The Institute for Illinois' Fiscal Sustainability

AT THE CIVIC FEDERATION

STATE OF ILLINOIS FY2012 RECOMMENDED OPERATING AND CAPITAL BUDGETS:

Analysis and Recommendations

May 9, 2011

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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.

The Civic Federation
would like to express its gratitude
to the John D. and Catherine T. MacArthur Foundation,
whose generous grant to fund
the Institute for Illinois' Fiscal Sustainability at the Civic Federation
made the research and writing of this report possible

TABLE OF CONTENTS

EXECUTIVE SUMMARY

Although the Civic Federation is **encouraged** that Governor Quinn has taken steps to help resolve the fiscal crisis—including signing temporary income tax increase legislation and proposing some cuts in spending—we **cannot support** the Governor's proposed FY2012 State of Illinois operating budget because it is unbalanced and continues to rely heavily on borrowing, effectively pushing problems into the future.

Despite a major income tax increase that took effect on January 1, 2011, the Governor's FY2012 budget recommendation would create a $1.45 billion operating shortfall due to a proposed increase in expenditures. In addition, the Governor's General Funds revenue estimates for FY2012 are overstated by roughly $970.9 million because an inadequate amount of income tax revenues is set aside to pay down a backlog of business tax refunds. The actual operating shortfall for the year totals approximately $2.4 billion.

The Governor's proposed FY2012 spending plan would use part of the proceeds from the sale of 15-year General Obligation (GO) Restructuring Bonds to close the budgeted operating shortfall of $1.45 billion. Under the Governor's proposal, most of the proceeds of the $8.75 billion bond sale would be used to pay down the State's backlog of unpaid bills, Medicaid and employee health insurance claims and the backlog of income tax refunds owed to businesses.

The Civic Federation continues to **oppose** the Governor's long-term borrowing proposal because it is unaffordable and ensures future operating shortfalls. The borrowing for operations in FY2012 is likely to contribute to an operating shortfall in the following fiscal year because it is a non-recurring revenue source that far exceeds reasonable expectations for natural revenue growth. The proposed GO Restructuring Bonds will cost the State between $3.4 billion and $4.0 billion in interest costs and take 15 years to repay. Because the State has borrowed to make its statutorily required pension contributions over the last two years and must pay debt service on the pension bonds, it cannot afford to repay the principal on the GO Restructuring Bonds until after FY2015. The principal repayment will coincide with the scheduled partial sunset of the temporary income tax increases, setting the stage for even larger future operating shortfalls.

The Civic Federation offers the following key findings on the State of Illinois' FY2012 budget:

- The Governor expects total General Funds revenues of $33.9 billion, which represents a projected $3.8 billion, or 12.7%, increase in state revenues from revised FY2011 estimates and includes a decline in federal-source revenues of $622 million;
- General Funds revenue estimates for FY2011 increased by 8.9% after the State passed an increase in income tax rates half way through the fiscal year. FY2012 revenues are $6.8 billion, or 22.7%, more than the original FY2011 estimate of $27.7 billion before the income tax increases;
- The Governor's Office's estimates for General Funds revenues for FY2012 would decline by roughly $970.9 million if the Governor and General Assembly followed the existing statutory formula to determine Income Tax Refund Fund rates, the share of individual and business income tax collections diverted from General Funds and deposited into the Refund Fund to pay income tax refunds;
- Instead of using the existing statutory formula for determining the Refund Fund rates, the Governor proposes to set aside a much smaller amount to pay refunds and to pay down the backlog of business tax refunds through borrowing;

- The FY2012 recommended operating budget totals $52.7 billion, of which $26.9 billion are General Funds appropriations;
- General Funds appropriations increase by $1.1 billion from FY2011, with $2.1 billion in departmental increases offsetting $1.0 billion in departmental reductions;
- The largest proposed increase in General Funds appropriations totals $739.7 million for employee and retiree health insurance, which intentionally was severely underfunded in FY2011;
- The largest proposed decrease in General Funds appropriations of $388.5 million is for the Department of Human Services, which includes significant reductions in community services for the developmentally disabled and mentally ill and in addiction treatment services;
- The recommended number of full-time equivalent positions (FTEs) in agencies under the Governor increases by 1.1% or 645 FTEs, while salary costs increase by $317.1 million, or 9.2%, to $3.8 billion;
- For the first time since FY2009, the State's statutorily required contributions to its retirement systems are to be paid out of General Funds rather than through borrowing;
- Total recommended General Funds expenditures, including debt service and other statutory transfers, are $35.4 billion, an increase of $1.7 billion, or 5.1%, from the Governor's revised proposed FY2011 budget;
- The FY2012 budget includes an initial operating shortfall of $1.45 billion. If the statutory formula were used to determine the Income Tax Refund Fund rates, the operating shortfall increases to approximately $2.4 billion;
- The Governor's proposed budget would close the $1.45 billion initial operating shortfall by using some of the proceeds from the sale of $8.75 billion in 15-year General Obligation (GO) Restructuring Bonds;
- The remainder of the GO Restructuring Bond proceeds would be used to help pay off the State's backlog of unpaid bills and other obligations including unpaid business tax refunds and Medicaid and employee health insurance claims;
- The Governor's budget does not propose cost reductions for pensions or retiree healthcare; and
- The FY2012 proposed budget would end the year with an accumulated deficit from prior years of $453 million, after the Governor's proposed GO Restructuring Bond borrowing.
- Without the proposed $8.75 billion borrowing, the State would end FY2011 with $4.6 billion in unpaid bills and $2.4 billion in Medicaid and employee health insurance claims.

The Civic Federation **opposes** the following components of the Governor's recommendations in the FY2012 operating and capital budgets:

- Borrowing $8.75 billion over 15 years to pay for operating expenses in FY2012 and to pay down the State's backlog of unpaid bills and other obligations;
- Increasing appropriations despite an accumulated backlog of bills and other obligations;
- Reducing the Income Tax Refund Fund rate for business income taxes despite a backlog of unpaid business refunds expected to total roughly $879 million at the end of FY2011; and
- Reauthorizing the $15 billion in debt funded capital projects and new debt funded capital appropriations totaling $1.6 billion because the capital spending is not based on a comprehensive Capital Improvement Plan or adequate revenue sources.

The Civic Federation **supports** some aspects of the Governor's FY2012 operating budget:

- The use of General Funds rather than borrowing to make the State's $4.6 billion statutorily required contributions to its retirement systems, although the size and projected growth of the required contributions indicates that the State needs to enact pension changes for current employees;

- The Medicaid reforms enacted by the General Assembly and signed by the Governor in Public Act 96-1501 as a major step toward improving service delivery and reducing costs, although the State needs to set fixed goals for moving the developmentally disabled from state institutions to community settings;
- The budgetary reforms enacted by the General Assembly and signed by the Governor in Public Acts 96-958, 96-1354 and 96-1529 as an effort to make available more financial information and to establish a Budgeting for Results process, although much work needs to be done to establish effective performance monitoring and evaluation systems; and
- Recommended spending cuts, such as the elimination of the Illinois Cares Rx prescription drug program for seniors that is paid for solely by the State without federal reimbursement, although the State needs to show evidence that it has planned for unintended consequences of spending reductions that may cause demand for spending increases in other areas of the state budget.

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

- The State should use only currently enacted General Funds resources to pay down accrued liabilities over the next three years or consider a more reasonable short-term borrowing to be paid back prior to the partial sunset of the income tax increases in FY2015;
- Address the contributions and non-vested benefits of current employees to reduce the State's substantial unfunded pension liabilities;
- Require all state retirees to pay premiums for health insurance, starting with members of the Judges' and General Assembly Retirement Systems;
- Eliminate the practice of artificially reducing appropriations for employee health insurance, shifting costs to future years and avoiding necessary expenditure reductions in other areas.
- End funding of non-federally reimbursed Institutions for Mental Diseases as soon as possible and develop specific goals for moving residents of state institutions for the developmentally disabled into community settings;
- Follow the existing statutory formula for determining the Income Tax Refund Fund rates rather than lowering the Refund Fund rate for business incomes taxes, keeping the rate unchanged for personal income taxes and relying on borrowing to pay business refunds;
- Reopen negotiations with major labor unions to curtail salary increases;
- Establish a comprehensive Capital Improvement Plan that includes needs-based prioritization of all capital investments to ensure critical needs are met first and effective use of all long-term bond proceeds.
- Improve the budget document by including comprehensive data on State FTEs and personnel expenses; and
- Consolidate special purpose funds in order to have maximum flexibility in allocating resources to meet policy priorities.

CIVIC FEDERATION POSITION

The Civic Federation **opposes** Governor Pat Quinn's $52.7 billion FY2012 recommended operating budget for the State of Illinois because it is unbalanced by approximately $2.4 billion and is based on the premise that long-term borrowing is the right tool to dig the State out from under its massive backlog of unpaid bills and other obligations. To the contrary, the Governor's proposed borrowing is likely to make the State's financial condition worse over time.

Although the Civic Federation is **encouraged** that Governor Quinn has taken steps to resolve the fiscal crisis—including signing temporary income tax increase legislation and recommending some cuts in spending—we **cannot support** his FY2012 State of Illinois operating budget because it overestimates revenues and continues to rely heavily on borrowing for operations, which effectively pushes current financial problems into the future.

Despite a major income tax increase that took effect on January 1, 2011, the Governor's FY2012 budget recommendation would create a total operating shortfall of $2.4 billion. The shortfall consists of a $1.45 billion budget gap due to a recommended increase in expenditures and a $970.9 million overestimate of revenues due to a proposal to set aside insufficient income tax revenues to pay down a backlog of unpaid business tax refunds. The Civic Federation **opposes** the proposal to inadequately fund tax refunds because it does not accurately reflect the realistic amount of income tax revenue the State can expect to be available to use for current operations and to distribute to local governments.

The Governor's budget recommendation would use part of the proceeds from the sale 15-year General Obligation (GO) Restructuring Bonds to close the budgeted operating shortfall of $1.45 billion. Under the Governor's proposal, the rest of the proceeds of the $8.75 billion bond sale would be used to pay down the State's backlog of unpaid bills, income tax refunds owed to businesses and Medicaid and employee health insurance claims.

The Civic Federation **opposes** the Governor's proposed $8.75 billion borrowing to pay for current operating expenses because it will build deficits into future budgets, increase the cost of government and push the cost of current government operations onto future taxpayers. The increased debt service cost of the bonds is unaffordable over time. Because the State has borrowed to make its pension contributions over the last two years and must pay debt service on those pension bonds, it cannot afford to make any payment on the principal of the $8.75 billion in GO Restructuring Bonds until after FY2015. The proposed start of principal repayment will coincide with the partial sunset of the temporary income tax increases, setting the stage for larger operating shortfalls.

Although the Civic Federation has serious concerns about many aspects of the FY2012 operating and capital budgets, we commend the Governor and the General Assembly for taking steps toward meaningful reform of the Medicaid program and the budgetary process. We commend the State for making its statutorily required pension contributions from General Funds rather than through borrowing for the first time since FY2009.

Issues the Civic Federation Opposes

The Civic Federation opposes the following aspects of the Governor's recommendation for the FY2012 State of Illinois operating and capital budgets.

Issuing $8.75 Billion in 15-year Bonds for Unpaid Bills and Operating Expenses

The Governor's proposal to sell GO Restructuring Bonds totaling $8.75 billion to increase spending and pay down a portion of the State's unpaid bills is not a sustainable plan for funding government operations. This long-term borrowing will increase the cost of government operations by between $3.4 billion and $4.0 billion in new interest costs over the next 15 years and will not effectively stabilize the State's long-term finances.

The Governor's proposal ensures future budget gaps by using $1.45 billion of the proceeds to fund FY2012 operating expenses. The bond proceeds are a non-recurring revenue source that will not be available to fund ongoing operations in future budget years.

The proposed structure of borrowing means that debt service payments will dramatically increase just as the income tax rate increases are scheduled to partially sunset beginning in 2015. Such a large increase in debt service will make the planned partial sunset of the income tax increase very difficult to implement. The delay in principal repayment will also increase the total cost of the bonds.

The increase in State debt burden and debt service costs if the $8.75 billion GO Restructuring Bonds are authorized will limit the State's ability to access the credit markets through FY2026. If issued, the GO Restructuring Bonds will increase the State's debt burden to more than $40 billion, increase total tax supported debt service to more than $4.0 billion annually by FY2015 and nearly double the per capita debt burden from FY2009 levels.

Increasing Appropriations Despite a Backlog of Unpaid Bills and Other Obligations

Although the Governor's budget proposal recommends agency appropriations reductions of $1.0 billion, these cuts are offset by $2.1 billion in appropriations increases to other agencies. The resulting $1.1 billion net increase in General Funds appropriations contributes to a proposed operating shortfall of $1.45 billion.

Although the State enacted significant income tax increases in January 2011, the new revenues will not be adequate to support the proposed increases in expenditures. The new revenues are also scheduled to partially sunset on January 1, 2015, causing potential budget gaps. If the State does not control spending in FY2012 and maintain only marginal increases in appropriations through FY2015, the currently enacted revenues will not be sufficient to pay down accrued liabilities prior to the loss of the increased income tax revenues.

It should be noted that the largest increase in General Funds appropriations involves the State Employees' Group Health Insurance Program, which more than doubles to $1.4 billion in FY2012 from $695.8 million in FY2011. The increase reflects intentional underfunding in FY2011 that is expected to cause the backlog of employee health bills to grow to $1.1 billion by the end of that year.

In order to afford the program and fully appropriate for its anticipated cost, the State should require increased cost sharing by retirees based on income.

Reducing the Income Tax Refund Fund Rate for Business Income Taxes

The backlog of unpaid business refunds in the Income Tax Refund Fund has been growing since FY2008 and is expected to reach $879 million at the end of FY2011. The backlog is usually eliminated by raising the percentage of funds diverted from tax receipts and deposited in the Refund Fund. There are separate percentages—known as Refund Fund rates—for business and personal income taxes, but all refunds are paid out of the Refund Fund.

For FY2011 the General Assembly reduced the refund rate for personal income taxes from 9.75% to 8.75%. In his FY2012 budget, the Governor proposes to lower the refund rate for business income taxes from 17.5% to 12.5% and leave the refund rate for personal income taxes unchanged at 8.75%. The Governor proposes to eliminate the Refund Fund backlog through use of proceeds from the sale of GO Restructuring Bonds.

Reducing refund rates even though the State has unpaid refunds artificially inflates the amount of revenue for the State. The practice also artificially inflates the share of income tax collections that are forwarded to local governments because those distributions are made after diversions to the Refund Fund. In addition, both individual and business taxpayers who make overpayments to the State should have a reasonable expectation of getting their money in a timely fashion. Although the Governor has proposed to pay down the backlog of refunds through borrowing, the Civic Federation is opposed to using borrowed funds to cover this operating expense.

Reauthorizing and Expanding the Capital Budget

The Governor's FY2012 capital budget recommends the reauthorization of $15 billion in debt funded capital spending and the approval of $1.6 billion in additional bond financed capital projects.

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. Even so, the General Assembly passed a capital budget in FY2010 based on the Governor's proposal. In FY2011 the State reauthorized the capital budget totaling $26.2 billion in unspent appropriations but did not approve the additional $4.3 billion in new projects. In FY2012 the Governor proposes approval of $27.1 billion in capital spending, of which $23.1 billion are reappropriations and $4.0 billion are new projects. Of the total reauthorization, $15.0 billion is funded by proceeds from long-term capital debt and $1.6 billion of the new projects are bond financed.

The Civic Federation recognizes the need for infrastructure investment in Illinois to maintain the current 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 that will pay for the bonds needed to support the projects. 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 the prioritization of projects or when the approved projects 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.

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 tax on alcoholic beverages; and taxing legalized video poker. Recently the bill authorizing these revenues and appropriations was ruled in violation of the Illinois Constitution's single subject matter provisions. However, the State is appealing this verdict and has been granted a stay of the judge's order invalidating the bill and the appropriations.

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 sizable increases in pension-related debt will put a stranglehold on any future capital borrowing for decades to come. Illinois residents deserve a concrete multi-year capital plan before they are asked to support an extremely high level of indebtedness that will limit additional borrowing for decades to come and result in higher fees and taxes.

Issues the Civic Federation Supports

Pension Payments from General Funds

The cost of funding the State's five retirement systems is an operating expense that should be paid for with operating revenues. For the first time since FY2009, statutorily required contributions in FY2012 would be made from General Funds rather than through borrowing.

The State borrowed $3.5 billion in FY2010 and $3.7 billion in FY2011 to make its General Funds pension contributions. In FY2012 debt service costs on these bonds, as well as on Pension Obligation Bonds issued in 2003, will total $1.6 billion. Total FY2012 pension-related expenditures from General Funds, including contributions of $4.6 billion and debt service, will be approximately $6.2 billion, or more than 17% of total General Funds operating payments.

Medicaid Reforms

The reforms enacted by the General Assembly and signed by the Governor in Public Act 96-1501 could significantly improve the effectiveness and efficiency of Illinois' Medicaid program. The legislation addressed two of the program's major problems: overuse of institutional care for the elderly and disabled and inadequate use of managed care.

The legislation supported the idea of shifting more long-term care to community settings and required that the Governor create a unified budget report for long-term care services provided by different state agencies. Unified budgeting is aimed at preventing agencies from promoting their own particular programs at the expense of overall budgetary goals.

The Medicaid reform legislation also required that half of all Medicaid recipients be enrolled in coordinated care programs by January 1, 2015. Managed or coordinated care is particularly important for the disabled and elderly, who incur the highest Medicaid expenses. The State's first experiment with mandatory Health Maintenance Organization enrollment—a pilot program for approximately 40,000 elderly and disabled Medicaid recipients in the Chicago suburbs—was scheduled to start in July 2010, but the date has been postponed to later in 2011. As an incentive for hospitals to join the program's managed care networks, those that join will be exempt from proposed Medicaid rate cuts in the FY2012 budget.

Budgetary Reforms

Budgetary reforms enacted by the General Assembly and signed by the Governor will provide more information to the public, policymakers and stakeholders about multi-year revenue trends and expenditure options. The reforms are also intended to establish a process known as Budgeting for Results, which involves setting priorities and developing assessments to gauge performance in achieving predetermined benchmarks.

Public Act 96-1354, signed in July 2010, required the Governor's Office of Management and Budget to post on its website by January 1 of each year its fiscal policy intentions for the upcoming fiscal year and the next two fiscal years. Following this requirement, the budget office in January 2011 made public a three-year budget plan covering FY2012, FY2013 and FY2014.

Public Act 96-958, signed in July 2010, and Public Act 96-1529, signed in February 2011, relate to Budgeting for Results. Beginning in FY2011, the Governor was required to submit a spending plan based on available revenue, prioritized goals and effectiveness in achieving the goals. The FY2012 budget presented six major goals for the State and ranked them from highest to lowest according to the Governor's priorities. Selected programs in each area were designated as "above the line" or "below the line," based on whether they were best suited to achieve the goals with the resources available. Above the line programs were maintained and below the line programs were cut back or eliminated. The Governor also pledged over the next few years to establish improved performance measures to evaluate agency performance.

After the Governor presented his FY2012 budget, both the House and Senate in March 2011 approved their own FY2012 General Funds revenue estimates. The revenue estimates approved by the House and Senate are intended to be used as spending ceilings when appropriation bills are drafted. This process represents a shift from prior years, when legislators developed budget bills by focusing on the previous year's appropriations and gave relatively little attention to revenues.

The revised legislative process is in line with the Budgeting for Results process. Beginning in FY2013, appropriations made by the General Assembly are required to follow a method of budgeting in which priorities must be based on merit rather than the prior year's appropriations.

Recommended Spending Cuts

The Governor's FY2012 budget includes $1.0 billion in spending reductions for state agencies, which represent sharp cuts in some areas despite the $2.1 billion in offsetting spending increases for other agencies. The Civic Federation supports efforts to reduce agency spending in order to balance the budget and pay down liabilities.

In particular, the Federation supports the recommendation to save $107 million in FY2012 by eliminating Illinois Cares Rx, a prescription drug program for seniors and disabled people with income levels that exceed Medicaid limits. The cost of the program is entirely funded by the State without federal reimbursement. The program was started prior to the inception of prescription drug coverage under Medicare Part D, but the State opted to continue extra benefits for Part D-covered enrollees and enrollees who were not eligible for Part D. Gaps in Medicare Part D coverage are scheduled to be phased out under federal healthcare reform. Similarly, the Civic Federation supports the Governor's efforts to reduce or eliminate other medical assistance services for recipients who are not eligible for Medicaid.

The Civic Federation also supports the recommendation to save $14 million by eliminating the 47 Regional Offices of Education. The regional education offices offer mandated services such as teacher certification and provide professional development opportunities. However, these offices constitute another layer of management that is not affordable in light of the State's strained finances.

Ideally the allocation of state government resources should be based on a Budgeting for Results process that involves setting priorities and developing assessments to gauge performance in achieving predetermined benchmarks. This process was in a preliminary stage in the FY2012 budget. As a result, it is not clear how or if the steep spending reductions proposed in the area of human services relate to performance benchmarks.

Although the Civic Federation supports efforts to reduce agency spending in order to balance the budget and pay down liabilities, it urges the State to show evidence that it has considered potential unintended consequences of reductions, such as recognizing when they may cause spending increases in other areas of the state budget.

For example, the budget does not provide sufficient information to determine whether consideration has been given to the possible financial effects on the State resulting from Medicaid rate reductions to community-based service providers. The Illinois Department of Human Services has told the General Assembly that the proposed rate reductions will result in increased demand for admissions to state-run institutions, contrary to federal law and the Civic Federation-supported state goal of limiting unnecessary institutionalizations. At the same time, appropriations for the eight state-operated developmental centers will increase 9.5% from $293.8 million in FY2011 to $321.7 million in FY2012 because of salary increases under collective bargaining agreements. Investing in community-based service providers would be a better and less costly strategy.

Civic Federation Recommendations

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

Limit Spending and Pay Down Liabilities

The Civic Federation continues to urge the State to limit spending increases in FY2012 to create an operating budget that is balanced without borrowing and to generate operating surpluses based on new revenues from the income tax rate increases and use those funds to pay down its backlog of unpaid obligations. As previously discussed, the total budgeted operating shortfall is $1.45 billion. The gap increases to $2.4 billion if the State does not artificially inflate income tax revenues by manipulating the Refund Fund rates used to pay down tax refunds.

As recommended in February 2011 in the Civic Federation's *State of Illinois FY2012 Budget Roadmap*, if the State controls spending levels in FY2012 and limits increases in appropriations to 2.0% or less in FY2013 and FY2014 the State can significantly reduce its unpaid bills and other obligations without additional borrowing.

The Governor's proposed FY2012 budget includes General Funds appropriations increases of $2.1 billion for some agencies, which are partially offset by General Funds appropriations decreases of $1.0 billion for other agencies. The largest increase is $739.7 million to fully fund the employee health insurance program, which received insufficient appropriations in FY2011. It is important for the State to appropriate adequate funds to pay for this program, but it should also reduce its costs for retiree health insurance.

Eliminating all other appropriation increases in the FY2012 budget would result in an overall spending reduction from the Governor's proposal of $1.3 billion or more, depending on potential retiree health savings. The State would need to find $1.1 billion in additional savings to close the $2.4 billion operating shortfall. Of that amount, $403 million in savings could come from not issuing the proposed $8.75 billion of GO Restructuring Bonds and thus avoiding the budgeted $403 million in debt service costs. An additional $700 million in spending reductions would be required to close the operating shortfall. Further spending cuts would be needed to begin paying down the backlog of bills and other liabilities.

Short-Term Borrowing for Accrued Liabilities

Over the last three fiscal years the backlog of accounts payable in the State's General Funds and other liabilities such as business tax refunds and employee healthcare bills have increased dramatically, created financial difficulties for service providers, local governments and taxpayers owed money by the State. The General Funds surplus in FY2011 generated by borrowing for operations and the first six months of proceeds from the increase in the State's income tax rates will allow for the backlog of accounts payable to be reduced from $6.4 billion to $4.6 billion by the end of the current fiscal year.

The Governor has proposed borrowing over 15 years to pay down unpaid bills and fund FY2012 operations. Issuing long-term debt to pay for the State's backlog of accounts payable is very expensive and ensures future budgetary stress from increased debt service that rises to $1.0 billion annually in FY2015 and remains at that level through FY2026.

It is important for the State to pay its bills in a timely manner and to pay down liabilities accrued during the State's recent fiscal crisis. As discussed above, the increase in revenues from the higher income tax rates can generate enough in operating surpluses to pay off the majority of the State's backlog of bills if General Funds appropriations are not increased significantly in FY2012 and are held to a total increase of 2.0% in FY2013 and FY2014. However, most of the surpluses would come in FY2013 and FY2014. Even if the Governor's FY2102 budget is significantly reduced, new revenues from the tax increases are only adequate to balance the General Funds operating budget in FY2012. That is due to the fact that the State in FY2011 relied on non-recurring revenue sources, primarily borrowing, to pay for ongoing operations and underfunded expenses for tax refunds and employee health care.

Although it took three years of financial stress to accrue the State's backlog of bills and other obligations, the Governor has stated that paying down all of the current balance of liabilities should be a priority by the end of FY2011. If paying down the backlog of accounts payable by the end of FY2011 is a top priority, the State should only consider using short-term debt, such as a Tax Anticipation Note (TAN), that is repaid completely prior to the scheduled partial sunset of the income tax increase in FY2015. A TAN is a short-term loan based on expected revenues from future tax receipts. Because the loan would be much smaller and repaid much more quickly, the cost to the State would be affordable using currently enacted resources. The $8.75 billion GO Restructuring Bonds proposed by the Governor is estimated to cost more than $3.4 billion in total interest cost through FY2026. In its *State of Illinois FY2012 Budget Roadmap*, the Civic Federation estimated that issuing short-term TANs totaling between $2.2 billion and $4.6 billion at current market rates would only cost between $156.5 million and $261.2 million in interest.

Although a TAN could greatly reduce the State's backlog of bills and other liabilities in the near term, it would also necessitate disciplined spending control through FY2014 in order for the State to be able to afford the repayment of the debt within the scope of the temporary income tax rate increase.

Pension Reforms

The State of Illinois' pension burden is unaffordable. The Civic Federation believes that for current employees the State should reduce non-vested benefits, increase employee contributions or both.

The State's underfunding of its five retirement systems is a growing source of pressure on the budget. In the recommended budget for FY2012, for the first time since FY2009, Illinois plans to make its pension contributions from General Funds rather than through borrowing. In FY2012 pension-related General Funds expenses total $6.2 billion: statutorily required General Funds pension contributions of $4.6 billion plus debt service on Pension Obligation Bonds issued in 2003, 2010 and 2011 of $1.6 billion. Pension-related expenses account for more than 17% of the Governor's recommended General Funds operating payments of $35.4 billion.

A recent study based on FY2009 data found that Illinois' pensions had lower funded ratios than any other state. Using the market value of assets, the combined funded ratio for the retirement systems slipped from 38.5% at the end of FY2009 to 38.3% at the end of FY2010 and unfunded liabilities grew from $77.8 billion to $85.7 billion.

Illinois took an important first step toward pension reform by enacting reduced benefits for state employees hired on or after January 1, 2011. The new tier of benefits includes higher retirement ages, a cap on the maximum pensionable salary and lower cost of living adjustments. Over time, the reduced benefits will slow the growth in unfunded liabilities. In the short term, the reduction in future benefits lowers the annual required state contribution and increases unfunded liabilities because most workers earning benefits in the short term are covered by the more generous plan.

The State will continue to struggle to make its annual pension payments unless it reduces non-vested benefits for existing workers, increases their contributions or both. The Illinois Constitution provides that membership in any pension system in the State is an enforceable contractual relationship and that members' benefits "shall not be diminished or impaired." Legal experts have argued about whether this prohibition applies to non-vested benefits of current employees. Despite the legal controversy, this change must be pursued in the interests of the State's financial health. Any pension proposal considered by the State should be thoroughly reviewed by actuaries to determine savings both in the short run and over the long term.

Retiree Health Insurance Reforms

The Civic Federation recommends that all state retirees be required to share in the cost of their health insurance coverage. In his FY2010 budget Governor Quinn proposed increased premiums for both employees and retirees in the State's most generous health insurance plan. In his FY2011 budget, the Governor proposed increased premiums for retirees. These proposals were not taken up by the General Assembly and the Governor did not address the issue of health insurance in his FY2012 budget.

Under the State's group insurance program, 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 health insurance premiums. Exceptions include General Assembly members, who can retire with as little as four years of service and not have to pay premiums, and judges, who can retire with as little as six years of service and not pay premiums.

As of February 2011, 91.0% of the 81,833 retirees covered by the group insurance program were not required to pay any premiums. The State is expected to pay $497.6 million for health insurance coverage for retirees in FY2011, while retirees are expected to pay $12.0 million.

The General Assembly's Commission on Government Forecasting and Accountability (COGFA) recently hired a consulting firm to review the cost of retiree health insurance provided by the State and examine what other states charge for retiree coverage. The COGFA report is expected to present a possible new premium structure in which all retirees make contributions based on their overall household income. The study is due to be completed in early May 2011, in time for legislative proposals to be enacted before the General Assembly adjourns at the end of May.

Governor Quinn has indicated that he does not foresee any changes to the existing retiree health program until after collective bargaining agreements expire at the end of FY2012. The State's largest union, Council 31 of the American Federation of State, County and Municipal Employees, has taken the position that any proposed changes in retiree healthcare benefits must be negotiated with the union.

The Civic Federation supports immediate reform of the State's retiree health insurance system, even if legislative action results in litigation. As a first step the State should take administrative action to increase premiums for retirees in the Judges' and General Assembly retirement systems because such changes would not require legislation or union negotiations.

Adequate Budgeting for Employee and Retiree Health Insurance

The State should eliminate the practice of artificially reducing appropriations for employee health insurance, shifting costs to future years and avoiding necessary expenditure reductions in other areas.

The largest proposed increase in General Funds appropriations in FY2012 involves the State Employees' Group Health Insurance Program. The Governor recommends General Funds appropriations of $1.4 billion in FY2012 for employee group health, up from $695.8 million in FY2011.

The increase reflects underfunding in FY2011 that is expected to cause the backlog of unpaid employee health bills to grow to $1.1 billion by the end of the current fiscal year. The underfunding was predictable based on prior years' spending. In both FY2009 and FY2010, General Funds appropriations for employee group health totaled roughly $1.1 billion.

Additional Medicaid Reforms

While supporting the reforms enacted by the General Assembly and signed by the Governor in Public Act 96-1501, the Civic Federation believes that the State should move more aggressively to improve services and cut costs in the Medicaid program.

The Medicaid reform legislation supported the idea of shifting more long-term care to community settings and required that the Governor create a unified budget report for long-term care services provided by different state agencies. However, it did not establish specific goals for reducing reliance on institutional care. It is particularly troubling that under agreements with Council 31 of the American Federation of State, County and Municipal Employees, the State is prohibited from closing state facilities such as state centers for the developmentally disabled through June 30, 2012.

Short-term savings on Medicaid should come from reducing or eliminating spending for programs that are not eligible for federal reimbursement. The FY2012 budget includes proposed appropriations of $122.3 million for privately owned nursing homes known as Institutions for Mental Diseases (IMDs) that provide care for roughly 4,300 mentally ill people. Federal rules preclude use of Medicaid funds for people between 22 and 64 years of age in institutions in which more than half of the patients have mental illnesses. Under a federal court settlement, the State has agreed to move all willing and qualified IMD residents to community settings over five years. Developing alternative settings and moving residents is difficult, but state funding of IMDs should be ended as soon as possible.

Another Illinois program that is not federally reimbursed is the expanded AllKids program. The reform legislation ended coverage of children with family incomes greater than 300% of the Federal Poverty Level (FPL) in the AllKids program but continued enrollment for children with family incomes between 200% and 300% of the FPL. Neither group receives federal reimbursement. The former group (over 300% of FPL) cost the State $3.1 million in FY2010, while the latter group (200%-300% of FPL) cost $12.8 million. Instead of eliminating coverage for those with family incomes greater than 200% but below 300% of the FPL, the State is seeking federal reimbursement. Covering these expenses without federal assistance is not affordable given the State's available funds.

Labor Costs

In light of the State's continuing fiscal crisis, the Civic Federation believes that contract negotiations should be reopened with the State's largest union.

The current contract with Council 31 of the American Federation of State, County and Municipal Employees (AFSCME), negotiated by Governor Quinn's predecessor, runs from January 1, 2009 through June 30, 2012 and includes wage increases of 15.25% over four years. From the end of 2008 through the end of 2010, the consumer price index for urban consumers has risen by only 4.3%.

Governor Quinn has already reopened negotiations twice. In exchange for deferring part of the scheduled wage increases until January 1, 2011 and June 1, 2011, the Governor agreed to impose minimal layoffs and to refrain from shutting down any state facilities until after June 30, 2012. The union also agreed to a total of roughly $120 million in health care savings in exchange for the State waiving a provision that would have allowed it to reopen the contract to negotiate changes in employee health insurance contributions.

According to the Governor's Office of Management and Budget, wage increases due to union contracts account for $146.0 million in General Funds appropriations in the proposed FY2012 budget. Given the State's backlog of unpaid bills and other obligations and the required reductions in agency spending, the State cannot afford to pay these wage increases.

Business Tax Refunds

The Civic Federation recommends that the State use the statutory formula for determining the Income Tax Refund Fund rates rather than lowering the Refund Fund rate for business income taxes and keeping the rate unchanged for personal income taxes. Using the statutory formula accurately reflects the amount of income tax collections the State can afford to use for current operations and distribute to local governments.

The statutory formula uses the estimated amounts of paid refunds, unpaid but approved refunds and total income tax collections for the current year to determine the diversion rate for the next year. Separate rates are calculated for personal income taxes and business income taxes. In FY2012, the Refund Fund rates are currently estimated at 11.21% for personal income taxes and 30.47% for business income taxes, according to the statutory formula. If these rates were used, General Funds revenues would decline by roughly $970.9 million from the budgeted level.

Capital Improvement Plan

Before reauthorizing or expanding the State's capital budget, the Civic Federation urges the State of Illinois 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 nearly 9,000 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 proposed for FY2011. 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:

- 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 method of determining the specific goals of infrastructure investments and evaluating whether pay-as-you-go funding or bonding authority is needed to complete projects.

Budget Document Improvements

The State's annual budget document contains useful features, but the Civic Federation recommends that its content be improved to provide readers with more information on 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.

However, the State's information regarding personnel expenses is severely lacking. The only aggregate information on state personnel in this year's budget document consists of a chart depicting the number of FTEs and an accompanying descriptive paragraph. Although the chart only contains FTE information for agencies under the Governor, it is not labeled to explain that constitutional officers, the General Assembly, the judicial branch and certain other agencies are excluded. The Governor's Office of Management and Budget (GOMB) does not include FTE numbers for agencies not under the Governor because the Governor does not make FTE recommendations for agencies not under his control.

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 independently provided by the State in response to a request.

In addition, the budget has no information on employee numbers or salary costs for General Assembly staff. According to GOMB, this information is not made available by the General Assembly.

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 employee and salary cost information available to GOMB for inclusion in the budget.

Special Funds Consolidation

The vast majority of the State's more than 300 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 State should be afforded maximum flexibility in allocating resources to meet policy priorities.

ACKNOWLEDGEMENTS

The Institute for Illinois' Fiscal Sustainability at the Civic Federation would like to express our appreciation to Budget Director David Vaught and the staff of the Governor's Office of Management and Budget, the staff of the Department of Healthcare and Family Services, the staff of the Department of Revenue, and the staff of the Office of Comptroller for their assistance in providing information for this report.

BUDGET TIMELINE

Governor Pat Quinn presented his FY2012 budget recommendation on February 16, 2011. The FY2012 budget also included proposals to change the FY2011 budget before the end of the current fiscal year on June 30, 2011.

This section reviews changes in the FY2011 budget leading up to the Governor's budget recommendation for FY2012. It also explains how the budget process for FY2012 has been altered by budgetary reform legislation and by increased budgetary oversight by the Illinois General Assembly.

FY2011 Recommended Budget—March 2010

On March 10, 2010, Governor Quinn presented his FY2011 recommended budget, which totaled $52.0 billion and included $24.8 billion in General Funds appropriations. General Funds support the regular operating and administrative expenses of most state agencies and are the funds over which the State has the most control and discretion. General Funds are the largest component of the state budget. 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, and Federal Funds (other than those designated for General Funds), which support a variety of state programs financed with federal revenues.

When the Governor presented his FY2011 budget, the State was confronted with a General Funds deficit of approximately $13 billion.[1] The deficit consisted of an operating shortfall of more than $7 billion and an accumulated deficit from prior years of nearly $6 billion.

The Governor's FY2011 budget reduced the initial operating shortfall to $4.7 billion, mainly by proposing reductions in spending on education.[2] The remaining operating gap was closed through borrowing, with most of the proceeds used to pay for state contributions to its underfunded retirement systems.[3] The Governor's budget reflected savings from expected pension reform legislation affecting newly hired employees.[4] Under this plan the accumulated shortfall from prior years of $5.9 billion would have remained unchanged at the end of FY2011.

[1] See The Civic Federation, *State of Illinois FY2011 Recommended Operating and Capital Budgets: Analysis and Recommendations*, April 26, 2010, p. 78.
[2] Illinois State FY2011 Budget, p. 2-10.
[3] See the Retirement Systems section on page 56 of this report.
[4] Public Act 96-889, enacted in April 2010.

The table below summarizes Governor Quinn's FY2011 recommended budget plan.

State of Illinois FY2011 Recommended General Funds Budget Plan (in $ millions)	FY2011 Recommended
Total Operating Resources	$ 27,444
Total Expenditures	$ 32,117
Operating Surplus (Deficit)	**$ (4,672)**
Borrowing for Operations	$ 4,672
Operating Surplus (Deficit) After Borrowing	$ -
Accumulated Deficit From Prior Years	$ (5,868)
Total Surplus (Deficit)	**$ (5,868)**

Source: Illinois State FY2011 Budget, p. 2-10.

In his budget address to the General Assembly—but not in the proposed budget—the Governor also suggested a one-percentage point increase in income taxes, which would have raised personal tax rates from 3.0% to 4.0% to avert proposed cuts in education spending.

FY2011 Enacted Budget—July 2010

The FY2011 budget passed by the Illinois General Assembly and signed by the Governor in July 2010 included increased General Funds appropriations but not pension borrowing or a tax increase.[5] The enacted budget also granted the Governor emergency powers to require certain reserves and extended the lapse period, during which the State may use current-year revenues to pay prior-year bills, from two months to six months.[6] The initial operating shortfall increased to $5.8 billion, of which $2.1 billion was closed through borrowing.[7]

[5] See The Civic Federation's Institute for Illinois' Fiscal Sustainability, *State of Illinois Enacted Budget FY2011: A Review of the Operating Budget Enacted for the Current Fiscal Year*, November 16, 2010.
[6] Public Act 96-958.
[7] Civic Federation calculations based on State of Illinois $3.7 Billion General Obligation Bonds, *Official Statement*, February 23, 2011, p. 29.

The next table compares the Governor's FY2011 recommended budget with the FY2011 enacted budget.

State of Illinois FY2011 Recommended and Enacted General Funds Budget Plans (in $ millions)		
	FY2011 Rec.	FY2011 Enacted
Total Operating Resources	$ 27,444	$ 27,655
Total Expenditures	$ 32,117	$ 33,502
Operating Surplus (Deficit)	**$ (4,672)**	**$ (5,847)**
Borrowing for Operations	$ 4,672	$ 2,147
Operating Surplus (Deficit) After Borrowing	$ -	$ (3,700)
Accumulated Deficit From Prior Years	$ (5,868)	$ (6,475)
Total Surplus (Deficit)	**$ (5,868)**	**$ (10,175)**

Source: Illinois State FY2011 Budget, p. 2-10, State of Illinois $3.7 Billion General Obligation Bonds, *Official Statement* , February 23, 2011, p. 29.

FY2011 Revised Budget and Three-Year Plan—January 2011

After the November 2010 elections, major legislation was enacted that significantly changed the FY2011 budget.[8] Income tax rates were temporarily increased from 3.0% to 5.0% for individuals and from 4.8% to 7% for corporations.[9] The rate increases, enacted on January 13, 2011, were retroactive to January 1, 2011 and will remain in place until 2015. After that, they are scheduled to be rolled back over the next ten years, although the personal rate will eventually decline only to 3.25% rather than the previous rate of 3.0%. To further boost revenues, the legislation reinstated the state inheritance tax and suspended the net operating loss carryover deduction for corporation (but not for Subchapter S corporations) through 2014.

The legislation also established spending limitations for FY2012 through FY2015. The spending caps—set at $36.8 billion in FY2012, $37.6 billion in FY2013, $38.3 billion in FY2014 and $39.1 billion in FY2015—were well above projected expenditures of $33.5 billion in FY2011.

The Governor's proposal to sell Pension Obligation Bonds was passed by the General Assembly and subsequently enacted.[10] The $3.7 billion in proceeds were then used to pay the State's pension contributions in FY2011. The eight-year bonds were sold on February 23, 2011.[11]

Following these changes, Governor Quinn issued a budget plan for the next three years, as required under legislation passed in July 2010.[12] The plan also included a revised budget for FY2011. The Governor's budgets for FY2011 and FY2012 reflected a proposal to issue $8.75 billion in 15-year General Obligation Restructuring Bonds to help pay down the State's backlog of obligations and pay

[8] Public Act 96-1496.
[9] Corporations also pay a Personal Property Replacement Tax (PPRT) of 2.5%. The combined PPRT and corporate income tax rate rose to 9.5% as of January 1, 2011.
[10] Public Act 96-1497.
[11] See the Civic Federation's Institute for Illinois' Fiscal Sustainability blog at http://civicfed.org/iifs/blog/state-completes-pension-bonds-sale for more information on the pension bond sale.
[12] Public Act 96-1354.

for operating expenditures in FY2012.[13] The backlog of obligations included unpaid bills, employee health insurance claims and corporate income tax refunds. The proposal is still pending in the General Assembly as of the publication date of this report.

FY2011 Revised Budget and FY2012 Recommended Budget—February 2011

On February 16, 2011, Governor Quinn presented his FY2012 recommended budget. The FY2012 budget totaled $52.7 billion and included $26.9 billion in General Funds appropriations. The budget plan for FY2012 also proposed additional revisions for FY2011. The proposed budgets for FY2011 and FY2012 were based on issuance of the General Obligation Restructuring Bonds, which have not been approved by the legislature. On February 16, after the budget was presented, the Governor signed budgetary reform legislation that would have prohibited revenue sources not yet passed by the General Assembly from being included in budgeted revenue estimates.[14]

That budget reform measure and another new law are intended to establish a process known as Budgeting for Results.[15] Beginning in the FY2012 budget, the Governor was required to submit a spending plan based on available revenue, prioritized outcomes and effectiveness in achieving the outcomes.

The FY2012 budget presented six major outcomes for the State and ranked them from highest to lowest according to the Governor's priorities. Selected programs in each area were designated as "above the line" or "below the line," based on whether they were best suited to achieve the outcomes with the resources available. Above the line programs were maintained and below the line programs were cut back or eliminated. The Governor also pledged over the next few years to establish improved performance measures to evaluate agency performance.

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[13] 97th Illinois General Assembly, Senate Bill 3. See p. 77 of this report for more information on the General Obligation Restructuring Bonds.
[14] Public Act 96-1529.
[15] Public Acts 96-958 and 96-1529.

The next table summarizes the Governor's recommended budget for FY2012 and his proposed budget changes for FY2011. It also shows the revised enacted FY2011 budget—excluding measures that have not been passed by the legislature.

State of Illinois General Funds Budget Plans: Revised FY2011 Enacted and Governor's Proposed FY2011 and FY2012 (in $ millions)			
	Revised FY2011 Enacted*	Governor's FY2011 Changes	Governor's FY2012 Rec.
Total Operating Resources	$ 30,530	$ 30,613	$ 33,932
Total Expenditures	$ 33,567	$ 33,665	$ 35,382
Operating Surplus (Deficit)	**$ (3,037)**	**$ (3,052)**	**$ (1,450)**
Borrowing for Operations	$ 4,914	$ 8,914	$ 1,450
Operating Surplus (Deficit) After Borrowing	$ 1,877	$ 5,860	$ -
Accumulated Deficit From Prior Years	$ (6,314)	$ (6,314)	$ (454)
Total Surplus (Deficit)	**$ (4,437)**	**$ (454)**	**$ (454)**

*FY2011 enacted budget as of February 2011. Does not include impact of Governor's initiatives not passed by General Assembly, including proposed General Obligation Restructuring Bonds and proposed decoupling of Illinois from federal tax law regarding depreciation.

Source: State of Illinois $3.7 Billion General Obligation Bonds, Official Statement, February 23, 2011, p. 30; Illinois State FY2011 Budget, p. 5-15.

As currently enacted, the FY2011 revised budget does not include $4.0 billion of proceeds from the sale of the General Obligation Restructuring Bonds proposed by the Governor or the related $98 million in debt service on those bonds. The FY2011 revised enacted budget also does not assume passage of legislation to decouple Illinois from federal law regarding depreciation changes. If the decoupling legislation is not enacted, estimated resources would be reduced by roughly $82.5 million from the Governor's FY2011 revised proposal.[16]

Recent Developments—March and April 2011

After the Governor presented his FY2012 budget, both the House and Senate in March 2011 approved their own FY2012 General Funds revenue estimates. The House's FY2012 revenue estimate is $33.2 billion, which is $759 million below the Governor's estimate of $33.9 billion.[17] The Senate's FY2012 revenue estimate is $34.3 billion, or $350 million above the Governor's estimate.[18] Both the House and Senate revenue estimates are below the Governor's proposed FY2012 General Funds expenditures of $35.4 billion.

The revenue estimates approved by the House and Senate are intended to be used as spending ceilings when appropriation bills are drafted.[19] This process represents a shift from prior years, when

[16] Illinois State FY2011 Budget, p. 5-15.
[17] 97th Illinois General Assembly, House Resolution 110.
[18] 97th Illinois General Assembly, Senate Joint Resolution 29.
[19] Doug Finke, "House to start budget work with conservative spending goal," *The State Journal-Register*, March 3, 2011.

legislators developed budget bills by focusing on the previous year's appropriations and gave relatively little attention to revenues.

The revised legislative process is in line with the Budgeting for Results process. Beginning in FY2013, appropriations made by the General Assembly "must adhere to a method of budgeting where each priority must be justified each year according to merit rather than according to the amount appropriated for the prior year."[20]

[20] Public Act 96-1529.

REVENUES

Governor Pat Quinn's recommended budget for FY2012 is based on total revenues of $62.7 billion.[21] 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.[22] The remaining revenues are designated for Other State Funds or Federal Funds and are earmarked for specific purposes outside of the General Funds budget.

The FY2012 budget provides revised FY2011 revenue estimates that show General Funds revenues will be much higher than originally projected when budget was enacted in July 2010. The anticipated growth in FY2011 and FY2012 revenues will mark the first time State revenues will exceed FY2008 levels, the last year of growth experienced by the State prior to the effects of the national economic recession.[23]

Although moderate natural revenue growth is included in the revenue estimates, most of the increase in funds is due to the income tax increase enacted by the General Assembly in January 2011. The increase in FY2012 is partially offset by a loss of federal revenues from the end of increased matching rates for Medicaid expenditures. The higher reimbursement rates were part of the federal stimulus program, which ends on June 30, 2011.[24]

This section provides an overview of the revised estimates for FY2011 revenues and projections for FY2012 included in the Governor's proposed budget.

General Funds Revenues

The majority of the 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. These sources make up 85.6% of total General Fund revenues.[25] Both the income tax and sales tax are economically sensitive and declined dramatically during the recession that began in December 2007 and lasted until June 2009.[26] Total General Funds revenues declined by $2.3 billion from $29.7 billion in FY2008 to $27.4 billion in FY2010.[27] Although revenues began to stabilize and show marginal growth in FY2011, overall revenue projections remained weak for FY2011 when the State enacted its budget. Revenues in FY2011 were originally estimated to increase by approximately $268 million from FY2010 or just less than 1.0%.

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[21] Illinois State FY2012 Budget, p. 2-34.
[22] Illinois State FY2012 Budget, p. 2-35.
[23] National Bureau of Economic Research, "Determination of the December 2007 Peak in Economic Activity," December 1, 2008.
[24] See the Medicaid section on page 43 of this report for more information about the State's Medicaid expenditures and federal reimbursement rates.
[25] Illinois State FY2012 Budget, p. 5-8.
[26] National Bureau of Economic Research, "US Business Cycle Expansions and Contractions," September 20, 2010.
[27] Illinois State Budgets: FY2009- FY2012.

On January 13, 2011, the State enacted temporary increases in both the personal and corporate income tax rates, which was the first significant action taken to counteract the loss of revenue and curb the State's ongoing financial crisis.[28] 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%.

Illinois income taxes were first enacted in 1969 at the rate of 4% for the corporate income tax and 2.5% for the personal income tax.[29] The rates remained at that level until FY1983 when they were temporarily increased on January 1, 1983 to 4.8% for the corporate income and 3.0% for personal income tax until June 30, 1984. Rates reverted to the original levels until FY1989 when the State raised the rate to 4.8% for the corporate income tax and 3% for the personal income tax. Although these rates were originally scheduled to partially sunset to 4.4% and 2.75% respectively, the legislature made the higher rates permanent in FY1994. Income taxes in Illinois remained at 4.8% for corporate income and 3.0% for personal income until January 1, 2011 when the latest increase took effect retroactively. As enacted, the income tax rates are again scheduled to partially sunset first on January 1, 2015 to 5.25% for corporate income tax and 3.75% for personal income tax. They will be reduced again on January 1, 2025 to 4.8% and 3.25% respectively.

After the state income tax increase was enacted half way through FY2011, the estimated total General Funds revenues increased to $30.1 billion in FY2011 from $27.4 billion in FY2010.

FY2011 Enacted and Revised Estimates

The income tax rate change in the second half of FY2011 increased total General Fund revenue projections significantly.[30] Personal income tax proceeds for FY2011, net of refunds, are estimated to increase by $2.8 billion from $8.6 billion to $11.4 billion, or 31.7%, over the estimates from the originally enacted FY2011 budget. Corporate income tax revenues net of refunds are expected to increase by $148 million from $1.6 billion to $1.7 billion. Although no rate increase was enacted, sales tax receipts also are expected to increase in FY2011 by $140 million, or 2.2%, from $6.3 billion to $6.4 billion. These increases offset an 11.6% expected loss in federal revenues, which are estimated to decline by $721 million in FY2011 from the amount originally estimated.

[28] Public Act 96-1496.
[29] Legislative Research Unit, *Illinois Tax Handbook for Legislators*, 27th Edition, March 2011, pp. 55-63.
[30] The State's fiscal year runs from July 1 to June 30; the income tax increase took effect on January 1, 2011.

The following chart compares General Fund revenues from the enacted FY2011 budget to the revised FY2011 estimates included in the Governor's proposed FY2012 budget.

State of Illinois General Funds Revenue: Enacted FY2011 and Governor's Revised FY2011 (in $ millions)				
	FY2011 (Enacted)	FY2011 (Revised)	$ Change	% Change
Base Revenues				
State Sources				
Income Taxes	$ 10,256	$ 13,161	$ 2,905	28.3%
Personal	$ 8,686	$ 11,443	$ 2,757	31.7%
Corporate	$ 1,570	$ 1,718	$ 148	9.4%
Sales Taxes	$ 6,290	$ 6,430	$ 140	2.2%
Public Utility Taxes	$ 1,144	$ 1,101	$ (43)	-3.8%
Cigarette Taxes	$ 350	$ 355	$ 5	1.4%
Liquor Taxes	$ 161	$ 161	$ -	0.0%
Vehicle Use	$ 26	$ 30	$ 4	15.4%
Tax Amnesty Proceeds	$ 250	$ 274	$ 24	9.7%
Inheritance Taxes (Gross)	$ 56	$ 132	$ 76	135.7%
Insurance Taxes & Fees	$ 350	$ 319	$ (31)	-8.9%
Corporate Franchise Fees & Taxes	$ 205	$ 205	$ -	0.0%
Interest on State Funds and Investments	$ 35	$ 25	$ (10)	-28.6%
Cook County Intergov. Transfer	$ 243	$ 244	$ 1	0.4%
Other State Sources	$ 346	$ 362	$ 16	4.6%
State Source Revenue	**$ 19,712**	**$ 22,799**	**$ 3,087**	**15.7%**
Transfers-In				
Lottery	$ 636	$ 632	$ (4)	-0.6%
Riverboat Gaming Taxes	$ 428	$ 338	$ (90)	-21.0%
Other Transfers*	$ 652	$ 833	$ 181	27.8%
Subtotal State Sources & Transfers	**$ 21,428**	**$ 24,602**	**$ 3,174**	**14.8%**
Federal Sources	$ 6,227	$ 5,506	$ (721)	-11.6%
Total Base Revenues	**$ 27,655**	**$ 30,108**	**$ 2,453**	**8.9%**

*For comparision, Other Transfers were reduced by $505 million to account for interfund borrowing reported as transfers in the FY2012 Budget Book but reported as borrowing for operations in FY2011 enacted budget.
Sources: Commission On Government Forecasting and Accountability, *State of Illinois Budget Summary FY2011*, p.13; Illinois State FY2012 Budget, pp. 5-12 to 5-23.

The revised General Funds revenues estimates for FY2011 increase by $2.5 billion, or 8.9%, from the amounts estimated when the budget was originally enacted. Other than the income taxes, the inheritance tax also increased in the revised estimates from $56 million to $132 million.[31] The estimated increase in revenue is due to a decoupling from the federal estate tax code, which was repealed for individuals dying on or after January 1, 2010, leading to a drop in the original revenue estimates for FY2011. Although Congress reinstated the federal estate tax in December 2010, it increased the allowable exemptions, lowering the amount of estate transfers that are federally

[31] Illinois State FY2012 Budget, p. 5-18.

taxable.[32] The General Assembly approved decoupling from the new federal exemption calculation and reinstated the original lower exemption rate, which increased taxable estate transfers for Illinois. This change was part of the income tax legislation enacted on January 13, 2011. The higher state inheritance tax collection is retroactive, applying to individuals who died dating back to December 31, 2010.[33]

The State also approved a Tax Amnesty Program for FY2011 that exceeded revenue expectations included in the FY2011 enacted budget. The revised revenue estimates show the revenues related to the amnesty increased by $24 million from $250 million to $274 million in the enacted budget estimates.[34] The amnesty was granted for taxes owed from FY2003 through the end of FY2009 and ran from October 1, 2010 through November 8, 2010. The legislation provided that fines would be doubled for delinquent tax payments still owed after the amnesty period ended.[35] Although the program succeeded in increasing revenues in FY2011, it is estimated that only $12 million of the total revenue collected during the program are new revenues.[36] The other collections are considered accelerated revenues that would have been collected either later in FY2011 or in subsequent years through the State's normal tax enforcement procedures.

FY2011 Revised Estimates and FY2012 Projections

The Governor's proposed budget for FY2012 projects that General Funds revenues will total $33.9 billion, an increase of $6.3 billion, or 22.7%, over the originally enacted FY2011 budget estimates of $27.7 billion. However, as discussed above, the revised estimates for FY2011 revenues increased to $30.1 billion due to the midyear increase in income tax rates. Compared to the revised FY2011 General Funds estimates, FY2012 revenue projections show an increase of $3.8 billion, or 12.7%.

The increase in personal income tax rates from 3.0% to 5.0% accounts for the largest portion of the State's expected revenue increases in FY2011 and FY2012. Personal income tax revenues, net of refunds, are estimated to increase by $3.5 billion from the revised FY2011 total of $11.4 billion to $15.0 billion in FY2012. The personal income tax estimates for FY2012 include assumed natural growth of 2.5% and the rate increase from 3% to 5%. Corporate income tax revenues are expected to grow by $1.1 billion, from $1.7 billion in FY2011 to $2.8 billion in FY2012. This includes a natural growth rate of 5.2% from FY2011 to FY2012 and the rate increase from 4.8% to 7.0%. General Funds revenues from sales taxes are expected to grow 2.4% from FY2011 to FY2012, an increase of $156 million from $6.4 billion to $6.6 billion.

The increase in General Funds revenues are partially offset by other decreases. The State expects revenue losses from federal sources attributable to the reduction in the rate at which the federal government reimburses the State for Medicaid expenditures.[37] Total General Funds revenues from federal sources decline from $5.5 billion in the revised FY2011 budget to $4.8 billion in FY2012, a

[32] United States Senate, Committee on Finance, Summary of the Reid Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, p. 4.
[33] Public Act 96-1496.
[34] Illinois State FY2012 Budget, pp. 5-12, 5-14, 5-15.
[35] Public Act 96-1435.
[36] Illinois State FY2012 Budget, pp. 5-12, 5-14, 5-15.
[37] See the Medicaid section on page 43 of this report for more information about the State's Medicaid expenditures and federal reimbursement rates.

decrease of $622 million or 12.0%. General Funds resources also are reduced by the loss of non-recurring revenues from the Tax Amnesty program totaling $274 million.

The following chart compares the revised year-end estimated General Funds revenues for FY2011 to the FY2012 projections.

State of Illinois General Funds Revenue: Revised FY2011 Estimates and Estimated FY2012 (in $ millions)

	FY2011 (Revised)	FY2012 (Est.)	$ Change	% Change
Base Revenues				
State Sources				
Income Taxes	$ 13,161	$ 17,723	$ 4,562	34.7%
Personal	$ 11,443	$ 14,955	$ 3,512	30.7%
Corporate	$ 1,718	$ 2,768	$ 1,050	61.2%
Sales Taxes	$ 6,430	$ 6,586	$ 156	2.4%
Public Utility Taxes	$ 1,101	$ 1,082	$ (19)	-1.7%
Cigarette Taxes	$ 355	$ 355	$ -	0.0%
Liquor Taxes	$ 161	$ 162	$ 1	0.6%
Vehicle Use	$ 30	$ 32	$ 2	6.7%
Tax Amnesty Proceeds	$ 274	$ -	$ (274)	-100.0%
Inheritance Taxes (Gross)	$ 132	$ 182	$ 50	37.9%
Insurance Taxes & Fees	$ 319	$ 318	$ (1)	-0.3%
Corporate Franchise Fees & Taxes	$ 205	$ 204	$ (1)	-0.5%
Interest on State Funds and Investments	$ 25	$ 25	$ -	0.0%
Cook County Intergov. Transfer	$ 244	$ 244	$ -	0.0%
Other State Sources	$ 362	$ 365	$ 3	0.8%
State Source Revenue	**$ 22,799**	**$ 27,278**	**$ 4,479**	**19.6%**
Transfers-In				
Lottery	$ 632	$ 645	$ 13	2.1%
Riverboat Gaming Taxes	$ 338	$ 429	$ 91	26.9%
Other Transfers*	$ 833	$ 664	$ (169)	-20.3%
Tenth License	$ -	$ 73	$ 73	100.0%
Subtotal State Sources & Transfers	**$ 24,602**	**$ 29,089**	**$ 4,487**	**18.2%**
Federal Sources	$ 5,506	$ 4,844	$ (662)	-12.0%
Total Base Revenues	**$ 30,108**	**$ 33,933**	**$ 3,825**	**12.7%**

*For comparision, Other Transfers were reduced by $505 million to account for interfund borrowing reported as transfers in the FY2012 Budget Book but reported as borrowing for operations in FY2011 enacted budget.

Source: Illinois State FY2012 Budget, pp. 5-12 to 5-23.

Corporate income tax revenue estimates for FY2011 and FY2012 assume a decoupling from the federal corporate tax depreciation provisions enacted by the U.S. Congress at the end of calendar year 2010.[38] The law was passed to lower tax liability by increasing the amount of depreciation businesses may claim as an exemption from federally taxable income. If legislation in Illinois is not passed to decouple the State from this bonus depreciation change in the federal tax code, it is estimated that General Funds revenue will decline by between $50 million and $115 million in FY2011 and between $520 million and $615 million in FY2012.[39]

General Funds revenues for FY2011 and FY2012 are estimated to increase above FY2008 levels, which was the last year of revenue growth prior to the economic recession.[40] Although revenues decreased in both FY2009 and FY2010, General Funds revenues in FY2012 are expected to show an increase of $4.4 billion, or 14.4%, above the FY2008 total of $29.7 billion. The estimates in the Governor's proposed FY2012 budget show General Funds revenues increasing by $10.7 billion, or 46.1%, over the last 10 years, from $23.2 billion in FY2003 to $33.9 billion in FY2012. However, calculating from the Consumer Price Index as reported for all urban areas, inflation totals 21.2% between January 2003 and January 2011.[41] After adjusting for inflation, FY2003 General Funds revenue totals $28.2 billion in 2011 dollars. This reduces the 10-year revenue increase to $5.8 billion, or 20.5%, when accounting for inflation.

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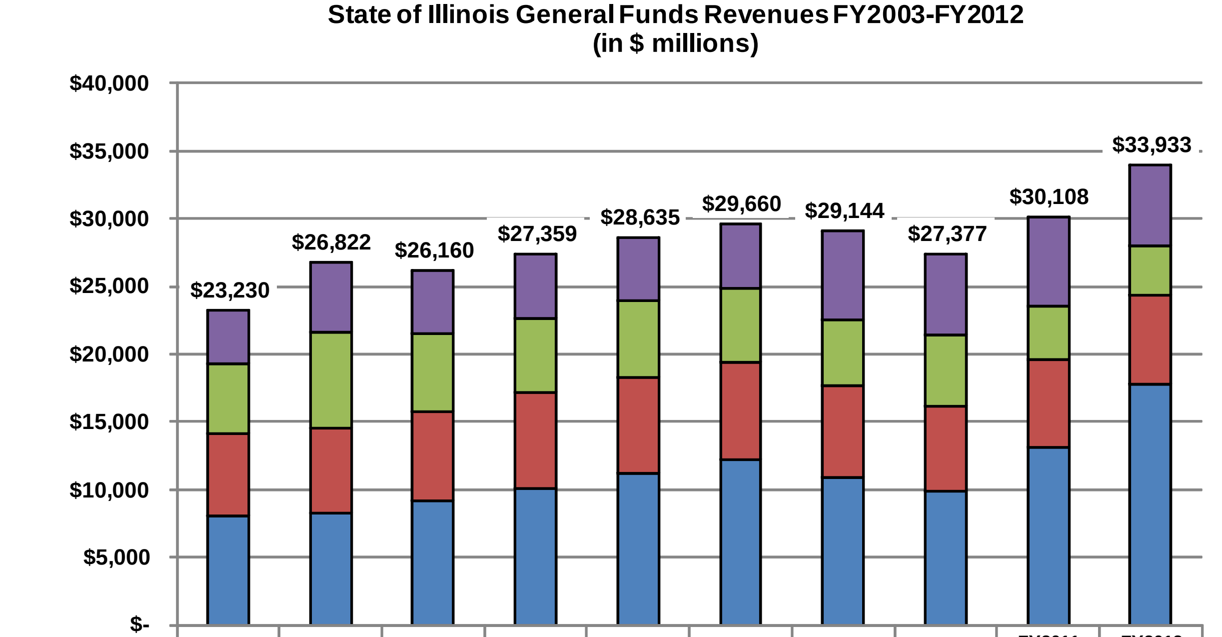
[38] Illinois State FY2012 Budget, p. 5-15.
[39] Illinois State FY2012 Budget, p. 5-15.
[40] National Bureau of Economic Research, "Determination of the December 2007 Peak in Economic Activity," December 1, 2008.
[41] U.S. Department Of Labor, Bureau of Labor Statistics, Consumer Price Index: All Urban Areas, ftp://ftp.bls.gov/pub/special.requests/cpi/cpiai.txt (last visited April 26, 2011).

The following chart shows General Funds revenues in nominal dollars by source of revenue between FY2003 and FY2012.

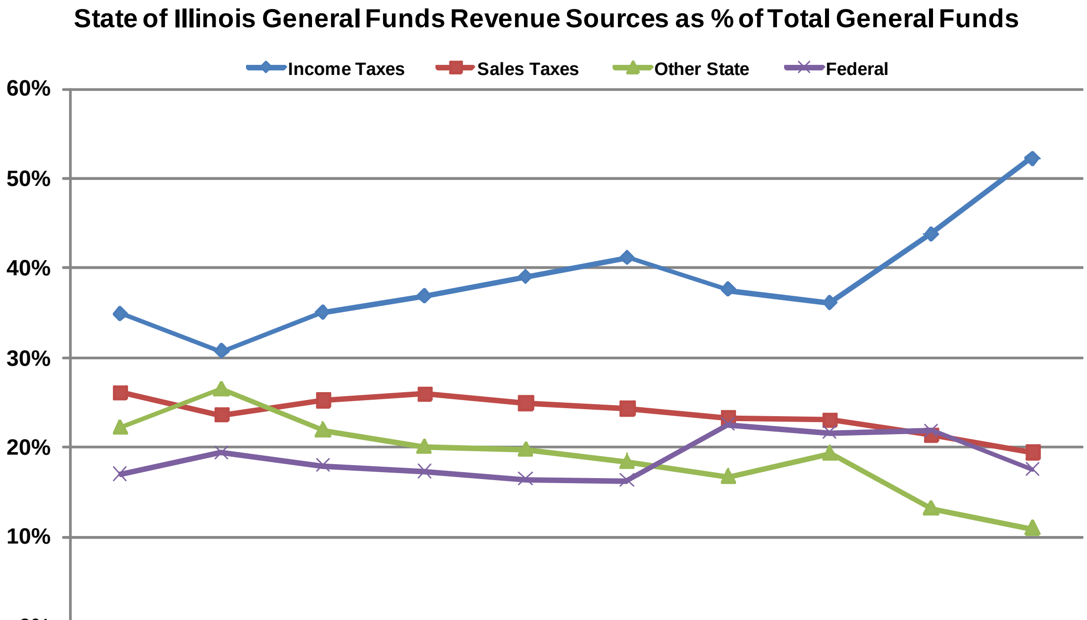


	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011 (est.)	FY2012 (proj.)
Total	$23,230	$26,822	$26,160	$27,359	$28,635	$29,660	$29,144	$27,377	$30,108	$33,933
Federal	$3,940	$5,189	$4,691	$4,725	$4,702	$4,815	$6,567	$5,920	$6,567	$5,920
Other State	$5,152	$7,094	$5,723	$5,479	$5,638	$5,450	$4,871	$5,279	$3,950	$3,704
Sales Taxes	$6,059	$6,331	$6,595	$7,092	$7,136	$7,215	$6,773	$6,308	$6,430	$6,586
Income Taxes	$8,079	$8,208	$9,151	$10,063	$11,159	$12,180	$10,933	$9,870	$13,161	$17,723

Source: State of Illinois Budgets FY2004-FY2012.

Between FY2003 and FY2010, state sales tax and income tax rates were unchanged, although exemptions and credits may have been adjusted in certain years. Proportionally, income tax has been the largest contributor to General Funds revenue. However, after the increase in rates half way through FY2011, the proportion of total General Funds revenues coming from income taxes increased dramatically. In FY2003 income tax made up 34.8% of General Funds revenues. In FY2012, the first full year of the income tax rate increases, income taxes are expected to make up 52.2%.

The following chart shows the annual proportion of General Funds revenue attributable to the major sources of funding for the State's operations from FY2003 to FY2010.



	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011 (est.)	FY2012 (proj.)
Income Taxes	34.8%	30.6%	35.0%	36.8%	39.0%	41.1%	37.5%	36.1%	43.7%	52.2%
Sales Taxes	26.1%	23.6%	25.2%	25.9%	24.9%	24.3%	23.2%	23.0%	21.4%	19.4%
Other State	22.2%	26.4%	21.9%	20.0%	19.7%	18.4%	16.7%	19.3%	13.1%	10.9%
Federal	17.0%	19.3%	17.9%	17.3%	16.4%	16.2%	22.5%	21.6%	21.8%	17.4%

Source: State of Illinois Budgets FY2004-FY2012.

All Funds Revenues

General Funds revenues are the focus of the 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 FY2012 recommended budget projects total All Funds revenues in FY2012 of $62.7 billion. This is an increase of $1.3 billion, or 2.1%, over year-end estimates of All Funds revenues in FY2011 totaling $61.4 billion. The total revenues collected include state taxes, licensing fees, gaming revenues, lottery proceeds, intergovernmental transfers and federal funds. The funds that are outside 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 $30.7 billion of the FY2012 All Funds revenues, which is an increase of $4.7 billion over FY2011, or 18.0%. Other receipts from assessments and fees decline from $16.5 billion in FY2011 to $15.9 billion in FY2012. The State also receives significant funding from the federal government. Total Federal Funds, including amounts used for General Funds revenues, are estimated to total $15.9 billion in FY2012. This is a decline of $2.7 billion from the FY2011 total of $18.9 billion.

The following chart compares All Funds revenue estimates for FY2011 to the projections for FY2012.

State of Illinois Revenues for All Funds: Estimated FY2011 and Projected FY2012 (in $ millions)				
	FY2011 (est.)	FY2012 (proj.)	$ Change	% Change
State Taxes				
Income Taxes (Net)	$ 13,351	$ 17,723	$ 4,372	32.7%
Individual	$ 11,466	$ 14,955	$ 3,489	30.4%
Corporate	$ 1,885	$ 2,768	$ 883	46.8%
Sales Taxes	$ 7,382	$ 7,589	$ 207	2.8%
Motor Fuel Tax (Gross)	$ 1,348	$ 1,340	$ (8)	-0.6%
Public Utility Taxes	$ 1,871	$ 1,839	$ (32)	-1.7%
Cigarette Taxes and Tobacco Products Taxes	$ 561	$ 556	$ (5)	-0.9%
Liquor Gallonage Taxes	$ 233	$ 234	$ 1	0.4%
Inheritance Tax	$ 132	$ 182	$ 50	37.9%
Insurances Tax and Fees	$ 416	$ 414	$ (2)	-0.5%
Corporate Franchise Taxes and Fees	$ 218	$ 217	$ (1)	-0.5%
Riverboat Gaming Taxes and Fees	$ 473	$ 581	$ 108	22.8%
Subtotal State Taxes	**$ 25,985**	**$ 30,675**	**$ 4,690**	**18.0%**
Other Revenues				
Motor Vehicle and Operations License Fees	$ 1,341	$ 1,323	$ (18)	-1.3%
Interest Income	$ 138	$ 138	$ -	0.0%
Revolving Fund Receipts	$ 746	$ 743	$ (3)	-0.4%
Lottery	$ 1,104	$ 1,266	$ 162	14.7%
Assessment Funds Receipts	$ 1,644	$ 1,789	$ 145	8.8%
Intergovernmental Receipts	$ 1,496	$ 1,425	$ (71)	-4.7%
Group Insurance Receipts	$ 1,504	$ 1,851	$ 347	23.1%
Tobacco Settlement Receipts	$ 326	$ 130	$ (196)	-60.1%
Other Taxes, Fees, Earnings and Net Transfers	$ 8,246	$ 7,195	$ (1,051)	-12.7%
Subtotal Other Revenues	**$ 16,545**	**$ 15,860**	**$ (685)**	**-4.1%**
Federal Revenues	**$ 18,914**	**$ 16,173**	**$ (2,741)**	**-14.5%**
Total	**$ 61,444**	**$ 62,708**	**$ 1,264**	**2.1%**

Source: Ilinois State FY2012 Budget, p. 2-34.

Income Tax Refund Fund

The corporate and personal income tax revenue estimates discussed in this section are net of amounts set aside by the State to pay for anticipated refunds in the Income Tax Refund Fund. Each year a Refund Fund rate is determined in order to refund expected overpayment of taxes by individuals and businesses.[42] 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.

[42] 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 deposited into the fund and the 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 both refunds paid and refunds approved but unpaid 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 it has been specifically designated in budget legislation passed by the General Assembly and signed by the Governor.[43]

The State has experienced an increase in the backlog of unpaid refunds each year beginning in FY2009. As shown in the chart below, approved but unpaid business refunds grew to $690.9 million at the end of FY2010 from $214.2 million at the end of FY2009 and are expected to grow in FY2011 and FY2012.

State of Illinois Income Tax Refund Fund Rates and Approved But Unpaid Refunds: FY1999-FY2012 (in $ millions)

	Personal Refund Rate	Unpaid Personal Refunds*	Business Refund Rate	Unpaid Business Refunds*
FY1999	7.10%	$ -	19.00%	$ 1.3
FY2000	7.10%	$ -	19.00%	$ 39.7
FY2001	7.10%	$ -	19.00%	$ 236.2
FY2002	7.60%	$ 204.6	23.00%	$ 455.5
FY2003	8.00%	$ -	27.00%	$ 425.4
FY2004	11.70%	$ -	32.00%	$ 115.6
FY2005	10.00%	$ -	24.00%	$ 0.1
FY2006	9.75%	$ -	20.00%	$ 1.9
FY2007	9.75%	$ -	17.50%	$ 10.3
FY2008	7.75%	$ -	15.50%	$ 3.5
FY2009	9.75%	$ 5.3	17.50%	$ 214.2
FY2010	9.75%	$ 43.6	17.50%	$ 690.9
FY2011**	8.75%	$ -	17.50%	$ 879.0
FY2012**	8.75%	$ -	12.50%	$ 1,074.0

*As of June 30.

**Rates for FY2011 and FY2012 proposed by Governor; unpaid refunds for FY2011 and FY2012 projected by Illinois Department of Revenue.

Source: Illinois State FY2012 Budget, pp. 5-12 to 5-14; State of Illinois $3.7 Billion General Obligation Bonds, *Preliminary Official Statement*, January 21, 2011, p. 30; Communication between Illinois Department of Revenue and Civic Federation staff, February 24, 2011.

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.

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

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. The Governor's recommended FY2012 budget proposes that the business refund rate be reduced from 17.5% to 12.5% and that the personal refund rate remain unchanged at 8.75%. At those rates, the Department of Revenue projects that the backlog of unpaid business refunds would increase to approximately $879 million by the end of FY2011 and roughly $1.1 billion by the end of FY2012.[44] The backlog of unpaid business refunds had been expected to reach $1.4 billion by the end of FY2011.[45] However, the projection has been reduced to approximately $879 million because businesses are believed to be reducing income tax payments to avoid overpayment and using refunds owed to offset their tax liabilities.[46]

Based on current estimates, if the Refund Fund rates for personal and business income taxes were set using the statutory formula in FY2012 they would both increase considerably. The formula would increase the personal income tax Refund Fund rate from 8.75% in FY2011 to 11.2 % in FY2012 and the business rate would increase from 17.0% in FY2011 to 30.5% in FY2012. [47] If these rates were applied to projected gross income tax revenues in FY2012, the personal income tax transfer to the Income Tax Refund Fund would increase from $1.4 billion to $1.8 billion and the corporate income tax transfer would increase from $395.4 million to $964.7 million. This would reduce the total FY2012 General Funds revenue estimate by $970.9 million but would pay off the current backlog of approved but unpaid refunds and prevent additional unpaid refunds from growing in FY2012.

The Governor proposes to eliminate the refund backlog by the end of FY2012 by using part of the proceeds of a planned sale of $8.75 billion in General Obligation (GO) Restructuring Bonds to pay tax refunds. It is unclear how much of the bond proceeds would be used to pay the refund backlog in FY2011. According to preliminary information provided by the State in connection with a bond sale on February 23, 2011, $460 million of the bond proceeds would be used to pay off the refund backlog in FY2012.

The State previously borrowed to pay income tax refunds in FY2003, according to the Department of Revenue. In May 2003, the Income Tax Refund Fund received $475 million of bond proceeds to help reduce the refund backlog, which totaled $660.1 million at the end of FY2002. Refund rates were also increased in FY2003 and FY2004.

Other Revenue Estimates

Each chamber of the Illinois General Assembly has passed separate resolutions endorsing alternative General Funds revenue estimates as part of their FY2012 budget negotiations. These estimates were produced after the publication of the Governor's recommended FY2012 budget and after the Commission on Government Forecasting and Accountability (COGFA) published its own FY2012 estimates. The resolutions in the General Assembly are intended as caps on spending and refer to the

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[44] Communication from between Department of Revenue and Civic Federation staff, February 24, 2011.
[45] State of Illinois $3.7 Billion General Obligation Bonds, *Preliminary Official Statement*, January 21, 2011, p. 30.
[46] The Governor's Office of Management and Budget published an estimated backlog of $868 million for FY2011 in the State of Illinois $3.7 Billion General Obligation Bonds, *Preliminary Official Statement*, January 21, 2011, p. 30. If the amount of the FY2011 backlog changes significantly, the projections for the FY2012 refund backlog may also change.
[47] Communication between Department of Revenue and Civic Federation staff, April 27, 2011.

Illinois State Constitutional provision that requires the Governor and General Assembly to pass a balanced budget for each fiscal year.[48]

The House of Representatives Resolution (HR) 110 estimates General Funds revenue will total $33.2 billion for FY2012. The revenue projections in HR 110 matched all of the estimates in the Governor's proposed FY2012 budget except for the corporate income tax, which was reduced by $759 million. This total is $2.1 billion less than the FY2012 General Funds expenditures of $35.4 billion in the Governor's proposed budget for FY2012.

The resolution passed by the Illinois Senate, Senate Joint Resolution (SJR) 29, endorsed a FY2012 revenue estimate and spending limit totaling $34.3 billion. This estimate more closely resembled the totals published by COGFA but also reduced the corporate income tax revenues for FY2012 by $500 million. The revenues in SJR 29 total $34.3 billion, which is $1.1 billion more than the House estimates and $349 million more than the estimates in the Governor's proposed FY2012 budget. The Senate revenue projection and spending cap is $1.1 billion less than the total General Funds expenditures proposed in the Governor's FY2012 budget.

[48] Illinois State Constitution, Article VII – Finance, section 2(a).

The following chart shows the General Funds revenue estimates published in the Governor's FY2012 budget and the amounts estimated by the separate resolutions in the General Assembly and by COGFA.

State of Illinois General Funds FY2012 Revenue Projections (in $ millions)				
	Governor	**COGFA**	**HR110**	**SJR29**
State Taxes				
Personal Income Tax (net)	$ 14,955	$ 15,786	$ 14,955	$ 15,786
Corporate Income Tax (net)	$ 2,768	$ 2,770	$ 2,009	$ 2,170
Sales Taxes	$ 6,586	$ 6,739	$ 6,586	$ 6,739
Public Utility Taxes	$ 1,082	$ 1,136	$ 1,082	$ 1,136
Cigarette Tax	$ 355	$ 355	$ 355	$ 355
Liquor Gallonage Taxes	$ 162	$ 161	$ 162	$ 161
Vehicle Use Tax	$ 32	$ 29	$ 32	$ 29
Inheritance Tax	$ 182	$ 196	$ 182	$ 196
Insurance Taxes & Fees	$ 318	$ 315	$ 318	$ 315
Corporate Franchise Tax & Fees	$ 204	$ 202	$ 204	$ 202
Interest on State Funds & Investments	$ 25	$ 35	$ 25	$ 35
Cook County Intergovernmental Transfer	$ 244	$ 244	$ 244	$ 244
Other Sources	$ 365	$ 379	$ 365	$ 379
Total State Taxes	**$ 27,278**	**$ 28,347**	**$ 26,519**	**$ 27,747**
Transfers				
Lottery	$ 645	$ 645	$ 645	$ 645
Riverboat Transfers & Receipts	$ 429	$ 357	$ 501	$ 432
Proceeds From 10th Gaming License	$ 73	$ 75	$ -	
Other	$ 664	$ 614	$ 664	$ 614
Total Transfers	**$ 1,811**	**$ 1,691**	**$ 1,810**	**$ 1,691**
Federal Sources	**$ 4,844**	**$ 4,844**	**$ 4,844**	**$ 4,844**
Total Revenue	**$ 33,933**	**$ 34,882**	**$ 33,173**	**$ 34,282**

Source: Illinois State Budget FY2012, pp. 5-1 to 5-27; Commission on Government Forecasting and Accountability, *FY2012 Economic Forecast and Revenue Estimate and FY2011 Revenue Update* , March 10, 2011, p. 25; Illinois 97th General Assembly, House Resolution 110; Illinois 97th General Assembly, Senate Joint Resolution 29.

APPROPRIATIONS

Governor Pat Quinn's FY2012 budget proposes total appropriations of $52.7 billion, including $26.9 billion in General Funds appropriations.[49]

This section analyzes appropriations by fund, agency and purpose. Appropriations for Medicaid, employee salaries and group health insurance are examined in more detail.

Appropriations by Funds

Total appropriations decline by $804 million, or 1.5%, from $53.5 billion in the FY2011 enacted budget to $52.7 billion in the FY2012 recommended budget. Appropriations for Other State Funds and Federal Funds decrease by 3.1% and 12.9%, respectively. However, General Funds appropriations increase by $1.1 billion, or 4.1%, from $25.8 billion to $26.9 billion.

State of Illinois Appropriations by Fund: FY2011 Enacted - FY2012 Recommended (in $ millions)

	FY2011 Enacted	FY2012 Rec.	$ Change	% Change
General Funds	$ 25,814	$ 26,868	$ 1,054	4.1%
Other State Funds	$ 17,493	$ 16,956	$ (537)	-3.1%
Federal Funds	$ 10,206	$ 8,885	$ (1,321)	-12.9%
Total	**$ 53,513**	**$ 52,709**	**$ (804)**	**-1.5%**

Source: Illinois State FY2012 Budget, p. 2-32.

The $1.3 billion decline in Federal Funds appropriations, from $10.2 billion in FY2011 to $8.9 billion in FY2012, would not necessarily translate into a comparable drop in actual spending. Actual expenditures of Federal Funds in FY2011 are estimated at only $7.9 billion.[50] In FY2010 $10.2 billion in Federal Funds were appropriated, but $5.5 billion were spent.[51] Expenditures may not reach the appropriated level because the State enacts appropriations bills without knowing the precise level of available federal funding or because the State must spend the money only for specific purposes and is not able to do so.

General Funds appropriations for FY2011 and FY2012 do not include contributions to the State's five retirement systems.[52] Prior to FY2010, contributions to the retirement systems were included within departmental appropriations. In FY2010 and FY2011, the contributions were paid for by issuing Pension Obligation Bonds (POBs), rather than with General Funds. The Governor's FY2012 budget proposes the use of General Funds for the State's statutorily required $4.6 billion in pension contributions, but the contributions are budgeted separately from other appropriations.

[49] General Funds, the largest component of the State budget, support the regular operating and administrative expenses of most state agencies and are the funds over which the State has the most control and discretion. The budget also includes Other State Funds, which are accounts for activities funded by earmarked revenue sources that may only be used for specific purposes, and Federal Funds (other than those designated for General Funds), which support a variety of state programs financed with federal revenues.
[50] Illinois State FY2012 Budget, p. 2-32.
[51] Illinois State FY2012 Budget, p. 2-32.
[52] See page 56 of this report for more information on the State's retirement systems.

Appropriations by Agency

General Funds appropriations increase a total of approximately $1.1 billion from the FY2011 enacted budget to the FY2012 recommended budget. Although many of the State's 95 agencies have unchanged General Funds appropriations, decreases totaling $1.0 billion for 15 agencies partially offset increases of $2.1 billion for 30 others.

As shown in the next table, the major decreases are concentrated in the Governor's Office and the Department of Human Services (DHS).

State of Illinois FY2012 Recommended General Funds Appropriation Decreases by Agency (in $ millions)					
	FY2011 Enacted*	FY2012 Rec.	$ Change	% Change	% of Total Decreases
Governor's Office	$ 522.9	$ 6.4	$ (516.5)	-98.8%	50.2%
Human Services	$ 3,662.5	$ 3,274.1	$ (388.5)	-10.6%	37.7%
Transportation	$ 79.0	$ 11.5	$ (67.6)	-85.5%	6.6%
Violence Prevention Authority	$ 61.0	$ 44.1	$ (16.8)	-27.6%	1.6%
Emergency Management Agency	$ 17.7	$ 3.2	$ (14.5)	-82.1%	1.4%
Public Health	$ 164.0	$ 156.0	$ (8.0)	-4.9%	0.8%
Central Management Services	$ 60.1	$ 52.7	$ (7.5)	-12.4%	0.7%
Court of Claims	$ 31.1	$ 25.9	$ (5.2)	-16.7%	0.5%
State Police	$ 276.5	$ 275.0	$ (1.5)	-0.5%	0.1%
Exec. Ethics Commission	$ 8.3	$ 7.0	$ (1.3)	-15.4%	0.1%
State's Attorneys App. Prosecutor	$ 9.2	$ 8.3	$ (0.9)	-9.8%	0.1%
Agriculture	$ 32.0	$ 31.4	$ (0.6)	-1.9%	0.1%
SW Illinois Development Authority	$ 2.5	$ 2.1	$ (0.4)	-16.1%	0.0%
State Police Merit Board	$ 0.9	$ 0.9	$ (0.0)	-3.6%	0.0%
Judicial Inquiry	$ 0.7	$ 0.7	$ (0.0)	-0.7%	0.0%
Total Appropriation Decreases			**$ (1,029.3)**		

*Source: Illinois State FY2012 Budget, pp. 2-24 to 2-31.

The FY2012 budget reduces General Funds appropriations for the Governor's Office by $516.5 million from FY2011. However, this represents the expected loss of discretionary authority granted to the Governor by the General Assembly in FY2011 to allocate certain lump sums among agencies.[53] The FY2011 lump sums shown in the budget are expected to be allocated to agencies by the end of the current fiscal year.[54] Without the lump-sum appropriations, the proposed $6.4 million in FY2012 appropriations for the Governor's Office remains unchanged from FY2011.

The General Funds budget for DHS declines by $388.5 million, or 10.6%, from $3.7 billion in FY2011 to $3.3 billion in FY2012. DHS appropriations cuts include:[55]

- A 6% rate reduction for all community-based Medicaid programs;

[53] Illinois State FY2012 Budget, p. 11-2.
[54] Email communication between the Civic Federation and the Governor's Office of Management and Budget, April 13, 2011.
[55] Illinois Department of Human Services, *FY2012 Budget Briefing: GRF Walk-Up*, http://www.dhs.state.il.us/page.aspx?item=54126 (last visited on April 7, 2011).

- A 10% reduction in the maximum payment for home-based services such as personal assistants;
- Reductions in community mental health programs;
- Elimination of funding for programs that are not eligible for federal reimbursement under Medicaid, including addiction treatment services; and
- Loss of federal stimulus funding under the American Recovery and Reinvestment Act of 2009 for programs such as the Put Illinois to Work jobs program.

According to testimony by DHS before a House Appropriations Committee, the proposed 6% rate reductions to community-based services for developmental disabilities will result in increased demands for admission to state-operated developmental centers and more psychiatric hospital admissions.[56] State-operated developmental centers are state institutions for the developmentally disabled.

At the same time, appropriations for the eight state-operated developmental centers increase 9.5% from $293.8 million in FY2011 to $321.7 million in FY2012 because of salary increases under collective bargaining agreements.[57]

State of Illinois General Funds Appropriations for State Operated Developmental Centers: FY2011-FY2012 (in $ millions)

Center	FY2011 Enacted	FY2012 Rec.	$ Change	% Change
Ludeman	$ 56.0	$ 59.1	$ 3.1	5.5%
Jacksonville	$ 28.3	$ 31.2	$ 2.9	10.2%
Mabley	$ 10.6	$ 11.4	$ 0.8	7.5%
Murray	$ 37.7	$ 42.3	$ 4.6	12.2%
Shapiro	$ 77.4	$ 83.9	$ 6.5	8.4%
Kiley	$ 29.3	$ 33.1	$ 3.8	13.0%
Choate	$ 37.3	$ 41.6	$ 4.3	11.5%
Fox	$ 17.2	$ 19.1	$ 1.9	11.0%
Total	**$ 293.8**	**$ 321.7**	**$ 27.9**	**9.5%**

Source: Illinois State FY2012 Budget, pp. 9-36 to 9-37.

[56] Illinois Department of Human Services, House Appropriations Hearing, April 28, 2011, p. 6.
[57] Civic Federation calculation based on Illinois Department of Human Services, *FY2012 Budget Briefing, Operating Division Detail Pages*, http://www.dhs.state.il.us/page.aspx?item=54134 (last visited on April 8, 2011).

The next table shows the 30 agencies with appropriations increases. The major increases are concentrated in employee group health, the State Board of Education and the Departments of Healthcare and Family Services (HFS), Aging and Corrections.

State of Illinois FY2012 Recommended General Funds Appropriation Increases by Agency (in $ millions)					
	FY2011 Enacted*	FY2012 Rec.	$ Change	% Change	% of Total Increases
Group Insurance (CMS)	$ 695.8	$ 1,435.5	$ 739.7	106.3%	35.7%
Healthcare & Family Services	$ 6,970.6	$ 7,592.8	$ 622.2	8.9%	30.0%
State Board of Education	$ 7,019.8	$ 7,244.8	$ 225.0	3.2%	10.9%
Aging	$ 628.8	$ 798.9	$ 170.1	27.1%	8.2%
Corrections	$ 1,114.9	$ 1,278.0	$ 163.1	14.6%	7.9%
Supreme Court	$ 309.6	$ 347.5	$ 37.9	12.2%	1.8%
IL Student Assistance	$ 425.0	$ 450.0	$ 25.0	5.9%	1.2%
Commerce & Economic Opportunity	$ 40.2	$ 58.2	$ 18.0	44.8%	0.9%
Employment Security	$ 6.9	$ 24.0	$ 17.1	247.8%	0.8%
Juvenile Justice	$ 137.2	$ 152.7	$ 15.5	11.3%	0.7%
Revenue	$ 119.3	$ 132.3	$ 13.0	10.9%	0.6%
Children and Family Services	$ 836.3	$ 843.6	$ 7.3	0.9%	0.4%
Natural Resources	$ 51.5	$ 55.1	$ 3.6	7.0%	0.2%
Comptroller	$ 107.4	$ 110.5	$ 3.1	2.9%	0.1%
Veterans' Affairs	$ 65.7	$ 68.1	$ 2.4	3.7%	0.1%
Exec. Inspector General	$ 6.9	$ 8.5	$ 1.6	23.1%	0.1%
Dept. Human Rights	$ 7.7	$ 9.0	$ 1.3	17.3%	0.1%
Guardianship & Advocacy	$ 9.6	$ 10.8	$ 1.1	11.9%	0.1%
Commerce Commission	$ -	$ 1.0	$ 1.0	100.0%	0.0%
Management & Budget	$ 2.3	$ 3.0	$ 0.7	30.7%	0.0%
Upper IL River Dev. Authority	$ 1.6	$ 2.3	$ 0.7	43.6%	0.0%
Lt. Governor	$ 1.4	$ 2.0	$ 0.6	46.7%	0.0%
Human Rights Commission	$ 2.2	$ 2.8	$ 0.6	26.2%	0.0%
Arts Council	$ 8.5	$ 9.5	$ 1.0	11.8%	0.0%
Labor	$ 5.1	$ 5.5	$ 0.4	7.8%	0.0%
State Appellate Defender	$ 21.6	$ 21.9	$ 0.3	1.4%	0.0%
Historic Preservation	$ 10.8	$ 11.1	$ 0.3	2.7%	0.0%
Prisoner Review Board	$ 1.2	$ 1.5	$ 0.3	23.2%	0.0%
Deaf & Hard of Hearing	$ 0.6	$ 0.7	$ 0.0	6.7%	0.0%
Procurement Board	$ 0.6	$ 0.6	$ 0.0	2.0%	0.0%
Total Appropriation Increases			**$ 2,073.0**		

Source: Illinois State FY2012 Budget, pp. 2-24 to 2-31.

General Funds appropriations for the State Employees' Group Health Insurance Program more than double to $1.4 billion in FY2012 from $695.8 million in FY2011. The increase reflects underfunding in FY2011 that is expected to cause the backlog of employee health bills to grow to $1.1 billion by the end of the current fiscal year.[58]

[58] Email communication between the Civic Federation and the Illinois Department of Healthcare and Family Services, February 10, 2011.

HFS administers the State's Medicaid program and accounts for most of its Medicaid spending.[59] The agency's General Funds appropriation in the FY2012 recommended budget increases 8.9% from FY2011 even though total costs are expected to decline somewhat. State Medicaid expenditures are reimbursed by the federal government at a rate known as the Federal Medical Assistance Percentage (FMAP). After federal stimulus funding for Medicaid ends on June 30, 2011, the FMAP will decline to roughly 50% from a high of nearly 62% in FY2011, meaning that a smaller share of total expenses will be paid by the federal government. Because the State will have less spending power in Other State Funds due to the lower FMAP, more spending will be done out of General Funds. General Funds appropriations shown in the budget are gross amounts, meaning that they represent authorized state spending before netting out federal reimbursements.

The Governor proposed a 3.2% increase in General Funds appropriations for the State Board of Education from $7.0 billion in FY2011 to $7.2 billion in FY2012. This increase includes an addition of nearly $150 per student to the Foundation Level, a level of funding that is established annually by statute and is the minimum per child expenditure a school district is supposed to make.[60] General State Aid, which is designed to fill the gap between the Foundation Level and the amount a district can provide from local property tax revenues and other local resources, increases by $262.0 million, from $4.6 billion in FY2011 to $4.9 billion in FY2012.[61] The FY2012 budget also includes a proposal to save $14 million by eliminating the 47 Regional Offices of Education. The regional education offices offer mandated services such as teacher certification and provide professional development opportunities.[62]

General Funds appropriations of the Department on Aging increase 27.1% from $628.8 million in FY2011 to $798.9 million in FY2012. The increase largely reflects growth in the Community Care Program, which helps senior citizens who might otherwise need nursing care remain in their homes by providing in-home and community services such as adult daycare service and home care aides.[63] The number of clients in the program is expected to grow from 66,400 in FY2011 to 71,100 in FY2012.[64] The Department on Aging's FY2012 budget also includes $24 million in General Funds savings through the elimination of the Circuit Breaker program, which provides property tax relief for low-income seniors.

The Governor proposed a 14% increase in General Funds appropriations for the Department of Corrections from $1.1 billion in FY2011 to $1.3 billion in FY2012. The recommended number of employees grows by 137, or 1.2%, to 11,766.[65] The expanded number of FTEs is intended to improve the staff-to-inmate ratio and reduce overtime pay.

In some cases, changes in an agency's General Funds appropriations are offset by changes in appropriations for other funds. For example, although recommended General Funds appropriations for

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[59] Illinois Department of Healthcare and Family Services, *Annual Report: Medical Assistance Program Fiscal Years 2008, 2009 and 2010*, April 1, 2011, p. 12.
[60] State of Illinois, *Fiscal Year 2012 Agency Fact Sheets*, p. 18.
[61] Illinois State FY2012 Budget, p. 6-3.
[62] Jamey Dunn, "Regional superintendents dispute proposed elimination," Illinois Issues blog, March 24, 2011, http://illinoisissuesblog.blogspot.com/2011/03/regional-superintendents-dispute.html (last visited on April 27, 2011).
[63] http://www.state.il.us/aging/1athome/ccp.htm (last visited on April 11, 2011).
[64] Illinois Department on Aging, *Fiscal Year 2012 Budget*, February 23, 2011, p. 17.
[65] State of Illinois, *Fiscal Year 2012 Agency Fact Sheets*, p. 7.

HFS increase by 8.9% in FY2012, total appropriations decline by 3.7% because of a reduction in appropriations for Other State Funds due to the lower FMAP.

The next table shows appropriations for all funds for the ten largest state agencies.

State of Illinois All Funds Appropriations to Ten Largest Agencies: FY2011-FY2012 (in $ millions)				
Agency	FY2011 Enacted	FY2012 Rec.	$ Change	% Change
Healthcare and Family Services	**$ 15,566**	**$ 14,987**	**$ (579)**	**-3.7%**
General Funds	$ 6,971	$ 7,593	$ 622	8.9%
Other State Funds	$ 8,395	$ 7,191	$ (1,204)	-14.3%
Federal Funds	$ 200	$ 200	$ -	0.0%
State Board of Education	**$ 11,201**	**$ 10,759**	**$ (442)**	**-3.9%**
General Funds	$ 7,020	$ 7,245	$ 225	3.2%
Other State Funds	$ 53,874	$ 53,881	$ 7	0.0%
Federal Funds	$ 4,127	$ 3,461	$ (666)	-16.1%
Human Services	**$ 6,075**	**$ 5,481**	**$ (594)**	**-9.8%**
General Funds	$ 3,663	$ 3,274	$ (389)	-10.6%
Other State Funds	$ 774	$ 560	$ (214)	-27.6%
Federal Funds	$ 1,638	$ 1,647	$ 9	0.5%
Group Insurance (CMS)*	**$ 3,084**	**$ 4,115**	**$ 1,031**	**33.4%**
General Funds	$ 696	$ 1,436	$ 740	106.3%
Other State Funds	$ 2,389	$ 2,680	$ 291	12.2%
Federal Funds	$ -	$ -	$ -	na
Transportation	**$ 2,553**	**$ 2,678**	**$ 125**	**4.9%**
General Funds	$ 79	$ 11	$ (68)	-86.1%
Other State Funds	$ 2,470	$ 2,663	$ 193	7.8%
Federal Funds	$ 4	$ 4	$ -	0.0%
Commerce and Economic Opportunity	**$ 2,383**	**$ 2,003**	**$ (380)**	**-15.9%**
General Funds	$ 40	$ 58	$ 18	45.0%
Other State Funds	$ 271	$ 400	$ 129	47.6%
Federal Funds	$ 2,071	$ 1,545	$ (526)	-25.4%
State Treasurer	**$ 1,735**	**$ 1,735**	**$ -**	**0.0%**
General Funds	$ 17	$ 17	$ -	0.0%
Other State Funds	$ 1,719	$ 1,719	$ -	0.0%
Federal Funds	$ -	$ -	$ -	na
Revenue	**$ 1,195**	**$ 1,659**	**$ 464**	**38.8%**
General Funds	$ 119	$ 132	$ 13	10.9%
Other State Funds	$ 996	$ 1,527	$ 531	53.3%
Federal Funds	$ 20	$ 21	$ 1	5.0%
Corrections	**$ 1,233**	**$ 1,361**	**$ 128**	**10.4%**
General Funds	$ 1,115	$ 1,278	$ 163	14.6%
Other State Funds	$ 119	$ 83	$ (36)	-30.3%
Federal Funds	$ -	$ -	$ -	na
Children and Family Services	**$ 1,266**	**$ 1,294**	**$ 28**	**2.2%**
General Funds	$ 836	$ 844	$ 8	1.0%
Other State Funds	$ 422	$ 442	$ 20	4.7%
Federal Funds	$ 8	$ 8	$ -	0.0%

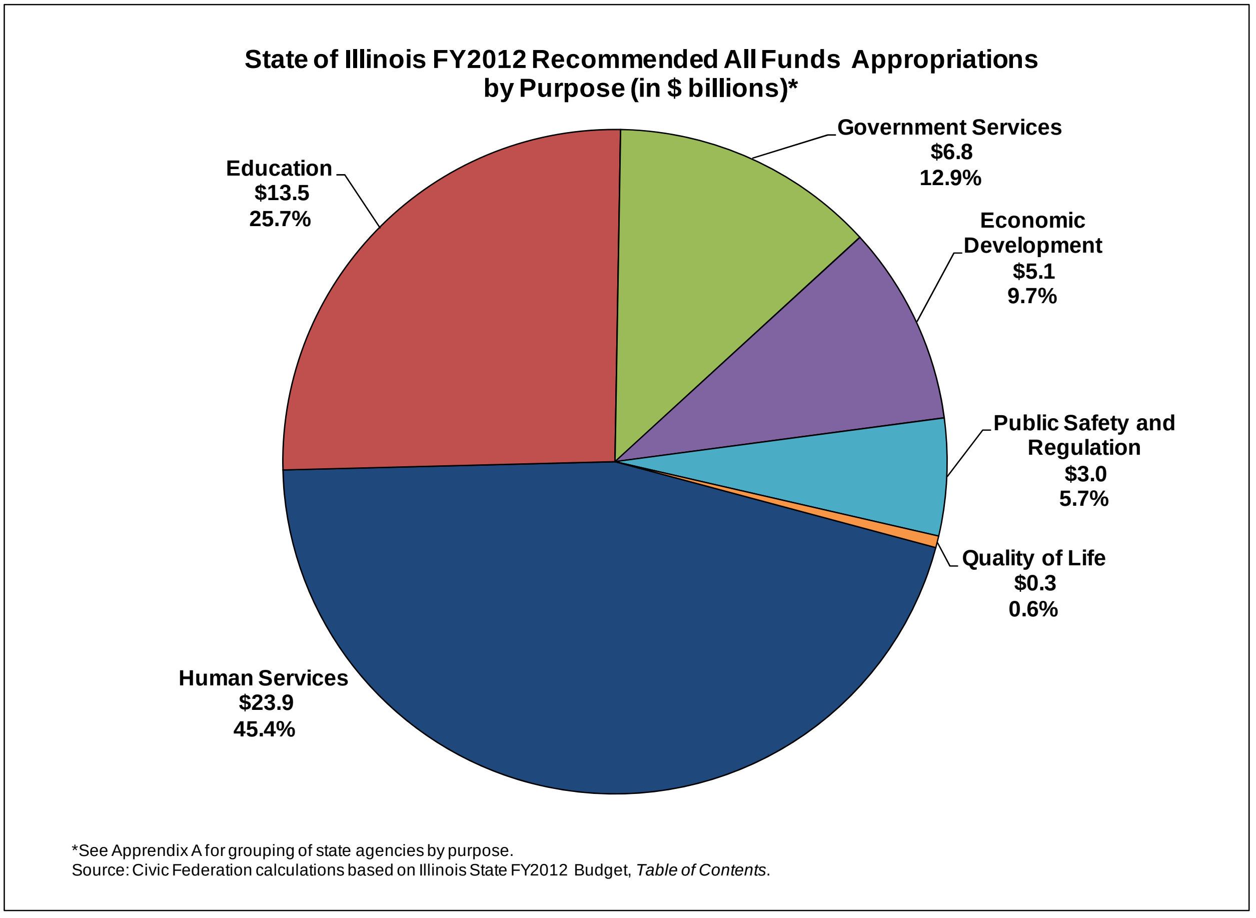
*Group insurance total is overstated because General Funds and Road Funds are appropriated and then deposited into revolving funds, where they are again appropriated for the purpose of making actual insurance payments.

Source: Illinois State FY2012 Budget, pp. 2-24 to 2-32.

While proposed FY2012 General Funds appropriations for the State Board of Education increase by 3.2%, total funds appropriations decline by 3.9% due to a reduction in Federal Funds. Federal Funds appropriations are reduced because of the loss of stimulus funding under the American Recovery and Reinvestment Act of 2009. Recommended total funds appropriations for the Department of Commerce and Economic Opportunity also decline in FY2012 despite an increase in General Funds appropriations due to a drop in Federal Funds. The Department of Transportation's General Funds appropriations decline in FY2012, but the reduction is offset by increased appropriations from Other State Funds, including the Road Fund.

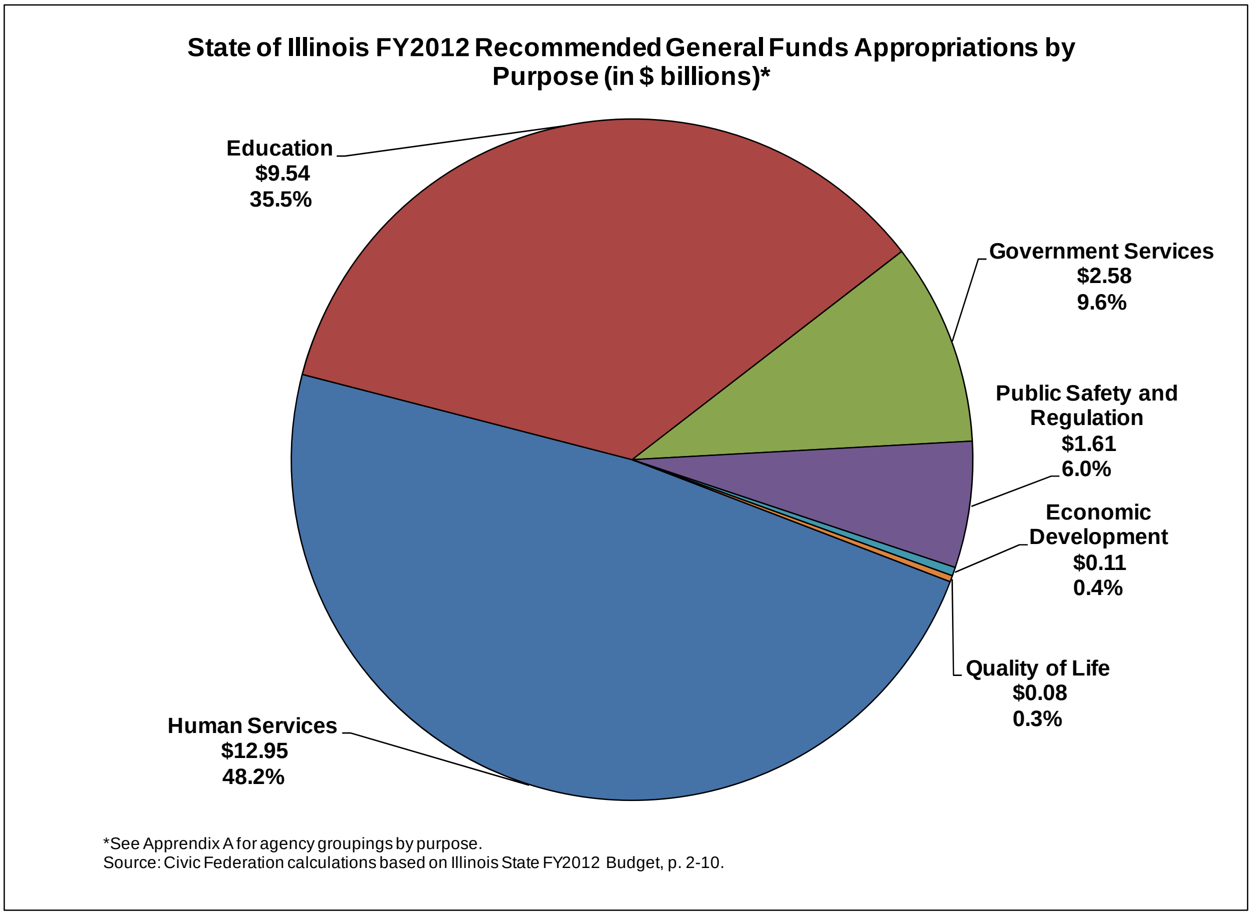
Appropriations by Purpose

The following chart shows how FY2012 recommended appropriations are allocated across all funds according to major purpose as determined by the Governor.[66] The FY2012 budget groups principal spending activities of agencies into six categories, with human services accounting for 45.4% of total appropriations of $52.7 billion; education, 25.7%; government services, 12.9%; economic development, 9.7%; public safety and regulation, 5.7%; and quality of life, 0.6%.



[66] See Appendix A for a list of the state agencies in each purpose category.

The chart below shows the allocation of FY2012 recommended General Funds appropriations by major purpose.[67] Human services accounts for 48.2% of General Funds appropriations of $26.9; education, 35.5%; government services, 9.6%; economic development, 6.0%; public safety and regulation, 0.4%; and quality of life, 0.3%.



In the FY2012 budget, the six major spending areas in the charts above were treated as outcomes and ranked according to the Governor's priorities, as required by the Budgeting for Results process mandated by new state laws.[68] Beginning with the FY2012 budget, the Governor was required to submit a spending plan based on available revenue, prioritized outcomes and effectiveness in achieving the outcomes. The outcomes ranked from highest to lowest priority are education, economic development, public safety and regulation, human services, quality of life and government services.

Selected programs in each of the six areas were designated as "above the line" or "below the line" based on whether they were best suited to achieve the outcomes with the resources available.[69] Above the line programs were maintained and below the line programs were cut back or eliminated. The procedures used to determine above the line and below the line programs

[67] See Appendix A for a list of state agencies in each purpose category.
[68] Public Acts 96-958 and 96-1529.
[69] Illinois State FY2012 Budget, p. 3-4.

were not specified in the budget. The largest proposed spending reduction—an estimated $552 million across-the-board rate cut for healthcare providers in the Medicaid program—appeared to be based on the amount of expected savings rather than other budgetary principles. According to an FY2012 budget presentation by HFS, the rate reduction was needed to meet a General Funds spending cap for the agency established by the Governor's Office.[70]

The Governor has acknowledged that it will take several years to fully implement the Budgeting for Results process and has pledged to establish improved performance measures to monitor and evaluate agency performance.[71]

Medicaid

Medicaid, the joint federal-state program that funds healthcare for certain categories of low-income people, represents a significant part of the State of Illinois budget. However, analyzing spending trends in the program is difficult due to its complex funding structure.

This section provides a brief overview of the Medicaid program, reviews various ways to examine FY2012 projected Medicaid spending and summarizes recent Medicaid reforms.

Medicaid Overview

By federal law, Medicaid covers low-income people who belong to certain categories, including pregnant women, children, the elderly and the disabled.[72] States have also been allowed to receive federal support for expanding Medicaid eligibility to optional groups.

Recipients must be citizens or certain lawfully residing immigrants. Beginning in 2014 under federal healthcare reform, the program will also cover needy non-senior adults without children. The federal healthcare reform act requires that states not tighten existing eligibility requirements.[73]

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[70] Illinois Department of Healthcare and Family Services, *Fiscal Year 2012 Budget Overview*, February 16, 2011, pp. 13-14.
[71] Illinois State FY2012 Budget, p. 3-2.
[72] Kaiser Family Foundation, *Medicaid: A Primer 2010*, June 2010, p. 8. For more information on the Medicaid program in Illinois, 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, 2011).
[73] Patient Protection and Affordable Care Act, P.L. 111-148, as amended by the Health Care and Education Reconciliation Act of 2010, P.L. 111-152.

The table below shows enrollment in Illinois' Medicaid program by eligibility category from FY2008 to FY2010.[74] Total enrollment increased by 12.1% during the period, from 2.6 million recipients at the end of FY2008 to 2.9 million at the end of FY2010.

State of Illinois Medicaid Enrollment by Population Category: FY2008-FY2010					
Category	**FY2008**	**FY2009**	**FY2010**	**# Change**	**% Change**
Comprehensive Benefits					
Children	1,455,172	1,553,255	1,630,291	175,119	12.0%
Disabled Adults	237,750	244,598	252,795	15,045	6.3%
Other Adults	520,838	563,068	608,283	87,445	16.8%
Seniors	147,649	152,894	161,088	13,439	9.1%
Total Comprehensive Benefits	**2,361,409**	**2,513,815**	**2,652,457**	**291,048**	**12.3%**
Partial Benefits*	267,584	280,067	294,280	26,696	10.0%
Total Enrollment	**2,628,993**	**2,793,882**	**2,946,737**	**317,744**	**12.1%**

*Includes prescription drug and insurance premium rebate programs.

Source: Illinois Department of Healthcare and Family Services, *Annual Report: Medical Assistance Program Fiscal Years 2008, 2009 and 2010* , April 1, 2011, p. 1.; Civic Federation calculations.

Although most Medicaid recipients are children and non-disabled, non-senior adults, disabled adults and seniors are much costlier to serve. The latter two groups represented approximately 14% of Illinois recipients in FY2010 but accounted for roughly 55% of costs.[75]

Compared with other states, Illinois' Medicaid program covers a large number of people but is roughly average with regard to its percentage of Medicaid recipients and spending per Medicaid enrollee, according to the most recent available rankings from the Kaiser Family Foundation.[76] In FY2007 18% of Illinois' population was enrolled in Medicaid; 24 states enrolled a smaller share of the population. Illinois spent $5,386 per Medicaid recipient in FY2007; 25 states spent less per recipient.

Illinois ranked below 33 other states in FY2009 in use of comprehensive Medicaid managed care at 7.7% of total enrollment.[77] The percentage of long-term care expenditures going for home health and personal care is relatively low at 31.5% in FY2009, with 44 states spending a larger share. Medicaid physician fees in Illinois are relatively low, with 40 states paying more in FY2008.

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 nearly 62% as a result of the federal American Recovery and Reinvestment Act of 2009 but is expected to return to roughly 50% after stimulus funding ends on June 30, 2011.

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[74] Illinois Department of Healthcare and Family Services, *Annual Report: Medical Assistance Program Fiscal Years 2008, 2009 and 2010*, April 1, 2011, p. 1.
[75] Illinois Department of Healthcare and Family Services, House Appropriations Hearing on Services to Seniors, March 10, 2011, p. 3. FY2010 costs have not been completely reported. There is no breakdown by client type for the 9.8% of recipients who get partial benefits, which account for 2.4% of costs.
[76] Kaiser Family Foundation, statehealthfacts.org http://www.statehealthfacts.org/comparecat.jsp?cat=4 (last visited on April 15, 2011).
[77] Comprehensive managed cared is defined as Health Maintenance Organization-style managed care in which the managed care organization bears financial risk for increased health care expenses.

Illinois also draws additional federal Medicaid funds through financing arrangements involving payments by local governments and assessments on healthcare providers. The arrangements are structured to enhance federal reimbursements. Because of these arrangements and stimulus funding, the share of total Medicaid costs paid for by General Funds in FY2010 is estimated at less than 20%.[78]

FY2012 Medicaid Budget

As a program involving several state agencies, Medicaid has no single programmatic appropriation in the state budget. HFS administers the State's Medicaid program and accounts for most of its spending, but a significant share of Medicaid expenditures is made by other agencies.[79] In the state budget, the best approximation to the Medicaid program is HFS' Medical Assistance program, although roughly 10% of these appropriations are outside of the Medicaid program.

The FY2012 budget proposes total Medical Assistance appropriations of $14.6 billion, down 3.9% from $15.2 billion in FY2011. General Funds appropriations increase 9.2% from $6.8 billion in FY2011 to $7.5 billion in FY2012. Increases in General Funds are used to offset reduced federal reimbursements to Other State Funds due to the lower FMAP. General Funds appropriations shown in the budget are gross amounts, meaning that they represent authorized state spending before netting out federal reimbursements.

The Governor's FY2012 budget recommends supplemental appropriations to Other State Funds of $1.3 billion for HFS in FY2011. The supplemental appropriations would be funded with proceeds of the proposed $8.75 billion in General Obligation Restructuring Bonds and would be used to pay down bills before the end of FY2011, taking advantage of the enhanced FMAP.[80]

The next table shows all funds and General Funds Medical Assistance appropriations for FY2011 and FY2012.

Illinois Department of Healthcare and Family Services Medical Assistance Program Appropriations: FY2011-FY2012 (in $ millions)

	FY2011 Enacted	FY2011 Rec. with Supplemental	FY2012 Rec.
All Funds	$ 15,160	$ 16,548	$ 14,568
General Funds	$ 6,825	$ 6,825	$ 7,452

Souce: Illinois Department of Healthcare and Family Services, Fiscal Year 2012 Budget Overview, February 16, 2011, p. 15.

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[78] Illinois Department of Healthcare and Family Services, *Annual Report: Medical Assistance Program Fiscal Years 2008, 2009 and 2010*, April 1, 2011, p. 13.
[79] Illinois Department of Healthcare and Family Services, *Annual Report: Medical Assistance Program Fiscal Years 2008, 2009 and 2010*, April 1, 2011, p. 12. Other agencies include the Departments of Human Services, Public Health and Children and Family Services and the Department on Aging.
[80] Illinois Department of Healthcare and Family Services, *Fiscal Year FY2012 Budget Overview*, February 16, 2011, p. 13; Illinois State FY2012 Budget, p. 2-14.

Despite the increase in General Funds appropriations from FY2011, the FY2012 General Funds budget depends on the following proposed spending reductions:[81]

- $233 million from Medicaid reform;
- $522 million from a 6% rate reduction for most healthcare providers;
- $107 million from elimination of the Illinois Cares Rx prescription drug program for seniors;
- $320 million from using a transfer out of General Funds rather than General Funds appropriations to offset the impact of the issuance of bonds based on proceeds of a tobacco litigation settlement; and
- $359 million from delaying bill payment.

Medicaid reform relates to legislation enacted in January and February 2011.[82] The legislation, discussed in more detail below, is generally designed to create significant long-term changes in the way healthcare services are delivered under the Medicaid program. Expected savings in FY2012 include a $100 million reduction in hospital outlier rates, the rates paid to hospitals for exceptionally costly inpatient stays. In exchange for the reduction, the State has extended by one year through FY2014 the hospital assessment program, which brings in additional federal funding. Projected FY2012 savings also include $116 million in improved management of prescription drug benefits.

The proposed 6% rate reduction for most providers is projected to result in a $522 reduction in HFS' General Funds appropriation. However, the net savings—after accounting for the decline in federal reimbursements due to reduced state spending—is estimated at roughly $267 million.[83]

The State plans to end the Illinois Cares Rx prescription drug program, which does not receive federal reimbursement. Illinois Cares Rx supplements coverage in the Medicare Part D drug program for seniors and disabled people with income levels that exceed Medicaid limits. Gaps in Medicare Part D coverage are scheduled to be phased out under federal healthcare reform.

HFS lost roughly $160 million in annual funding because the State in FY2011 sold bonds based on a settlement of tobacco-related litigation; the settlement money that previously went to HFS for medical expenses is now being used for debt service on the bonds.[84] The FY2012 budget proposes a $160 million transfer out of General Funds to the Healthcare Provider Relief Fund, which is shown as a gross reduction of $320 million in General Funds appropriations.

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[81] Illinois Department of Healthcare and Family Services, *Fiscal Year FY2012 Budget Overview*, February 16, 2011, p. 14.
[82] Public Acts 96-1501 and 96-1530.
[83] Email communication between the Civic Federation and the Governor's Office of Management and Budget, April 13, 2011.
[84] Preston, Darrell, "Illinois Plans $1.5 Billion Tobacco Bond for Budget," *Business Week*, November 9, 2010. http://www.businessweek.com/news/2010-11-09/illinois-plans-1-5-billion-tobacco-bond-for-budget.html (last visited on April 16, 2011).

The FY2012 budget proposes paying down outstanding Medicaid bills by using proceeds of the planned sale of $8.75 billion in General Obligation Restructuring Bonds. However, delaying payment on new bills is expected to free up $359 million in General Funds.

The FY2012 budget includes proposed appropriations of $122.3 million for privately owned nursing homes known as Institutions for Mental Diseases (IMDs) that provide care for roughly 4,300 mentally ill people. Federal rules preclude use of Medicaid funds for people between 22 and 64 years of age living in institutions in which more than half of the patients have mental illnesses. Under a federal court settlement, the State has agreed to move all willing and qualified IMD residents to community settings over five years.[85]

In addition to other budgetary complications, it is difficult to calculate the actual growth in the Medicaid program for any specific period because the erratic payment cycle—the time it takes for bills to be paid—makes it hard to determine which changes are due to real growth and which are due to payment cycle issues. Illinois law allows payment for Medicaid claims to be made out of future years' appropriations.[86] This provision, known as the Section 25 loophole after 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.[87] Because of these complications, a more stable way of measuring changes in the Medicaid program over time is to look directly at the liabilities, which are the amount of valid bills the State has on hand regardless of when they get paid.

This year the annual report on the Medical Assistance program that is submitted to the General Assembly by HFS includes tables showing liabilities from FY2009 to FY2012.[88] Liabilities are projected to increase by 10.1% from $12.6 billion in FY2009 to $13.9 billion in FY2012. From FY2011 to FY2012, liabilities are projected to decline by 1.3% from $14.0 billion.

Medicaid Reform

The State enacted legislation in January 2011 designed to make long-term changes in Illinois' Medicaid program.[89] The legislation supported the goal of shifting more long-term care to community settings and required that the Governor create a unified budget report for long-term care services provided by different state agencies.

The reform legislation required that half of all Medicaid recipients be enrolled in coordinated care programs by January 1, 2015. The State's first experiment with mandatory Health Maintenance Organization enrollment—a pilot program for approximately 40,000 elderly and disabled Medicaid recipients in the Chicago suburbs—was scheduled to start in July 2010 but the date has been postponed to later in FY2011.

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[85] Williams v. Blagojevich, No.05-4673 (N.D. Ill. filed August 15, 2005).
[86] 30 ILCS 105/25.
[87] Illinois State Comptroller, "The Section 25 Budget 'Loophole,'" *Fiscal Focus*, July 2008, p. 7.
[88] Illinois Department of Healthcare and Family Services, *Annual Report: Medical Assistance Program Fiscal Years 2008, 2009 and 2010*, April 1, 2011, pp. 14-17.
[89] Public Act 96-1501.

The reform legislation ended coverage of children with family incomes greater than 300% of the Federal Poverty Level (FPL) in the AllKids program but continued enrollment for children with family incomes greater than 200% but below 300%.[90] Neither group receives federal reimbursement. The former group cost the State $3.1 million in FY2010, while the latter group cost $12.8 million.[91] The State is seeking federal reimbursement for children with family incomes greater than 200% but below 300% of the FPL.

In addition, the legislation phases out the Section 25 loophole over ten years. Beginning in FY2021, the State would not be able to pay Medicaid bills from a future year's appropriations.

State Employee Payroll

Expenditures for state employee salaries historically have made up approximately 8% of the State's total appropriated expenditures and 10% of the State's General Funds appropriated expenditures. A relatively small proportion of the state budget is spent on salaries because many state services and operations are not performed by state employees. State government in Illinois provides many services through funding for local governments, health care providers and human services providers, rather than having state employees perform and provide those services.

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[90] In FY2011 the Federal Poverty Level is $22,350 a year for a family of four. See U.S. Department of Health and Human Services, Assistant Secretary for Planning and Evaluation, *The 2011 HHS Poverty Guidelines*, http://aspe.hhs.gov/poverty/11poverty.shtml (last visited on April 28, 2011).

[91] Illinois Office of the Auditor General, *Program Audit of the Covering All Kids Health Insurance Program*, April 2011, p.vii.

FY2012 Recommended Payroll

As shown in the table below, the FY2012 budget recommends increasing the number of authorized full-time equivalent (FTE) positions in agencies under the Governor by 645, or 1.1%, from an estimated 56,998 in FY2011 to 57,643 in FY2012.[92]

State of Illinois FTEs: FY2010-FY2012					
	FY2010 Actual	**FY2011 Estimated**	**FY2012 Rec.**	**# Change**	**% Change**
Human Services	23,777.0	25,665.0	25,882.0	217.0	0.8%
Public Safety and Regulation	17,123.0	17,671.0	17,880.0	209.0	1.2%
Economic Development	6,423.0	7,091.0	7,261.0	170.0	2.4%
Government Services Under Governor	3,853.0	4,087.0	4,108.0	21.0	0.5%
Quality of Life	1,453.0	1,587.0	1,615.0	28.0	1.8%
Education*	863.0	897.0	897.0	0.0	0.0%
Total Under Governor	**53,492.0**	**56,998.0**	**57,643.0**	**645.0**	**1.1%**
Government Services Not Under Governor**	7,388.0	7,475.5	7,486.0	10.5	0.1%
Total	**60,880.0**	**64,473.5**	**65,129.0**	**655.5**	**1.0%**

*Includes state education agencies but not the State's nine public universities or the Illinois Math and Science Academy. Public school teachers are employees of local school districts and not the State.

**For agencies not under the Governor, FY2012 FTE numbers are based on agencies' requests if available or left unchanged from the prior year. Table includes revised FTE number of 168.0 for Treasurer's Office. General Assembly members are included but not General Assembly staff. See Appendix B for a list of agencies under the Governor.

Source: Illinois State FY2012 Budget.

The Governor's Office does not make FTE recommendations for agencies not under the Governor, including other Illinois Constitutional offices, legislative and judicial agencies, the State Board of Elections, the Office of the Executive Inspector General and the Executive Ethics Commission. For these agencies, the Governor's Office of Management and Budget (GOMB) seeks information on requested FTE numbers; if no information is available from the agencies, staffing levels are shown as unchanged in the budget.[93] As a result, it is not clear how much weight should be given to the FY2012 recommended FTE number for agencies not under the Governor.

In addition, FTE numbers for agencies not under the Governor in the table above include the 177 General Assembly members but not General Assembly staff. The General Assembly does not provide GOMB with FTE numbers for staff.

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[92] See Appendix B for a list of agencies under the Governor.
[93] In the budget document, FTE numbers for agencies not under the Governor are presented in chapters dealing with those agencies but not in the personnel chart in the front of the document.

In FY2009 and FY2010, FTE estimates by agencies under the Governor have exceeded the actual employee total.[94] GOMB estimates that the number of FTEs for the Governor's agencies at the end of FY2011 will be 54,610, compared with the agencies' combined estimates of 56,998.[95] The actual number of FTEs depends on the availability of resources to fund positions.

The largest recommended increase in FTEs for any agency from FY2011 to FY2012 is 187 FTEs for the Department of Corrections to improve the staff-to-inmate ratio and reduce overtime work. Other large proposed increases are for the Department of Transportation, 150 FTEs; the Department of Public Health, 101 FTEs; the Department of Veterans' Affairs, 97 FTEs; and the Department of Juvenile Justice, 73 FTEs.

Although the proposed number of FTEs in human services increases in FY2012, the additional recommended FTEs are in the Departments of Public Health, Veterans' Affairs and Employment Security. Proposed position numbers for the Department of Human Services, the largest state agency with 13,972 FTEs in FY2011, declines by 110 FTEs in FY2012. A decrease of 71 FTEs is also recommended in FY2012 for the Office of the State Police.

While the FY2012 budget proposes an FTE increase of 1.1% in agencies under the Governor, salary costs rise by 9.2%, or $317.0, from $3.5 billion to $3.8 billion. The table below only shows information for agencies under the Governor because complete data are not available for other agencies and the available data are not consistent with the information presented in the previous table on state FTEs.

State of Illinois Salary Costs for Agencies Under the Governor for All Funds FY2011-FY2012 (in $ thousands)*

	FY2011 Enacted	FY2012 Rec.	$ Change	% Change
Human Services	$ 1,473,757.9	$ 1,616,959.6	$ 143,201.7	9.7%
Public Safety and Regulation	$ 1,091,370.1	$ 1,218,005.8	$ 126,635.8	11.6%
Economic Development	$ 518,819.3	$ 542,862.3	$ 24,043.0	4.6%
Government Services	$ 247,693.5	$ 260,264.5	$ 12,571.0	5.1%
Quality of Life	$ 84,520.5	$ 94,631.6	$ 10,111.1	12.0%
Education**	$ 36,869.8	$ 37,351.0	$ 481.2	1.3%
Total	**$ 3,453,031.1**	**$ 3,770,074.8**	**$ 317,043.8**	**9.2%**

*See Appendix B for list of agencies under the Governor.

**Includes state education agencies but not the State's nine public universities or the Illinois Math and Science Academy. Public school teachers are employees of local school districts.

Source: Civic Federation calculations based on email communication from the Governor's Office of Management and Budget, March 31, 2011.

The increase in total salary costs for public safety and regulation is primarily due to a $111.9 million increase for the Department of Corrections. In the human services category, salary costs for the Department of Human Services rise by $86.4 million or 11.4% despite the proposed reduction of 110 FTEs. The large percentage increase in the quality of life category, which

[94] Illinois State FY2010 Budget, p. 2-13; Illinois State FY2011 Budget, p. 2-11; Illinois State FY2012 Budget, p. 2-15.

[95] Illinois State FY2012 Budget, p. 2-15.

includes only three agencies,[96] is related to the addition of 28.7 FTEs in the Department of Natural Resources.

The next chart shows salary costs for General Funds-supported positions in the agencies under the Governor. Salary costs increase by 10.8%, or $247.3 million, from $2.3 billion in FY2011 to a recommended $2.5 billion in FY2012.

State of Illinois Salary Costs for Agencies Under the Governor for General Funds: FY2011-FY2012 (in $ thousands)*

	FY2011 Enacted	FY2012 Rec.	$ Change	% Change
Human Services	$ 1,159,694.1	$ 1,275,309.4	$ 115,615.3	10.0%
Public Safety and Regulation	$ 941,684.7	$ 1,055,985.3	$ 114,300.7	12.1%
Economic Development	$ 27,514.8	$ 29,747.1	$ 2,232.3	8.1%
Government Services	$ 92,173.2	$ 99,293.0	$ 7,119.8	7.7%
Quality of Life	$ 40,886.2	$ 48,389.6	$ 7,503.4	18.4%
Education**	$ 36,705.0	$ 37,186.1	$ 481.1	1.3%
Total	**$ 2,298,658.0**	**$ 2,545,910.5**	**$ 247,252.6**	**10.8%**

*See Appendix B for list of agencies under the Governor.

**Includes state education agencies but not the State's nine public universities or the Illinois Math and Science Academy. Public school teachers are employees of local school districts.

Source: Civic Federation calculations based on email communication from the Governor's Office of Management and Budget, March 31, 2011.

Union members reportedly represent more than 94% of the State's workforce, with 10,000 state employees joining unions in the past eight years.[97] In January 2010, the American Federation of State, County and Municipal Employees (AFSCME), the State's largest union, agreed to negotiated changes in its contract that runs from FY2009 through FY2012. The agreement came after Governor Quinn proposed 2,600 layoffs and the union won a preliminary injunction in state court blocking the action.[98]

The original contract increased wages by 15.25% over four years.[99] Under the January 2010 agreement, Council 31 of AFSCME deferred scheduled wage increases in exchange for a promise of virtually no layoffs and no state facility closures through June 30, 2011.[100] Workers were to receive 2% wage increases on July 1, 2010 and January 1, 2011, but half of these increases were deferred until June 1, 2011. The union also agreed to voluntary furloughs and to $70 million in health insurance savings. The agreement nullified a provision in the contract that would have allowed the State to reopen discussions on employee health insurance costs.

[96] The quality of life category includes the Illinois Arts Council, the Department of Natural Resources and the Illinois Historic Preservation Council.
[97] John O'Connor, "State Union Numbers Surge, *Chicago Sun-Times*, March 27, 2011.
[98] Dave McKinney, "Judge puts brakes on gov's layoff plan; Says AFSCME, state need arbitration over 2,600 jobs," *Chicago Sun-Times*, September 29, 2009.
[99] AFSCME Council 31, "State contract ratified by huge margin," September 5, 2008, AFSCME Council 31 (last visited on April 28, 2011).
[100] AFSCME Council 31, "AFSCME, state reach mediated resolution on layoff grievances," http://www.afscme31.org/news?id=0011 (last visited on April 25, 2011).

In September 2010, the January agreement was extended through the end of FY2012 and AFSCME agreed to $50 million in additional spending cuts.[101] The union also agreed to defer half of the 4% raise due on July 1, 2011 to February 1, 2012.[102] Employees were scheduled to receive 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%.

The collective bargaining increases represent a total cost of $200.5 million in FY2012, including $146.0 million in General Funds costs, according to the Governor's Office.[103]

State Employee and Retiree Health Insurance

The FY2012 budget recommends that General Funds appropriations for the State Employees' Group Insurance Program be more than doubled to $1.4 billion from $695.8 million in FY2011. This proposal reflects significant underfunding of the program in FY2011. Because of the lack of funds, claims payments are currently delayed by as much as 11 months.[104] The backlog of unpaid health claims is expected to reach $1.1 billion by the end of FY2011.[105]

This section provides a brief overview of the group insurance program, a review of the FY2012 budget proposal and a summary of reforms being considered by the General Assembly.

Employee Health Insurance Overview

The State Employees' Group Insurance Program provides medical, dental, vision and life insurance coverage for employees, retirees and dependents of the state government, state universities, the General Assembly and the judiciary.[106] The program offers an indemnity plan called the Quality Care Health Plan (QCHP), in which participants are permitted to choose any physician or hospital.[107] The program also offers various managed care plans such as health

[101] Chris Wetterich, "AFSCME, state need to find $90 million in savings," *The State Journal-Register,* October 6, 2010.
[102] Council 31 of the American Federation of State, County and Municipal Employees, AFL-CIO v. Pat Quinn et al., No. 11-3203 (C.D. Ill filed July 8, 2011). This report was corrected on July 12, 2011 to reflect the contract change.
[103] Email communication between the Civic Federation and the Governor's Office of Management and Budget, April 13, 2011.
[104] Illinois Department of Central Management Services website, Notice Regarding QCHP and QCDP Claim Payment Delay, Updated April 6, 2011, http://www.state.il.us/cms/3_servicese_ben_choice/claims-delay-notice.htm (last visited on April 17, 2011).
[105] Email communication between the Civic Federation and the Illinois Department of Healthcare and Family Services, February 10, 2011.
[106] 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 21, 2011).
[107] Although participants may choose any medical services provider, they receive enhanced benefits for using doctors and hospitals that are members of a network. Indemnity plans also typically have higher participant out-of-pocket costs than managed care plans.

maintenance organizations (HMOs), in which choices are more restricted than in the indemnity plan.

The group insurance program had an estimated 351,566 participants in FY2011, of which 33.8% were in the QCHP and 66.2% were in managed care plans, according to the General Assembly's Commission on Government Forecasting and Accountability (COGFA).[108] Membership in the QCHP has been declining since FY2005, while membership in managed care plans has been increasing since FY2004.

The average annual premium cost per participant varies by type of plan chosen and whether Medicare is the primary insurer. In FY2011, the average cost per participant is estimated at $6,399 in the QCHP plan and $5,567 in managed care. The State is expected to pay on average $5,596 a year for a QCHP participant and $4,913 for a managed care participant.[109]

The next table shows the average cost per participant for health coverage in FY2011 and the share paid by the State and the participant by type of plan chosen.

State of Illinois State Employees' Group Insurance Plan
Average Health Insurance Cost Per Participant: FY2011

Plan	Member Contribution	State Contribution	Average Cost Per Participant
QCHP	$ 803	$ 5,596	$ 6,399
Managed Care	$ 654	$ 4,913	$ 5,567

Source: Illinois General Assembly, Commission on Government Forecasting and Accountability, *Liabilities of the State Employees' Group Health Insurance Program FY2012* , March 2011, p. 10.

In FY2011, 66.6% of retirees chose QCHP, compared to less than 30% of employees and dependents. More than 70% of employees and dependents favored the managed care plans.[110]

State employees who retired before January 1, 1998 do not have to pay health insurance premiums. Those who retired after that date with at least 20 years of service also do not pay premiums.[111] Exceptions include General Assembly members, who can retire with as little as four years of service and not have to pay premiums, and judges, who can retire with as little as six years of service and not pay premiums.[112]

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[108] Commission on Government Forecasting and Accountability, *State Employees' Group Insurance Program Project FY2011 Liabilities Report*, March 2011, p. 6, http://www.ilga.gov/commission/cgfa2006/Upload/StateEmployeesInsuranceFY2012.PDF (last visited on April 21, 2011).
[109] Commission on Government Forecasting and Accountability, *State Employees' Group Insurance Program Project FY2011 Liabilities Report*, March 2011, p. 10.
[110] Commission on Government Forecasting and Accountability, *State Employees' Group Insurance Program Project FY2011 Liabilities Report*, March 2011, p. 7.
[111] 5 ILCS 375/10.
[112] Email communication between the Civic Federation and the Illinois Department of Healthcare and Family Services, February 28, 2011. General Assembly members can retire at age 62 with four years of service or at age 55 with eight years of service. Judges can retire at 62 with six years of service or at 60 with ten years of service.

As of February 2011, 91.0% of the 81,833 retirees covered by the group insurance program were not required to pay any premiums.[113] The State is expected to pay $497.6 million for health insurance coverage for retirees in FY2011, while retirees are expected to pay $12.0 million. The table below shows average monthly retiree health costs for members and for the State in FY2011 and total state costs. These figures do not include the cost of coverage for retirees' dependents; retirees are required to pay premiums for their dependents.

State Employees' Group Insurance Program
Retiree Health Costs: FY2011*

	Avg. Monthly Member Contribution	Avg. Monthly State Cost	Total Avg. Monthly Plan Cost	Total Enrollment	Total Annual State Cost
QCHP					
Medicare Retiree	$ 10.09	$ 322.29	$ 332.38	41,267	$ 159,600,852
Non-Medicare Retiree	$ 14.43	$ 892.61	$ 907.04	13,196	$ 141,346,327
Managed Care Plans					
Medicare Retiree	$ 16.56	$ 312.71	$ 329.27	12,999	$ 48,778,615
Non-Medicare Retiree	$ 12.44	$ 857.52	$ 869.96	14,371	$ 147,880,190
Total				**81,833**	**$ 497,605,984**

*Does not include coverage of dependents.

Source: Illinois Department of Healthcare and Family Services, Letter to Senator Jeffrey Schoenberg, February 16, 2011, http://www.ilga.gov/commission/cgfa2006/Upload/S235RFPreviewHealthcareCoverageProvidedToILretirees.pdf (last visited on April 21, 2011).

The State uses a pay-as-you-go method to pay healthcare expenses for retirees. According to the latest available actuarial valuation, the State's actuarial accrued liability for retiree insurance benefits was $27.1 billion at the end of FY2009.[114]

FY2012 Employee Health Insurance Budget

Health insurance costs for employees and retirees have been a rapidly growing part of the state budget, increasing by $545.3 million, or 30.5%, from $1.8 billion in FY2007 to $2.3 billion in FY2011, according to COGFA.[115] Costs are projected to rise by $53.9 million, or 2.3%, to $2.4 billion in FY2012.[116]

The FY2012 budget proposes a General Funds appropriation of $1.4 billion for health insurance. The program also receives funding from member contributions, the Road Fund and university funding. Funding from all of the sources is deposited into the Health Insurance Reserve Fund to pay insurance claims. The total appropriation for FY2012 is estimated at $2.4 billion.[117]

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[113] Illinois Department of Healthcare and Family Services, Letter to Senator Jeffrey Schoenberg, February 16, 2011.
[114] Illinois State Comptroller, *Comprehensive Annual Financial Report 2009*, June 30, 2010, p. x.
[115] Commission on Government Forecasting and Accountability, *State Employees Group Insurance Program Projected FY2011 Liabilities Report*, March 2011, p. 8.
[116] Commission on Government Forecasting and Accountability, *State Employees Group Insurance Program Projected FY2011 Liabilities Report*, March 2011, p. 8. This is an estimate by the Illinois Department of Healthcare and Family Services; the estimate by the Commission on Government Forecasting and Accountability is higher, at $2.5 billion in FY2012.
[117] Commission on Government Forecasting and Accountability, *State Employees Group Insurance Program Projected FY2011 Liabilities Report*, March 2011, p. 5. The total appropriation listed in the FY2012 budget overstates actual appropriations because amounts deposited in the Health Insurance Reserve Fund are appropriated again.

In FY2011 $695.8 million in General Funds were appropriated for health insurance, compared with roughly $1.1 billion in FY2009 and in FY2010. The backlog of unpaid health claims is expected to reach $1.1 billion by the end of FY2011.[118] Like the Medicaid program, the employee health program is covered by the Section 25 loophole that allows prior years' bills to be paid from future years' appropriations.[119]

However, the FY2012 budget proposes a supplemental appropriation of approximately $1.1 billion for Other State Funds for FY2011 to pay down the backlog of claims. As with the Medicaid bills, the health insurance backlog would be paid with proceeds of the Governor's proposed $8.75 billion sale of General Obligation Restructuring Bonds.

Employee Health Insurance Reforms

On February 9, 2011, COGFA members voted to hire a consulting firm to study the cost of retiree healthcare provided by the State.[120] The study will review what other states charge for retiree coverage and will present a possible new premium structure in which all retirees make contributions based on their overall household income. The study is due to be completed in early May 2011, in time for legislative proposals to be enacted before the General Assembly adjourns at the end of May.

HFS Director Julie Hamos testified at the COGFA meeting on February 9 that Governor Quinn did not foresee any changes to the existing retiree health program until after collective bargaining agreements expire at the end of FY2012. Council 31 of ASCME has taken the position that any proposed changes in retiree healthcare benefits must be negotiated with the union.[121]

However, Ms. Hamos also stated that HFS could propose new rules requiring retired General Assembly members and judges to pay health insurance premiums but has not done so. Currently, there are a total 1,343 retirees in the General Assembly and Judges' plans with total estimated costs of $8.45 million in FY2011.[122]

In his FY2010 budget, the Governor proposed increased premiums for both employees and retirees who participated in QCHP. The proposal faced considerable opposition and no action was taken on the proposal by the General Assembly.

In his FY2011 budget, the Governor proposed that the State limit its share of retiree health insurance premiums to $300 per month. The change meant that Medicare-eligible retirees, for whom the state plan serves as supplemental insurance, would have paid between $4 per month

[118] Email communication between the Civic Federation and the Illinois Department of Healthcare and Family Services, February 10, 2011.
[119] 30 ILCS 105/25.
[120] Commission on Government Forecasting and Accountability website, http://www.ilga.gov/commission/cgfa2006/MeetingInformation.aspx?id=52 (last visited on April 17, 2011).
[121] AFSCME Council 31 website, "Attacks on retiree health insurance renewed," February 7, 2011, http://www.afscme31.org/news?id=0147 (last visited on April 17, 2011).
[122] Email communication between the Civic Federation and the Illinois Department of Healthcare and Family Services, February 28, 2011.

and $50 per month, depending on which insurance plan they chose. For retirees not yet on Medicare, the cost would have been between $290 per month and $500 per month. The proposal was initially projected to save $255 million.[123] However, HFS subsequently said that only $136 million of the $255 million would come from savings and the remainder would come from delaying payment of health insurance claims.[124] The proposal failed to advance in the General Assembly.

In October of 2009, the State began charging retirees a monthly premium for dental insurance. This action did not require a change in state law, because dental insurance is not part of basic health coverage. AFSCME Council 31 filed a grievance against the State, arguing that it had historically bargained with the union over the terms of retiree healthcare and that the State could not unilaterally make a change. An arbitrator ruled against the union and in March of 2010 the union filed a lawsuit against the State in Cook County Court over the issue.[125]

[123] Illinois Department of Healthcare and Family Services, *Fiscal Year 2011 Budget Overview*, March 20, 2010, p. 10.
[124] Email communication between the Civic Federation and the Illinois Department of Healthcare and Family Services, May 5, 2010.
[125] Council 31 AFSCME, *AFSCME Sues State Over Change to Retiree Insurance*, March 9, 2010, at http://www.afscme31.org/news?id=0035 (last visited on April 8, 2010).

STATE RETIREMENT SYSTEMS

Illinois' severely underfunded retirement systems represent a growing burden on the State's operating budget. This section presents an overview of the retirement systems, examines their impact on the FY2012 budget and reviews proposals for pension reform.

Retirement Systems Overview

The State of Illinois funds five state retirement systems: the Teachers' Retirement System, the State Employees' Retirement System, the State Universities Retirement System, the Judges' Retirement System and the General Assembly Retirement System.[126] Employees also contribute to the systems, with contributions ranging from 8% to 11.5% of salary depending on the system.[127] As of June 30, 2010, there were a total of 736,867 participants in the systems.[128]

Members of Illinois Retirement Systems: Enrollment as of June 30, 2010

Pension Fund	Members*	Annuitants	Total
Teachers	281,031	97,796	378,827
Universities	163,180	48,903	212,083
State Employees	84,655	58,664	143,319
Judges	986	999	1,985
General Assembly	255	398	653
Total	**530,107**	**206,760**	**736,867**

*Includes active and inactive members.

Source: State of Illinois $3.7 Billion General Obligation Bonds, *Official Statement* , February 23, 2011, p. 53.

The financial health of a retirement system is typically measured by the funded ratio, which shows the percentage of the actuarial accrued liability that is covered by the system's assets.[129] The actuarial accrued liability is an estimate of the present value of the benefits owed to current and retired employees. The present value of benefits is the amount that must be invested at a specified rate of return to provide benefit payments as they come due.

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[126] The State also contributes to the Public School Teachers' Pension and Retirement Fund of Chicago. The State's FY2012 budget includes a total contribution of $43.9 million to the Chicago fund.

[127] Commission on Government Forecasting and Accountability, *A Report on the Financial Condition of the Illinois State Retirement System as of June 30, 2010*, March 2011, pp. 31, 43, 55, 57 and 79. Members of the State Employees' Retirement System who are covered by Social Security contribute 4%.

[128] State of Illinois, $3.7 Billion General Obligation Bonds, *Official Statemen*t, February 23, 2011, p. 53.

[129] State of Illinois, $3.7 Billion General Obligation Bonds, *Official Statemen*t, February 23, 2011, p. 54.

A recent nationwide study based on FY2009 data found that Illinois' pensions had lower funded ratios than any other state.[130] As shown in the table below, Illinois' retirement systems had combined unfunded liabilities of $85.6 billion and a combined funded ratio of 38.3% as of June 30, 2010. These numbers are based on the market value of assets, which recognizes gain and losses on investments as they occur.

State of Illinois Retirement Systems Funded Ratios and Unfunded Liabilities: June 30, 2010 Assets at Market Value (in $ millions)				
Pension Fund	**Accrued Liability**	**Net Assets**	**Unfunded Liability**	**Funded Ratio**
Teachers	$ 77,293.3	$ 31,323.8	$ 45,969.4	40.5%
Universities	$ 30,120.4	$ 12,121.5	$ 17,998.9	40.2%
State Employees	$ 29,309.5	$ 9,201.8	$ 20,107.6	31.4%
Judges	$ 1,819.4	$ 523.3	$ 1,296.2	28.8%
General Assembly	$ 251.8	$ 54.7	$ 197.1	21.7%
Total	**$ 138,794.3**	**$ 53,225.1**	**$ 85,569.2**	**38.3%**

Source: Commission on Government Forecasting and Accountability, *Report on the Financial Condition of the Illinois State Retirement Systems as of June 30, 2010* , March 2011, p. 23.

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 has minimized the investment losses suffered by the state retirement systems as a result of the 2008-2009 market downturn.

Using the asset-smoothing approach, the next table shows that the retirement systems had combined unfunded liabilities of $75.7 billion and a combined funded ratio of 45.4% as of June 30, 2010.

State of Illinois Retirement Systems Funded Ratios and Unfunded Liabilities: June 30, 2010 With Asset Smoothing (in $ millions)				
Pension Fund	**Accrued Liability**	**Net Assets**	**Unfunded Liability**	**Funded Ratio**
Teachers	$ 77,293.3	$ 37,439.1	$ 39,854.1	48.4%
Universities	$ 30,120.4	$ 13,966.6	$ 16,153.8	46.4%
State Employees	$ 29,309.5	$ 10,961.5	$ 18,347.9	37.4%
Judges	$ 1,819.4	$ 619.9	$ 1,199.5	34.1%
General Assembly	$ 251.8	$ 66.2	$ 185.6	26.3%
Total	**$ 138,794.3**	**$ 63,053.4**	**$ 75,740.9**	**45.4%**

Source: Commission on Government Forecasting and Accountability, *Report on the Financial Condition of the Illinois State Retirement Systems as of June 30, 2010* , March 2011, p. 22.

[130] The Pew Center on the States, *The Widening Gap: The Great Recession's Impact on State Pension and Retiree Health Care Costs*, April 2011, p. 3, http://www.pewcenteronthestates.org/uploadedFiles/Pew_pensions_retiree_benefits.pdf (last visited on April 28, 2011).

[131] Public Act 96-43.

The State's pensions are funded through a 50-year plan that took effect in July 1995.[132] After a phase-in period of 15 years, the law required State contributions at a level percentage of payroll beginning in FY2011 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. The funding schedule does not require the State to make adequate contributions to keep unfunded liabilities from growing until approximately 2034.[133] 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.[134]

In April 2010, legislation was enacted that created a two-tier benefit system with lower benefits for state and many local government employees hired on or after January 1, 2011.[135] The new tier of benefits includes higher retirement ages, a cap on the maximum pensionable salary and lower cost of living adjustments. Over time, the reduced benefits will slow the growth in unfunded liabilities. In the short term, the reduction in future benefits lowers the annual required state contribution and increases unfunded liabilities because most workers earning benefits in the short term are covered by the more generous plan.[136]

Three of the five retirement systems decided to lower their projected rates of return on investment as of June 30, 2010 to bring them more in line with recent market performance. The expected rate of return is used to determine the present value of benefits to members. For FY2009, each retirement system assumed a rate of return of 8.00% or 8.50%. For FY2010 the universities' and the state employees' systems lowered their assumed rate of return to 7.75% and the judges' system reduced its rate of return to 7.00%. Lowering the assumed rate of return increases unfunded liabilities and raises statutorily required contributions because plan assets are expected to produce less income to pay projected benefits.[137]

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[132] Public Act 88-593.
[133] 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.
[134] State of Illinois, $3.7 Billion General Obligation Bonds, *Official Statement*, February 23, 2011, pp. 54-56.
[135] Public Act 96-889.
[136] State of Illinois, $3.7 Billion General Obligation Bonds, *Official Statement*, February 23, 2011, p. 69.
[137] State of Illinois, $3.7 Billion General Obligation Bonds, *Official Statement*, February 23, 2011, p. 57.

FY2012 Budget Impact

In FY2012, the State plans to pay its statutorily required General Funds pension contributions from operating funds.[138] In FY2010 and FY2011, the contributions were made through the sale of Pension Obligation Bonds (POBs).

The State's required FY2012 General Funds contributions to the retirement systems total $4.59 billion.[139] General Funds contributions were $3.92 billion in FY2011 and $3.47 billion in FY2010.

The State is also obligated to make interest and principal payments on pension-related bonds. In addition to the POBs sold in FY2010 and FY2011, Illinois issued $10 billion in pension bonds in FY2003. Of the total proceeds of the 2003 bond sale, $2.2 billion was used to make required annual contributions in FY2003 and FY2004 and $7.3 billion went to pay down unfunded liabilities. It should be noted that pension contributions may be changed by statute, but debt payments on general obligation bonds such as POBs are guaranteed by the full faith and credit of the State.[140] More information on pension borrowing costs can be found in the Debt Trends section on p. 71 of this report.

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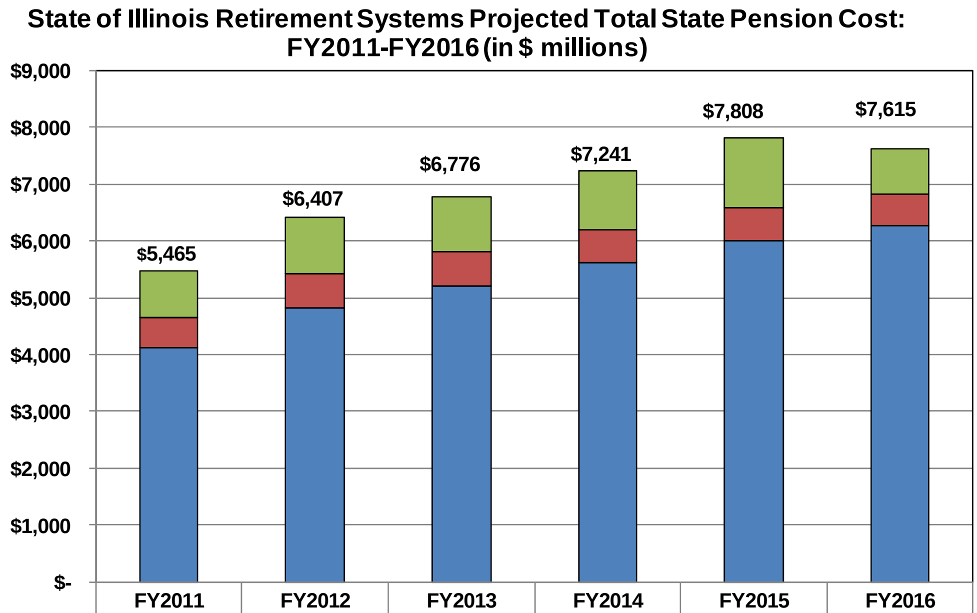
[138] Most but not all state pension contributions come from General Funds. For example, roughly 35% of the total annual contribution to the State Employees' Retirement System comes from Other State Funds.

[139] Illinois State FY2012 Budget, p. 2-13. The General Funds contribution includes the State's payment of $43.9 million to the Public School Teachers' Pension and Retirement Fund of Chicago and $87.6 million to the Teachers' Retirement Insurance Program for health insurance for retired teachers outside of Chicago, according to the Governor's Office of Management and Budget.

[140] Illinois State Constitution, Article IX, Sec. 9(a).

The following chart shows how pension funding pressures will affect the operating budget over the next five years. Pension contributions shown in the chart are total state contributions, including Other State Funds as well as General Funds.[141] Pension contributions increase by 51.9% from $4.1 billion in FY2011 to $6.3 billion in FY2016. Debt service rises from $1.3 billion in FY2011 to $1.8 billion in FY2015 and then declines to $1.4 billion in FY2016, after the FY2010 POBs are retired.



	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
2010&2011 POB debt service	$803	$989	$975	$1,052	$1,219	$782
2003 POB debt service	$542	$590	$587	$583	$579	$575
Regular contribution*	$4,117	$4,828	$5,214	$5,607	$6,011	$6,258

*Includes General Funds and Other State Funds. Does not include the $75.5 million of debt service for the State Employees' Retirement System paid through payroll deduction.
Source: Commission on Government Forecasting and Accountability, *A Report on the Financial Condition of the Illinois State Retirement Systems June 30, 2010*, March 2011, pp. 27, 91 and 115.

By 2045, when the retirement systems are required to be 90% funded, total annual state contributions (not including debt service) are expected to reach $18.9 billion.[142]

Pension Reforms

The pension reform legislation enacted in April 2010 contained major reductions in pension benefits for newly hired state employees, including higher retirement ages, a cap on the maximum pensionable salary and lower cost of living adjustments.[143] The legislation did not affect the current pension structure for existing employees. The FY2012 budget states that

[141] Pension contributions do not include portion of debt service for the State Employees' Retirement System that is paid through payroll deduction.
[142] Commission on Government Forecasting and Accountability, *A Report on the Financial Condition of the Illinois State Retirement System as of June 30, 2010*, March 2011, p. 91.
[143] Public Act 96-889.

additional reforms are needed but does not propose a specific plan.[144] In the FY2010 budget, the Governor proposed increased contributions for existing state employees, but no action was taken by the General Assembly.[145]

A pension reform bill introduced in the General Assembly in January 2011[146] is based on a proposal by the Civic Committee of the Commercial Club of Chicago.[147] The proposal would not affect benefits already earned by existing employees. Under the proposal, existing employees would be given three options: stay in the state's traditional defined benefit pension plan but pay significantly higher contributions; switch to the less generous defined benefit plan for new employees; or enter a defined contribution plan with a matching state contribution.[148]

In addition, the State would make a contribution to the retirement systems in an amount determined to be sufficient to pay down by the end of FY2045 the unfunded liability attributable to service completed by the end of FY2012, calculated using FY2012 wage levels.[149] Existing employees who choose the traditional plan would be responsible for additional contributions sufficient to pay down the portion of the unfunded liability at the end of FY2012 attributable to wage increases after the effective date of the bill. Existing employees who switch out of the traditional plan would have their benefit levels frozen at their salary level at the time they switch plans.

An actuary for the General Assembly's Commission on Government Forecasting and Accountability concluded that it was not possible to determine the overall financial impact of the bill partly because of difficulties in calculating the amount of unfunded liability as of a specific date attributable to salary increases after that date.[150] Without including those additional payments, participants in the traditional plan would pay between 13.5% and 36.5% of their salaries to stay in the traditional plan.

The State's labor unions are expected to oppose such changes.[151] Council 31 of the American Federation of State, County and Municipal Employees (AFSCME) has stated that the Illinois Constitution prohibits any legislation to reduce benefits or force increased contributions.[152]

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[144] Illinois State FY2012 Budget, p. 2-7.
[145] Illinois State FY2010 Budget, p. 4-2.
[146] 97th Illinois General Assembly, House Bill 149.
[147] Tom Cross, "More pension reforms ahead; Getting Illinois' systems in good financial shape," *Chicago Tribune*, December 17, 2010.
[148] A defined benefit plan is a traditional pension plan that pays fixed, periodic payments during retirement. In a defined contribution plan, the employee and the employer contribute specified amounts to the pension plan; only employer contributions to the plan are guaranteed and not the benefits paid.
[149] Sandor Goldstein, Goldstein & Associates Actuaries and Consultants, Letter to Dan Hankiewicz, Commission on Government Forecasting and Accountability, February 16, 2011.
[150] Sandor Goldstein, Goldstein & Associates Actuaries and Consultants, Letter to Dan Hankiewicz, Commission on Government Forecasting and Accountability, February 16, 2011.
[151] Chris Wetterich, "Madigan hints at pension reductions for state workers; House speaker says tough choices ahead," *The State Journal-Register*, February 9, 2011.
[152] AFSCME Council 31, "Pension study: state constitution means what it says," March 4, 2011, http://www.afscme31.org/news?id=0154 (last visited on April 19, 2011).

The Illinois Constitution provides that membership in any pension system in the State is an enforceable contractual relationship and that members' benefits "shall not be diminished or impaired."[153] In support of its position, AFSCME Council 31 cited a recent legal analysis by the Chief Legal Counsel to the Illinois Senate President.[154] Competing legal opinions have argued that the constitutional prohibition applies only to benefits already accrued from an employee's prior service and not to benefits that an employee hopes to earn in the future.[155]

153 Illinois Constitution, Article XIII, Section 5.
154 Eric M. Madiar, "Is Welching On Public Pension Promises An Option For Illinois? An Analysis of Article XIII, Section 5 of the Illinois Constitution," March 2011.
155 Various documents related to the Illinois Constitution and pension guarantees, including the analysis by Eric Madiar, can be found at http://www.senatedem.ilga.gov/index.php/component/content/article/108-public-information-brochures/1517-pension-debate (last visited on April 19, 2011).

GENERAL FUNDS BUDGET DEFICIT

Under the Illinois Constitution, the Governor must propose a balanced budget in which expenditures do not exceed revenues estimated to be available for the year.[156] Similarly, the General Assembly is required to pass a balanced budget.[157] A balanced General Funds budget requires enough revenue to meet expenditures and transfers out.[158] In addition, if the State issued short-term debt in the previous year because of a revenue shortfall, there must be enough revenue available for repayment.

Budget Deficit in FY2011

As explained in the Budget Timeline section of this report, projections of the FY2011 General Funds deficit have changed since the budget was enacted in July 2010 largely because of the income tax increases enacted in January 2011.[159] In addition, the Governor presented a revised FY2011 budget when he announced his FY2012 budget recommendation in February 2011.

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[156] Constitution of the State of Illinois, Article VIII, Section 2(a).
[157] Constitution of the State of Illinois, Article VIII, Section 2(b).
[158] General Funds support the regular operating and administrative expenses of most state agencies and are the funds over which the State has the most control and discretion. General Funds are the largest component of the state budget. 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, and Federal Funds (other than those designated for General Funds), which support a variety of state programs financed with federal revenues.
[159] See the Budget Timeline section on page 18 for more information on the enacted increase in the State's income tax rates.

The next table shows the Governor's proposed budget changes for FY2011 and the revised enacted FY2011 budget excluding the Governor's proposed changes that have not been passed by the legislature. In the table, appropriations are reduced by unspent appropriations to obtain net appropriations. Appropriations may be unspent at the end of a fiscal year because they are held back at the Governor's direction, because expenses do not reach budgeted levels or because checks issued by the State have not been cashed. General Funds are also used to make statutory transfers out, which include legislatively required diversions to Other State Funds and amounts dedicated to debt service.

State of Illinois General Funds Budget Plans: Revised FY2011 Enacted and Governor's FY2011 Changes (in $ millions)		
	Revised FY2011 Enacted*	Governor's FY2011 Changes
Revenues		
State Sources	$ 22,716	$ 22,799
Federal Sources	$ 5,506	$ 5,506
Total Revenues	$ 28,222	$ 28,305
Statutory Transfers In		
Statutory Transfers In	$ 1,803	$ 1,803
Interfund Borrowings	$ 505	$ 505
Total Statutory Transfers In	$ 2,308	$ 2,308
Total Operating Receipts	**$ 30,530**	**$ 30,613**
Expenditures		
Appropriations	$ 26,071	$ 26,071
Minus Unspent Appropriations	$ (1,758)	$ (1,758)
Net Appropriations Before Pension Contributions	$ 24,313	$ 24,313
Pension Contributions	$ 3,919	$ 3,919
Total Expenditures	$ 28,232	$ 28,232
Statutory Transfers Out		
Legislatively Required Transfers	$ 2,061	$ 2,061
Debt Service and Interfund Borrowing Repayments	$ 3,274	$ 3,372
Total Statutory Transfers Out	$ 5,335	$ 5,433
Total Operating Payments	**$ 33,567**	**$ 33,665**
Operating Surplus (Deficit)	**$ (3,037)**	**$ (3,052)**
Borrowing for Operations	$ 4,913	$ 8,913
Operating Surplus (Deficit) After Borrowing	$ 1,876	$ 5,861
Accumulated Deficit From Prior Years	$ (6,314)	$ (6,314)
Total Surplus (Deficit)	**$ (4,438)**	**$ (453)**

*FY2011 enacted budget as of February 2011. Does not include impact of Governor's initiatives not passed by General Assembly, including proposed General Obligation Restructuring Bonds and proposed decoupling of Illinois from federal law regarding depreciation.

Source: State of Illinois $3.7 Billion General Obligation Bonds, Official Statement, February 23, 2011, p. 30; Illinois State FY2011 Budget, p. 5-15.

As currently enacted, the FY2011 revised budget does not include $4.0 billion of proceeds from the sale of the General Obligation (GO) Restructuring Bonds proposed by the Governor or the related $98 million debt service on the bonds. The FY2011 budget also does not assume passage of legislation to decouple Illinois from federal law regarding depreciation changes. If the decoupling legislation is not enacted, estimated resources would be reduced by roughly $82.5 million from the Governor's FY2011 revised proposal.[160]

The operating deficit is similar under both scenarios: $3.05 billion under the revised enacted FY2011 budget with the Governor's proposed changes and $3.04 billion without the proposed changes. The main difference is the additional borrowing, which results in an operating surplus after borrowing of $5.9 billion with the Governor's proposed changes compared with an operating surplus of $1.9 billion without the proposed changes. Combined with the accumulated deficit from prior years, the total deficit at the end of FY2011 is $453 million with the Governor's changes and $4.4 billion without the changes.

The following table shows the State's General Funds backlog of unpaid bills, or accounts payable, at the end of FY2011 under the two scenarios. With the Governor's proposed changes, all but $600 million of the $6.4 billion in accounts payable at the beginning of the year would be paid off using $5.8 billion of the operating surplus after borrowing. Without the Governor's changes, $1.9 billion of the accounts payable would be paid off.

State of Illinois FY2011 General Funds Accounts Payable: Revised Enacted and Governor's Changes (in $ millions)

	Revised FY2011 Enacted*	Governor's FY2011 Changes
Accounts Payable Beginning of Year	$ (6,444)	$ (6,444)
Operating Surplus Applied To Accounts Payable	$ 1,876	$ 5,844
Accounts Payable End of Year	**$ (4,568)**	**$ (600)**

*FY2011 enacted budget as of February 2011. Does not include impact of Governor's initiatives not passed by General Assembly, including proposed General Obligation Restructuring Bonds and proposed decoupling of Illinois from federal law regarding depreciation.
Source: Illinois State FY2011 Budget, pp. 2-13 and 5-15.

In addition to using $4 billion from the proposed sale of GO Restructuring Bonds to help pay down General Funds bills in FY2011, the Governor has identified other State obligations that would be paid down using proceeds from the sale.

[160] Illinois State FY2011 Budget, p. 5-15.

The next table provides an estimate of the additional liabilities to be repaid with bond proceeds: $879 million in business tax refunds, $1.1 billion in state employee health bills and $1.3 billion in Medicaid bills.

State of Illinois Non-General Funds Liabilities To Be Repaid Through GO Restructuring Bond Sale (in $ millions)		
Category		**Estimated Amount**
Business Tax Refunds	$	(879)
State Employee Health Bills	$	(1,100)
Medicaid Bills	$	(1,300)
Total	**$**	**(3,279)**

Source: Email communication between the Civic Federation and the Illinois Department of Revenue, April 27, 2011; Illinois Department of Healthcare and Family Services (HFS), *FY2012 Budget Overview* , February 16, 2011, p. 13; email communication between the Civic Federation and HFS, February 10, 2011.

In FY2012 the most significant change in the budget relates to the increase in state source revenues generated by the first full year of the income tax increase. This is partly offset by decreased federal revenues and increased pension contributions.

The Governor's FY2012 proposal assumes that Illinois will be decoupled from federal law regarding depreciation changes; if this measure does not pass, the State's revenue loss is estimated at between $520 million and $615 million.[161] The Governor's proposal contains a $1.6 billion increase in net appropriations (after unspent appropriations) and requires spending an additional $403 million on debt service for the proposed GO Restructuring Bonds. Legislatively required transfers out increase by $256 million primarily because of the Medicaid-related transfer to the Healthcare Provider Relief Fund.[162]

[161] Illinois State FY2012 Budget, p. 5-15.
[162] See the Medicaid section on page 43 of this report.

The chart below shows the Governor's FY2011 changes and recommended budget plan for FY2012. The FY2012 recommended budget includes an operating shortfall of $1.45 billion, which would be closed through the use of proceeds from the sale of the GO Restructuring Bonds.

State of Illinois Governor's FY2011 Changes and FY2012 Recommended General Funds Budget Plan (in $ millions)		
	Governor's FY2011 Changes	Governor's FY2012 Rec.
Revenues		
State Sources	$ 22,799	$ 27,278
Federal Sources	$ 5,506	$ 4,844
Total Revenues	$ 28,305	$ 32,122
Statutory Transfers In		
Statutory Transfers In	$ 1,803	$ 1,810
Interfund Borrowings	$ 505	$ -
Total Statutory Transfers In	$ 2,308	$ 1,810
Total Operating Receipts	**$ 30,613**	**$ 33,932**
Expenditures		
Appropriations	$ 26,071	$ 26,733
Minus Unspent Appropriations	$ (1,758)	$ (802)
Net Appropriations Before Pension Contributions	$ 24,313	$ 25,931
Pension Contributions	$ 3,919	$ 4,594
Total Expenditures	$ 28,232	$ 30,525
Statutory Transfers Out		
Legislatively Required Transfers	$ 2,061	$ 2,317
Debt Service and Interfund Borrowing Repayments	$ 3,372	$ 2,540
Total Statutory Transfers Out	$ 5,433	$ 4,857
Total Operating Payments	**$ 33,665**	**$ 35,382**
Operating Surplus (Deficit)	**$ (3,052)**	**$ (1,450)**
Borrowing for Operations	$ 8,913	$ 1,450
Operating Surplus (Deficit) After Borrowing	$ 5,861	$ -
Accumulated Deficit From Prior Years	$ (6,314)	$ (453)
Total Surplus (Deficit)	**$ (453)**	**$ (453)**

Source: Illinois State FY2012 Budget, p. 2-13.

As previously discussed, the Governor's budget proposal for FY2012 recommends that the backlog of income tax refunds owed to businesses be paid down through borrowing.[163] If the

[163] See the Revenues section on page 22 of this report.

backlog were instead paid down by increasing the amount of income tax collections diverted from General Funds, then the Governor's budgeted General Funds operating receipts would decline by roughly $970.9 million.

As shown in the following chart, General Funds accounts payable would remain at $600 million at the end of FY2012 under the Governor's recommended budget.

State of Illinois General Funds Accounts Payable: Governor's FY2011 Changes and Recommended FY2012 (in $ millions)		
	Governor's FY2011 Changes	**Governor's FY2012 Rec.**
Accounts Payable Beginning of Year	$ (6,444)	$ (600)
Operating Surplus Applied To Accounts Payable	$ 5,844	$ -
Accounts Payable End of Year	**$ (600)**	**$ (600)**

Source: Illinois State FY2011 Budget, p. 2-13.

DEBT TRENDS

The Governor's proposed FY2012 budget relies heavily on 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. The Governor also proposes reauthorization of the ongoing *Illinois Jobs Now*! capital budget for FY2012, which includes the issuance of additional debt to support the State's infrastructure spending.

In FY2011 the State's total debt burden will have increased by $9.5 billion since FY2009, primarily due to the sale of more than $7 billion in new pension-related debt. If the State were to issue all currently authorized capital purpose bonds and approve the sale of the additional restructuring bonds proposed for FY2012, the total debt burden would grow from the current total of $30.6 billion to approximately $48.4 billion.

Although using the proceeds from the sale of the GO Restructuring Bonds for operating purposes is included in the Governor's proposed budget plan, specific details regarding the increase in overall debt burden and cost of these bonds are not included in the Debt Management chapter of the budget.

The following section examines the increase in the State's total debt over the last 10 years due to ongoing borrowing for capital purposes and increased reliance on borrowing to pay for pensions. It also provides an overview of the estimated cost of the proposed issuance of $8.75 billion in General Obligation (GO) Restructuring Bonds and the long-term effects of this additional debt.

General Obligation and Revenue Bonds

Under the General Obligation Bond Act, the State is authorized to issue General Obligation Bonds (GO Bonds) to fund a variety of capital investments including roads, schools, mass transit, environmental projects and other facilities.[164] 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 $17.1 billion in capital projects to be funded by borrowing in FY2010, of which $13.5 billion were new appropriations.[165] As part of the FY2010 capital budget, the Governor and General Assembly 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 on January 13, 2011.[166] Authorized but unissued capital bonds currently total $8.2 billion.

The total GO debt issued since the start of the capital program in FY2010 will be $2.7 billion by the end of FY2011. The Governor's FY2012 budget proposes that the State issue an additional

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[164] 30 ILCS 330/1.
[165] Commission on Government Forecasting and Accountability, *2011 Capital Plan*, April 2010, p. 5.
[166] Public Act 96-1554.

$1.5 billion in capital GO Bonds in FY2012.[167] The proposed FY2012 budget estimates that the State will issue a total of $12.9 billion in capital debt between FY2011 and FY2017.[168]

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.[169] 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.

Illinois 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 Authority's bond program was supported by the issuance of Civic Center Bonds, the last of which were sold in 1992. The FY2012 budget shows $91.4 million in Civic Center Bonds outstanding; the State will make its final payment on this debt in FY2021.[170] Although originally financed in part by horseracing taxes, these bonds are now fully repaid by General Funds and are treated more like GO bonds.[171]

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 Governor James Thompson's inaugural program in the late 1980s. The Governor's proposed FY2012 budget estimates that the State will have issued $300 million in new Build Illinois debt by the end of FY2011 and proposes selling an additional $370 million to support capital projects in FY2012.[172] At the end of fiscal year 2011, the State will have $2.6 billion worth of outstanding Build Illinois bonds.[173]

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 (POB) to pay for unfunded liabilities of the State's retirement systems. A portion of the bond proceeds were 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 that would have come from the State's General Funds for that year. The bonds will be repaid over the next five years. In FY2011 the State again issued POBs to make its annual contribution to its retirement systems, this time totaling $3.7 billion to be repaid over eight years.

The State receives General Funds relief for the debt service it owes on the $10 billion in POBs sold in FY2003 because of an equivalent 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

[167] Illinois State FY2012 Capital Budget, p. 104.
[168] Illinois State FY2012 Budget, p. 12-11.
[169] Public Act 96-885.
[170] Illinois State FY2012 Budget, p. 12-15.
[171] 30 ILCS 355.
[172] Illinois State FY2012 Budget, p. 12-11.
[173] Illinois State FY2012 Budget, p. 12-15.

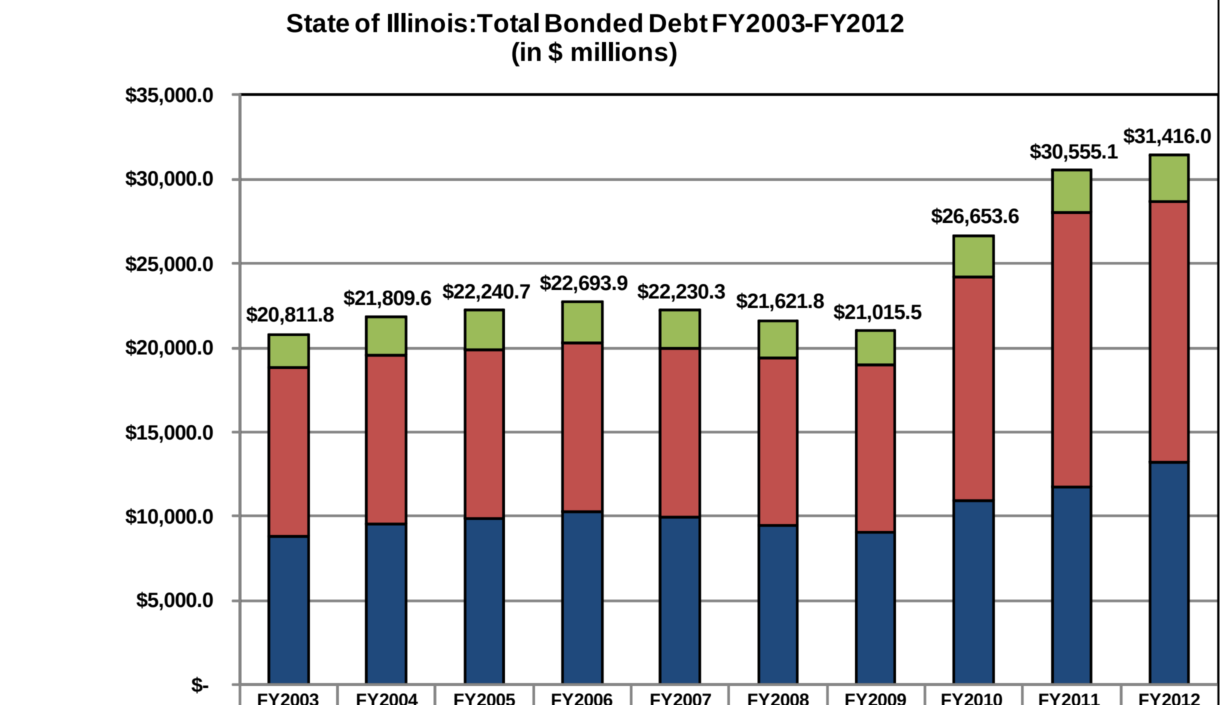
annual debt service owed on the FY2003 POBs in each fiscal year.[174] This effectively pays for the pension bonds debt service each year by freeing up General Funds resources that would otherwise be used to make the required pension payments. The original FY2003 POBs were financed over 30 years and the last bonds will be retired in FY2033.

The debt service owed by the State on the FY2011 and FY2012 POBs is paid directly from the General Funds without any offsetting of the pension contribution. 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 the FY2010 bonds have been prepaid. 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 in principal and will cost $382 million in interest over five years. The FY2011 bonds, which totaled $3.7 billion in principal, will cost the state $1.3 billion in interest cost 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.

The Governor's budget estimates the State of Illinois at the end of FY2012 will increase total GO Debt to $31.4 billion. This is a $10.6 billion increase, or 51.0%, over FY2003. State debt at the end of FY2012 includes capital purpose GO debt of $13.1 billion and $15.5 billion in total POBs issued. The State will also have $2.7 billion in revenue bonds outstanding in FY2012.

[174] Public Acts 94-004, 93-009.

The following chart shows the increase in State GO bonds and revenue bonds over the last 10 fiscal years.



	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012
Total Existing Debt	$20,811.8	$21,809.6	$22,240.7	$22,693.9	$22,230.3	$21,621.8	$21,015.5	$26,653.6	$30,555.1	$31,416.0
Build Illinois/Civic Center	$1,999.2	$2,253.3	$2,347.7	$2,442.5	$2,304.6	$2,208.9	$2,063.7	$2,443.6	$2,553.3	$2,749.9
Pension Bonds	$10,000.0	$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
GO Capital Bonds	$8,812.6	$9,556.3	$9,893.0	$10,251.4	$9,925.7	$9,462.9	$9,051.8	$10,894.0	$11,729.0	$13,186.5

Source: Illinois State Budgets FY2004-FY2012.

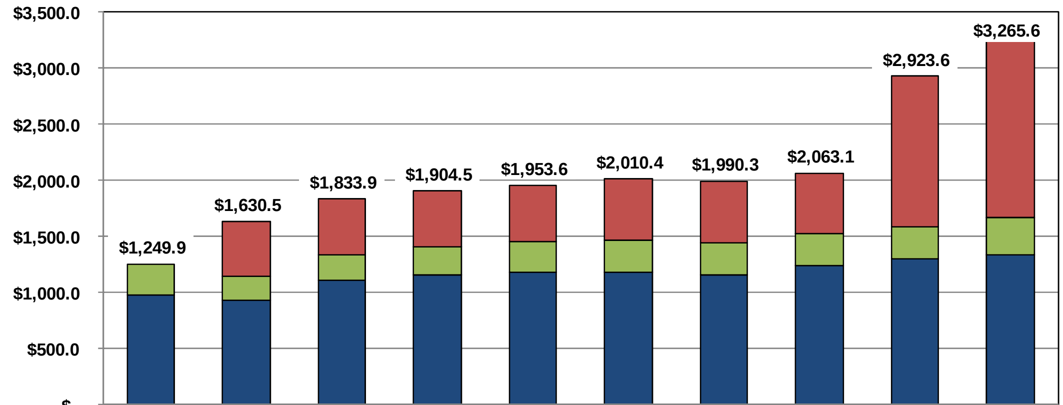
Illinois' total GO debt increased dramatically in FY2003 due to the issuance of $10 billion in Pension Obligation bonds. In FY2002, the total bonded debt of the State was only $9.5 billion or $11.3 billion less than FY2003. Likewise, the new capital borrowing and pension borrowing approved in FY2010 and FY2011 have contributed to another significant increase in outstanding state debt of $8.9 billion or 41.3% from FY2008 to FY2012.

Debt Service

The State's debt service schedule sets forth the principal and interest amounts due for outstanding bonds on an annual basis. In FY2012 the State estimates its required debt payment will total $3.0 billion for all outstanding GO bonds, POBs and revenue bonds for which it directly appropriates funds.[175] This amounts to a $341.9 million increase, or 3.0%, from FY2011 and a 62.4% increase since FY2008, totaling $1.3 billion in additional annual cost. Over the last 10 years, the largest increases to annual debt service came in FY2004, FY2011 and FY2012, which are years immediately following the sale of new POBs. Since FY2003 total debt service will have increased by $2.0 billion in FY2012, which represents a 161.3% rise in annual debt related costs over the last 10 years.

The following chart shows the total debt service for existing Pension Obligation bonds, GO capital bonds and other capital bonds.

State of Illinois Total Capital Purpose and Pension Bonds Debt Service (Principal + Interest) FY2003-FY2012 (in $ millions)



	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012*
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	$2,923.6	$3,265.6
Pension Bonds	$-	$481.0	$496.2	$496.0	$496.0	$546.0	$544.0	$543.6	$1,344.4	$1,598.6
Build Illinois/Civic Center	$275.9	$218.5	$234.5	$255.0	$278.0	$280.0	$286.0	$286.0	$280.0	$336.0
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	$1,299.3	$1,331.0

*Includes estimated cost of proposed FY2012 issuances.
Source: Illinois State Budgets FY2005-FY2012.

It should also be noted that the State does not pay for all of the debt service associated with the capital purpose GO bonds out of the General Funds. In FY2012 the State projects that its General Funds expense for the capital bond debt service will total $578 million.[176] The remaining debt service for the GO capital bonds is paid from the Capital Projects Fund, Common School Fund and the Road Fund, which have dedicated revenue sources outside the State's operating budget.

When the current capital budget was first enacted in FY2010, a series of new fees and taxes to pay for the increase in capital purpose debt service was also enacted. However, no new revenues were passed to pay for the increase in debt service for the FY2010 and FY2011 pension bonds.

[175] Illinois State FY2012 Budget, pp. 12-13, 12-15.
[176] Illinois State FY2012 Budget, p. 2-13.

The debt service amounts above represent the actual total cost associated with State debt but do not include additional transfers associated with the POB issuance. The General Funds cost of the new POBs totals $1.7 billion in FY2011 and $1.6 billion in FY2012. The State GO Bond Act requires the State to transfer an extra month's worth of debt service into the bond payment fund in the first year of a new debt issuance to ensure there is no delay in payment to bond holders between fiscal years.

Between FY2010 and FY2033, the State of Illinois will pay a total of $27.3 billion in POB debt service, of which $10.2 billion is interest and $17.0 billion is principal for all pension related GO debt combined. It will also pay $19.4 billion in total debt service for the total outstanding GO bonds for capital purposes.[177] The capital GO debt service is made up of $6.8 billion in interest due on $12.6 billion of principal spread over the next 25 years.

Short-Term Debt

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.[178]

Under the Short Term Borrowing Act, the State may issue short-term debt certificates based upon revenue anticipation or shortfall. The act provides for two qualifications for short-term borrowing. 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.[179] The State may also borrow up to 15% of the total appropriations for any year if there is a declared failure in revenue.[180] 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.

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[177] Illinois State FY202 Budget, p. 12-13.
[178] 30 ILCS 340.
[179] 30 ILCS 340/1.
[180] 30 ILCS 340/1.1.

The State will most likely continue to rely on short-term borrowing to finance part of the State's anticipated $4.3 billion backlog of unpaid bills in FY2012. However, the recommended budget does not include any information on the type or amount of short-term debt that the State may issue at the end of FY2011 or throughout FY2012. The following chart shows the increased frequency and total amount of short-term certificates issued and repaid from FY2003 through FY2011.

Short-Term Debt Certificates Issued: FY2003- FY2011 (in $ millions)	
Year	**Total Short-Term Debt**
FY2003	$ 2,500.0
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

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

In both FY2003 and FY2009, the State borrowed under the State's revenue failure provisions to carry forward portions of the State's deficits from one year to the next.

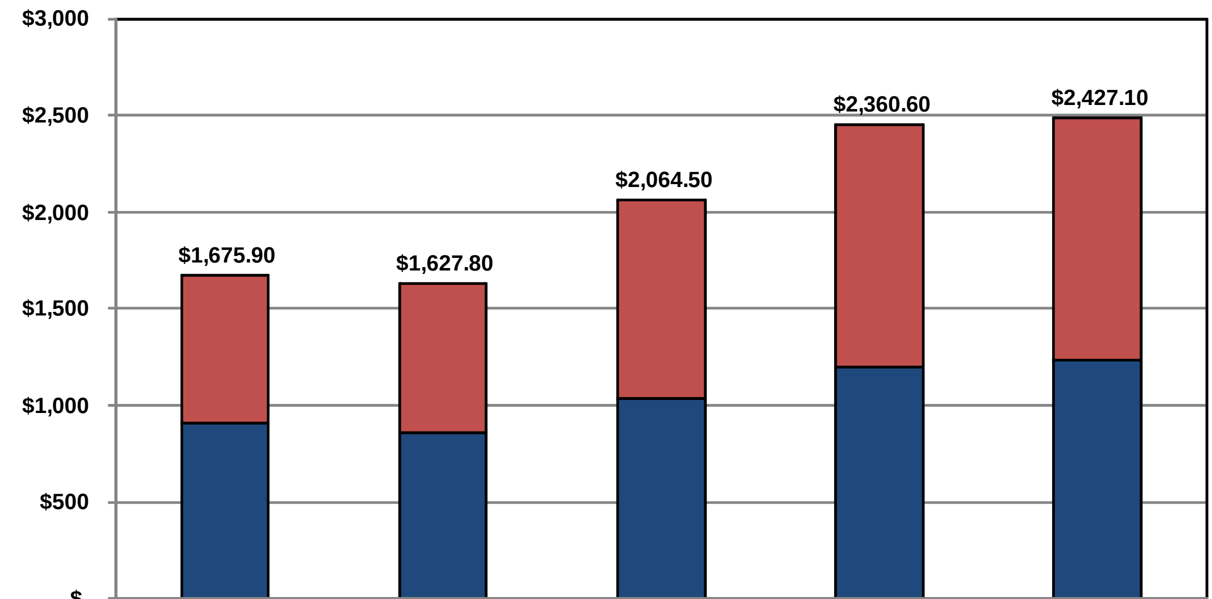
In December of 2008, the State issued $1.4 billion in short-term debt to pay down some of the State's outstanding liabilities. These notes were due to be repaid by the end of FY2009. However, the State declared a failure of revenue for FY2009 as part of the FY2010 budget and sold $1 billion of new short-term 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 $2.3 billion in outstanding short-term borrowing was repaid in FY2010. The July 2010 short-term notes totaling $1.3 billion were issued to pay down the liabilities carried forward from FY2010 to FY2011.

As mentioned in the General Obligation and Revenue Bonds section, the State sold $250 million of special purpose bonds for Medicaid payments that were repaid within one year. Although this debt was issued under the GO Bond Act and not the Short Term Borrowing Act, the bonds functioned like a short-term issuance for failure of revenues, passing on liabilities from FY2010 to FY2011.

Debt Per Capita

One of the most common measures used to analyze a state's debt burden is the ratio of total outstanding debt to the state's estimated population. Between FY2008 and FY2012, existing debt per capita for all capital purpose and pension debt increased by $751.20, or 44.8%. The majority of the increase in debt per capita can be attributed to the sales of POBs in FY2010 and FY2011. The Governor's proposed budget for FY2012 shows the total debt per capita increasing by 2.8%, or $66.50 from.[181] In FY2011 due to the issuance of $3.7 billion in new POBs, the portion of the State's debt per capita attributable to pension borrowing surpassed the amount of the debt per capita attributed to capital bonds.

The following exhibit shows total Illinois' debt per capita including capital purposes and pension debt from FY2008 to FY2012.



	FY2008	FY2009	FY2010	FY2011	FY2012 (est.)
Total	$1,675.90	$1,627.80	$2,064.50	$2,360.60	$2,427.10
Pension	$771.20	$766.80	$1,031.40	$1,257.20	$1,257.20
Capital	$904.70	$861.00	$1,033.10	$1,195.90	$1,231.20

Source: Illinois State FY2012 Budget, p. 12-11.

[181] Ibid., p. 11-9.

General Obligation Restructuring Bonds

Governor Pat Quinn supports the proposed sale of $8.75 billion in new General Obligation (GO) Restructuring Bonds to pay down a portion of the State's accounts payable at the end of FY2011 and to close the State's $1.45 billion operating shortfall in the FY2012 proposed budget. Under the borrowing legislation proposed in the 97th General Assembly as Senate Bill 3, the remaining $3.3 billion in proceeds are available for a wide range of purposes including to pay vouchers that are more than 60 days past due, medical expenses from employee health plans, corporate income tax refunds and other operating expenses of the State.[182] Although the proceeds from the bonds are included as part of the Governor's proposed General Funds budget plan for FY2012, the budget document does not include detailed explanation of the other uses of funds or the estimated cost of the debt.

In FY2011 the State used a total of $5.4 billion in debt proceeds to pay for General Funds operations, including $3.7 billion in POBs, $1.2 billion from securitization of half the State's tobacco liability settlement payments and $500 million from interfund borrowing. The Governor's proposal to use $1.45 billion of the GO Restructuring Bonds proceeds for operations is a decrease of $3.9 billion in proposed borrowing for General Funds operations in FY2012. However, the total proposed borrowing of $8.75 billion in GO Restructuring Bonds is intended to pay down liabilities accrued from operating expenditures that have exceeded resources over the past three fiscal years. Thus, the total proposed borrowing for All Funds operations and liabilities of $8.75 billion would be an increase of $3.35 billion or 62.0% more than in FY2011.

The proposed legislation to enact the borrowing includes dates that the principal amounts borrowed will be repaid, which can be used to calculate anticipated debt service costs. The following chart shows that if the bonds were sold under January 2011 market conditions, the State's projected interest cost for the bonds would total $3.4 billion over the next 15 years.

[182] Illinois 97th General Assembly, Senate Bill 3. Introduced, January 13, 2011.

State of Illinois: Proposed $8.75 Billion General Obligation Restructuring Bonds (SB03) Estimated Total Debt Service Based on Current Market Rates (in $ thousands)								
Year	**AAA Rate**	**IL Spread**	**IL Rate**		**Maturity**	**Principal**	**Interest**	**Debt Service**
1	0.37	70	1.07		01/01/12	$ 100,000.0	$ 347,657.8	**$ 447,657.8**
2	0.73	81	1.54		01/01/13	$ 100,000.0	$ 346,587.8	**$ 446,587.8**
3	1.11	88	1.99		01/01/14	$ 200,000.0	$ 345,047.8	**$ 545,047.8**
4	1.57	85	2.42		01/01/15	$ 450,000.0	$ 341,067.8	**$ 791,067.8**
5	1.86	96	2.82		01/01/16	$ 765,000.0	$ 330,177.8	**$ 1,095,177.8**
6	2.17	101	3.18		01/01/17	$ 765,000.0	$ 308,604.8	**$ 1,073,604.8**
7	2.52	101	3.53		01/01/18	$ 765,000.0	$ 284,316.0	**$ 1,049,316.0**
8	2.84	99	3.83		01/01/19	$ 765,000.0	$ 257,311.5	**$ 1,022,311.5**
9	3.12	101	4.13		01/01/20	$ 765,000.0	$ 228,012.0	**$ 993,012.0**
10	3.37	102	4.39		01/01/21	$ 765,000.0	$ 196,417.5	**$ 961,417.5**
11	3.58	103	4.61		01/01/22	$ 765,000.0	$ 162,834.0	**$ 927,834.0**
12	3.74	108	4.82		01/01/23	$ 765,000.0	$ 127,605.8	**$ 892,605.8**
13	3.89	110	4.99		01/01/24	$ 765,000.0	$ 90,732.8	**$ 855,732.8**
14	4.04	111	5.15		01/01/25	$ 765,000.0	$ 52,597.5	**$ 817,597.5**
15	4.18	110	5.28		01/01/26	$ 250,000.0	$ 13,200.0	**$ 263,200.0**
					Total	**$ 8,750,000.0**	**$ 3,432,170.5**	**$ 12,182,170.5**

Source: Principal maturities and term based on Illinois 97th General Assembly Senate Bill 3; Civic Federation estimates based on MMD AAA Rates and IL Spreads from Bloomberg and Thomson MMD, January 25, 2011.

The estimates in the chart above are probably conservative for two reasons. First, the rates are based on market conditions as of January 25, 2011. If interest rates for municipal bonds continue to rise, the total interest cost would also increase. The estimates also assume that the bonds will be sold as traditional tax-exempt municipal bonds. Tax-exempt bonds typically have much lower rates than taxable bonds because investors do not have to pay federal income taxes on the earnings from the bonds. The Internal Revenue Service enforces federal rules for issuance of tax-exempt bonds that limit the total amount of tax-exempt bonds a government may sell for operating funding. If the IRS found that some of the proposed bonds exceeded the State's limit, they would not qualify as tax exempt and the total debt service cost would increase.

Debt Service Increase

If the GO Restructuring Bonds are authorized by the General Assembly, the State's total annual debt service due on all existing debt, including the FY2011 pension bonds, will climb to $4.3 billion by FY2015.[183] The State has seen a significant rise in the amount of annual debt service owed over the past two years due to the sale of $7.2 billion bonds make its annual pension contributions. The State has also increased its total debt service owed by selling additional capital bonds to support its *Illinois Jobs Now!* capital program.

According to the Governor's FY2010 budget, before the issuance of the FY2010 pension bonds the State's total debt service for that year would have totaled just under $2.0 billion, or 110% less than the peak level in FY2015.[184] Under the Governor's proposed borrowing plan, the State's total annual debt service would remain above $3.0 billion annually until FY2019 and not decline significantly until the last of the GO Restructuring Bonds are retired in FY2026.

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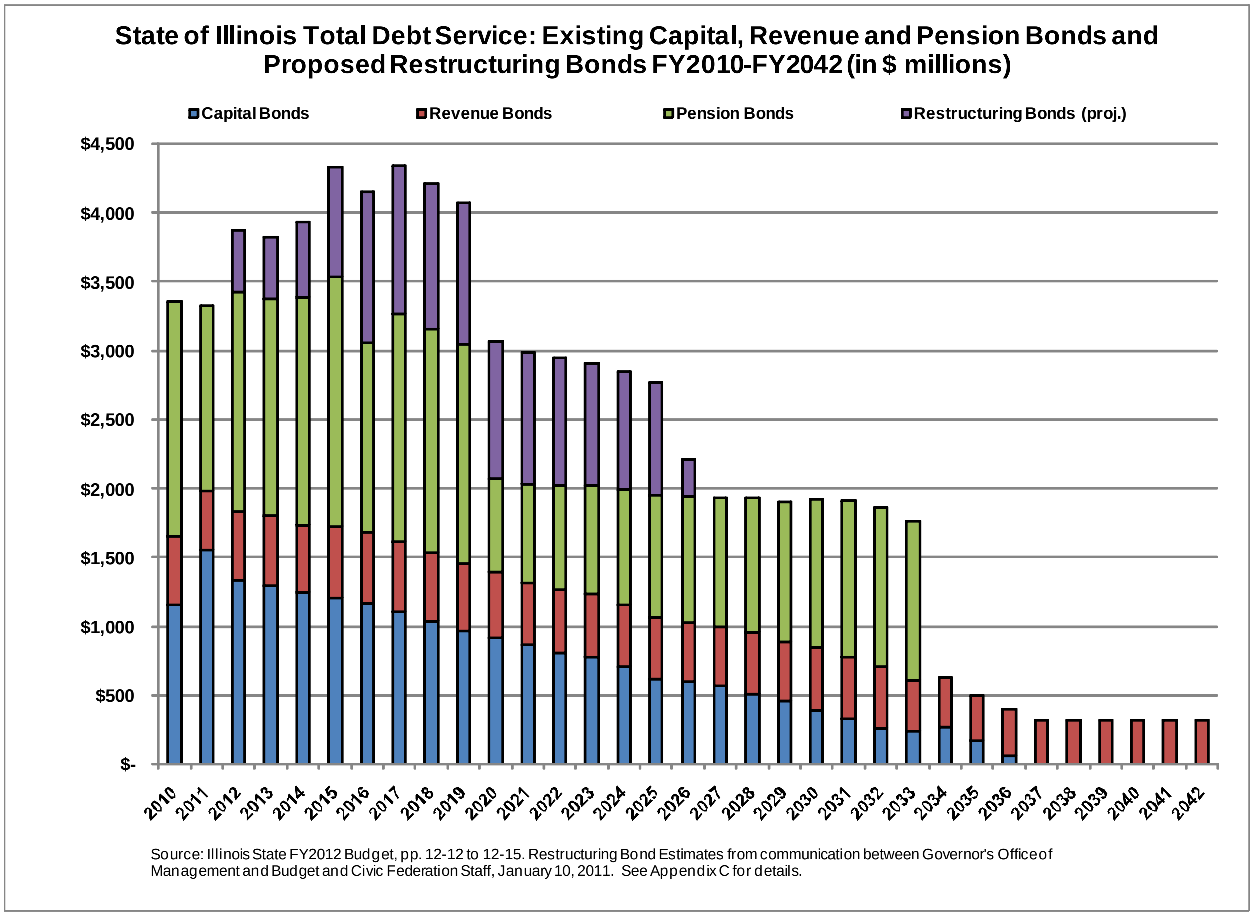
[183] See Appendix C for total debt service data and sources.
[184] Illinois State FY2010 Budget, p. 12-11.

The following chart shows total debt service owed by the State for all outstanding debt combined with estimated cost of the proposed GO Restructuring Bonds.



As shown in the chart above, the years of the highest debt service for the GO Restructuring Bonds coincide with the same years the income tax increases are scheduled to partially sunset. As enacted, the income tax increases are temporary and under the legislation roll back halfway through FY2015 from 5.0% to 3.75% for the personal income tax and 7.0% to 5.25% for the corporate income tax.

The estimates above do not account for additional authorized bonds that have not yet been issued as part of the State's ongoing capital program. The General Assembly approved $4.2 billion in additional GO Bonds for capital purposes on January 13, 2011, bringing the total outstanding but unissued capital bonds to $8.2 billion.[185] The Governor's FY2012 capital budget proposes the sale of an additional $1.5 billion in FY2012 and a total of $12.9 billion through FY2017.[186]

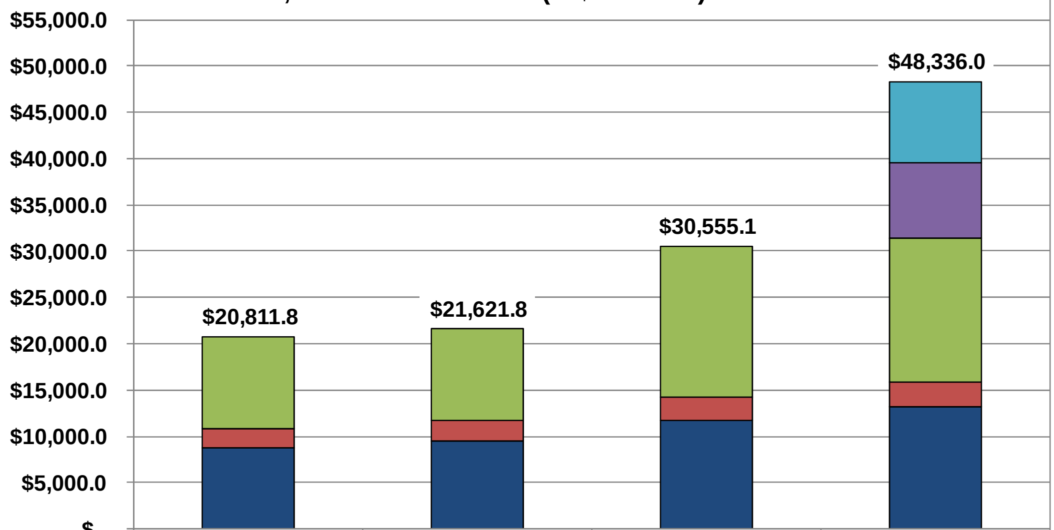
[185] State of Illinois, $3.7 billion General Obligation Bonds, *Official Statement*, January 21, 2011, p. 35.
[186] Illinois State FY2012 Budget, p. 12-11.

Total Debt Burden Increase

The State's total debt burden would increase dramatically if the borrowing for proposed GO Restructuring Bonds were approved as part of the FY2012 budget. The State has also authorized $8.2 billion in capital GO Bonds not yet issued to support capital projects.[187]

If all of the new debt previously authorized by the State is sold and the GO Restructuring Bonds are approved, the State's total debt outstanding will increase to $48.3 billion. This is an increase of $27.5 billion, or 132.3%, since FY2003. The following chart shows the State's total existing debt in FY2012, authorized but unissued bonds and the proposed additional borrowing, compared with total debt levels two years, five years and 10 years prior.

State of Illinois Total Bonded Indebtedness: Existing, Approved and Proposed FY2003, FY2008, FY2011 and FY2012 (in $ millions)



	FY2003	FY2008	FY2011	FY2012
Total Bonded Indebtedness	$20,811.8	$21,621.8	$30,555.1	$48,336.0
GO Restructuring Bonds	$-	$-	$-	$8,750.0
Authorized New Capital Bonds*	$-	$-	$-	$8,170.0
Outstanding Pension Bonds	$10,000.0	$9,950.0	$16,272.8	$15,479.6
Build Illinois/Civic Center Bonds	$1,999.2	$2,208.9	$2,553.3	$2,749.9
Outstanding GO Capital	$8,812.6	$9,462.9	$11,729.0	$13,186.5

*Authorized GO Bonds for capital purposes was increased in January 2011, outstanding unissued debt increased from $3.9 billion to $8.2 billion, Public Act 96-1554.
Illinois State Budgets FY2005, FY2009 and FY2012.

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[187] Public Act 96-1554.

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, the recent decline in the State's rating will lead to an overall increase in debt service costs for Illinois.

The State of Illinois' GO bond ratings have been lowered by each of the three major rating agencies since FY2009. The State's debt has been the second lowest rated among all states for two years, just one level above California. The following chart shows the ratings decline over the last three fiscal years.

State of Illinois General Obligation Bond Ratings

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

Source: Commission on Government Forecasting and Accountibility, *State of Illinois Budget Summary: Fiscal Year 2011*, p. 162; Illinois State FY2012 Budget, p. 12-2.

In downgrading the State's rating and future financial outlook, each agency has pointed to several of the same financial 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 grows in order to make up for past underfunding and losses in the pension funds due to the recession.

CAPITAL BUDGET

Since FY2005, the Governor's annual recommendations for the capital budget and the operating budget have been submitted as separate documents. The budgets are primarily different insomuch as the appropriations in the operating budget are intended to be spent in the year they are approved, while appropriations in the capital budget are to fund large infrastructure investments that often take several years to complete and must be reappropriated each year as a project moves forward. The capital budget is also primarily funded by long-term debt to pay for major projects over 20 to 30 years.

The following section examines the Governor's recommended capital budget for FY2012, which marks the second annual reauthorization of unspent appropriations from the *Illinois Jobs Now!* capital spending program approved in FY2010.[188] In FY2012 the Governor proposes reauthorizing $23.1 billion in capital appropriations from previous years. The Governor's FY2012 capital budget also includes proposed expansion of the capital budget through the addition of $4.0 billion in new capital projects, bringing the total proposed capital appropriations to $27.1 billion for FY2012. The capital budget includes appropriations for maintenance on state-owned assets such as roads and bridges, transit facilities, schools, economic development projects, environmental infrastructure, energy programs and state facilities. It also includes building new assets that the State will have to maintain and operate in future years.

Capital Planning

The State of Illinois does not have an established and publicly available capital improvement plan (CIP) to explain the prioritization of projects in the capital budget or the overall needs assessment for all state-owned assets. Although a list of nearly 9,000 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. 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, but no documentation of the process, comprehensive needs assessment or final ranking of projects was included with the budget.[189] Some of the important elements of a CIP that are missing from the Governor's proposed capital budget include:

- 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;

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[188] Public Acts 96-0004, 96-0035, 96-0039, 96-0819.
[189] Illinois State FY2012 Capital Budget, p. 4.

- 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.

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.[190]

The Governor's proposed budget includes some elements of a CIP such as the estimated effect of some completed projects on the State's operating budget. However, the only estimates provided are for State-owned facilities, which total only $1.7 billion in proposed projects, or 6.4% of the $27.1 billion capital budget. The Governor's proposed FY2012 capital budget estimates that over the next five years, the State will save $1.7 billion in operating expenses for reduced repair, maintenance and utility savings when the proposed State facilities projects are completed. However, these savings are offset by an estimated increase of $2.0 billion in operating expenses for new personnel and increased utilities expense associated with new facilities.[191] The five-year net operating increase of $317 million may be underestimated because it only includes increased costs associated with the completion of two relatively small projects out of 8,774 appropriations included in the budget. The purchase of the Tinley Dry Goods Store for the Illinois Historic Preservation Department is estimated to cost $43,000 annually to operate, and construction of a new State Police forensic lab in the city of Belleville will cost the State $350,000 annually. Because the State only reports the impact of these projects, the impact of the total facilities expansion included in the proposed FY2012 capital budget on the State's already stressed operating budget is unclear.

It is also important that the capital budget prioritize and fund the State's most critical infrastructure needs before funding new facilities or initiatives. The American Society of Civil Engineers recently released a study on the condition of Illinois' infrastructure. The report compared the State's infrastructure needs to its funding and plans to address those needs, including the projects approved in FY2010. The report concluded that the overall condition and investment in the Illinois' infrastructure was "poor." Specifically, the report showed the State's aviation facilities, dams and bridges were in "mediocre" condition and the State's infrastructure for drinking water, navigable waterways, rail, roads, transit and wastewater were in "poor" condition.[192]

Three of the largest areas of capital expense for the state are surface transportation, public transit and education. In 2007, the Regional Transportation Authority, which manages public transit for the State's population center in Northeastern Illinois, estimated that it would need $7.3 billion over the next five years to bring the CTA, Metra and Pace systems into a state of good repair.[193] The Illinois State Board of Education reports a need of $9.9 billion for statewide maintenance of

[190] Vogt, A. John, *Capital Budgeting and Finance: A Guide for Local Governments* (International City/County Management Association, 2004) p. 62.
[191] Illinois State FY2012 Capital Budget, p. 103.
[192] American Society of Civil Engineers, *Illinois Infrastructure 2010 Report Card*, http://www.isasce.org/web/2010InfrastructureReport.htm (last visited April 15, 2010).
[193] Regional Transit Authority, Moving Beyond Congestion, June 2007, http://www.movingbeyondcongestion.org/downloads/10_Billion_new.pdf (last visited April 15, 2010).

elementary and high school facilities.[194] However, the survey only represents the needs of the 618 school districts that responded to the survey and the State has 870 total school districts. The Illinois Department of Transportation reports that it needs an annual budget of at least $6.1 billion to keep pace with maintenance and replacement of the State's road and bridge inventory.[195] Illinois' wastewater infrastructure reportedly needs $13.4 billion in maintenance funding.[196]

The examples above are just a few of the known critical areas of infrastructure maintained by the State of Illinois. These funding requests illustrate how the State's capital funding needs far outpace even the resources proposed in State's capital budget. An annually updated CIP would provide for a strategic, transparent and comprehensive approach to infrastructure investment and would make clear to what extent the Governor's proposed capital budget will address the most critical needs first.

Total Appropriations

The FY2012 capital budget recommends the reauthorization of $23.1 billion and new spending totaling $4.0 billion, or a 17.5% increase, bringing the total for capital appropriations to $27.1 billion in FY2012. The largest proposed investment of capital funds in the FY2012 capital budget is $8.8 billion for state highways and bridges, which makes up 32.3% of the total capital appropriations. This is nearly three times as much as the next largest category, public transit, which is allocated $3.0 billion or 12.0 % of the appropriations. Both of these areas of funding are managed by the Illinois Department of Transportation (IDOT), as are the rail and airport investments.

The majority of the appropriations included it the FY2012 capital budget are for general departmental spending as was the case in the previous two fiscal years. More than $20.0 billion are general grants for areas of expenditures and not specific projects. The largest appropriation for a specific project in the capital project list released with the budget is the reappropriation of $250 million for upgrades to the Capitol Complex in Springfield.[197] The second largest project is $200 million in new appropriations for an information technology upgrade to the State's healthcare management systems in Central Management Services.[198]

Multiple funding sources will be accessed to pay for the $27.1 billion capital appropriations. The largest source of funding for the capital budget is state-issued debt through the General Obligation Bond and Build Illinois Bond programs. The Debt Trends section, which begins on page 71, discusses the history and current total indebtedness associated with the capital budget.

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194 Illinois State Board of Education, *Capital Needs Assessment Survey Results 2010*, http://www.cdb.state.il.us/forms/download/cnas_FY11.pdf (last visited May 3, 2011).

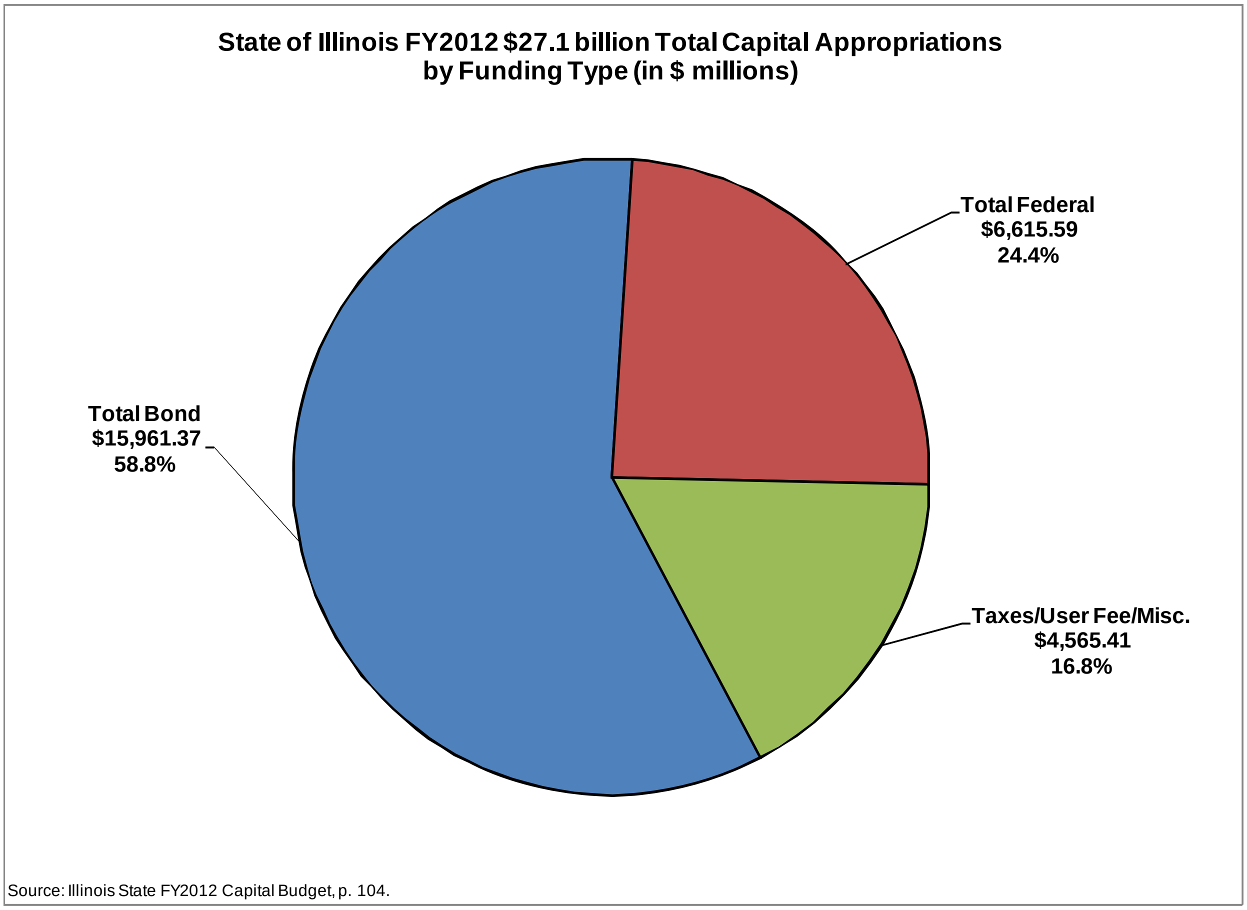
195 Illinois Department of Transportation, Illinois State Transportation Plan, Special Report: Transportation Funding, June 2007, p. 19.

196 American Society of Civil Engineers, *Illinois Infrastructure 2010 Report Card*, http://www.isasce.org/web/2010InfrastructureReport.htm (last visited April 15, 2010).

197 Illinois State FY2012 Capital Budget, Capital Projects List, http://www.state.il.us/budget/FY2012/FY12_Capital_Projects_List.xls (last visited May 3, 2011).

198 Illinois State FY2012 Capital Budget, Capital Projects List, http://www.state.il.us/budget/FY2012/FY12_Capital_Projects_List.xls (last visited May 3, 2011).

Debt-funded projects total $16.0 billion or 58.8% of the total capital budget. The following graph shows the funding for the FY2012 capital budget by source.



To fund all the appropriations included in the capital budget, the General Assembly will need to approve additional bond authorization by a three-fifths vote. The State currently has authorized $8.2 billion in GO bonds for capital purposes that are unissued and has issued approximately $2.7 billion in new capital purposes debt since the start of the capital program in FY2010. The remaining pay-as-you-go funding comes from federal funds, tax revenue, user fees and other miscellaneous sources.[199]

Federal funds for capital focus primarily on transportation projects including highways, aeronautics, rail and public transportation provided through the federal transportation bill called the Safe, Accountable, Flexible and Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU).[200] Federal funds also include some grants for environmental projects and appropriations for the State's inland ports. Federal funding for capital totals $6.6 billion or 24.4% of the total capital budget.

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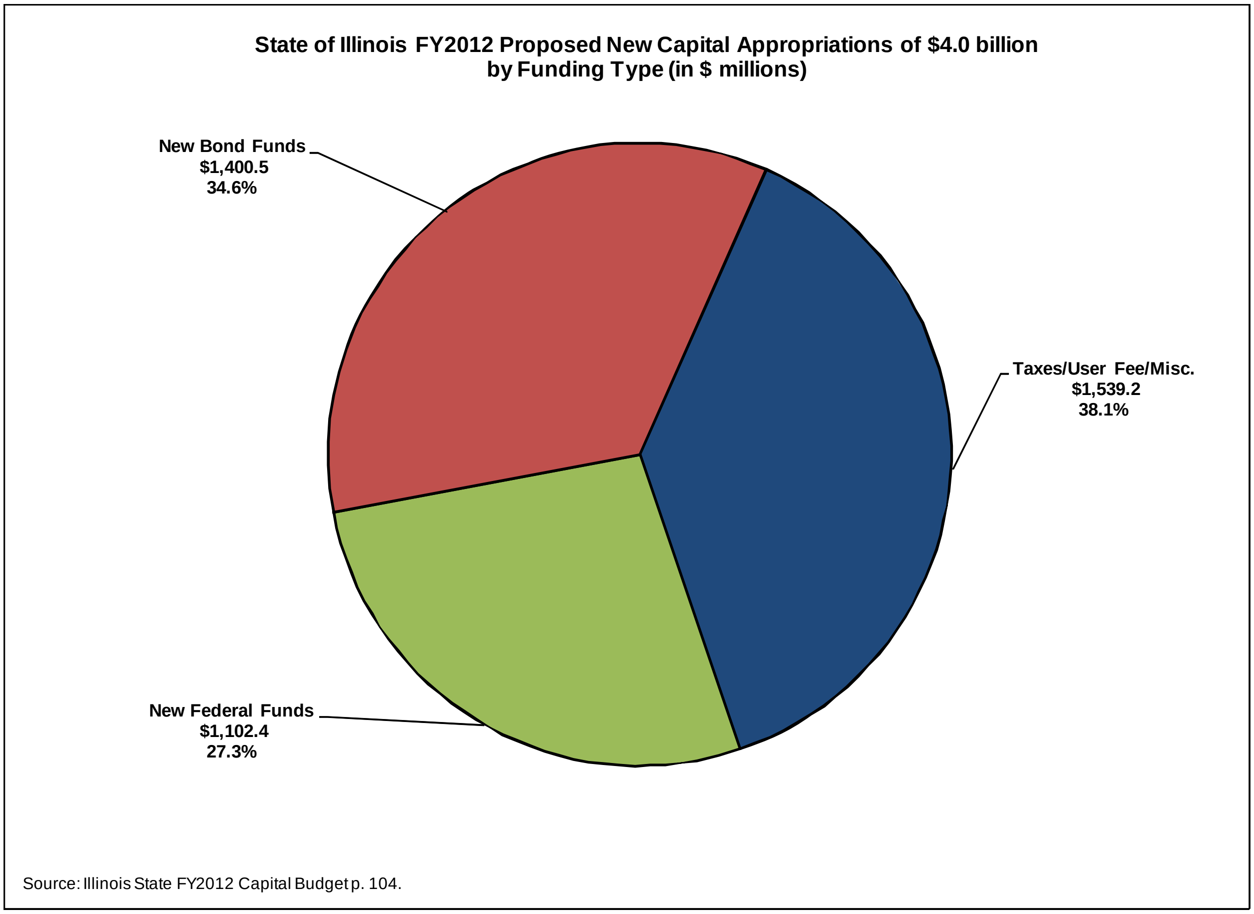
[199] Miscellaneous includes loan repayments, investment income and settlements. Illinois State FY2012 Capital Budget, p. 104.
[200] Illinois State FY2012 Capital Budget, p. 39.

Tax funds are primarily generated from the motor fuel tax charged by the State. User fees are primarily generated through vehicle licensing, registration and title fees.[201]

FY2012 New Appropriations

The proposed increase of $4.0 billion in new capital spending in FY2012 will mostly be funded through a variety of pay-as-you-go sources. The Governor's proposed FY2012 capital budget includes $1.4 billion in new bond funded appropriations, which makes up $34.6% of the new project funding.

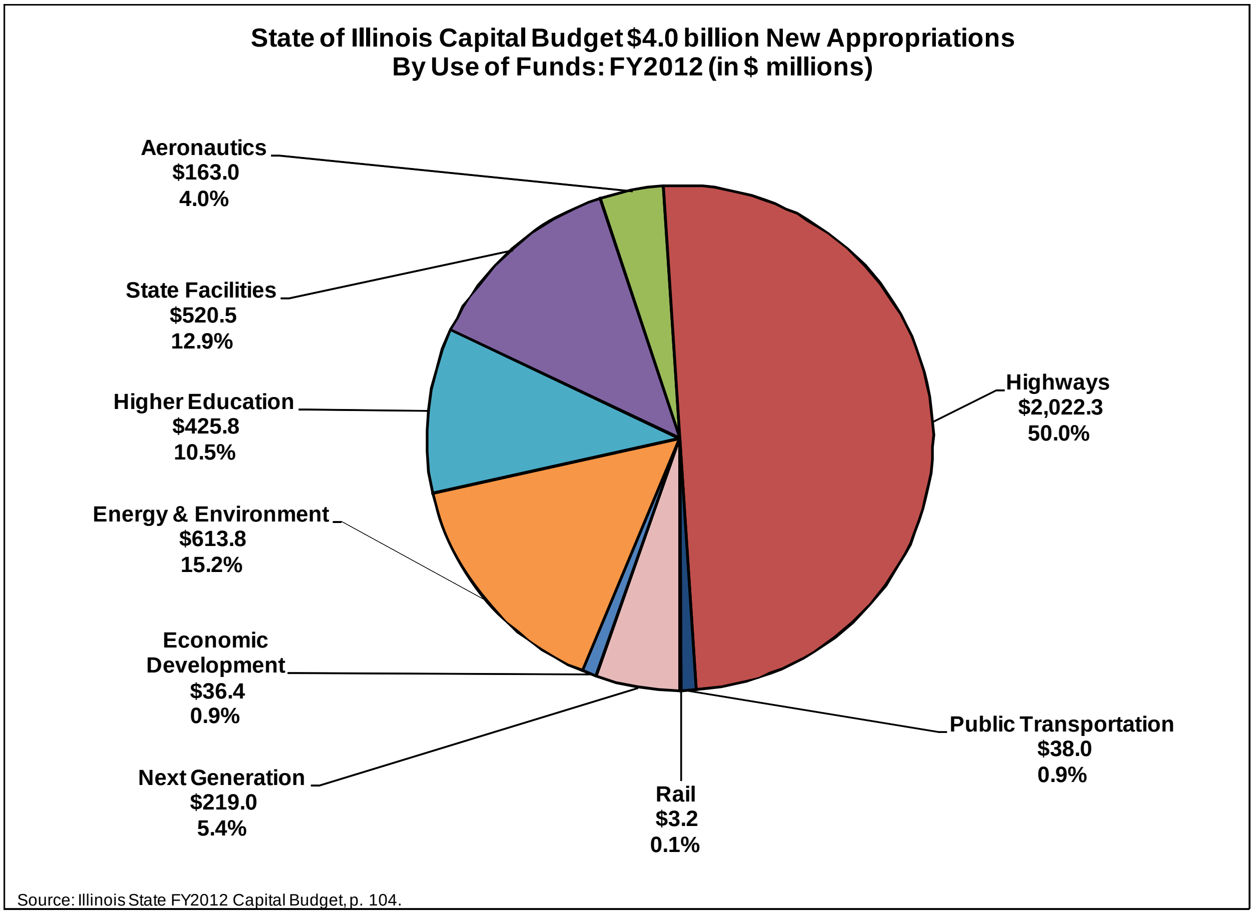
The following chart shows the proposed new capital projects in the FY2012 capital budget by funding source.



The largest increase in new appropriation proposed in the FY2012 capital budget for additional highway projects totaling $2.0 billion. All of the proposed new highway funds are from pay-as-you-go sources including federal, tax and user fee generated funds. The Illinois Community College Board also received a significant amount of new funding totaling $94.1 million for both new construction and facility renewal.

[201] Illinois State FY2012 Capital Budget, p. 104.

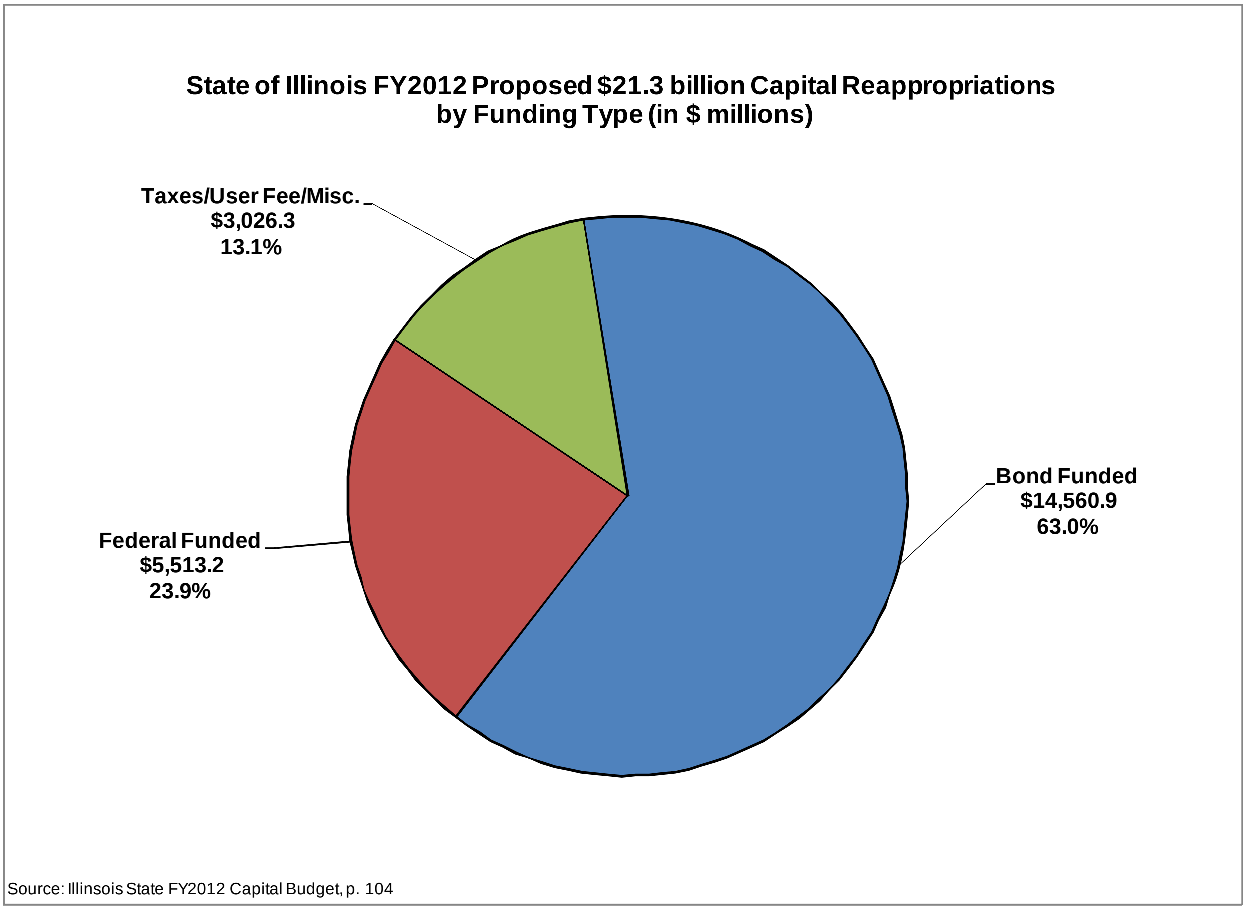
The following graph shows the proposed new FY2012 capital appropriations by purpose.



FY2012 Reappropriations

On July 13, 2009, the Governor signed the $31.0 billion *Illinois Jobs Now!* program as enacted by the General Assembly. This was the first statewide transportation bill enacted in Illinois since the *Illinois FIRST* capital program in 1999. As part of the FY2011 capital budget, the State reauthorized $26.2 billion of unspent appropriations from the FY2010 capital budget. In FY2012 the Governor proposes the reauthorization of $23.1 billion in capital appropriations. The capital budget is largely funded through the issuance of addition GO Bonds and Build Illinois Bonds. Bond funded projects make up $14.6 billion of the proposed reappropriations or 63.0%.

The following chart shows the total proposed capital reappropriations for FY2012 by funding type.



The largest use of the reappropriated funds is $6.7 billion for highways followed by the $3.0 for public transportation. The new and reappropriated highway funds are part of the State's multi-year road programs. However, the $8.8 billion in capital spending on road and bridges in the capital budget do not match the totals in the recently announced update to the multi-year road plan. The Governor's office announced on April 7, 2011 a new multi-year program for FY2012 through FY2017 totaling $11.5 billion.[202] The total appropriations and sources of funding in the State's multi-year road program do not match the proposal in the Governor's FY2012 capital budget.

Of the $3.6 billion originally allocated in the FY2010 capital budget for public transit funding, only $900 million will be spent on maintenance to the Chicago Transit Authority, the largest provider of mass transit in the State. The CTA has identified a need of more than $6 billion in capital funding to maintain its bus and rail system. A portion of the $38 million in new federal funding grant for mass transit in the proposed FY2012 capital budget may be used for CTA planning purposes, such as preparation for the proposed Circle Line train service or other

[202] FY2012-FY2016 *Proposed Highway Improvement Program*. http://www.dot.state.il.us/hip1116/hwyimprov.htm (last visited April 7, 2011).

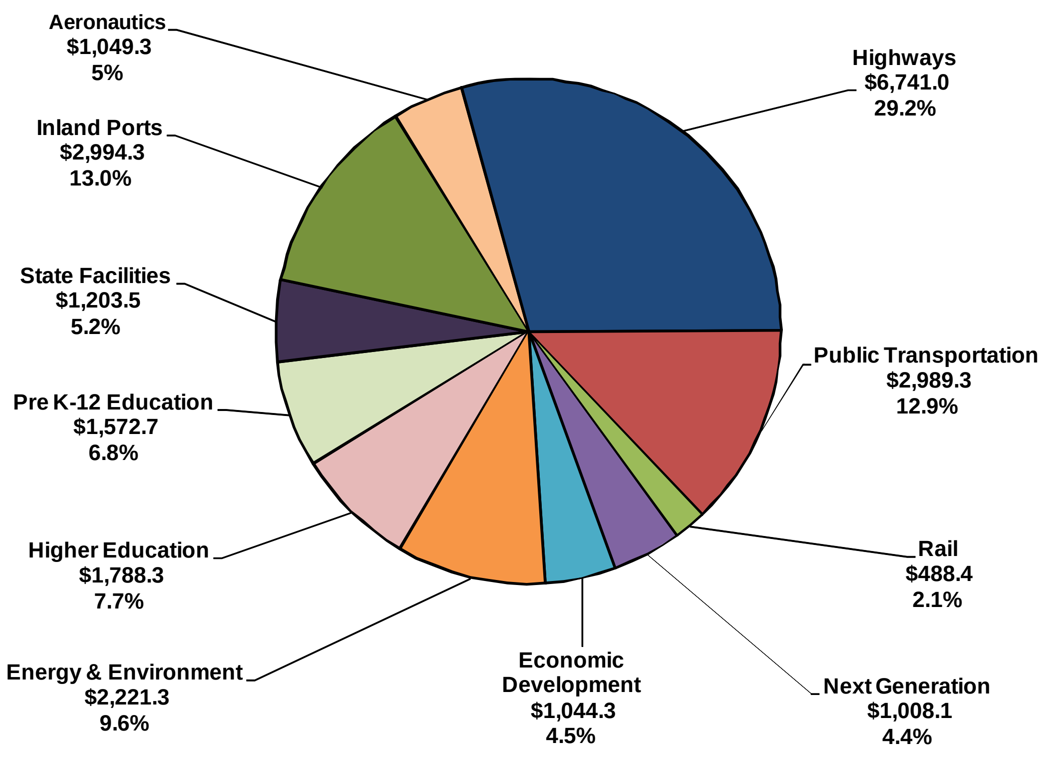
expansion projects.[203] The budget document does not specify the precise apportionment of this new federal mass transit funding for transit planning purposes.

The reappropriations also include $400 million within the inland ports budget to fund high-speed rail. Illinois was awarded $1.2 billion in additional funding for high-speed rail from the federal government.[204] The inland ports appropriations also include $300 million for the Chicago Environmental and Transportation Efficiency Program (C.R.E.A.T.E.) and $110.5 million to build a third Chicago regional airport south of the city.

The FY2012 capital budget includes reappropriation of $1.6 billion for the statewide school construction program and $1.8 billion for projects at public universities.

The following chart shows the proposed reappropriations in FY2012 capital budget by type of project.

State of Illinois FY2012 Capital Budget $23.1 billion Reappropriations By Use of Funds (in $ millions)



Source: Illinois State FY2012 Capital Budget, p. 104.

[203] Illinois State FY2012 Capital Budget, p. 44.
[204] Illinois State FY2012 Capital Budget, p. 45.

Capital Revenues

In 2009 the State approved a package of revenues expected to total $943 million to $1.2 billion annually to support the new capital borrowing associated with the *Illinois Jobs Now!* capital program. These revenue sources and estimated annual revenues from each included:[205]

- Statewide legalization and taxation of video poker – $288 to $534 million;
- Expanded sales tax on candy, sweetened beverages and some hygiene products – $65 million;
- Leasing a portion of state lottery operations – $150 million;
- Increased per gallon tax on beer, wine and liquor – $108 million; and
- Increased license and vehicle fees – $332 million.

The proceeds from these sources are deposited in the Capital Projects Fund and used to pay for debt service on new capital bonds and pay for some ongoing capital expenses. The FY2012 capital budget does not include details of the revenues being generated from these sources since enactment or the increase in debt service specifically attributable to the bonds sold to support the *Illinois Jobs Now!* projects.

However, since the enactment of legalized video poker, more than 76 communities and 4 counties have taken advantage of an opt-out clause in the legislation and the City of Chicago already has a prohibition on video gaming in the city.[206] Without the participation of these governments, the revenue from video poker is expected to drop by between $102.2 million and $189.7 million.[207] The Illinois Gaming Board also has stated that it does not expect to be ready to monitor and issue licenses until after January 2012.

The State only recently entered into an agreement with a private company to manage the lottery on January 18, 2011.[208] It remains to be seen if the revenue increase from the privatized marketing operations of the lottery will generate the amounts originally projected.

The State's capital program is also the subject of taxpayer litigation challenging the validity of the legislation that authorized the new revenue sources.[209] On January 26, 2011, the First District Appellate Court ruled that the enacting legislation for the capital program revenues was invalid and all of the appropriations based on the bill were invalid. The State of Illinois appealed this ruling and was granted a stay by the Illinois Supreme Court on February 1, 2011. This has allowed the State to continue with the capital program for the time being. If the State does not prevail in its appeal, it would have to reauthorize each of the capital revenues sources in separate measures and reauthorize all of the capital appropriations from FY2010 that are still associated with the original appropriations in the capital budget.

[205] Public Act 096-0034.
[206] Illinois Gaming Board, Memorandum January 2011.
http://www.igb.illinois.gov/VideoGaming/VideoGamingBanMemo.pdf (last visited May 3, 2011)
[207] Commission on Government Forecasting and Accountability, 2011 *Capital Plan*, April 2010, p. 10.
[208] Illinois Lottery, Private management agreement, January 18, 2011.
http://www.illinoislottery.com/subsections/Management/LotteryPMAExecution.pdf (last visited May 3, 2011)
[209] State of Illinois, $3.7 billion General Obligation Bonds, *Official Statement*, January 21, 2011, pp. 73-74.

APPENDIX A: STATE OF ILLINOIS AGENCIES BY PURPOSE

This appendix presents the State's grouping of agencies according to principal spending activities.[210]

Human Services
Department on Aging
Department of Children and Family Services
Comprehensive Health Insurance Plan
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
Teachers' Retirement System[211]
Illinois Board of Higher Education
Public Universities
Illinois Community College Board
Illinois Student Assistance Commission
Illinois Mathematics and Science Academy
State Universities Retirement System[212]
State Universities Civil Service System

Government Services
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
Judges' Retirement System[213]
Judicial Inquiry Board
Office of the State Appellate Defender
Office of the State's Attorneys Appellate Prosecutor

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[210] Illinois State FY2012 Budget, *Table of Contents*.
[211] FY2012 pension contributions are not included in appropriation amounts.
[212] FY2012 pension contributions are not included in appropriation amounts.
[213] FY2012 pension contributions are not included in appropriation amounts.

Supreme Court and Illinois Court System
Supreme Court Historical Preservation Commission
Office of the Auditor General
General Assembly
General Assembly Retirement System[214]
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
Civil Service Commission
Court of Claims
State Board of Elections
Executive Ethics Commission
Procurement Policy Board
Drycleaner Environmental Response Trust Fund Council
Office of the Executive Inspector General
Governor's Office of Management and Budget
Capital Development Board
Department of Central Management Services
Illinois Gaming Board
State Employees' Retirement System[215]

Economic Development
Department of Agriculture
Department of Commerce and Economic Opportunity
East St. Louis Financial Advisory Authority
Illinois Commerce Commission
Illinois Power Agency
Illinois Finance Authority
Illinois Sports Facilities Authority
Department of Labor
Metropolitan Pier and Exposition Authority
Southwestern Illinois Development Authority
Department of Transportation
Upper Illinois River Valley Development Authority

Public Safety and Regulation
Department of Corrections
Environmental Protection Agency

[214] FY2012 pension contributions are not included in appropriation amounts.
[215] FY2012 pension contributions are not included in appropriation amounts.

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 B: AGENCIES UNDER THE GOVERNOR

The following agencies are considered to be under the Governor's Office for purposes of the headcount numbers provided in the FY2012 budget.[216]

Department of Human Services
Department of Corrections
Department of Transportation
Department of State Police
Department of Children and Family Services
Department of Healthcare and Family Services
Department of Revenue
Department of Employment Security
Department of Central Management Services
Department of Juvenile Justice
Department of Natural Resources
Department of Veterans' Affairs
Department of Public Health
Illinois Environmental Protection Agency
Department of Financial and Professional Regulation
State Board of Education
Department of Agriculture
Department of Commerce and Economic Opportunity
Department of Insurance
Illinois Commerce Commission
Illinois Student Assistance Commission
Department of Military Affairs
Illinois Emergency Management Agency
Illinois Gaming Board
Illinois Historic Preservation Agency
Workers' Compensation Commission
Department of Human Rights
Department on Aging
Office of the State Fire Marshal
Capital Development Board
Illinois Guardianship and Advocacy Commission
Office of the Governor
Department of Labor
Illinois Criminal Justice Information Authority
Illinois Community College Board
Governor's Office of Management and Budget
Human Rights Commission
Board of Higher Education

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

Prisoner Review Board
Illinois Labor Relations Board
Property Tax Appeal Board
Illinois Arts Council
Illinois Law Enforcement Training and Standards Board
Illinois Educational Labor Relations Board
Illinois Racing Board
Illinois Violence Prevention Authority
Illinois Council on Developmental Disabilities
Illinois State Police Merit Board
Civic Service Commission
Illinois Deaf and Hard of Hearing Commission
Procurement Policy Board
Illinois Power Agency
State Employees' Retirement System

APPENDIX C: TOTAL DEBT SERVICE

State of Illinois Total Debt Service: Existing, Authorized and Proposed (in $ thousands)					
Fiscal Year	Capital Bonds	Revenue Bonds	Pension Bonds	Restructuring Bonds (proj.)	Total Debt Service
2010	$ 1,159,673	$ 490,088	$ 1,703,223	$ -	**$ 3,352,984**
2011	$ 1,553,464	$ 425,278	$ 1,344,377	$ -	**$ 3,323,119**
2012	$ 1,330,618	$ 499,707	$ 1,598,566	$ 447,658	**$ 3,876,549**
2013	$ 1,291,464	$ 509,416	$ 1,576,182	$ 446,588	**$ 3,823,650**
2014	$ 1,242,447	$ 493,121	$ 1,648,771	$ 545,048	**$ 3,929,387**
2015	$ 1,209,532	$ 514,484	$ 1,812,322	$ 791,068	**$ 4,327,406**
2016	$ 1,167,430	$ 518,695	$ 1,369,840	$ 1,095,178	**$ 4,151,143**
2017	$ 1,101,902	$ 507,129	$ 1,658,318	$ 1,073,605	**$ 4,340,954**
2018	$ 1,037,120	$ 497,160	$ 1,626,275	$ 1,049,316	**$ 4,209,871**
2019	$ 970,696	$ 486,273	$ 1,589,994	$ 1,022,312	**$ 4,069,275**
2020	$ 919,393	$ 477,225	$ 674,550	$ 993,012	**$ 3,064,180**
2021	$ 868,443	$ 446,659	$ 713,412	$ 961,418	**$ 2,989,932**
2022	$ 805,885	$ 462,389	$ 749,800	$ 927,834	**$ 2,945,908**
2023	$ 774,594	$ 458,238	$ 783,712	$ 892,606	**$ 2,909,150**
2024	$ 704,994	$ 449,347	$ 840,150	$ 855,733	**$ 2,850,224**
2025	$ 615,000	$ 447,006	$ 892,200	$ 817,598	**$ 2,771,804**
2026	$ 601,356	$ 427,130	$ 915,425	$ 263,200	**$ 2,207,111**
2027	$ 567,745	$ 429,640	$ 936,100	$ -	**$ 1,933,485**
2028	$ 511,055	$ 444,378	$ 979,225	$ -	**$ 1,934,658**
2029	$ 457,998	$ 424,030	$ 1,018,525	$ -	**$ 1,900,553**
2030	$ 385,192	$ 457,243	$ 1,079,000	$ -	**$ 1,921,435**
2031	$ 325,955	$ 455,048	$ 1,134,375	$ -	**$ 1,915,378**
2032	$ 254,706	$ 452,143	$ 1,159,650	$ -	**$ 1,866,499**
2033	$ 243,507	$ 361,806	$ 1,156,100	$ -	**$ 1,761,413**
2034	$ 264,526	$ 359,979	0	$ -	**$ 624,505**
2035	$ 167,091	$ 335,972	$ -	$ -	**$ 503,063**
2036	$ 61,836	$ 335,272	$ -	$ -	**$ 397,108**
2037	$ -	$ 322,572	$ -	$ -	**$ 322,572**
2038	$ -	$ 322,572	$ -	$ -	**$ 322,572**
2039	$ -	$ 322,572	$ -	$ -	**$ 322,572**
2040	$ -	$ 322,572	$ -	$ -	**$ 322,572**
2041	$ -	$ 322,572	$ -	$ -	**$ 322,572**
2042	$ -	$ 322,576	$ -	$ -	**$ 322,576**
Total	**$ 20,593,622**	**$ 14,100,292**	**$ 28,960,092**	**$ 12,182,171**	**$ 75,836,177**

Source: Illinois State FY2012 Budget, pp. 12-12 to 12-15; GO Restructuring Bond estimated debt service based on principal maturities and term included in 97th Illinois General Assembly Senate Bill 3 and Civic Federation interest calculation using MMD AAA Rates and IL Spreads from Bloomberg and Thomson MMD, January 25, 2011.