 million in FY2013 from $737 million in FY2012. The Governor recommended additional funding for the Community Care Program, which provides services aimed at allowing seniors to stay out of nursing homes. General Funds appropriations for the Department on Aging grow by $276 million, or 51.2%, from $539 million in FY2009.

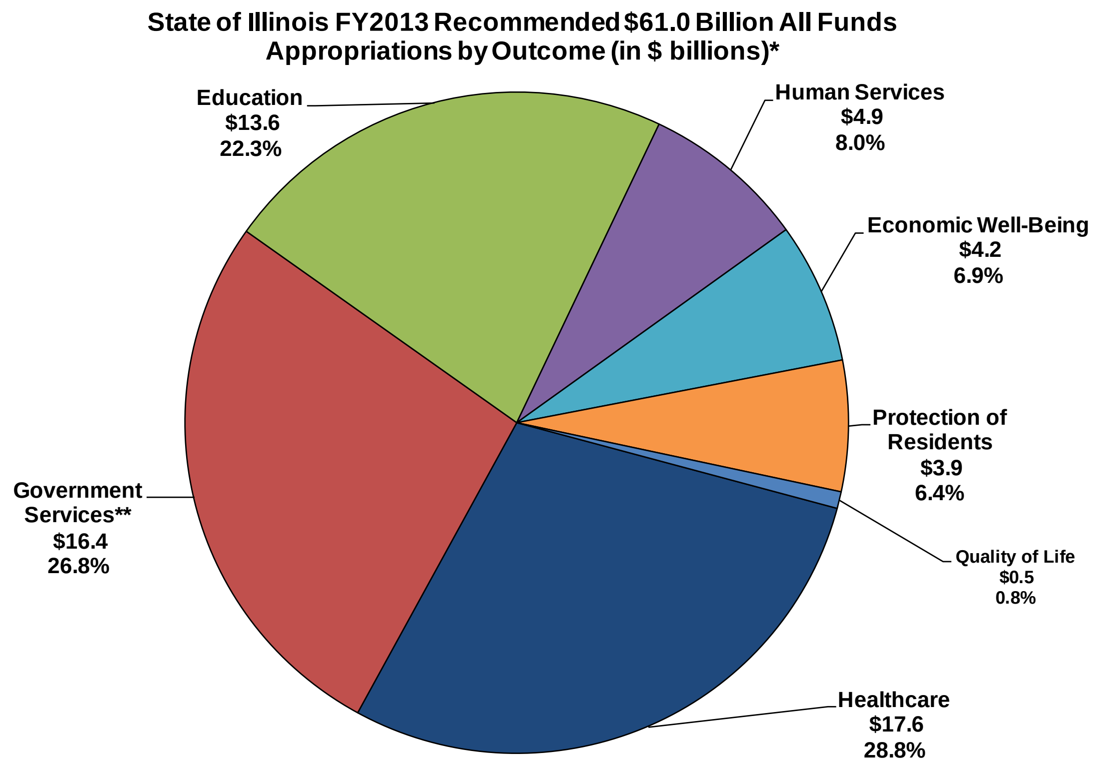
Recommended General Funds appropriations for The Department of Veterans' Affairs increase by $4.9 million, or 7.6%, to $69.0 million in FY2013 from $64.1 million in FY2012. Staffing would increase by 78 full-time equivalent positions (FTEs), or 5.9%, from 1,311 FTEs to 1,389 to improve care at veterans' homes.

[84] Another state center for the developmentally disabled, in Centralia, would be closed in FY2014.
[85] Illinois Department of Healthcare and Family Services, *Five Year Medical Assistance Budget Outlook*, March 2012, http://www.state.il.us/budget/Five%20Year%20MA%20Outlook%20FY12-FY17%20UPDATE%20for%20FY13%20budget.pdf (last visited on April 3, 2012).

## Appropriations by Outcome

The following chart shows how FY2013 recommended appropriations are allocated across all funds according to major purpose or intended outcome. The FY2013 budget groups principal spending activities into seven outcomes: economic well-being, education, government services, healthcare, human services, protection of residents and quality of life.[86] Goals that will contribute to outcomes were developed in consultation with the State's Budgeting for Results Commission, and each agency program was matched to a goal.[87]

Healthcare accounts for 28.8% of total FY2013 appropriations and includes programs at HFS, DHS, the Department on Aging and several other agencies. The government services outcome, which includes pension contributions and group insurance payments, accounts for 26.8% of total FY2013 appropriations. Education ranks third with 22.3% of total appropriations.




*Appropriations total $61.0 billion due to inclusion of revolving funds appropriations.
**Includes pension contributions and State group insurance payments.
Source: Civic Federation calculations based on Illinois State FY2013 Budget, p. 2-16.

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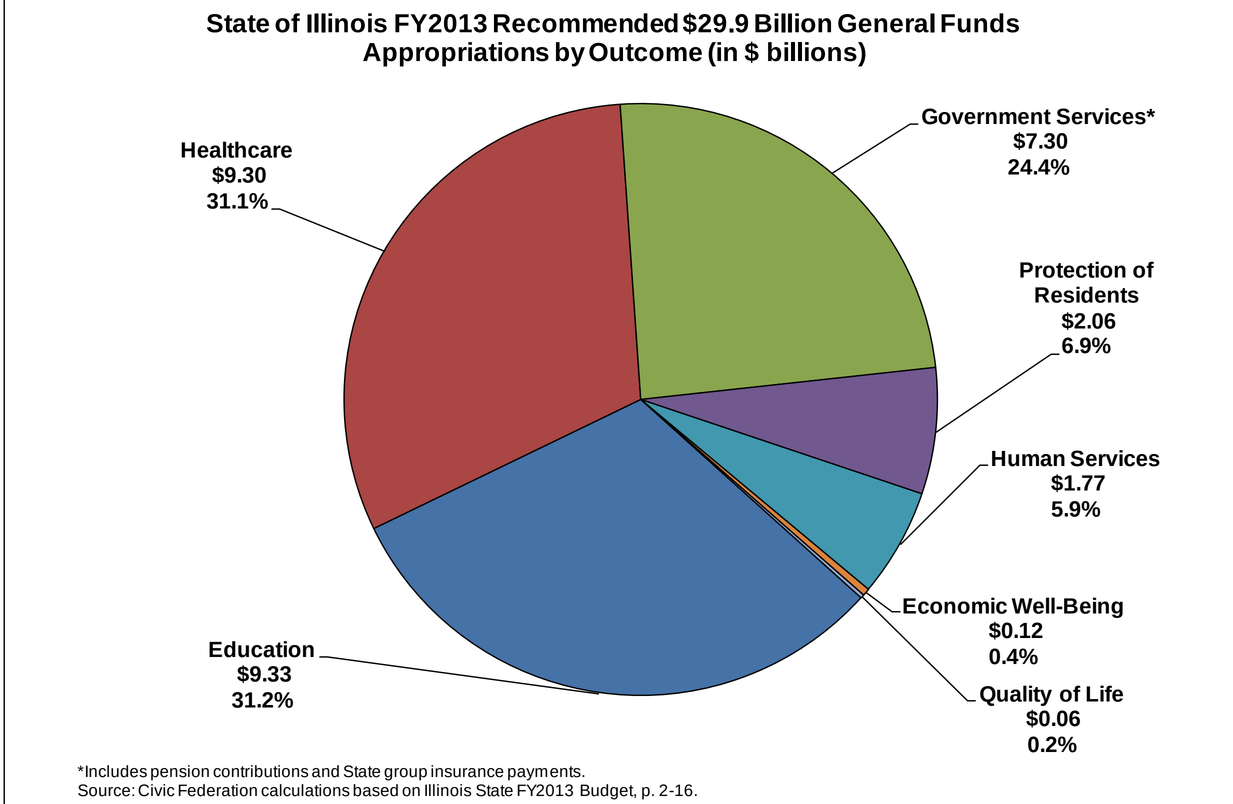
[86] The full titles of the outcomes are enhanced economic well-being of residents and communities; quality education and opportunities for growth and learning for all Illinois students; improved efficiency and stability of State government; improved access to and cost effectiveness of healthcare; protection of the most vulnerable of our residents; protection of residents' lives and property; and improved quality of life of residents.

[87] For a more detailed explanation of outcomes and goals, see Illinois State FY2013 Budget, pp. 2-4 to 2-7 and pp. 2-38 to 2-60.

Because many agencies have programs with goals that match different outcomes, the outcomes do not correspond to particular agencies. For example, programs at DHS are included in six different outcomes. The human services outcome includes DHS' substance abuse and delinquency prevention programs. The education outcome includes early childhood development programs at DHS. Healthcare includes long-term care programs at DHS. Economic well-being includes DHS' employment and training support programs. Protection of residents includes DHS' mental health services used for law enforcement purposes. The government services outcome includes administration and management information services at DHS.

The next chart shows the allocation of FY2013 recommended General Funds appropriations by outcome. Education has the largest allocation of General Funds, with 31.2%, followed by Healthcare (31.1%) and Government Services (24.4%). As noted previously, Government Services includes pension contributions and State group insurance payments.




## Personnel

The FY2013 budget proposes a decrease of 1,453 full-time equivalent positions (FTEs) at the Governor's agencies.[88] That represents a decline of 2.7% from an estimated 53,015 FTEs at the end of FY2012 to 51,564 at the end of FY2013.

[88] See Appendix A for a listing of agencies by category.

The decrease in positions at the Governor's agencies mainly reflects the planned facilities closures in FY2013. The closures are expected to result in 786 layoffs at the Department of Corrections and 326 layoffs at the Department of Juvenile Justice.[89] DHS, which operates the State psychiatric hospitals and centers for developmental disabilities, has an FTE decline of 623, or 5%, from an estimated 12,439 at end of FY2012 to 11,816 at the end of FY2013.

The table below shows personnel numbers for the Governor's agencies by major agency purpose.[90] The table also shows FTEs for judicial agencies and elected officials and the State Board of Elections. In preparing the budget, the Governor's Office of Management and Budget (GOMB) seeks requested headcounts from agencies not under the Governor; if the information is not provided, GOMB keeps headcounts unchanged from the prior year. As a result of these data limitations, the FY2013 FTE numbers for agencies not under the Governor are rough approximations. Legislative agencies are not included in the table because the budget contains virtually no information about staffing of these agencies, including the General Assembly.

**State of Illinois Full-Time Equivalent Positions: FY2009-FY2013***

| | FY2009 Actual | FY2010 Actual | FY2011 Actual | FY2012 Est. | FY2013 Rec.** |
|---|---|---|---|---|---|
| Governor's Agencies | | | | | |
| Education | 908 | 872 | 802 | 795 | 801 |
| Economic Development | 6,280 | 6,421 | 6,429 | 6,444 | 6,483 |
| Public Safety | 17,160 | 17,088 | 17,327 | 17,117 | 16,174 |
| Human Services | 24,329 | 23,822 | 23,951 | 23,445 | 22,836 |
| Quality of Life | 1,526 | 1,454 | 1,425 | 1,369 | 1,335 |
| Government | 4,042 | 3,852 | 3,799 | 3,848 | 3,935 |
| **Total Governor's Agencies** | **54,245** | **53,509** | **53,733** | **53,017** | **51,564** |
| Judicial Agencies | 1,979 | 2,016 | 2,014 | 1,986 | 1,985 |
| Elected Officials and Elections | 5,174 | 5,138 | 5,123 | 5,095 | 5,108 |
| **Total** | **61,398** | **60,663** | **60,870** | **60,098** | **58,657** |

*See Appendix A and Appendix B for categorization of agencies.

**For FY2013, FTEs for Governor's agencies are targets set by the Governor's Office. FTEs for agencies not under the Governor are requests by those agencies or the same number as FY2012 if no request is made.

Source:Email communication between Civic Federation and Governor's Office of Management and Budget, April 6, 2012; Illinois State FY2011 and FY2012 Budgets.

The number of positions in the Governor's agencies declines by 1,228, or 2.3%, from 54,245 in FY2009 to a projected 53,017 at the end of FY2012. Most of the decrease has been in the area of human services, where the number of FTEs declines by 884 positions, or 3.6%.

The following charts show appropriations for employee salaries. Appropriations for the other employee-related costs of pensions and State group insurance are discussed in separate sections of this report. A relatively small portion of the State budget—roughly 8% of General Funds appropriations—is spent on salaries because many State services and operations are not performed by State employees. The State provides many services through funding for local

[89] Office of Governor Pat Quinn, *Efficiencies Fact Sheet – FY2013 Budget*, February 22, 2012.
[90] Email communication between the Civic Federation and the Governor's Office of Management and Budget, April 6, 2012.

governments, healthcare providers and social service agencies, rather than having State employees provide those services.

As with data on FTEs, budget data on employee salaries for agencies not under the Governor are limited. For FY2013, the numbers represent either requested appropriations or the enacted FY2012 appropriation. No information is available on General Assembly staff, although the budget has data on General Assembly members and other legislative agencies.

For the Governor's agencies, proposed salary appropriations for all funds decline by $38 million, or 1.2%, from an estimated $3.13 billion in FY2012 to a proposed $3.09 billion in FY2013. Salary appropriations for the Governor's agencies do not include salaries for employees at state institutions for the developmentally disabled and mentally ill. For these institutions, appropriations are in lump sums rather than line-items classified by purpose of expenditure.

| State of Illinois All Funds Salary Costs: FY2012-FY2013 (in $ millions)* | | | |
|---|---|---|---|
| | FY2012 Enacted | FY2012 Est. | FY2013 Rec. |
| Governor's Agencies | $ 3,206.2 | $ 3,125.6 | $ 3,087.5 |
| Legislative Agencies** | $ 29.3 | $ 29.3 | $ 29.4 |
| Judicial Agencies | $ 232.9 | $ 232.2 | $ 250.5 |
| Elected Officials and Elections | $ 299.9 | $ 299.9 | $ 302.1 |
| **Total** | **$ 3,768.3** | **$ 3,687.0** | **$ 3,669.5** |

*See Appendix A for classification of agencies.

**Includes General Assembly members but not General Assembly staff.

Source: Civic Federation calculations based on email communication with Governor's Office of Management and Budget, March 12, 2012; Illinois State FY2013 Budget, p. 5-43.

General Funds salary appropriations for the Governor's agencies decline by $89.4 million, or 4.6%, from an estimated $1.95 billion in FY2012 to a proposed $1.86 billion in FY2013.

| State of Illinois General Funds Salary Costs: FY2012-FY2013 (in $ millions)* | | | |
|---|---|---|---|
| | FY2012 Enacted | FY2012 Est. | FY2013 Rec. |
| Governor's Agencies | $ 1,948.1 | $ 1,945.1 | $ 1,855.7 |
| Legislative Agencies** | $ 29.3 | $ 29.3 | $ 29.4 |
| Judicial Agencies | $ 232.1 | $ 231.4 | $ 249.6 |
| Elected Officials and Elections | $ 281.7 | $ 281.7 | $ 281.6 |
| **Total** | **$ 2,491.2** | **$ 2,487.5** | **$ 2,416.3** |

*See Appendix A for classification of agencies.

**Includes General Assembly members but not General Assembly staff.

Source: Civic Federation calculations based on email communication with Governor's Office of Management and Budget, March 12, 2012; Illinois State FY2013 Budget, p. 5-43.

Approximately 90% of State employees are covered by collective bargaining agreements, which began on July 1, 2008 and expire on June 30, 2012.[91] The State is currently in negotiations regarding new collective bargaining agreements. The proposed FY2013 budget does not reflect any wage increases for union employees.[92]

The State's current contract with its largest union, Council 31 of the American Federation of State, County and Municipal Employees (AFSCME), increased wages by 15.25% over four years. In exchange for a promise of limited layoffs and no state facilities closures through the end of FY2012, AFSCME deferred part of the wage increases scheduled for FY2010 and FY2011. The revised contract called for the following wage increases: January 1, 2011 – 1%; June 1, 2011 – 2%; July 1, 2011 – 2%; January 1, 2012 – 1.25%; and February 1, 2012 – 2%.

On July 1, 2011, Governor Quinn cancelled all scheduled FY2012 raises for employees in 14 agencies, citing inadequate appropriations by the General Assembly. A lawsuit filed by AFSCME, challenging the State's failure to pay the negotiated increase, is pending in Cook County Circuit Court.[93]

### General Funds Expenditures

Expenditures from General Funds consist of net appropriations spent and statutory transfers out. General Funds are diverted or transferred out to Other State Funds to make debt service payments on bonds and for a wide range of other legislatively required transfers. The following table shows General Funds expenditures from FY2009 to FY2013.

**State of Illinois General Funds Expenditures: FY2009-FY2013 (in $ millions)**

| | FY2009 Actual | FY2010 Actual | FY2011 Preliminary | FY2012 Enacted | FY2013 Rec. | $ Change FY2009-FY2013 | % Change FY2009-FY2013 |
|---|---|---|---|---|---|---|---|
| Agency Appropriations | $ 27,796 | $ 26,354 | $ 25,845 | $ 25,252 | $ 24,828 | $ (2,968) | -10.7% |
| Less Unspent Appropriations | $ (507) | $ (896) | $ (350) | $ (904) | $ (500) | $ 7 | -1.4% |
| Net Agency Appropriations | $ 27,289 | $ 25,458 | $ 25,495 | $ 24,348 | $ 24,328 | $ (2,961) | -10.9% |
| Pension Contributions* | $ 2,486 | $ 3,466 | $ 3,680 | $ 4,135 | $ 5,090 | $ 2,604 | 104.7% |
| **Net Appropriations Spent** | **$ 29,775** | **$ 28,924** | **$ 29,175** | **$ 28,483** | **$ 29,418** | **$ (357)** | **-1.2%** |
| Statutory Transfers Out | | | | | | | |
| Legislatively Required Transfers | $ 2,082 | $ 2,007 | $ 2,399 | $ 2,461 | $ 2,142 | $ 60 | 2.9% |
| Debt Service on Pension Obligation Bonds | $ 466 | $ 564 | $ 1,667 | $ 1,605 | $ 1,552 | $ 1,086 | 233.0% |
| Other Debt Service and Statutory Transfers Out** | $ 660 | $ 1,759 | $ 739 | $ 1,177 | $ 666 | $ 6 | 0.9% |
| **Total Transfers Out** | **$ 3,208** | **$ 4,330** | **$ 4,805** | **$ 5,243** | **$ 4,360** | **$ 1,152** | **35.9%** |
| **Total Expenditures** | **$ 32,983** | **$ 33,254** | **$ 33,980** | **$33,726** | **$33,778** | **$ 795** | **2.4%** |

*Pension contributions in FY2010 and FY2011 were made primarily by issuance of pension obligation bonds, rather than from General Funds.

**FY2010 interest on short term borrowing includes $1.0 billion to repay failure of revenue borrowing in FY2009.

Source:Illinois State FY2013 Budget, p. 2-18; Illinois State FY2010 Budget, p. 2-12.

[91] State of Illinois, General Obligation Bonds, Series of March 2012, *Official Statement*, March 15, 2012, p. 7.

[92] Email communication between the Civic Federation and the Governor's Office of Management and Budget, April 3, 2012.

[93] Council 31 AFSCME, "Pay Lawsuit Winds SlowlyThrough the Courts," March 28, 2012, http://www.afscme31.org/news?id=0345 (last visited on April 6, 2012).

General Funds expenditures increase by $795 million, or 2.4%, to $33.8 billion in FY2013 from FY2009. A decrease of nearly $3.0 billion in net agency appropriations is more than offset by increases in pension-related costs.

Pension contributions rise by $2.6 billion, or 104.7%, to $5.1 billion from $2.5 billion over the same time period. Debt service on pension bonds increases by $1.1 billion, or 233%, to $1.6 billion in FY2013 from $466 million in FY2009. The State sold pension bonds in FY2010 and FY2011 to pay for its required General Funds pension contributions.[94] Pension-related costs are expected to account for 19.7% of General Funds expenditures in FY2013, up from 9.0% in FY2009.

[94] The State's first sale of pension bonds was in FY2003.

## MEDICAID

The FY2013 budget recommends that General Funds appropriations for Medicaid be kept unchanged from FY2012 at $6.6 billion. This level of spending authorization—on top of inadequate appropriations in FY2012—is expected to underfund FY2013 Medicaid costs by approximately $2.7 billion.

Governor Quinn's budget acknowledges the underfunding and calls for a reduction in Medicaid costs. On April 19, 2012, the Governor proposed a plan to eliminate the underfunding through program changes, reductions in reimbursement rates paid to healthcare providers and resources provided by an increase in the State's cigarette tax.

This section gives a brief overview of the Medicaid program, explains the difference between FY2013 Medicaid appropriations and projected costs and describes the Governor's proposal to eliminate the projected $2.7 billion funding shortfall in FY2013.

### Medicaid Overview

Medicaid is a joint federal-state program that funds medical services for certain categories of low-income people, including children, pregnant women, the elderly and the disabled.[95] The federal government requires states to provide certain services, such as inpatient hospital services and nursing home care. Other services are optional and are provided at the discretion of each state. For example, prescription drug coverage for outpatients is an optional service that all states have chosen to provide.[96]

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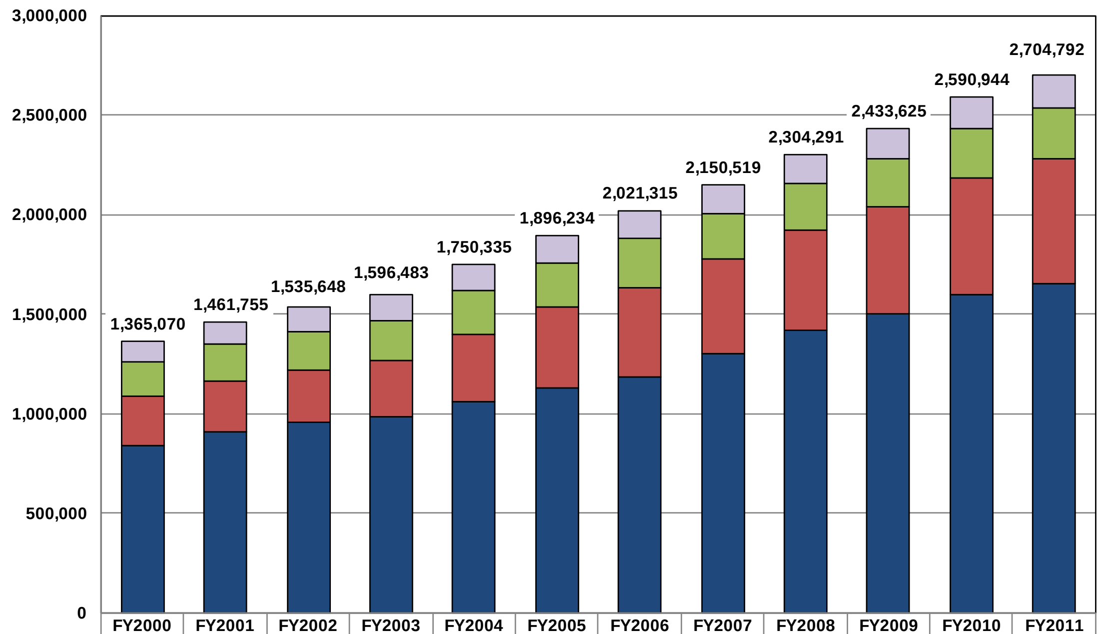
[95] For more information on Medicaid, see the Civic Federation's Institute on Illinois' Fiscal Sustainability, *Illinois Medicaid Program: An Issue Brief*, May 22, 2009, http://www.civicfed.org/iifs/publications/illinois-medicaid-program-issue-brief (last visited on April 15, 2012).

[96] Kaiser Commission on Medicaid and the Uninsured, *Medicaid Payment for Outpatient Prescription Drugs*, September 2011.

As shown in the following chart, enrollment in the Illinois Medicaid program nearly doubled to 2.7 million in FY2011 from 1.4 million in FY2000.[97] Nationwide Medicaid enrollment increased approximately 63% during the same period.[98]

**State of Illinois Medicaid Enrollment***




| | FY2000 | FY2001 | FY2002 | FY2003 | FY2004 | FY2005 | FY2006 | FY2007 | FY2008 | FY2009 | FY2010 | FY2011 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Total | 1,365,070 | 1,461,755 | 1,535,648 | 1,596,483 | 1,750,335 | 1,896,234 | 2,021,315 | 2,150,519 | 2,304,291 | 2,433,625 | 2,590,944 | 2,704,792 |
| Seniors | 103,308 | 114,239 | 120,779 | 127,458 | 132,954 | 137,270 | 140,842 | 142,257 | 146,314 | 150,515 | 156,001 | 166,104 |
| Disabled Adults | 172,114 | 185,585 | 196,491 | 205,648 | 217,299 | 225,738 | 246,277 | 231,209 | 235,965 | 241,288 | 249,517 | 258,672 |
| Non-Disabled Adults | 253,540 | 251,461 | 260,434 | 280,627 | 340,774 | 405,383 | 448,439 | 473,558 | 505,979 | 537,765 | 588,451 | 623,807 |
| Children | 836,108 | 910,470 | 957,944 | 982,750 | 1,059,308 | 1,127,843 | 1,185,757 | 1,303,495 | 1,416,033 | 1,504,057 | 1,596,975 | 1,656,209 |

*Enrollees receiving comprehensive benefits.
Source: Email communication between Civic Federation and Illinois Department of Healthcare and Family Services, April 13, 2012.

Enrollment of children in Illinois grew by 820,101 to 1.7 million in FY2011 from 836,108 in FY2000. During the same period, Illinois enrollment of adults without disabilities increased by 370,267, adults with disabilities by 86,558 and seniors by 62,796.

Medicaid enrollment in Illinois grew 57.5% from FY2000 through FY2007, compared with national Medicaid enrollment growth of 34.5%. The relatively rapid increase in Illinois enrollment was fueled by eligibility expansion, as well as increased enrollment by those previously eligible. For example, from FY2001 to FY2003 the State phased in an expanded eligibility standard for the aged, blind and disabled, increasing eligibility from about 36% of the Federal Poverty Level (FPL) to 100%.[99] Beginning in October 2002, eligibility standards for the FamilyCare program, which covers parents of low-income children, were increased from

[97] Email communication between the Civic Federation and the Illinois Department of Healthcare and Family Services, April 13, 2012. These numbers refer to recipients of comprehensive benefits; another 297,702 people received partial benefits in FY2011.
[98] U.S. Department of Health and Human Services, Centers for Medicare and Medicaid Services, *2011 Actuarial Report on the Financial Outlook for Medicaid*, March 16, 2012, pp. 24-25. Enrollment numbers for FY2010 and FY2011 are projections.
[99] The FY2012 Federal Poverty Level is $11,170 for a single person and $23,050 for a family of four.

approximately 36% of FPL to 185%. Effective July 1, 2006, the All Kids program expanded Medicaid coverage to uninsured children with family income above 200% of the FPL and children who are undocumented immigrants. However, most of the growth in children's enrollment has involved families with income below 133% of the FPL, who had previously been covered by Medicaid.[100]

From FY2008 through FY2011, Medicaid eligibility in Illinois has not been expanded through policy changes.[101] Instead, enrollment growth during this period is mainly attributed to the national economic recession and subsequent sluggish economic growth.[102] Economic downturns cause increased unemployment, lower family income and a decline in employer-sponsored health insurance coverage.[103] During this period, the growth in Illinois enrollment at 17.4% is in line with the projected national growth rate of 17.6%.

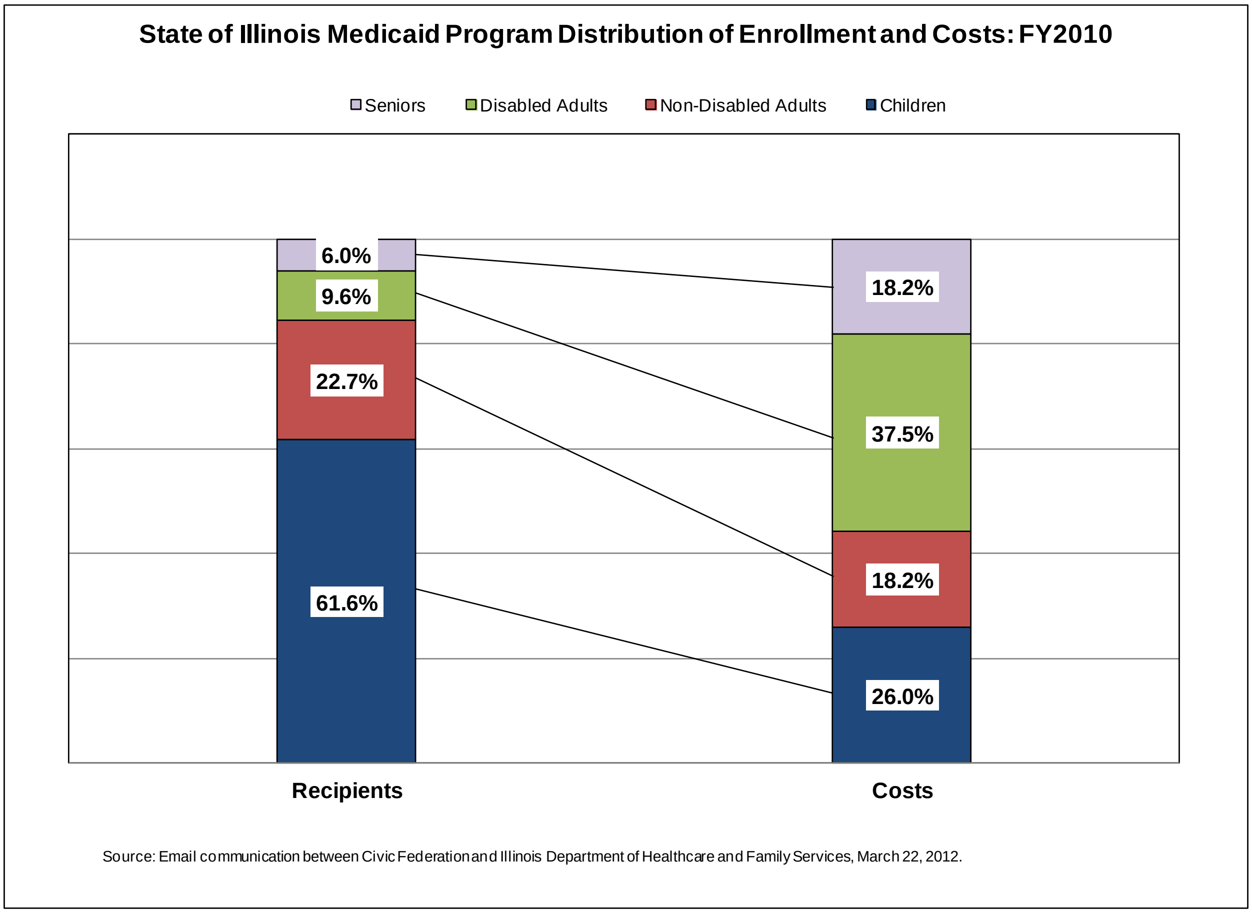
The persistent enrollment growth in Illinois has raised questions about the number of Medicaid recipients in the State who might be improperly enrolled in the program. It is not clear, however, how much money the State might be losing as a result of improper enrollment. The Illinois Department of Healthcare and Family Services (HFS) found that nearly 6% of the medical identification cards it mailed out in November 2011 were returned due to recipients living out of state.[104] A review of children's enrollment by the HFS Inspector General found that 34% of the 1,089 cases reviewed contained eligibility errors, although 86% of those recipients would have been eligible for related State programs, including some that required the payment of insurance premiums.[105] The uncollected premiums totaled $12,675, or $47 per recipient.

Medicaid reform legislation enacted by the State in January 2011 required verification of Illinois residency and one full month of income for applicants and recipients and eliminated "passive redetermination," in which annual coverage for children was automatically renewed if their families did not respond to renewal notices.[106] HFS officials pursued the use of electronic databases to verify eligibility, including drivers license and identification card information maintained by the Illinois Secretary of State.[107] The Centers for Medicare and Medicaid Services (CMS) of the U.S. Department of Health and Human Services approved the concept of electronic data matching but questioned its application to recipient groups such as homeless people. CMS initially expressed concern that changes in the State's procedures might violate provisions of

[100] HFS, Response to Questions from Governor's Taxpayer Action Board, May 5, 2009.
[101] HFS Director Julie Hamos, testimony before Senate Appropriations Committee, March 26, 2012. Public Act 96-1501, enacted in January 2011, placed a two-year moratorium on expansion of the program.
[102] The recession began in December 2007 and officially lasted until June 2009. See the National Bureau of Economic Research, "US Business Cycle Expansions and Contractions," September 20, 2010.
[103] U.S. Department of Health and Human Services, Centers for Medicare and Medicaid Services, *2011 Actuarial Report on the Financial Outlook for Medicaid*, March 16, 2012, pp. 24-25.
[104] Letter from HFS Director Julie Hamos to Cindy Mann, Center for Medicaid and CHIP Services, Centers for Medicare and Medicaid Services, U.S. Department of Health and Human Services, February 7, 2012.
[105] HFS Office of the Inspector General, Bureau of Medicaid Integrity, *FY09 MEQC Pilot Project Passive Redeterminations*, September 2010, p. 9.
[106] Public Act 96-1501. Before the new law, an applicant was not generally required to show documentation to prove Illinois residency. Parents were required to provide just one document for all income received during a month; if an applicant was paid twice a month, one pay stub was sufficient. For children whose only benefit was medical coverage, a form was sent out with information of record and families were not required to respond unless a change had occurred in their circumstances.
[107] HFS, *Illinois Medical Programs: Residency and Income Eligibility Verification*, February 7, 2012.

federal healthcare reform that prohibit restrictions on eligibility prior to 2014.[108] CMS officials recently approved the State's new procedures to verify residence, and the State is working on a plan for income verification.[109]

Children and adults without disabilities have been the fastest growing segments of Illinois' Medicaid enrollment but are the least costly to serve. As in other states, adults with disabilities and seniors are by far the most expensive recipients of Medicaid services. The following chart shows that adults with disabilities and seniors represented 15.6% of Illinois' Medicaid enrollment but 55.7% of program costs in FY2010.




Outside of program changes, increases in Medicaid spending largely reflect rising costs throughout the United States' healthcare system. U.S. healthcare spending is expected to increase by 5.5% in 2013, according to National Health Expenditure projections.[110] Such an increase is roughly equal to the projected growth of 5.6% in Illinois' Medicaid costs in FY2013.[111]

[108] The Maintenance of Effort requirement of the Affordable Care Act specifies that in order to receive federal Medicaid funding states must maintain eligibility standards, methodologies and procedures that are no more restrictive than they were on March 23, 2010.
[109] Letter to HFS Director Julie Hamos from Cindy Mann, February 29, 2012 and email communication between the Civic Federation and HFS, April 18, 2012.
[110]See http://www.cms.gov/NationalHealthExpendData/downloads/proj2010.pdf (last visited on April 18, 2012).
[111] HFS, *Five Year Medical Assistance Budget Outlook*, March 2012.

Compared with other states, Illinois' Medicaid program covers a large number of people but is average with regard to the percentage of its population who are Medicaid recipients and has relatively low spending per enrollee, according to the most recent data available from the Kaiser Family Foundation.[112] In FY2008 19% of the Illinois population was enrolled in Medicaid; the U.S. average was 20%. Illinois spent $4,711 per recipient in FY2008; the U.S. average was $5,337 and 35 states spent more per recipient than Illinois.

Illinois ranked below 44 other states in the share of long-term care spending going for home health and personal care, with Illinois spending 31.5% compared with a national average of 43.3%. Medicaid physician fees in Illinois have been relatively low; 40 states paid higher fees to physicians in FY2008.

### Medicaid Appropriations and Costs

As a program involving several state agencies, Medicaid has no single programmatic appropriation in the State budget. The Medicaid program in Illinois is administered primarily by HFS, and the Medical Assistance program at HFS is often used as the best available approximation to the Medicaid program.[113]

Medicaid funding is complex. State Medicaid expenditures are reimbursed by the federal government at a rate known as the Federal Medical Assistance Percentage (FMAP). The FMAP for Illinois rose to 61.88% as a result of the American Recovery and Reinvestment Act of 2009 (ARRA) but has dropped back to 50% since stimulus funding ended on June 30, 2011.

General Funds appropriations in the State budget are gross amounts, meaning they represent total authorized spending funded by both the State and federal governments. In simple terms, a $1 appropriation represents 50 cents in State-funded spending and 50 cents in federally-funded spending.

In addition to General Funds, the Medicaid program receives funding from a number of other sources, including rebates paid by prescription drug manufacturers, proceeds from the settlement of tobacco-related litigation and payments by local governments and healthcare providers that are structured to enhance federal reimbursements. These Other State Funds outside the General Funds are relatively stable funding sources.

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[112] Kaiser Family Foundation, statehealthfacts.org, http://www.statehealthfacts.org/compare.jsp (last visited on April 18, 2012).

[113] HFS administers the State's Medicaid program and accounts for most of its spending, but roughly $2 billion a year in expenditures are made by other agencies, including the Departments of Human Services and Children and Family Services and the Department on Aging. Although the HFS Medical Assistance program is the best available approximation to the Medicaid program, roughly 10% of its appropriations are outside of the Medicaid program.

The next table shows appropriations to the HFS Medical Assistance program for FY2009 and FY2012 and as proposed for FY2013.

| HFS Medical Assistance Program Appropriations: FY2009-FY2013 (in $ millions) | | | |
|---|---|---|---|
| | FY2009 Actual | FY2012 Enacted | FY2013 Rec. |
| General Funds | $ 8,344.1 | $ 6,639.0 | $ 6,639.0 |
| Other State Funds | $ 5,451.7 | $ 7,266.1 | $ 7,595.9 |
| Total | $ 13,795.8 | $ 13,905.1 | $ 14,234.9 |

Source: Illinois Department of Healthcare and Family Services, *HFS Program Area Appropriations Comparison*, February 22, 2012; Communication between Civic Federation and Governor's Office of Management and Budget, April 26, 2012.

In FY2009 General Funds appropriations were boosted to $8.3 billion by a supplemental appropriation designed to allow the State to take advantage of the enhanced federal reimbursement for Medicaid spending available under ARRA.[114] The federal stimulus program required that states pay bills owed to doctors, hospitals and nursing homes within 30 days. The supplemental appropriation was needed so that Illinois could pay off past-due bills. In FY2013 proposed General Funds appropriations are unchanged from FY2012 at $6.6 billion.[115]

As discussed in the Appropriations and Expenditures section of this report, year-to-year comparisons of appropriations to Other State Funds can be misleading because requested appropriations often overstate available resources.[116] For example, HFS Medical Assistance program spending from Other State Funds was $5.5 billion in FY2009, compared with Other State Funds appropriations that year of $6.3 billion. In FY2013 the proposed Other State Funds appropriation is $7.6 billion, but available Other State Funds spending is estimated at $5.7 billion.[117]

The total cost of HFS' Medical Assistance program in FY2013 is expected to be $15.0 billion.[118] This includes approximately $3.6 billion related to special funding agreements such as the hospital assessment program that cannot be used for other purposes. General Funds appropriations for Medicaid underfund program costs by approximately $1.5 billion in FY2012 and $2.7 billion in FY2013.[119] State law allows Medicaid bills, unlike most other State bills, to

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[114] State of Illinois, General Obligation Bonds, Taxable Series of February 2011, *Official Statement*, February 23, 2011, p. 15. The American Recovery and Reinvestment Act required that states pay bills owed to doctors, hospitals and nursing homes within 30 days. The supplemental appropriation was needed so that Illinois could pay off past-due bills.

[115] Actual General Funds spending in FY2012 is estimated at roughly $400 million less than the enacted appropriation because insufficient funds were available to pay Medicare premiums owed to the federal government. The federal government offset this liability by withholding the equivalent amount of Medicaid reimbursements owed to the State.

[116] See Appropriations and Expenditures section starting on p. 31 of this report for more details on All Funds Appropriations.

[117] HFS, *Five Year Medical Assistance Budget Outlook*, March 2012; Illinois State FY2013 Budget, pp. 2-68 to 2-79.

[118] HFS, *Five Year Medical Assistance Budget Outlook*, March 2012; Illinois State FY2013 Budget, pp. 2-68 to 2-79.

[119] HFS, *Five Year Medical Assistance Budget Outlook*, March 2012.

be paid from future years' appropriations.[120] This exception to Section 25 of the State Finance Act has repeatedly been used to budget an insufficient amount of Medicaid appropriations to cover costs for a given fiscal year, knowing that the bills will be paid from the next year's appropriations.[121]

The following chart shows HFS' latest five-year projections for growth in unpaid Medicaid bills. Costs in the chart are based on HFS' Medical Assistance program, excluding special funding agreements such as the hospital assessment program. The projections assume that General Funds appropriations are unchanged from FY2012 and that no policy changes are enacted. As shown in the chart, unpaid Medicaid bills rise from $1.9 billion at the end of FY2012 to $4.5 billion at the end of FY2013 and reach $22.7 billion at the end of FY2017.

**State of Illinois Projected Medicaid Costs and Unpaid Bills: FY2012-FY2017 (in $ millions)***

| | FY2012 | FY2013 | FY2014 | FY2015 | FY2016 | FY2017 |
|---|---|---|---|---|---|---|
| Total General Funds and Related Costs** | $ 10,869 | $ 11,476 | $ 12,047 | $ 12,657 | $ 13,308 | $ 14,002 |
| Less General Funds Resources*** | $ (7,090) | $ (6,660) | $ (6,626) | $ (6,626) | $ (6,626) | $ (6,626) |
| Less Other Funds Resources | $ (2,232) | $ (2,131) | $ (1,840) | $ (1,840) | $ (1,840) | $ (1,840) |
| **Underfunding (Increase in Unpaid Bills)** | **$ 1,547** | **$ 2,685** | **$ 3,581** | **$ 4,191** | **$ 4,842** | **$ 5,536** |
| Bills on Hand End of Prior Fiscal Year | $ 314 | $ 1,861 | $ 4,546 | $ 8,127 | $ 12,318 | $ 17,160 |
| **Bills on Hand End of Current Fiscal Year** | **$ 1,861** | **$ 4,546** | **$ 8,127** | **$ 12,318** | **$ 17,160** | **$ 22,696** |

*HFS' Medical Assistance program is used as an approximation to the Medicaid program.
**Excludes approximately $3.5 billion in special funding agreements such as a hospital assessment program.
***General Funds resources exceed FY2012 and FY2013 appropriations due to use of prior year appropriations for lapse period spending.
Source: HFS, *Five Year Medical Assistance Budget Outlook* , March 2012.

A $1.9 billion backlog of unpaid bills means that payments to healthcare providers will be delayed by as much as 120 days.[122] If the backlog grows to $4.5 billion, the payment delay is projected at 300 days, raising questions about whether many healthcare providers would continue to accept Medicaid patients.

## Governor's Medicaid Proposal

In his FY2013 budget address on February 22, 2012, Governor Quinn said that the State must reduce Medicaid costs by $2.7 billion to prevent growth in unpaid bills.[123] The Governor said he planned to work with the General Assembly to reduce program costs by that amount and to call the legislature into special session during the summer to solve the problem, if necessary.

Simply reducing Medicaid appropriations does not cut Medicaid spending. Medicaid is an entitlement program under which certain categories of low-income people who meet eligibility requirements are entitled to specified medical services. Reducing Medicaid spending requires reductions in program eligibility, benefits or reimbursement rates paid to healthcare providers such as hospitals, nursing homes and pharmacies.

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[120] 30 ILCS 105/25. Public Act 96-1501 limits this liability to $6.0 billion for FY2012, $5.3 billion for FY2013, $4.6 billion for FY2014, $4 billion for FY2015, $3.3 billion for FY2016, $2.6 billion for FY2017, $2.0 billion for FY2018, $1.3 billion for FY2019, $600.0 million for FY2020 and zero thereafter.
[121] Illinois State Comptroller, "The Section 25 Budget 'Loophole'," *Fiscal Focus*, July 2008, p.7.
[122] HFS Director Julie Hamos, *Presentation to the Civic Federation*, March 19, 2012.
[123]The text of the Governor's budget speech is available at http://www2.illinois.gov/budget/Documents/Budget%20Book/FY%202013/FINAL%20FY13%20BUDGET%20SPEECH.pdf (last visited on April 18, 2012).

As discussed above, states face restrictions on program reductions. Certain coverage is mandated by the federal government. In addition, as a condition of continued participation in the Medicaid program, national healthcare reform legislation enacted in 2010 generally requires that states not tighten existing eligibility requirements.

In cooperation with HFS officials, a bipartisan working group of General Assembly members considered savings options not expected to run afoul of federal rules. Many potential spending cuts were regarded as medically unwise and some were considered to be financially imprudent. The most expensive service that is optional under federal law is adult pharmaceuticals at $815 million, but elimination of all adult drugs would lead to an increase in costly hospitalizations, according to medical experts.[124]

On April 19, 2012, Governor Quinn announced a proposal for dealing with the Medicaid underfunding.[125] The Governor issued his proposal after the legislative working group charged with finding $2.7 billion savings reportedly was unable to agree on a plan.[126]

The Governor's plan eliminates the underfunding through a combination of Medicaid program changes (used to fill 50% of the $2.7 billion funding gap); reductions in reimbursement rates paid to healthcare providers excluding doctors (25%); additional revenues for Medicaid from a cigarette tax increase (12.5%); and federal reimbursements on Medicaid spending due to the cigarette tax increase (12.5%).

The program changes affect 58 areas and are projected to reduce unfunded Medicaid costs by $1.38 billion. The largest projected savings would come from the following:

- Shifting more costs for children with special healthcare needs who are covered by both Medicaid and private insurance to private insurers ($250 million);
- Limiting adult prescriptions to five per month ($136 million);
- Removing ineligible recipients from Medicaid rolls ($120 million);
- Imposing a moratorium on new admissions to intermediate care nursing homes ($114 million);
- Eliminating the Illinois Cares Rx program, which provides prescription drug coverage to low-income seniors and is not federally reimbursed ($72.2 million);
- Reducing the return on capital investment used to establish reimbursement rates for nursing homes from 11% to 4% ($71.1 million);
- Eliminating restorative dental treatment for adults ($51.4 million); and
- Reducing eligibility to 133% of FPL from 185% for parents in the FamilyCare program ($49.9 million).

Rates paid to healthcare providers (excluding doctors) would be reduced by $675 million. The Governor's Office reportedly estimated that this would represent a rate reduction of

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[124] Doug Finke, "Quinn's proposed $2.7 billion Medicaid cut might be biggest in nation," *State Journal-Register*, March 22, 2012.
[125] Office of Governor Pat Quinn, *FY13 Medicaid Liability and Spending Reductions: Governor's Proposal to General Assembly*, April 19, 2012, http://www2.illinois.gov/gov/Documents/Medicaid/Medicaid%20Spending%20Reductions.pdf (last visited on April 19, 2012).
[126] Sophia Tareen, "State Medicaid committee can't agree on cuts," *State Journal-Register*, April 18, 2012.

approximately 8% to 9%.[127] The Governor proposed a rate reduction of $552 million in his FY2012 budget, but the proposal was not supported by the General Assembly.

The cigarette tax would rise by $1 a pack to $1.98, bringing in an estimated $337.5 million in revenue. Federal reimbursements on Medicaid spending due to the increased cigarette tax would generate another $337.5 million. The tax revenue is doubled through a cycle of State Medicaid spending and federal reimbursement known in Illinois as "churning."[128]

For example, suppose that all the revenue from the tax increase is collected at one time. The cycle starts when the State spends $337.5 million on Medicaid bills and receives a 50% reimbursement from the federal government, or $168.75 million. The State then spends the $168.75 million on Medicaid and receives another 50% reimbursement, or $84.375 million, and so on. This process can be repeated until Medicaid spending totals $675 million: half from the State and half from federal reimbursements.

[127] Greg Hinz, "Quinn proposes $2.7 billion in cuts and taxes to 'save' Medicaid," *ChicagoBusiness.com*, April 19, 2012.
[128] For a detailed explanation of churning, see the Civic Federation's Institute on Illinois' Fiscal Sustainability blog at http://www.civicfed.org/iifs/blog/medicaid-101-how-3375-million-turns-675-million (last visited on April 26, 2012).

## STATE RETIREMENT SYSTEMS

The proposed FY2013 budget includes statutorily required General Funds pension contributions of $5.1 billion and General Funds debt service costs of $1.6 billion on pension bonds. These combined pension-related costs of $6.6 billion represent 22.1% of projected State-source General Funds revenues in FY2013.

This section provides a brief overview of the State's five retirement systems, a discussion of pension costs in the FY2013 budget and in subsequent years and a summary of Governor Quinn's pension reform proposal announced on April 20, 2012.

### State Retirement Systems Overview

The State of Illinois funds five State retirement systems: the Teachers' Retirement System (TRS), the State Universities Retirement System (SURS), the State Employees' Retirement System (SERS), the Judges' Retirement System (JRS) and the General Assembly Retirement System (GARS). Employees also contribute to the systems, with contributions ranging from 4% to 12.5% of salary depending on the plan and whether the member is also covered by Social Security. As of June 30, 2011, there were a total of 749,894 participants in the systems.

**State of Illinois Retirement Systems: Enrollment and Member Contribution Rates as of June 30, 2011**

| Pension Fund | Members | Annuitants | Total | Member Contribution* |
|---|---|---|---|---|
| Teachers | 285,485 | 101,352 | 386,837 | 9.4% |
| Universities | 161,533 | 51,370 | 212,903 | 8.0%-9.5%** |
| State Employees | 87,661 | 59,786 | 147,447 | 4.0%-12.5%*** |
| Judges | 984 | 1047 | 2,031 | 11.0% |
| General Assembly | 266 | 410 | 676 | 11.5% |
| **Total** | **535,929** | **213,965** | **749,894** | |

*Percentage of salary a member is required to contribute under the Illinois Pension Code.

**Most members contribute 8.0%. Police officers and firefighters contribute 9.5%.

***Members covered by Social Security contribute 4% if ineligible for an alternative benefits formula and 8.5% if eligible. Members not covered by Social Security contribute 8% if ineligible for an alternative benefits formula and 12.5% if eligible.

Source: State of Illinois, General Obligation Bonds, Series of March 2012, *Official Statement* , March 15, 2012, p. 51.

TRS covers public school teachers outside of Chicago and receives employer contributions from local school districts, special districts and other State agencies, although 93.3% of its funding comes from the State.[129] SURS covers employees of State universities, community colleges and related agencies and receives employer contributions from community college districts and other State agencies. SERS covers most State employees not eligible for another plan. JRS covers judges, and GARS covers members of the legislature, constitutional officers and clerks of the

[129] State of Illinois, General Obligation Bonds, Series of March 2012, *Official Statement*, March 15, 2012, p. 49.

House and Senate. According to the Governor's Office, 78% of the State's FY2013 pension contributions are for non-State employees.[130]

One measure of the financial health of a retirement system is the funded ratio, which shows the percentage of the actuarial accrued liability that is covered by the system's assets. The actuarial accrued liability is an estimate of the present value of the benefits owed to current and retired employees. The unfunded liability represents the amount by which the system's liability exceeds its assets.

As shown in the table below, Illinois' retirement systems had a total unfunded liability of $83.1 billion and a combined funded ratio of 43.3% as of June 30, 2011. These numbers are based on the market value of assets, which recognizes gains and losses on investments as they occur.

**State of Illinois Retirement Systems**
**Funded Ratios and Unfunded Liability: June 30, 2011**
**Assets at Market Value (in $ millions)**

| Pension Fund | Accrued Liability | Net Assets | Unfunded Liability | Funded Ratio |
|---|---|---|---|---|
| Teachers | $ 81,299.7 | $ 37,471.3 | $ 43,828.4 | 46.1% |
| Universities | $ 31,514.3 | $ 14,274.0 | $ 17,240.3 | 45.3% |
| State Employees | $ 31,395.0 | $ 10,970.8 | $ 20,424.2 | 34.9% |
| Judges | $ 1,952.5 | $ 606.0 | $ 1,346.5 | 31.0% |
| General Assembly | $ 298.4 | $ 60.4 | $ 238.0 | 20.2% |
| **Total** | **$ 146,459.9** | **$ 63,382.5** | **$ 83,077.4** | **43.3%** |

Source: Commission on Government Forecasting and Accountability, *Report on the Financial Condition of the Illinois State Retirement Systems as of June 30, 2011* , March 2012, p. 25.

Beginning in FY2009, the retirement systems have been required to recognize gains and losses on assets over a five-year period.[131] This method, known as asset smoothing, mitigates the effects of short-term stock market volatility and minimized the investment losses suffered by the systems as a result of the 2008 to 2009 market downturn. Using the asset smoothing approach, the system had a total unfunded liability of $82.9 billion and a combined funded ratio of 43.4% as of the end of FY2011.[132]

State pension contributions are determined by a 50-year funding plan that began in FY1996.[133] At the end of FY1995, the total unfunded liability stood at approximately $19.5 billion.[134] After a phase-in period of 15 years, the law requires State contributions at a level percentage of payroll sufficient to achieve a 90% funded ratio by the end of FY2045. The retirement systems calculate and certify the amounts needed each year to meet the requirements of this funding schedule.

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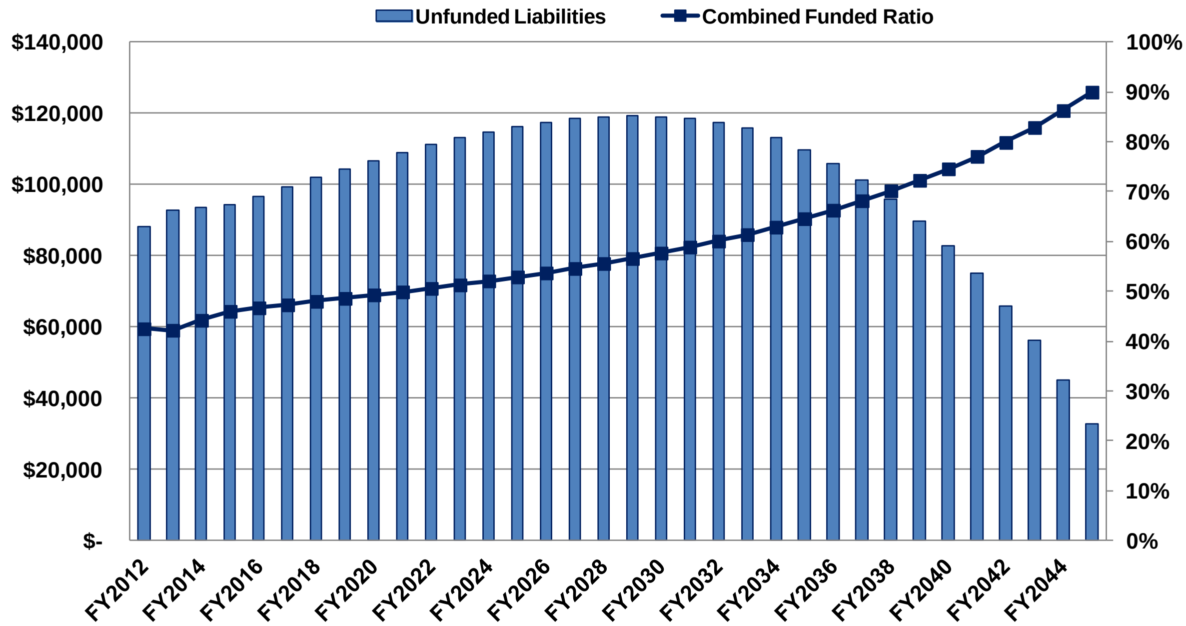
[130] Office of Illinois Governor Pat Quinn, *Pensions Fact Sheet*, April 20, 2012, http://www2.illinois.gov/gov/Documents/Pensions/Pensions%20Fact%20Sheet-%20SSH.pdf (last visited on April 22, 2012).
[131] Public Act 96-0043.
[132] Commission on Government Forecasting and Accountability, *Report on the Financial Condition of the Illinois State Retirement Systems as of June 30, 2011*, March 2012, p. 24.
[133] Public Act 88-0593.
[134] Commission on Government Forecasting and Accountability, *Report on the 90% Funding Target of Public Act 88-0593*, January 2006, p. i. This statistic is based on the market value of assets.

The funding plan and subsequently enacted changes deferred a large portion of the required State contributions to later years. The next chart shows the retirement systems' most recent funding projections through FY2045.

**State Retirement Systems Unfunded Liabilities and Combined Funded Ratio: FY2012-FY2045 (in $ millions)***




*Asset values are based on asset smoothing rather than market value. See Appendix D for data.
Source: Commission on Government Forecasting and Accountability, *A Report on the Financial Condition of the Illinois State Retirement Systems as of June 30, 2011,* March 2012, p. 95.

The funding schedule does not require the State to make adequate contributions to keep unfunded liabilities from growing until approximately 2031.[135] State contributions required by the statutory funding plan have also been less than those required under the reporting standards of the Governmental Accounting Standards Board.[136]

Beginning in FY2005, State contributions were reduced by the amount of debt service on $10.0 billion in pension bonds issued in FY2003.[137] The State issued a total of $7.2 billion in POBs to make its General Funds pension contributions for FY2010 and FY2011, but debt service amounts on those bonds are not deducted from statutorily required contributions. State contributions for

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135 Commission on Government Forecasting and Accountability, *Report on the Financial Condition of the Illinois State Retirement Systems as of June 30, 2011*, March 2012, p. 95. The contribution amount that is adequate to keep unfunded liabilities from growing consists of the normal cost, which is the amount needed to cover the present value of benefits earned by system members in each fiscal year, plus interest on the unfunded liability. This contribution, while adequate to prevent growth in unfunded liabilities, is not enough to pay down unfunded liabilities.
136 State of Illinois, General Obligation Bonds, Series of March 2012, *Official Statement*, March 15, 2012, p. 52.
137 Public Act 93-0002. The bonds will be retired in 2033.

FY2006 and FY2007 were also reduced by law when the State took a partial pension holiday to free up funds for other expenses.[138]

To lower pension costs, the State in April 2010 created a two-tier benefits system with less generous benefits for workers hired on or after January 1, 2011.[139] The new tier of benefits, known as Tier 2, includes higher retirement ages, a maximum pensionable salary and lower cost of living adjustments.

Tier 2 employees receive annual benefit increases of 3% or one-half of the annual increase in the Consumer Price index, whichever is less. Current Illinois retirees and those hired before January 1, 2011 receive automatic annual increases of 3%. New workers' benefits grow more slowly over time because the annual increase is based on a simple rate, while the benefits of retirees and existing employees are increased based on a compounded rate.[140]

Savings due to these benefit reductions will increasingly affect the State's budget in future years. As a larger percentage of the workforce is covered by the lower benefits, the accrued pension liability will decline and statutorily required State contributions will be reduced.[141]

### Budget Impact in FY2013 and Beyond

In the FY2013 budget, statutorily required General Funds pension contributions are $5.1 billion.[142] The FY2013 payments will be made from General Funds rather than through issuing pension bonds, as in FY2010 and FY2011.

Transfers out of General Funds to pay for debt service on outstanding pension bonds are $1.6 billion in FY2013. Total General Funds pension-related costs of $6.6 billion represent 22.1% of projected FY2013 State-source General Funds revenues.

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[138] Public Act 94-0004.

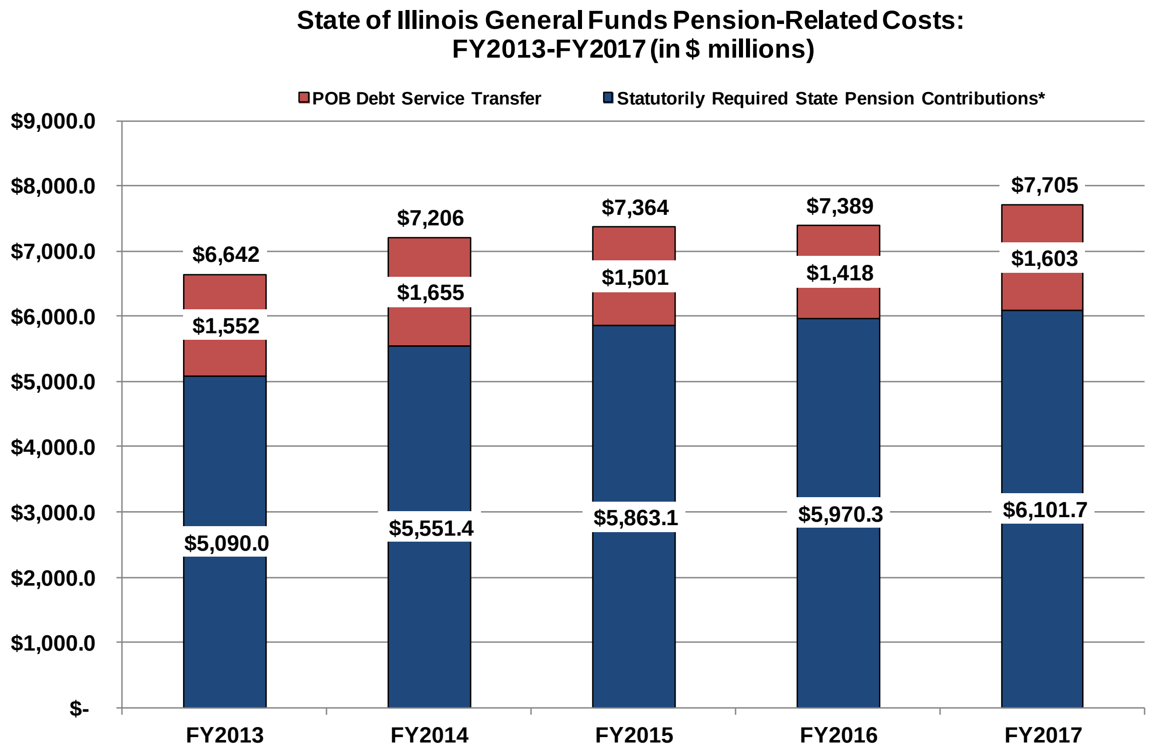
[139] Public Act 96-0889. This legislation also applies to most non-public safety local government pension funds across the State.

[140] A simple rate increase is based on the initial benefit amount only, while a compounded rate is based on the initial benefit plus previously earned rate increases.

[141] State of Illinois, General Obligation Bonds, Series of March 2012, *Official Statement*, March 15, 2012, p. 69.

[142] Roughly $778 million in pension contributions will come from Other State Funds in FY2013.

The following chart shows General Funds pension costs from FY2013 to FY2017. Contribution amounts after FY2013 are Civic Federation estimates based on data from the legislature's Commission on Government Forecasting and Accountability.[143] Debt service is not reduced significantly until FY2019, after the FY2011 pension bonds are paid off completely.

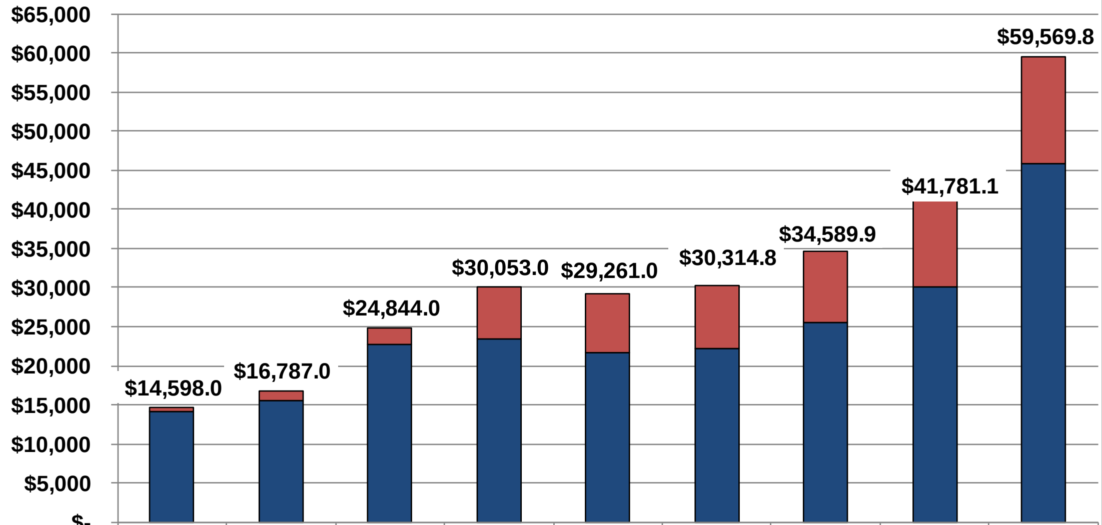



Source: Contributions calculated by Civic Federation based on data in Commission on Government Forecasting and Accountability, *A Report On The Financial Condition of the Illinois State Retirement Systems As of June 30, 2011,* March 2012, p. 95; POB debt service transfer from communication between Civic Federation and Governor's Office of Management and Budget, January 5, 2012.

[143] Commission on Government Forecasting and Accountability, *Report on the Financial Condition of the Illinois State Retirement Systems as of June 30, 2011*, March 2012, p. 95. It is assumed that General Funds account for 66% of the State's total contributions to the State Employees' Retirement System. In addition, SERS contributions are not adjusted for the portion of 2003 pension bond debt service collected through payroll deduction.

The next chart compares the growth of General Funds pension costs—including both contributions and debt service—to the growth of actual and projected State-source General Funds revenue through FY2045. The chart reflects scheduled partial sunsets in 2015 and 2025 of temporary income tax increases enacted in 2011 and assumes that State-source General Funds revenue will increase at a compound average rate of 3% a year. Pension costs grow from 3.6% of revenue in FY1996 to 22.1% in FY2013 to 27.8% in FY2033.

**State of Illinois General Funds Pension Cost Compared to Actual and Projected Revenues (in $ millions)**




| | FY1996 | FY2002 | FY2008 | FY2013 | FY2015 | FY2019 | FY2025 | FY2033 | FY2045 |
|---|---|---|---|---|---|---|---|---|---|
| State-Source Revenue* | $14,598.0 | $16,787.0 | $24,844.0 | $30,053.0 | $29,261.0 | $30,314.8 | $34,589.9 | $41,781.1 | $59,569.8 |
| Pension Cost** | $526.1 | $1,253.3 | $2,153.1 | $6,642.0 | $7,661.0 | $8,171.4 | $9,081.6 | $11,617.8 | $13,706.2 |
| Remaining Revenue | $14,071.9 | $15,533.7 | $22,690.9 | $23,411.0 | $21,600.0 | $22,143.4 | $25,508.3 | $30,163.3 | $45,863.6 |
| Pensions as % Revenue | 3.6% | 7.5% | 8.7% | 22.1% | 26.2% | 27.0% | 26.3% | 27.8% | 23.0% |

* State-source revenue projections assume a 3.0% compound annual growth rate and incoporate income tax rollbacks under current law scheduled for FY2015 and FY2025.
** Includes Pension Obligation Bond debt service and pension contributions from General Funds. Contributions for FY2012 and FY2013 are actual contributions certified by the retirement systems in accordance with Public Act 88-0593. Contributions for FY2014 through FY2045 are retirement system projections. Debt service amounts are transfers out of General Funds for FY2013 and prior years and actual payments amounts thereafter.
Source: Civic Federation calculations based on data from Commission on Government Forecasting and Accountability, *FY2012 Economic Forecast and Revenue Estimate and FY2011 Revenue Update,* March 2012, pp. 7, 11; Illinois State FY1999 Budget p. 11-17; Commission on Government Forecasting and Accountability, *A Report on the Financial Condition of the Illinois State Retirement Systems as of June 30, 2011*, March 2012, pp. 95-100.

After analyzing how much of the State's future revenues will have to go toward pension costs under current law, the TRS Board of Trustees approved a resolution on March 30, 2012 stating that it no longer had confidence that the State could meet its funding obligations to TRS.[144] The resolution represented a change of position for TRS, which had previously maintained that the State would adhere to the pension funding law requiring 90% funding by FY2045.

TRS accounted for $2.4 billion, or 58.2%, of the State's General Funds pension contributions in FY2012 and is budgeted to account for $2.7 billion, or 53.1%, in FY2013. TRS' actuaries examined how the fund would fare under several different scenarios: if the FY2012 contribution grows by 3% a year for 37 years; if the FY2012 contribution is frozen for 37 years; and if the FY2012 contribution is cut to $1.4 billion and is frozen at that level for 37 years. The analysis

[144] Teachers' Retirement System of the State of Illinois, *Board of Trustees Resolution*, March 30, 2012, http://trs.illinois.gov/subsections/press/TRSBoardResolution.pdf (last visited on April 23, 2012).

showed that the fund would become insolvent in 2049 under the first scenario, in 2038 under the second and in 2030 under the third.

### Governor's Pension Plan

In his budget speech on February 22, 2012, Governor Quinn called for major pension reforms to curb the growth in required State contributions.[145] The Governor directed a working group of the General Assembly to develop a plan by April 17, 2012 that would consider historical funding practices, employer and employee contributions, the retirement age and the annual automatic benefit increase.

On April 20, 2012, Governor Quinn proposed a plan that is projected to reduce the State's pension contributions by an amount between $65 billion and $85 billion through FY2045.[146] The plan is based on ideas discussed by the legislative working group but on which members of the group were reportedly unable to reach consensus.[147]

Major components of the Governor's plan include the following:

- Employees hired before January 1, 2011 would be allowed to choose between 1) Keeping existing benefits, but with their pensionable salary frozen at the current level and no subsidy for retiree health insurance or 2) Moving to a new system with a 3 percentage point increase in contributions, higher retirement age of 67 phased in over time and a lower, delayed, simple-interest annual benefit increase;
- Employees who move to the lower-benefit plan would continue to have pay increases counted in the calculation of their pensions and would continue to receive subsidized retiree health insurance;
- Responsibility for funding the normal cost (the retirement benefits earned by workers during a given fiscal year) of pension benefits for TRS and SURS will be gradually shifted from the State to local school districts, public universities and community colleges; and
- State funding would be based on actuarially required contributions that would lead to a 100% funded ratio by FY2042.

Many aspects of the proposal remain unclear. For example, Governor Quinn has not yet made available data to show the basis of the projected $65 billion to $85 billion decline in State contributions or the projected schedule of annual contributions through FY2042. At a press conference, the Governor suggested that the $85 billion savings estimate assumes that three-

[145] Office of Governor Pat Quinn, *Fiscal Year 2013 Budget Address*, February 22, 2012, http://www2.illinois.gov/budget/Documents/Budget%20Book/FY%202013/FINAL%20FY13%20BUDGET%20SPEECH.pdf (last visited on April 22, 2012).
[146] Office of Governor Pat Quinn, "Governor Quinn Proposes Bold Plan to Stabilize the Public Pension System," *news release*, April 20, 2012, http://www.illinois.gov/PressReleases/ShowPressRelease.cfm?SubjectID=1&RecNum=10188 (last visited on April 20, 2012).
[147] Chris Wetterich, "Quinn: Delay retirement, charge employees more to fix pensions," *State Journal-Register*, April 20, 2012.

quarters of State workers choose the new plan, while the $65 billion savings estimate is based on a lower level of participation.[148]

It also remains to be seen whether the proposal could withstand legal challenges. The Illinois Constitution provides that membership in any pension system in the State is an enforceable contractual relationship and that member benefits "shall not be diminished or impaired."[149] Legal opinions have varied on whether this prohibition applies to non-vested benefits of current employees.

A coalition of labor unions has stated that it opposes the Governor's plan and considers it to be unconstitutional.[150] The President of the Senate, who has opposed other pension reform proposals on constitutional grounds, reportedly said that the Governor's plan is based on a legal framework that will allow the State to control pension costs in a constitutional way.[151]

Another issue involves shifting normal costs for TRS and SURS from the State to participants' employers. In FY2013 the State's share of normal cost is $676.2 million for TRS and $411.0 million for SURS.[152] Many school districts are in counties where property tax caps are in effect, limiting their ability to pay the additional pension costs from property tax increases.

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[148] The Governor's press conference can be viewed at http://www.illinois.gov/PressReleases/ShowPressRelease.cfm?SubjectID=1&RecNum=10188 (last visited on April 23, 2012).

[149] Illinois Constitution, Article XIII, Section 5.

[150] We Are One Illinois, *Statement on Quinn news*, April 20, 2012, http://www.weareoneillinois.org/news/we-are-one-illinois-statement-on-quinn-pension-proposal (last visited on April 23, 2012).

[151] Chris Wetterich, "Quinn: Delay retirement, charge employees more to fix pensions," *State Journal-Register*, April 20, 2012.

[152] Email communication between Civic Federation and TRS, April 12, 2012; email communication between Civic Federation and SURS, April 11, 2012.

## STATE GROUP HEALTH INSURANCE

The FY2013 budget proposes a reduction of $265 million in General Funds appropriations for the State Employees' Group Insurance Program from $1.436 billion in FY2012 to $1.171 billion in FY2013. The proposal assumes approximately $250 million in cost reductions that are currently under negotiation with the State's labor unions.[153]

This section provides a brief overview of the State group insurance program, an analysis of the FY2013 budget proposal and a review of the limited details available on changes being considered in group insurance as part of pension reforms and labor negotiations.

The section also discusses the State's separate retiree health insurance programs for teachers and community college employees outside of Chicago: the Teachers' Retirement Insurance Program (TRIP) and the College Insurance Program (CIP).

### State Group Insurance Overview

The State Employees' Group Insurance Program provides health insurance coverage to an estimated 357,738 participants, including employees and retirees and their dependents.[154] Funding for the program comes from General Funds, the State's Road Fund, State universities, member contributions and other sources, including a retiree Medicare Part D prescription drug coverage subsidy from the federal government.

The cost of the group insurance program is expected to increase by $174.9 million, or 7.1%, to $2.65 billion in FY2013 from $2.48 billion in FY2012.[155] The program's cost has risen by 79.7% from $1.47 billion in FY2004, or at an annual average rate of 6.7%.

The State offers both a traditional health insurance plan, which allows participants to choose any doctor or hospital, and managed care plans such as Health Maintenance Organizations (HMOs), which generally restrict choices. The traditional health plan, the Quality Care Health Plan (QCHP), is more costly and requires participants to pay higher premiums.[156] Membership in QCHP is expected to decline by 18.1% from 142,779 in FY2005 to an estimated 116,952 in FY2013.[157] In FY2013 32.9% of participants were expected to be enrolled in QCHP and 67.1% in managed care plans.

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[153] Email communication between the Civic Federation and the Governor's Office of Management and Budget, March 12, 2012.

[154] Commission on Government Forecasting and Accountability, *Liabilities of the State Employees' Group Health Insurance Program FY2013*, March 2012, p. 7. For more information on the State's group insurance program, see The Civic Federation, *State of Illinois Employee Health Insurance Plans: Analysis and Recommendations for Cost Containment*, April 16, 2007, http://www.civicfed.org/civic-federation/publications/state-illinois-employee-health-insurance-plans-analysis-and-recommenda (last visited on April 20, 2012).

[155] Commission on Government Forecasting and Accountability, *Liabilities of the State Employees' Group Health Insurance Program FY2013*, March 2012, p. 9.

[156]Although participants may choose any medical services provider, they receive enhanced benefits for using doctors and hospitals that are members of a network.The State assumes the risk for some of its insurance plans, including QCHP, and contracts with insurance companies to provide other plans.

[157] Commission on Government Forecasting and Accountability, *Fiscal Year 2006 Liabilities of the State Employees' Group Insurance Program,* March 2005, *p. 4;* Commission on Government Forecasting and Accountability, *Liabilities of the State Employees' Group Health Insurance Program FY2013*, March 2012, p. 7.

Retirees, however, overwhelmingly choose the more expensive traditional health plan. In FY2012 64.9% of retirees were enrolled in QCHP.[158] Illinois law provides that State employees who retired before January 1, 1998 and those who retired after that date with at least 20 years of service do not pay healthcare premiums.[159] Exceptions include General Assembly members, who can retire with as few as four years of service and not pay any premiums, and judges, who can retire with as few as six years of service and not pay premiums.[160]

As of February 2011, 91.0% of the 81,900 retirees covered by the group insurance program were not required to pay any premiums.[161] The State's cost for retiree health insurance coverage in FY2012 was estimated at $684.3 million, while retirees' contribution was estimated at $25.8 million.[162] These figures do not include the cost of coverage for retirees' dependents; all retirees are required to pay premiums for their dependents.

The State makes contributions to the group insurance program on a pay-as-you go basis rather than prefunding future obligations to retirees. As of June 30, 2011, the program's accrued liability for current and future retirees was estimated at $33.3 billion.[163]

### FY2013 State Group Insurance Appropriations

The FY2013 budget proposes total appropriations of $2.7 billion for State group insurance. The recommended FY2013 General Funds appropriation is $1.17 billion, or $264.3 below the FY2012 General Funds appropriation of $1.436 billion.

The lower General Funds appropriation for FY2013 is based on the assumption that the State will reduce its insurance costs by approximately $250 million either through program changes or increased employee contributions.[164] The Governor's Office has not made details of these proposals public due to ongoing labor negotiations.

However, retiree health insurance is a component of the Governor's pension reform proposal announced on April 20, 2012.[165] The proposal offers employees a choice between their current plans and a new plan involving higher employee contributions, lower benefits and more stable

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[158] Commission on Government Forecasting and Accountability, *Liabilities of the State Employees' Group Health Insurance Program FY2013*, March 2012, p. 8.
[159] 5 ILCS 375/10. The State contributes 5% of the premium cost for each full year of service, up to a maximum of 100% for retirees with 20 or more years of service.
[160] General Assembly members elected before January 1, 2011 can retire at age 62 with four years of service; those elected on or after that date must be 67 with eight years of service. Judges elected or appointed before January 1, 2011 can retire at 62 with six years of service; judges elected or appointed on or after that date must be 67 with eight years of service.
[161] Commission on Government Forecasting and Accountability, *Request for Proposals to Provide Consulting Services*, February 17, 2011, p. 2.
[162] Commission on Government Forecasting and Accountability, *Liabilities of the State Employees' Group Health Insurance Program FY2013*, March 2012, p. 13.
[163] Illinois State Employees Group Insurance Program, *GASB No. 45 Actuarial Valuation Report as of June 30, 2011*, December 22, 2011, p. 2.
[164] Email communication between the Civic Federation and the Governor's Office of Management and Budget, March 12, 2012. Road Fund appropriations also increase by $11.7 million.
[165] Office of Governor Pat Quinn, "Governor Quinn Proposes Bold Plan to Stabilize the Public Pension System," *news release*, April 20, 2012.

funding. Employees who do not choose the new plan will lose the State subsidy for retiree health coverage. Employees who select the new plan will retain State support for retiree health insurance, but it is not clear whether State assistance will remain at the current level.

Group health insurance bills, like Medicaid bills, are covered by the Section 25 exception to the State Finance Act that allows prior years' bills to be paid from future years' appropriations.[166] Due to inadequate appropriations, unpaid group health insurance bills will grow from $321.1 million at the end of FY2009 to $1.06 billion at the end of FY2012. The following chart shows unpaid health insurance bills at $1.13 billion at the end of FY2013. This projection assumes that budgeted cost reductions of $250 million are achieved.

**State of Illinois Group Insurance Program**
**General Funds Appropriations and Unpaid Bills:**
**FY2009-FY2013 ($ in millions)**

| | FY2009 Actual | FY2010 Actual | FY2011 Actual | FY2012 Est. | FY2013 Rec. |
|---|---|---|---|---|---|
| General Funds Appropriations | $ 1,057.9 | $ 1,146.4 | $ 884.9 | $ 1,435.5 | $ 1,171.2 |
| Unpaid Bills End of Year | $ 321.1 | $ 523.5 | $ 1,088.0 | $ 1,058.9 | $ 1,129.9 |

Source: Illinois State FY2013 Budget, p. 2-31; Illinois State FY2012 Budget, p. 2-26; Illinois State FY2011 Budget, p. 2-20; State of Illinois, General Obligation Bonds, Series of March 2012, *Official Statement* , March 15, 2012, p. 40; Email communication between Civic Federation and Governor's Office of Management and Budget, March 29, 2012.

## TRIP and CIP

The State also makes General Funds contributions to the Teachers' Retirement Insurance Program (TRIP) and the College Insurance Program (CIP) to cover retired teachers outside Chicago and downstate retired community college employees. Unlike most retirees in the State group health program, retirees in TRIP and CIP are required to pay premiums.

TRIP has 262,180 participants, including 59,358 retirees.[167] Benefits offered by TRIP are funded through retiree premiums; percentage-of-payroll contributions from active employees (0.88%), local school districts (0.66%) and the State (0.84%); and a Medicare Part D prescription drug subsidy from the federal government.[168] The estimated State contribution for FY2013 is $86.7 million.[169]

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[166] 30 ILCS 105/25 (b-4).
[167] Teachers' Retirement Insurance Program of the State of Illinois, *GASB No. 43 Actuarial Valuation Report as of June 30, 2011*, January 6, 2012, p. 8.
[168] Teachers' Retirement Insurance Program of the State of Illinois, *GASB No. 43 Actuarial Valuation Report as of June 30, 2011*, January 6, 2012, p. 1.
[169] Email communication between the Civic Federation and the Governor's Office of Management and Budget, April 5, 2012.

There is no arrangement to prefund benefits for TRIP, although a trust exists into which employers are making contributions that slightly exceed annual expected net claim payments. The unfunded liability was $18.9 billion as of June 30, 2011.[170]

CIP has 34,473 participants, including 5,240 retirees.[171] Benefits offered by CIP are funded through retiree premiums; percentage-of-payroll contributions from active employees (0.50%), community colleges (0.50%) and the State (0.50%); and a Medicare Part D prescription drug subsidy from the federal government.[172] The estimated State contribution for FY2013 is $4.2 million.[173]

As is the case with TRIP, there is no arrangement to prefund benefits for CIP. A trust exists into which employers are making contributions, but benefit payments slightly exceeded contributions in FY2011. The unfunded liability was $2.1 billion as of June 30, 2011.[174]

The proposed FY2013 budget does not include State funding for TRIP or CIP. However, these contributions are covered by continuing appropriations under State law.[175] Without a change in the law, the contributions will continue to be made.

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[170] Teachers' Retirement Insurance Program of the State of Illinois, *GASB No. 43 Actuarial Valuation Report as of June 30, 2011*, January 6, 2012, p. 2.
[171] College Insurance Program of Illinois, *GASB No. 43 Valuation as of June 30, 2011*, December 20, 2011, p. 8.
[172] College Insurance Program of Illinois, *GASB No. 43 Valuation as of June 30, 2011*, December 20, 2011, p. 1.
[173] Email communication between the Civic Federation and the Governor's Office of Management and Budget, April 5, 2012.
[174] College Insurance Program of Illinois, *GASB No. 43 Valuation as of June 30, 2011*, December 20, 2011, p. 2.
[175] 40 ILCS 15/1.3 and 40 ILCS 15/1.4.

## BUDGET DEFICIT AND UNPAID BILLS

The proposed FY2013 budget results in a total General Funds deficit of $5.0 billion and a backlog of unpaid bills of roughly $9.1 billion at the end of the fiscal year. These results are based on reducing Medicaid costs by $2.7 billion.

This section reviews the FY2013 budget plan and provides information on other General Funds liabilities that are not included in the budget.

### General Funds Budget Plan

The total deficit consists of the operating deficit or surplus and the accumulated deficit from prior years. As shown in the following table, the FY2013 budget generates an operating surplus of $163 million. This surplus partially offsets the accumulated deficit from prior years of $5.2 billion, resulting in a total deficit of $5.0 billion. The total deficit at the end of FY2013 declines 3.1% from $5.2 billion at the end of FY2012.

**State of Illinois General Funds Budget Plan: FY2012-FY2013 (in $ millions)**

| | FY2012 Enacted | FY2013 Rec. | $ Change | % Change |
|---|---|---|---|---|
| **Operating Resources** | | | | |
| State Source Revenues | $27,587 | $28,205 | $ 618 | 2.2% |
| Federal Source Revenues | $ 3,805 | $ 3,935 | $ 130 | 3.4% |
| **Subtotal Revenues** | **$31,392** | **$32,140** | **$ 748** | **2.4%** |
| Statutory Transfers In | $ 1,829 | $ 1,800 | $ (29) | -1.6% |
| **Total Operating Resources** | **$33,221** | **$33,940** | **$ 719** | **2.2%** |
| **Expenditures** | | | | |
| Agency Appropriations | $25,252 | $24,828 | $ (424) | -1.7% |
| Less Unspent Appropriations | $ (904) | $ (500) | $ 404 | -44.7% |
| **Subtotal Net Agency Appropriations** | **$24,348** | **$24,328** | **$ (20)** | **-0.1%** |
| **Pension Contributions** | **$ 4,135** | **$ 5,090** | **$ 955** | **23.1%** |
| **Net Agency Appropriations and Pension Contributions** | **$28,483** | **$29,418** | **$ 935** | **3.3%** |
| Statutory Transfers Out | | | | |
| Legislatively Required Transfers | $ 2,461 | $ 2,142 | $ (319) | -13.0% |
| Debt Service on Pension Bonds | $ 1,605 | $ 1,552 | $ (53) | -3.3% |
| Debt Service Transfers for Capital Projects | $ 551 | $ 519 | $ (32) | -5.8% |
| Interfund Borrowing Repayments* | $ 626 | $ 147 | $ (479) | -76.5% |
| **Total Statutory Transfers Out** | **$ 5,243** | **$ 4,360** | **$ (883)** | **-16.8%** |
| **Total Expenditures** | **$33,726** | **$33,777** | **$ 51** | **0.2%** |
| **Operating Surplus (Deficit)** | **$ (506)** | **$ 163** | **$ 669** | **-132.2%** |
| Accumulated Deficit From Prior Years | $ (4,679) | $ (5,185) | $ (506) | 10.8% |
| **Total Surplus (Deficit)** | **$ (5,185)** | **$ (5,022)** | **$ 163** | **-3.1%** |

*Includes Budget Stabilization Fund Repayment for FY2012.

Source: Illinois State FY2013 Budget, p. 2-18.

The operating surplus of $163 million at the end of FY2013 is based on underfunding projected Medicaid costs by $2.7 billion. Under the Governor's Medicaid plan, increased cigarette taxes matched by federal reimbursements would bring in additional resources of $675 million for

Medicaid.[176] Thus, increased Medicaid appropriations of $675 million would be offset by increased revenues, leaving the operating surplus unchanged if proposed cuts are also achieved.

The following table shows the impact of the budget plan on the State's backlog of General Funds bills. With the operating surplus of $163 million used to reduce unpaid bills, the General Funds backlog declines from $5.7 billion at the end of FY2012 to $5.5 billion at the end of FY2013.

| State of Illinois General Funds Accounts Payable: FY2012-FY2013 (in $ millions) | | |
|---|---|---|
| | **FY2012 Enacted** | **FY2013 Rec.** |
| Accounts Payable Beginning of Year | $ (5,148) | $ (5,654) |
| Paydown of Accounts Payable/(Increase in Accounts Payable) | $ (506) | $ 163 |
| **Accounts Payable End of Year** | **$ (5,654)** | **$ (5,491)** |

Source: Illinois State FY2013 Budget, p. 2-18.

As previously explained in this report, most State bills from a given fiscal year must be paid with that same year's appropriations.[177] Unpaid General Funds bills at the end of a fiscal year must be paid during the lapse period, during which revenues from the next fiscal year may be used to pay for the current fiscal year's appropriations. The lapse period is usually two months but was extended to six months for FY2010 and FY2011 because of the large amount of unpaid bills.

However, that deadline does not apply to Medicaid bills, State employee health insurance claims and certain other State bills, which can be paid from subsequent years' appropriations. These liabilities are not shown in the General Funds budget.

Another liability that is not shown in the budget is the State's backlog of unpaid business income tax refunds. This backlog is a result of underfunding the Income Tax Refund Fund.[178]

[176] See p. 49 of this report for a more detailed discussion of resources provided by the increased cigarette tax.
[177] See p. 15 of this report for a more detailed discussion of the State bill payment.
[178] See p. 29 of this report for a more detailed discussion of unpaid tax refunds.

The next table provides estimates of the State's total backlog of unpaid bills at the end of FY2012 and FY2013. The backlog is expected to decline slightly, from $9.2 billion at the end of FY2012 to $9.1 billion at the end of FY2013.

| State of Illinois Estimated Unpaid Bills: Year End FY2012 and FY2013 (in $ millions) | | |
|---|---|---|
| **Category** | **FY2012** | **FY2013** |
| General Funds Bills | $ (5,654) | $ (5,492) |
| Income Tax Refunds* | $ (643) | $ (643) |
| Medicaid Bills** | $ (1,861) | $ (1,861) |
| Employee Group Health Bills | $ (1,059) | $ (1,130) |
| **Total** | **$ (9,217)** | **$ (9,126)** |

*Unpaid business income tax refunds as of April 24, 2012. Updated end of year estimates were not available.

**FY2013 estimate assumes that Medicaid underfunding of $2.7 billion will be eliminated.

Source: Illinois State FY2013 Budget, p. 2-18; State of Illinois, General Obligation Refunding Bonds, Series of May 2012, *Official Statement* , April 24, 2012, p. 41; llinois Department of Healthcare and Family Services, *Five Year Medical Assistance Budget Outlook* , March 2012; Communication between Civic Federation and Governor's Office of Management and Budget, March 29, 2012.

It is important to note that the decrease in unpaid bills is based on the assumption that Medicaid underfunding of $2.7 billion is eliminated in FY2013. Any unresolved funding gap would add to the backlog of bills.

## DEBT TRENDS

The State of Illinois currently has a total of $30.9 billion in outstanding bonded debt issued to pay for capital investments and to fund its pension systems. In FY2013 the State will pay a total of $3.5 billion in debt service, including both principal and interest, of which $2.2 billion comes from the General Funds.

The following section examines existing long-term and short-term debt issued by the State of Illinois and the amount of debt service owed by the State on an annual basis. It shows that Illinois' outstanding long-term debt nearly tripled between FY2003 and FY2013 after the State issued pension bonds and authorized the current capital budget. This section demonstrates how the debt service associated with such a large level of indebtedness has become a much larger drain on the State's financial resources.

### General Obligation and Revenue Bonds

Under the General Obligation Bond Act, the State is authorized to issue General Obligation (GO) bonds to fund a variety of capital investments including roads, schools, mass transit, environmental projects and other facilities.[179] GO Bonds are guaranteed by a pledge of the full faith and credit of the State, which is a legally binding pledge to pay both principal and interest on these loans as required by the bond agreements prior to any other use of state funds.

The State appropriated a total of $16.0 billion in capital projects to be funded by borrowing in FY2010 as part of the ongoing *Illinois Jobs Now!* capital program.[180] The capital budget approved by the Governor and General Assembly in FY2010, the State initially approved the sale of $5.8 billion in new GO Bonds to support capital projects. The total capital bond authority was increased by an additional $4.2 billion in March 2011.[181] The total bonding authority is still below the $16.0 billion appropriations and will need further increases to enable the all approved bond funded projects to be completed.

GO debt issued since the start of the capital program in FY2010 totaled $2.7 billion by the end of FY2011. In FY2012 the State issued a total of $800 million in additional GO bonds as of March 15, 2012.[182] At the end of FY2012, the State estimates outstanding capital purpose GO bonds will total $12.3 billion.[183] The Governor's recommended budget projects total capital purpose GO bonds will increase by $1.3 billion, or 10.2%, by the end of FY2013, raising the total to $13.6 billion.

Illinois has also issued several types of revenue bonds to fund capital projects. Unlike GO Bonds, revenue bonds are not guaranteed by the full faith and credit of the State but rather pledge a portion of specific state revenues. The State currently pays directly for two types of revenue bonds. The Metropolitan Exposition and Auditorium Authorities bond program was supported by the issuance of Civic Center Bonds, the last of which were sold in 1992. The FY2013 budget

[179] 30 ILCS 330/1 (2001).
[180] Illinois State FY2013 Budget, p. 6-11.
[181] Public Act 96-1554.
[182] Illinois State FY2013 Budget, p. 6-13.
[183] Illinois State FY2013 Budget p. 6-9.

shows $82.3 million in Civic Center Bonds outstanding; the State will make its final payment on this debt in FY2021.[184] Although originally financed in part by horseracing taxes, these bonds are now fully repaid by General Funds and are treated more like GO bonds.[185]

Build Illinois Bonds were first issued in 1985 and are backed by 3.8% of the State's sales tax receipts. The total bond authorization has been increased by the General Assembly on several occasions since then. The State issued a total of $300 million of Build Illinois Bonds in FY2012 and proposes selling an additional $300 million to support capital projects in FY2013.[186] At the end of fiscal year 2012, the State estimates outstanding Build Illinois Bonds will total $2.6 billion.[187]

The GO Bond Act was amended in FY2003 to allow for debt-funded payments to the State's retirement systems. The State approved $10 billion in Pension Obligation Bonds (POBs) to fund a part of the unfunded liabilities of the State's retirement systems. A portion of the bond proceeds was also used to make part of the State's required annual contributions to the fund in FY2003 and FY2004. The pension bond authorization was increased in FY2010 by $3.5 billion to make the annual contributions to the retirement systems that would have come from the State's General Funds. The bonds will be repaid over the next five years. In FY2011 the State again issued POBs to make its annual contribution to the retirement systems, this time totaling $3.7 billion to be repaid over eight years.[188]

The State receives General Funds relief for the debt service it owes on the $10 billion in POBs sold in FY2003 because of a reduction in the amount required to be paid into the retirement systems each year. Provisions of the authorization for the bonds allow the State to reduce the required annual pension contributions certified by the pension funds by the total annual debt service owed on the FY2003 POBs in each fiscal year.[189] This effectively pays for the pension bonds each year by freeing up General Funds resources that would otherwise be used to make required pension payments. The original FY2003 POBs were financed over 30 years and the last bonds will be retired in FY2033.

The debt service owed by the State on the FY2010 and FY2011 POBs is paid directly from General Funds without any offsetting reduction in pension contributions. The FY2010 POBs are retired over five years and the FY2011 series are eight-year bonds. The principal repayment on the FY2011 POBs is delayed until after the majority of the FY2010 bonds have been repaid. This back loading of the principal for the FY2011 POBs keeps the aggregate debt service owed on both series relatively level but greatly increases the total cost of the FY2011 Bonds. The FY2010 POBs totaled $3.5 billion and will cost $382 million in interest over five years. The FY2011 bonds, which totaled $3.7 billion, will cost the State $1.3 billion in interest costs over eight years. Although the total principal borrowed only increased by $234 million, or 6.8%, the State will pay $897.5 million more in interest for the FY2011 bonds, or a 234.8% increase over the total interest cost for the FY2010 bonds. At the end of FY2012, the State will have a total of $15.5 billion in POBs still outstanding.

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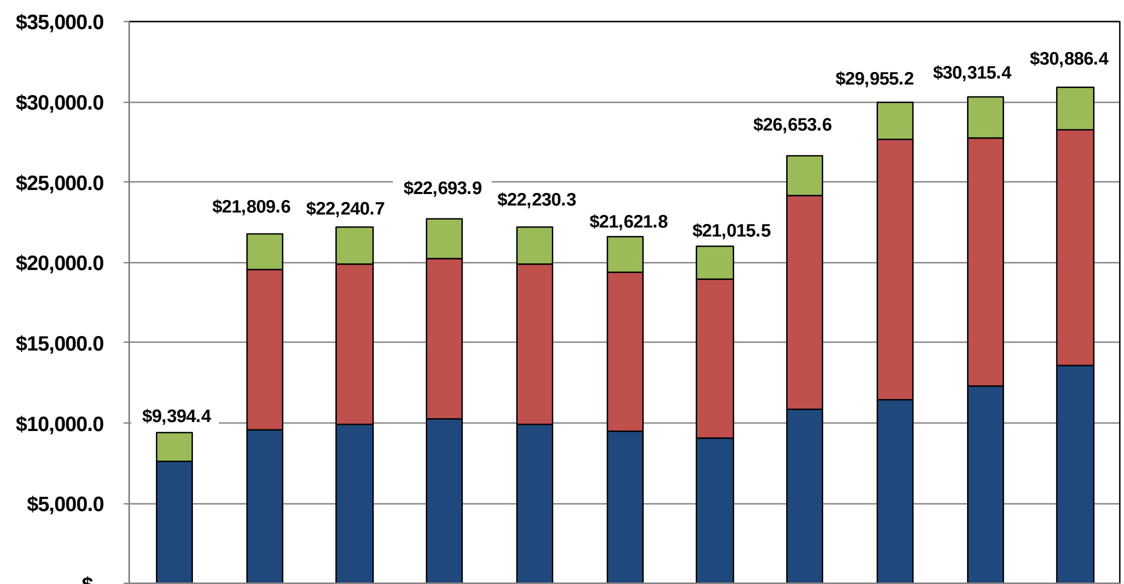
[184] Illinois State FY2012 Budget, p. 12-15.
[185] 30 ILCS 355, Metropolitan Civic Center Support Act, 1987.
[186] Illinois State FY2013 Budget, p. 6-13.
[187] Illinois State FY2013 Budget, p. 6-13.
[188] See page 52 for more details on the unfunded liabilities of the State's retirement systems.
[189] Public Acts 98-593, 94-004 and 93-009.

The Governor's FY2013 recommended budget anticipates the State's total bonded indebtedness will increase by $571 million to $30.9 billion, which is 1.9% more than the FY2012 total of $30.3 billion.

Over the last ten years the State's total debt burden increased by $9.1 billion. In FY2004 the State's bonded debt totaled $21.8 billion, or 41.6% less than the projected FY2013 total. The majority of the increase took place over the last five fiscal years, as outstanding debt declined slightly from FY2006 to FY2009 before increasing dramatically due to the pension bonds issued in FY2010 and FY2011.

The following chart shows the total debt increase for all GO bonds and revenue bonds over the last ten fiscal years. FY2002 is included in the chart to show the State debt burden prior to the issuance of the POBs in FY2003.

**State of Illinois Total Bonded Indebtedness: FY2002, FY2004-FY2013 (in $ millions)**




| | FY2002 | FY2004 | FY2005 | FY2006 | FY2007 | FY2008 | FY2009 | FY2010 | FY2011 | FY2012 (est.) | FY2013 (Proj.) |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Total Existing Debt | $9,394.4 | $21,809.6 | $22,240.7 | $22,693.9 | $22,230.3 | $21,621.8 | $21,015.5 | $26,653.6 | $29,955.2 | $30,315.4 | $30,886.4 |
| Build Illinois/Civic Center | $1,764.5 | $2,253.3 | $2,347.7 | $2,442.5 | $2,304.6 | $2,208.9 | $2,063.7 | $2,443.6 | $2,253.5 | $2,529.8 | $2,633.8 |
| Pension Bonds | $- | $10,000.0 | $10,000.0 | $10,000.0 | $10,000.0 | $9,950.0 | $9,900.0 | $13,316.0 | $16,272.8 | $15,479.6 | $14,686.0 |
| GO Capital Bonds | $7,629.9 | $9,556.3 | $9,893.0 | $10,251.4 | $9,925.7 | $9,462.9 | $9,051.8 | $10,894.0 | $11,428.9 | $12,306.0 | $13,566.6 |

Source: Illinois State Budgets FY2005-FY2013.

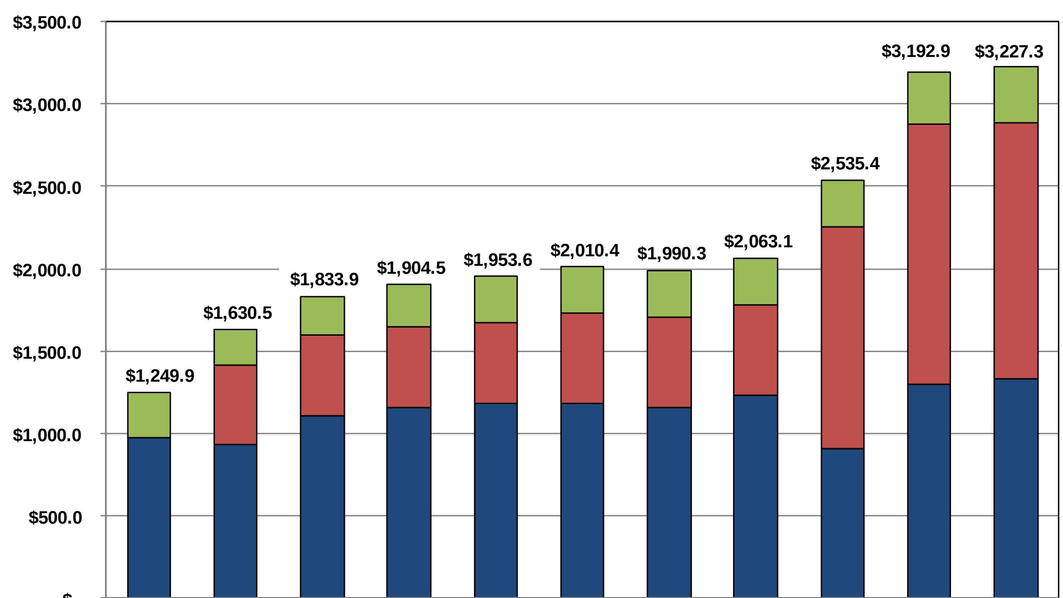
## Total Debt Service

The State's debt service schedule sets forth the principal and interest amounts due for outstanding bonds on an annual basis. In FY2013 the State estimates its required debt payments will total $3.2 billion for all the outstanding GO Bonds, POBs and revenue bonds for which it directly appropriates funds. The total debt service owed remains almost flat from FY2012 payments, which also were $3.2 billion. This marks the first time in the last five years that the total debt service owed by the State will not increase significantly from year to year. Over the last 10 years, the largest increases to annual debt service were in FY2004, FY2011 and FY2012, which are the years immediately following the sale of new POBs.

In FY2003 annual debt service totaled $1.2 billion, which was the last year that the State's annual debt service did not include payments for POBs. Since then the total annual debt service owed by the State has more than doubled, increasing by $2.0 billion, or 153.2%, as of FY2013.

The following chart shows total debt service owed for existing Pension Obligation bonds, GO capital bonds and Build Illinois/Civic Center Bonds from FY2003 through FY2013.

**State of Illinois Total Capital Purpose and Pension Bonds Debt Service (Principal + Interest) FY2003-FY2013 (in $ millions)**

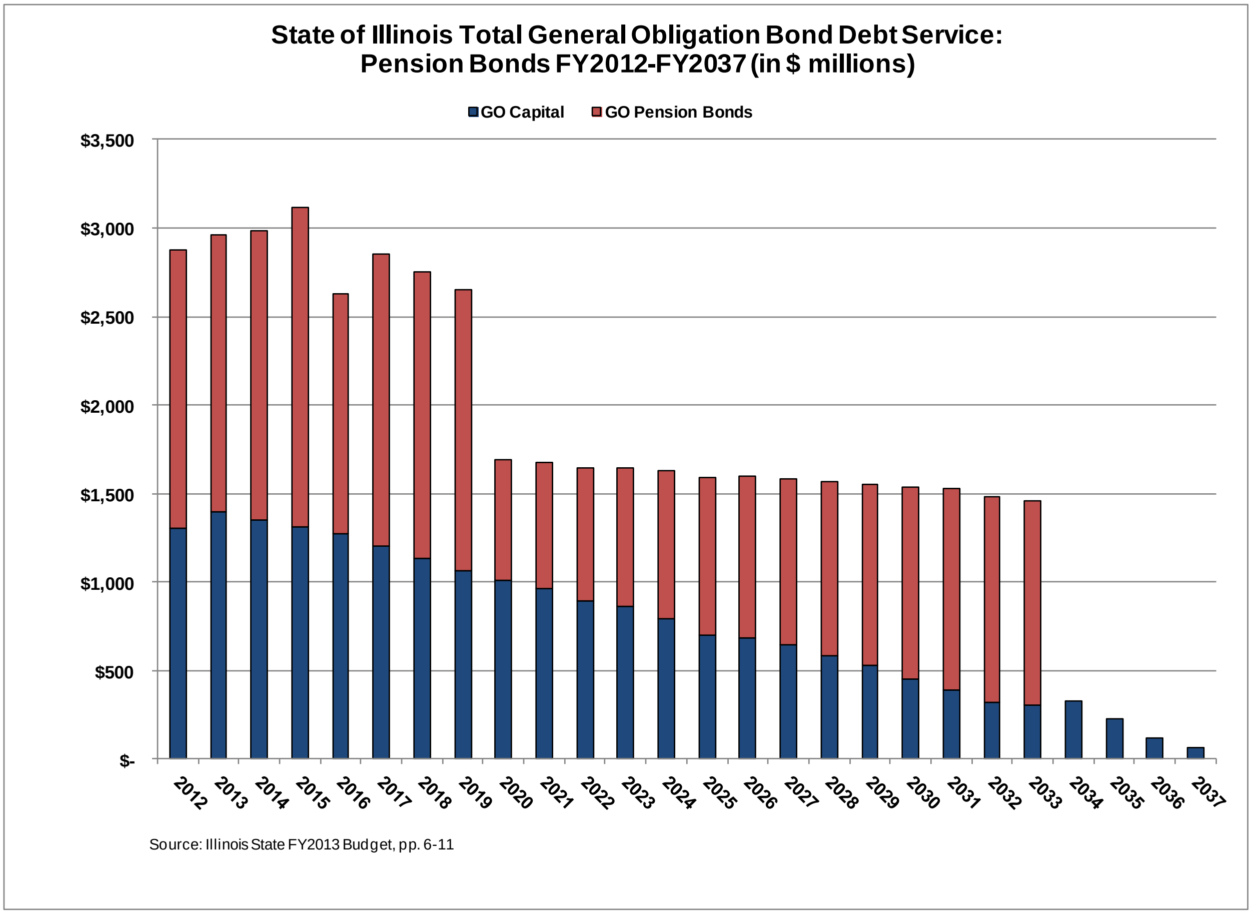



| | FY2003 | FY2004 | FY2005 | FY2006 | FY2007 | FY2008 | FY2009 | FY2010 | FY2011 | FY2012 | FY2013* |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Total Debt Service | $1,249.9 | $1,630.5 | $1,833.9 | $1,904.5 | $1,953.6 | $2,010.4 | $1,990.3 | $2,063.1 | $2,535.4 | $3,192.9 | $3,227.3 |
| Build Illinois/Civic Center | $275.9 | $218.5 | $234.5 | $255.0 | $278.0 | $280.0 | $286.0 | $286.0 | $279.9 | $313.4 | $338.7 |
| Pension Bonds | $- | $481.0 | $496.2 | $496.0 | $496.0 | $546.0 | $544.0 | $543.6 | $1,344.4 | $1,578.9 | $1,561.0 |
| GO Capital Bonds | $974.0 | $931.0 | $1,103.2 | $1,153.5 | $1,179.6 | $1,184.4 | $1,160.3 | $1,233.6 | $911.2 | $1,300.6 | $1,327.7 |

*Projected.
Source: Illinois State Budgets FY2009-FY2013.

Between FY2012 and FY2038, the State of Illinois will pay a total of $45.7 billion in debt service for all currently outstanding GO Bonds backed by the full faith and credit of the State. Of that total, $25.8 billion is POB debt service, including $9.5 billion in interest and $16.3 billion of principal. The State's total GO debt service also includes $20.0 billion for all outstanding capital purpose GO bonds.[190] The capital GO debt service is made up of $6.9 billion in interest due on $13.0 billion of principal spread over the next 25 years.

The following chart shows the total annual debt service due on the State's outstanding GO Bonds from FY2012 through FY2037, when all outstanding bonds are repaid.




## General Funds Debt Service

The State does not pay for all of the debt service associated with the capital purpose GO bonds out of the General Funds. GO capital bonds are also funded through transfers from the Capital Projects Fund, Common School Fund and the Road Fund, which have dedicated revenue sources outside the State's operating budget. The total debt service owed on the outstanding POBs are paid out of the General Funds.

In FY2013 the State estimates that the General Funds debt service transfer for capital GO bonds will total $494.4 million, down slightly from the FY2012 total of $543.7 million.[191] The

[190] Illinois State FY202 Budget, p. 12-13.

following chart shows the General Funds debt service transfer in FY2012 compared to the projected amount that will be paid from General Funds for the next five fiscal years.

| State of Illinois General Funds Debt Service Transfer: FY2012-FY2017 (in $ millions) | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Bond Type** | **FY2012** | **FY2013** | **FY2014** | **FY2015** | **FY2016** | **FY2017** | **$ Change** | **% Change** |
| **Capital Bonds** | | | | | | | | |
| Previous Capital Bonds* | $ 535.6 | $ 481.7 | $ 507.4 | $ 452.4 | $ 430.4 | $ 371.4 | $ (164.2) | -30.7% |
| New Capital Bonds | $ 16.5 | $ 12.7 | $ 20.3 | $ 20.0 | $ 19.6 | $ 18.9 | $ 2.4 | 14.7% |
| **Total Capital Bond Transfer** | **$ 552.1** | **$ 494.4** | **$ 527.7** | **$ 472.4** | **$ 450.0** | **$ 390.3** | **$ (161.8)** | **-29.3%** |
| **Pension Obligation Bonds** | | | | | | | | |
| Series FY2003 | $ 559.8 | $ 556.1 | $ 552.2 | $ 548.2 | $ 546.2 | $ 566.8 | $ 7.0 | 1.3% |
| Series FY2010 | $ 784.7 | $ 763.6 | $ 738.0 | $ 361.9 | $ - | $ - | $ (784.7) | -100.0% |
| Series FY2011 | $ 261.0 | $ 232.8 | $ 364.8 | $ 591.0 | $ 872.0 | $1,036.1 | $ 775.1 | 297.0% |
| **Total Pension Bond Transfer** | **$ 1,605.5** | **$1,552.5** | **$1,655.0** | **$1,501.1** | **$1,418.3** | **$1,602.9** | **$ (2.6)** | **-0.2%** |
| **Total Debt Service Transfer** | **$ 2,157.6** | **$2,046.9** | **$2,182.6** | **$1,973.5** | **$1,868.3** | **$1,993.1** | **$ (164.4)** | **-7.6%** |

*Bonds sold in previous years before the authorization of new debt for the current capital program in FY2010.

Source: Email Communication between Civic Federation and Governor's Office of Management and Budget, April 25, 2012.

### Short-Term Debt

The State did not issue short-term debt in FY2012. According to the Governor's recommended FY2013 budget, the State does not anticipate selling short-term bonds in FY2013.[192]

Short-term debt is a financial obligation that must be satisfied within one year. An increasing trend in short-term debt may be a warning sign of future financial difficulties. The amount of short-term debt issued is a good measure of budgetary solvency, or a government's ability to generate enough revenue over the course of a normal budgetary period to meet its expenditures and prevent deficits. The State of Illinois Short Term Borrowing Act governs the State's ability to access short-term capital.[193]

Under the Short Term Borrowing Act, the State may issue short-term debt certificates based upon revenue anticipation or shortfall. If the State experiences significant timing variations between disbursement of appropriations and receipt of revenues, it may borrow up to 5% of the State's total appropriations for that fiscal year that must be repaid entirely within the same budget cycle.[194] The State may also borrow up to 15% of the total appropriations for any year if there is a declared failure in revenue.[195] This type of short-term borrowing must be paid back within 12 months of issuance.

When the State issues failure of revenue borrowing and does not repay the debt until the following fiscal year, it effectively transfers current liabilities into future fiscal years. This is an indicator of deficit spending in the year the debt is issued.

[191] Email Communication between the Civic Federation and the Governor's Office of Management and Budget, April 25, 2012.
[192] Illinois State FY2013 Budget, p. 6-5.
[193] 30 ILCS 340 (2004).
[194] 30 ILCS 340/1 (2004).
[195] 30 ILCS 340/1.1 (2004).

The following chart shows the total amount of short-term certificates issued from FY2003 through FY2011.

| Short-Term Debt Certificates Issued: FY2004-FY2012 (in $ millions) | |
|---|---|
| Year | Total Short-Term Debt |
| FY2003 | $ 1,350.0 |
| FY2004 | $ 850.0 |
| FY2005 | $ 765.0 |
| FY2006 | $ 1,000.0 |
| FY2007 | $ 900.0 |
| FY2008 | $ 2,400.0 |
| FY2009 | $ 2,400.0 |
| FY2010 | $ 1,250.0 |
| FY2011 | $ 1,300.0 |
| FY2012 | $ - |

Source: Illinois State FY2012, p.12-6;
Illinois State FY2013 Budget, p. 6-5.

In both FY2003 and FY2009, the State borrowed under the failure of revenue provisions of the State's Short-Term Borrowing Act[196] to carry forward portions of the State's deficits from one year to the next.

In December 2008, the State issued $1.4 billion in short-term debt to pay down some of the State's outstanding liabilities. These notes were due to be repaid by the end of FY2009. However, the State declared a failure of revenue for FY2009 as part of the FY2010 budget and sold $1 billion of new short-term notes shortly after repaying the December notes to carry forward the deficit to the new fiscal year. As part of the FY2010 budget, the State sold an additional $1.25 billion in short-term debt in August 2009. The combined total of $2.25 billion in outstanding short-term borrowing was repaid in FY2010. Short-term notes totaling $1.3 billion were issued in July 2010 to pay down the liabilities carried forward from FY2010 to FY2011.

The State sold $250 million of special purpose bonds to pay for Medicaid bills in March 2010. These bonds were repaid within one year. Although this debt was issued under the GO Bond Act and not the Short Term Borrowing Act, the bonds are listed as short-term issuance for failure of revenues, passing on liabilities from FY2010 to FY2011.

### Borrowing for Operations

The Governor's recommended FY2013 budget does not propose additional borrowing for operations in the coming fiscal year. The State borrowed a total of $10.7 billion to pay for General Funds operations between FY2009 and FY2011. The total borrowing for operations excludes short-term borrowing that was repaid in the same fiscal year that it was borrowed. Although some of the amounts were repaid within that time period, the total includes all borrowings that were used in one fiscal year and paid back with resources from another.

[196] 30 ILCS 340.

The largest portion of the State's borrowing for operations is attributable to the Pension Obligation Bonds (POB) sold in FY2010 and FY2011, which totaled $7.2 billion. The proceeds from these bonds were used to make the State's annual General Funds contribution to its pension funds and will be paid back over eight years. The State has also relied on short-term failure of revenue borrowing, interfund borrowing and other debt to fund ongoing operations over the past three fiscal years.

In FY2012 the Governor's budget proposed the issuance of $8.75 billion in General Obligation (GO) Restructuring Bonds to support General Funds operations and to pay down a portion of the State's backlog of bills. Approximately $1.5 billion of the GO Restructuring Bonds would have been used for FY2012 General Funds operations. However, the budget passed by the General Assembly did not include authorization for this borrowing.

The following chart shows total borrowing for operations from FY2009 through the enacted FY2012 budget.

**State of Illinois Borrowing for Operations FY2009 to FY2012**
**(in $ millions)**

| Type of Debt | FY2009 | FY2010 | FY2011 | FY2012 | Total |
|---|---|---|---|---|---|
| Pension Bonds | $ - | $ 3,466 | $ 3,680 | $ - | $ 7,146 |
| Interfund Borrowing | $ - | $ 276 | $ 762 | $ - | $ 1,038 |
| Railsplitter Tobacco Settlement Sec. | $ - | $ - | $ 1,250 | $ - | $ 1,250 |
| Short-Term Failure of Revenue Borrowing | $ 1,000 | $ - | $ - | $ - | $ 1,000 |
| GO Medicaid Bonds | $ - | $ 250 | $ - | $ - | $ 250 |
| **Total Borrowing for Operations** | **$ 1,000** | **$ 3,992** | **$ 5,692** | **$ -** | **$ 10,684** |

Source: State of Illinois, General Obligation Bonds, Series March 2012, *Official Statement* , March 15, 2012, pp. 15-23.

The State borrowed from its Special Funds through interfund borrowing in FY2010 and FY2011. The State has in excess of 600 Special Funds that are intended for designated purposes outside of the General Funds. Borrowing from these accounts allows the State to use cash balances to pay for its General Funds operations. These borrowings are repaid out of subsequent year General Funds resources.

In FY2010 the State transferred $276 million from the Budget Stabilization Fund to its General Funds.[197] Withdrawals from the Budget Stabilization Fund are required to be repaid before the end of each fiscal year. However, due to cash flow issues the transfer from FY2010 was not repaid until FY2011. The State transferred the same amount, $276 million, from the Budget Stabilization Fund in FY2011[198] and repaid the fund using FY2012 resources.

The remaining FY2011 interfund borrowing was authorized under the Emergency Budget Act of FY2011. The bill allowed the Governor to transfer funds from Special Funds to pay for General Funds appropriations for up to 18 months. The State borrowed a total of $496 million from the State's Special Funds in FY2011. The State plans to repay $350 million in FY2012 and $147 million in FY2013.[199]

[197] Illinois State FY2013 Budget, p. 2-18.
[198] Public Act 96-0958.
[199] Illinois State FY2013 Budget, pp. 2-19, 20.

The Emergency Budget Act of FY2011 established the Railsplitter Tobacco Settlement Authority.[200] This new bonding authority was authorized to sell a portion of the future revenues due to the Tobacco Settlement Fund. The State receives annual revenues to this fund from the settlement of its lawsuit against the tobacco industry. Illinois received a total of $9.1 billion in 1998 to settle its part of a multi-state civil liabilities lawsuit against the tobacco industry.[201] Under the agreement, the State will receive annual installment payments from cigarette producers through 2025.

The Railsplitter Authority was authorized to sell up to $1.75 billion in debt secured by these payments but only issued $1.5 billion in December 2010. A total of $1.3 billion of the proceeds were transferred to the General Funds to pay for operations. The bonds (also referred to as revenue notes) will be repaid over the next 19 years. The structure of the authority shelters the State from the need to pledge General Fund revenues in support of the sale of these bonds. Instead, the State pledged roughly half of its annual settlement payments to fund the debt service owed on these bonds.

In March 2010 the State also approved the sale of $250 million in special purpose GO debt to fund Medicaid payments through the Healthcare Provider Relief Fund.[202] This new borrowing authority was used to leverage enhanced federal matching and decrease the payment cycle of outstanding Medicaid bills. The debt was issued on April 1, 2010 and repaid by March 31, 2011.

**Bond Ratings**

Debt ratings are one of the factors that weigh heavily in determining the interest rate the State must pay to issue debt. Consequently, declines in the State's rating lead to an overall increase in debt service costs for Illinois.

The State of Illinois' GO bond ratings have been lowered multiple times by each of the three major rating agencies since FY2009. Illinois currently has the lowest rated credit of all 50 states by Moody's Investor services. It is the second lowest rated state by Fitch and Standard & Poor's, ahead of California which is rated A- by both.

The following chart shows the ratings decline over the last three fiscal years.

**State of Illinois General Obligation Bond Ratings FY2008-FY2012**

| | Moody's Investors Services | Standard & Poor's | Fitch Ratings |
|---|---|---|---|
| FY2008 | Aa3 | AA | AA |
| FY2009 | A1 | AA- | A |
| FY2010 | A1 | A+ | A |
| FY2011 | A1 | A+ | A- |
| FY2012 | A2 | A+ | A |

Commission on Government Forecasting and Accountability, *State Budget Summary FY2012* , August 2011, p. 187; State of Illinois, General Obligation Bonds, Series March 2012, *Official Statement* , p. 79.

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200 Public Act 96-0958.
201 Illinois Economic and Fiscal Commission, *Illinois Cigarette Tax and Tobacco Settlement*, November 2002, p. 15. http://www.ilga.gov/commission/cgfa2006/Upload/IllinoisCigaretteTax.pdf (last visited on November 8, 2010).
202 Public Act 96-885.

In downgrading the State's rating and future financial outlook, the agencies all highlighted several of the same problems facing Illinois. The agencies look negatively on the State's poor cash position, or the lack of available revenue to pay its bills, the FY2010 and FY2011 budgets' reliance on one-time revenue sources to pay for ongoing operational expenses, the growing imbalance in the operating budget and the State's unfunded pension liabilities. The agencies' reports also explain that the long-term challenge of properly funding the retirement systems has placed an increasing burden on the State's current finances, as the required annual contribution must grow to make up for past underfunding and losses in the pension funds due to the recession.

Both Moody's and Fitch have listed their outlook for the State as stable but Standard & Poor's rating currently includes a negative outlook, which could signal a future downgrade.

## CAPITAL BUDGET

Details on the Governor's recommended FY2013 capital budget are still not widely available. In most years, the Governor is required under the State Budget Act to deliver the operating and capital budgets for the coming year no later than the third Wednesday in February.[203] This year the deadline was extended to the fourth Wednesday through a resolution passed by the General Assembly during its FY2012 fall veto session.[204] On the day of the Governor's budget address, February 22, 2012, a full copy of the FY2013 operating budget book was made available on both the Governor's budget page and the website of the Governor's Office of Management and Budget (GOMB).[205] However, the Governor's recommended FY2013 capital budget book has not been published online as of the date of this report.

A list of nearly 5,000 capital expenditures, which total $24.9 billion in capital appropriations, has been made available on the Governor's budget website for FY2013.[206] A capital budget book for FY2013 was circulated on compact disk the day of the Governor's budget address but it has not been made widely available to the public through online publication like the operating budget and may still be subject to change.

In April the Commission on Government Forecasting and Accountability (COGFA) published an analysis of the FY2013 capital budget that details the projects and funding since the *Illinois Jobs Now!* capital program was first authorized in FY2010.[207] COGFA is required annually under State law to submit a capital plan analysis.[208]

Unlike the State's operating budget, which requires that all appropriated funds be spent in the same year they are approved, capital appropriations are reauthorized over multiple years as planning, approval, funding, engineering and construction of capital investments commence.

According to the capital projects list for FY2013, the Governor is recommending the reauthorization of $19.8 billion of spending approved in previous years and an increase of $5.0 billion for new projects in FY2013.[209] However, there is little explanation of these line items in the list and it is nearly impossible for the general public to understand the details of this proposal.

The State budget was separated into two documents beginning in FY2005 due to the differences between operating and capital spending. Not only are capital appropriations spent over multiple

[203] 15 ILCS 20/50-5.
[204] Public Act 97-0669.
[205] Governor's Office of Management and Budget, http://www.state.il.us/budget/ (last visited on April 26, 2012); Governor Pat Quinn's Budget website, Budget Books, http://www2.illinois.gov/budget/Pages/BudgetBooks.aspx (last visit on April 26, 2012).
[206] State of Illinois, FY2013 Capital Projects List, http://www2.illinois.gov/budget/Documents/Budget%20Book/FY%202013/Illinois%20FY%202013%20Capital%20Projects%20List.xls (last visited on April 26, 2012).
[207] Commission on Government Forecasting and Accountability, Analysis of the FY2013 Capital Infrastructure Plan for the State of Illinois, April 2012, http://www.ilga.gov/commission/cgfa2006/Upload/FY2013CapitalPlanAnalysis.pdf (last visited on April 26, 2012).
[208] 25 ILCS 155/3.
[209] State of Illinois, FY2013 Capital Projects List, http://www2.illinois.gov/budget/Documents/Budget%20Book/FY%202013/Illinois%20FY%202013%20Capital%20Projects%20List.xls (last visited on April 26, 2012).

years but funding of capital projects is also very different. Many of the State's infrastructure investments are financed through bonds and repaid over the life of the assets. The State then collects revenues from user fees and taxes outside the State's operating funds in designated funds to repay the capital borrowing. The largest of these funds is the Road Fund, but capital projects are also supported through the School Construction Fund, the Capital Projects Fund and many other smaller funds. The State also receives significant funding from the federal government and other sources for capital investments that are used to pay for some projects directly without bond funds.

The timing of projects and funding variables in the capital budget make balancing the revenues and other resources used to support the capital budget very different from the annual operating budget. Separating the budget documents for the State's capital spending and ongoing operations was intended to provide additional transparency and let the public more clearly track how all of the capital dollars are spent.

In FY2012 the General Assembly reauthorized the State's *Illinois Jobs Now!* capital program for the second time since its inception in FY2010.[210] The legislature also approved new capital appropriations totaling $2.2 billion in FY2012. The enacted FY2012 capital budget included reauthorization of $22.8 billion in previously approved projects, bringing the total to $25.1 billion. Although the capital budget included a significant increase last year, the enacted total was $2.1 billion less than the increase recommended by the Governor for FY2012.

In FY2010 the State also approved a package of revenues to pay for the more than $16.0 billion in debt that would be issued to support the new *Illinois Jobs Now!* spending.[211] These revenue sources included:[212]

- Statewide legalization and taxation of video poker;
- Expanded sales tax on candy, sweetened beverages and some hygiene products;
- Leasing a portion of state lottery operations;
- Increased per gallon tax on beer, wine and liquor; and
- Increased license and vehicle fees.

The proceeds from these sources are deposited in the Capital Projects Fund and used to pay for debt service on new capital bonds and some ongoing capital expenses. However, the taxes and fees have yet to produce the funding levels projected when *Illinois Jobs Now!* was originally approved.

[210] Public Act 97-0076.
[211] Public Act 96-0034, 96-0037, 96-0038.
[212] Public Act 096-0034.

The following table compares the annual revenue estimates published when the capital budget was first enacted in FY2010 to the actual amounts collected from FY2010 through the year-to-date totals for FY2012.

| Capital Projects Fund: Revenues by Source (in $ millions) | | | | |
|---|---|---|---|---|
| **Source** | **Original Projections** | **FY2010** | **FY2011** | **FY2012 YTD** |
| Video Poker Tax | $288 - $534 | $ - | $ - | $ - |
| Lottery Fund* | $ 150.0 | $ 32.9 | $ 54.1 | $ - |
| Sales Tax | $ 65.0 | $ 39.0 | $ 52.0 | $ 39.5 |
| Liquor Tax | $ 108.0 | $ 77.6 | $ 105.2 | $ 86.4 |
| Vehicle Related | $ 332.0 | $ 117.7 | $ 294.6 | $ 218.4 |
| Investment Income and Other | $ - | $ 0.3 | $ (0.0) | $ 0.3 |
| **Total** | **$934 - 1,189** | **$ 267.5** | **$ 505.9** | **$ 344.6** |

*Lottery Fund transfer takes palce at the end of the fiscal year.

Source: Commission on Government Forecasting and Accountability, *Analysis of the FY2013 Capital Infrastructure Plan for the State of Illinois* , pp.11-13.

According to the Governor's budget presentation, the FY2013 capital budget recommendation appears to include three new areas of bond-funded spending outside the *Illinois Jobs Now!* program.[213] These projects make up $3.0 billion of the total $5.0 billion in new recommended spending and would need additional revenue sources to support the increase in capital borrowing, according to the Governor's senior budget officials. However, the possible revenue sources have not yet been proposed.

The capital projects list for FY2013 includes $950 million for a new program called 21st Century Schools to upgrade education technology and facilities statewide. It does not specify individual projects but divides the program into separate grants areas including $566 million for pre-kindergarten through 12th grade, $240 million for public universities, $144 million for community colleges and $50 million for construction of early childhood education facilities. Other new bond-funded appropriations include unspecified grants totaling $500 million for drinking water projects, $400 million for wastewater projects and $100 million for flood control initiatives. Finally, the FY2013 capital list includes roughly 120 lines for grants and projects to upgrade and maintain to State facilities totaling approximately $1 billion.

Beyond the lack of a publicly available capital budget for FY2013, the State also has reauthorized and expanded its current capital spending without developing and publishing a comprehensive capital improvement plan (CIP). A well-organized and annually updated CIP helps ensure efficient and predictable execution of capital projects and helps prevent the waste of scarce funding resources.

[213] State of Illinois, Governor's Budget Presentation FY2013, p. 9, http://www2.illinois.gov/budget/Documents/Budget%20Book/FY%202013/FY13%20Budget%20Presentation%20FINAL.pdf (last visited on April 26, 2012).

Establishing a multi-year CIP is a best practice recommended by the Government Finance Officers Association and includes:[214]

- A comprehensive inventory of all state-owned assets, with description of useful life and current condition;
- A five-year summary list of all projects and expenditures per project as well as funding sources per project;
- Criteria for projects to earn funding in the capital budget including a description of an objective and needs-based prioritization process;
- Information about the impact of capital spending on the annual operating budget of each project;
- Brief narrative descriptions of individual projects, including the purpose, need, history, and current status of each project; and
- An expected timeframe for completing each project and a plan for fulfilling overall capital priorities.

Although the annual capital budget book usually contains some of these elements for some projects, a large portion of the budget lacks such important detail. A list of nearly 5,000 appropriations usually accompanies the capital budget document but no planning documents are available to explain the prioritization of projects or the total capital needs of the State. The capital budget book usually includes a description of a process coordinated by the Capital Development Board and GOMB to assemble and prioritize the projects in the capital program, but typically no documentation of the process, comprehensive needs assessment, final ranking or schedule for funding projects are included in the budget book. More than half of the spending in the capital budget is described in terms of broad grants for various spending areas.

Although the State lacks a comprehensive CIP, some agencies and other governments that receive capital funding do maintain CIPs outside the Governor's budget. Some good examples of organizations that receive funding from the state capital budget and maintain multi-year CIPs include the Illinois Department of Transportation,[215] the Illinois State Board of Education[216] and the Regional Transportation Authority,[217] which oversees funding for mass transit in northeastern Illinois.

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[214] Government Finance Officers Association, *Best Practices: Preparing and Adopting Multi-Year Capital Planning*, February 24, 2006.
[215] Illinois Department of Transportation, FY2012-FY2015 State Transportation Improvement Program, http://www.dot.state.il.us/opp/STIP2012_2015/stip1215.html (last visited on April 26, 2012).
[216] Illinois State Board of Education, School Construction Program, http://www.isbe.state.il.us/construction/default.htm (last visited on April 26, 2012).
[217] Regional Transportation Authority, RTA Strategic Plan 2012-2016, http://www.rtachicago.com/about-the-rta/strategic-plan.html (last visited on April 26, 2012).

## APPENDIX A: STATE OF ILLINOIS AGENCIES

This appendix presents the classification of State agencies used in the tables on pp. 35 and 38 of this report. This classification is based on the Governor's recommended FY2013 budget.[218]

**Governor's Agencies**
Department on Aging
Department of Agriculture
Department of Central Management Services
Department of Children and Family Services
Department of Commerce and Economic Opportunity
Department of Natural Resources
Department of Juvenile Justice
Department of Corrections
Department of Employment Security
Department of Financial and Professional Regulation
Department of Human Rights
Department of Human Services
Illinois Power Agency
Department of Insurance
Department of Labor
Department of Lottery
Department of Military Affairs
Department of Healthcare and Family Services
Department of Public Health
Department of Revenue
Department of State Police
Department of Transportation
Department of Veterans' Affairs
Illinois Arts Council
Governor's Office of Management and Budget
Office of Executive Inspector General
Executive Ethics Commission
Capital Development Board
Civil Service Commission
Illinois Commerce Commission
Drycleaner Environmental Response Trust Fund Council
Illinois Deaf and Hard of Hearing Commission
Comprehensive Health Insurance Plan
East St. Louis Financial Advisory Authority
Environmental Protection Agency
Illinois Guardianship and Advocacy Commission
Illinois Historic Preservation Agency
Human Rights Commission

[218] See Illinois State FY2013 Budget, Table of Contents. Certain education agencies are grouped with Governor's Agencies for simplicity.

Illinois Criminal Justice Information Authority
Illinois Educational Labor Relations Board
Illinois Sports Facilities Authority
Illinois State Toll Highway Authority
Illinois Council on Developmental Disabilities
Illinois Violence Prevention Authority
Illinois Finance Authority
Procurement Policy Board
Illinois Workers' Compensation Commission
Illinois Gaming Board
Law Enforcement Training Standards Board
Metropolitan Pier and Exposition Authority
Prisoner Review Board
Illinois Racing Board
Property Tax Appeal Board
Southwestern Illinois Development Authority
Illinois Emergency Management Agency
State Employees' Retirement System
Illinois Labor Relations Board
State Police Merit Board
Office of the State Fire Marshal
Upper Illinois River Valley Development Authority
Illinois State Board of Education
Illinois Board of Higher Education
Illinois Community College Board
Illinois Student Assistance Commission
State Universities Civil Service System

**Legislative Agencies**
Office of the Auditor General
General Assembly
General Assembly Retirement System
Commission on Government Forecasting and Accountability
Joint Committee on Administrative Rules
Legislative Audit Commission
Legislative Ethics Commission
Legislative Information System
Legislative Printing Unit
Legislative Reference Bureau
Legislative Research Unit
Office of the Architect of the Capitol

**Judicial Agencies**
Judicial Inquiry Board
Office of the State Appellate Defender
Office of the State's Attorneys Appellate Prosecutor
Supreme Court and Illinois Court System
Supreme Court Historical Preservation Commission

Court of Claims
Judges’ Retirement System

**Elected Officials and Elections**
Office of the Governor
Office of the Lieutenant Governor
Office of the Attorney General
Office of the Secretary of State
Office of the State Comptroller
Office of the State Treasurer
State Board of Elections

## APPENDIX B: STATE OF ILLINOIS AGENCIES BY PURPOSE

This appendix presents the State's grouping of agencies under the Governor according to principal spending activities.[219]

**Human Services**
Department on Aging
Department of Children and Family Services
Department of Employment Security
Department of Healthcare and Family Services
Department of Human Rights
Human Rights Commission
Department of Human Services
Illinois Deaf and Hard of Hearing Commission
Illinois Council on Developmental Disabilities
Illinois Guardianship and Advocacy Commission
Department of Public Health
Department of Veterans' Affairs

**Education**
Illinois State Board of Education
Illinois Board of Higher Education
Illinois Community College Board
Illinois Student Assistance Commission

**Government Services**
Office of the Governor
Civil Service Commission
Procurement Policy Board
Governor's Office of Management and Budget
Capital Development Board
Department of Central Management Services
Department of Revenue
Illinois Gaming Board
Illinois Racing Board
State Employees' Retirement System

**Economic Development**
Department of Agriculture
Department of Commerce and Economic Opportunity
Illinois Commerce Commission
Illinois Power Agency
Department of Labor
Department of Transportation

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[219] Email communication between the Civic Federation and the Governor's Office of Management and Budget, April 22, 2011.

**Public Safety and Regulation**
Department of Corrections
Department of Juvenile Justice
Environmental Protection Agency
Department of Financial and Professional Regulation
Illinois Criminal Justice Information Authority
Illinois Educational Labor Relations Board
Illinois Emergency Management Agency
Illinois Labor Relations Board
Illinois Violence Prevention Authority
Illinois Workers' Compensation Commission
Department of Insurance
Law Enforcement Training Standards Board
Department of Military Affairs
Prisoner Review Board
Property Tax Appeal Board
Office of the State Fire Marshal
Department of State Police
State Police Merit Board

**Quality of Life**
Illinois Arts Council
Illinois Historic Preservation Agency
Department of Natural Resources

## APPENDIX C: DATA ON ILLINOIS RETIREMENT SYSTEMS

| State of Illinois Retirement Systems: Projected Unfunded Liaibilities and Funded Ratio* | | | | | |
|---|---|---|---|---|---|
| Fiscal Year | Unfunded Liabilities | Combined Funded Ratio | Fiscal Year | Unfunded Liabilities | Combined Funded Ratio |
| FY2012 | $ 88,165.1 | 42.5% | FY2029 | $ 119,160.8 | 56.6% |
| FY2013 | $ 92,734.5 | 42.2% | FY2030 | $ 118,988.9 | 57.7% |
| FY2014 | $ 93,362.8 | 44.2% | FY2031 | $ 118,394.9 | 58.9% |
| FY2015 | $ 94,268.4 | 46.0% | FY2032 | $ 117,347.8 | 60.1% |
| FY2016 | $ 96,810.3 | 46.7% | FY2033 | $ 115,727.7 | 61.4% |
| FY2017 | $ 99,403.6 | 47.3% | FY2034 | $ 113,058.2 | 62.9% |
| FY2018 | $ 101,933.5 | 48.0% | FY2035 | $ 109,712.6 | 64.6% |
| FY2019 | $ 104,387.8 | 48.6% | FY2036 | $ 105,785.1 | 66.3% |
| FY2020 | $ 106,758.8 | 49.3% | FY2037 | $ 101,136.9 | 68.2% |
| FY2021 | $ 109,020.7 | 49.9% | FY2038 | $ 95,761.9 | 70.2% |
| FY2022 | $ 111,136.4 | 50.6% | FY2039 | $ 89,632.1 | 72.3% |
| FY2023 | $ 113,073.6 | 51.3% | FY2040 | $ 82,698.7 | 74.6% |
| FY2024 | $ 114,820.0 | 52.1% | FY2041 | $ 74,940.7 | 77.1% |
| FY2025 | $ 116,335.4 | 52.9% | FY2042 | $ 65,983.7 | 79.9% |
| FY2026 | $ 117,543.4 | 53.7% | FY2043 | $ 56,054.0 | 82.9% |
| FY2027 | $ 118,410.9 | 54.6% | FY2044 | $ 45,017.4 | 86.3% |
| FY2028 | $ 118,966.8 | 55.6% | FY2045 | $ 32,745.6 | 90.0% |

*Values reflect asset smoothing rather than market value of assets.

Source: Commission on Government Forecasting and Accountability, *A Report on the Financial Condition of the Illinois State Retirement Systems as of June 30, 2011* , March 2012, p. 95.

| State of Illinois General Statutorily Required FY2012-FY2045 (in $ millions)* | | | |
|---|---|---|---|
| Year | Contributions | Year | Contributions |
| FY2012 | $ 4,135.0 | FY2029 | $ 9,389.6 |
| FY2103 | $ 5,090.0 | FY2030 | $ 9,655.0 |
| FY2014 | $ 5,551.4 | FY2031 | $ 9,913.8 |
| FY2015 | $ 5,863.1 | FY2032 | $ 10,179.2 |
| FY2016 | $ 5,970.3 | FY2033 | $ 10,461.7 |
| FY2017 | $ 6,101.7 | FY2034 | $ 11,098.8 |
| FY2018 | $ 6,337.4 | FY2035 | $ 11,345.7 |
| FY2019 | $ 6,585.3 | FY2036 | $ 11,578.0 |
| FY2020 | $ 6,827.2 | FY2037 | $ 11,796.6 |
| FY2021 | $ 7,076.8 | FY2038 | $ 12,003.3 |
| FY2022 | $ 7,350.6 | FY2039 | $ 12,200.9 |
| FY2023 | $ 7,630.6 | FY2040 | $ 12,391.0 |
| FY2024 | $ 7,904.3 | FY2041 | $ 12,577.4 |
| FY2025 | $ 8,189.4 | FY2042 | $ 13,043.2 |
| FY2026 | $ 8,500.5 | FY2043 | $ 13,241.5 |
| FY2027 | $ 8,861.6 | FY2044 | $ 13,465.7 |
| FY2028 | $ 9,100.4 | FY2045 | $ 13,706.2 |

*Values reflect asset smoothing rather than market value of assets. Contributions for FY2012 and FY2013 are actual contributions; other contributions are projected. General Funds account for 66% of contributions to State Employees' System.

Source: Illinois State FY2013 Budget, p. 2-18; Commission on Government Forecasting and Accountability, *A Report on the Financial Condition of the Illinois State Retirement Systems as of June 30, 2011* , March 2012, pp. 96-100.