The Institute for Illinois' Fiscal Sustainability
AT THE CIVIC FEDERATION

State of Illinois Enacted Budget FY2011:

A Review of the Operating Budget Enacted for the Current Fiscal Year

November 18, 2010

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EXECUTIVE SUMMARY

This report examines the State of Illinois' $53.5 billion operating budget for Fiscal Year 2011, which began on July 1, 2010 and ends on June 30, 2011. The report focuses on the $25.8 billion General Funds budget, the largest component of the total operating budget. The key findings of the Civic Federation's analysis of the State's FY2011 enacted budget include the following:

Deficit

- The FY2011 enacted budget includes a General Funds operating shortfall of $5.8 billion due to annual spending levels that exceed forecasted revenues;
- The accumulated General Funds deficit from prior years, carried over to FY2011, amounts to $6.5 billion; and
- The total projected General Funds deficit in the enacted FY2011 budget totals $12.3 billion.

Borrowing for Operations

- In order to reduce the projected $5.8 billion operating shortfall in FY2011, the State enacted budget authorizes a total of $2.2 billion in new borrowing to pay for operations;
- Included in the total borrowing for operations is interfund borrowing of approximately $1.0 billion from Special State Funds that must be repaid within 18 months;
- The total approved borrowing for operations also includes authorization to sell bonds to securitize the long-term revenues expected from the State's tobacco litigation settlement. The enacted budget estimates $1.2 billion in onetime General Funds revenue from these bonds; and
- The State also has proposed selling an additional $3.7 billion of Pension Obligation Bonds to make the FY2011 pension payment. However, pension borrowing legislation had not passed the General Assembly as of the publication date of this report.

Unpaid Bills

- If borrowing to make pension contributions is approved, the backlog of unpaid bills at the end of FY2011 is projected to remain unchanged from year-end FY2010 at $6.4 billion;
- If pension contributions must be made from General Funds and no additional revenues are approved, the backlog of bills could increase by roughly $4 billion; and
- Due to cash flow problems, the State extended from two months to six months the period of time in FY2011 during which it can continue to pay off FY2010 bills.

Revenues

- The FY2011 enacted budget estimates General Funds revenues totaling $27.7 billion, a 2.1% increase over the FY2010 year-end estimate of $27.1 billion; and
- This represents the first projected year-to-year increase in total annual General Funds revenue since FY2008, but it is a moderate increase of $557 million.

Appropriations

- The FY2011 enacted budget includes General Funds appropriations of $25.8 billion, which is 2.0% lower than the FY2010 enacted General Funds budget of $26.4 billion and 4.2% higher than Governor Quinn's FY2011 recommended General Funds budget of $24.8 billion;
- The $25.8 billion of appropriations included in the General Funds budget for FY2011 is 7.1% lower than the FY2009 enacted General Funds budget of $27.8 billion;
- The General Funds appropriation of $25.8 billion for FY2011 does not include pension contributions. The State borrowed $3.5 billion to make required pension payments in FY2010, but it is unclear whether similar borrowing will be approved in FY2011; and
- **Despite the decline in General Funds appropriations, total spending from General Funds is projected to increase by 1.6% from $33.0 billion in FY2009 to $33.5 billion in FY2011 because of higher pension contributions and debt service payments.**

BUDGET TIMELINE

Entering FY2011, the State of Illinois faced a deepening financial crisis. Buffeted by a severe economic recession and suffering from years of poor fiscal management, the State was confronted with a record budget deficit projected to total approximately $13 billion.[1]

The projected deficit consisted of an operating shortfall of more than $7 billion and an accumulated deficit from prior years of nearly $6 billion. Much of the burden of the crisis fell on social service agencies and local governments, which were experiencing unprecedented delays in payments from the State.

Governor's FY2011 Operating Budget Recommendation—March 10, 2010

On March 10, 2010, Governor Pat Quinn presented his FY2011 recommended operating budget for the State. The $52.0 billion recommended budget 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. The operating budget also includes Other State Funds, which are accounts for activities funded by earmarked revenue sources that may only be used for special purposes, and Federal Funds (other than those designated for General Funds), which support a variety of state programs.

The Governor proposed net cuts in General Funds spending authority of $1.5 billion from the previous fiscal year, with the reductions concentrated in elementary and secondary education. In addition to appropriations reductions, the proposal included a $308 million cut in local governments' share of state income tax revenues. The Governor's proposal also included a $267 million reduction in required FY2011 pension contributions based on a pension stabilization measure that had not yet been introduced as a bill in the General Assembly.

Governor Quinn's recommendation would have reduced the total projected FY2011 General Funds deficit from $13 billion to approximately $10.5 billion. The approximately $10.5 billion deficit consisted of a $4.7 billion operating shortfall and an unchanged accumulated deficit of $5.9 billion from prior years. Most of the remaining operating shortfall was due to required state contributions to its severely underfunded retirement systems. Contributions were projected at $3.9 billion, even after the pension stabilization measure.

The Governor's proposal would have closed the operating shortfall through borrowing. In his budget address to the Illinois General Assembly, Governor Quinn also suggested a one-percentage point increase in income taxes to restore funding to education. The Governor's Office of Management and Budget later said that the Governor was proposing a one percentage point increase in both personal and corporate tax rates, from 3% to 4% and 4.8% to 5.8%, respectively.[2]

The Civic Federation, in a report on April 26, 2010, opposed the Governor's recommended budget because it was unbalanced and did too little to address the fiscal crisis.[3] The report said

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[1] Illinois State FY2011 Budget, The Governor's Letter of Transmittal, March 10, 2010.

[2] Jamey Dunn, "Education cuts or a tax increase," Illinois Issues blog, March 10, 2010, http://illinoisissuesblog.blogspot.com/2010/03/education-cuts-or-tax-increase.html (last visited October 29, 2010).

[3] The Institute for Illinois' Fiscal Sustainability at the Civic Federation, "State of Illinois FY2011 Recommended Operating and Capital Budgets: Analysis and Recommendations," April 26, 2010, http://www.civicfed.org/iifs/publications/illinoisfy2011budgetanalysis (last visited on October 11, 2010).

that the proposed budget borrowed billions to pay for operations while continuing to ignore a massive backlog of bills and that the proposal would worsen the State's financial condition.

Pension Reform—April 2010

A pension reform bill raced through the General Assembly—from introduction through passage by both the Senate and House of Representatives—on March 24, 2010.[4] Governor Quinn signed the bill into law on April 14, 2010.[5]

The legislation created a two-tiered benefits system with lower benefits for state and many local government employees hired on or after January 1, 2011. The Governor's Office estimated that the new law would save the State $67 billion in yearly pension payments through 2045.[6] In FY2011, the reforms were expected to save $360 million, up from the $267 million included in the Governor's recommended budget.[7]

General Assembly's Action on Operating Budget—May 2010

The General Assembly left Springfield on May 7, 2010, its previously scheduled adjournment date, without passing a budget for FY2011. The Senate approved a budget plan but the House failed to pass any budget legislation. The Senate plan authorized the following:[8]

- Skipping required pension payments until resources were available. Under state law, pension contributions are covered by continuing appropriations if not otherwise appropriated;[9]
- Cutting $2 billion from FY2010 spending levels;
- Borrowing from Special State Funds and issuing bonds based on the proceeds of tobacco litigation settlement;
- Using revenues from a cigarette tax increase previously passed by the Senate;
- Requiring lawmakers, constitutional officers and executive agency directors to take 12 furlough days; and
- Extending the lapse period from August 31 to December 31. The lapse period is the time period when the State can pay off bills from the previous fiscal year.[10]

The General Assembly reconvened two weeks later. On May 25, 2010, the House passed a budget plan that included a provision for $4.1 billion in borrowing to pay pension contributions. It also included a tax amnesty provision.

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[4] Senate Bill 1946.
[5] Public Act 96-0889.
[6] Governor's Office, "Governor Quinn Signs Historic Illinois Public Pension Reform Bill; New Law Saves Taxpayers Billion, Provides Retirement Protection for Illinois Workers," news release, April 14, 2010, http://www.illinois.gov/PressReleases/ShowPressRelease.cfm?SubjectID=3&RecNum=8368 (last visited on October 11, 2010).
[7] Office of the Governor, *Notice of Proposed Short Term Borrowing*, June 1, 2010, p. 2.
[8] For a detailed account of General Assembly actions, see Illinois Issues blog at illinoisissuesblog.blogspot.com, various dates, (last visited on October 11, 2010).
[9] State Pension Funds Continuing Appropriation Act (40 ILCS 15/0.1).
[10] State Finance Act (30 ILCS 105/25).

On May 27, 2010, the Senate passed all the components of the House's budget—except pension borrowing. The budget plan approved by the General Assembly consisted of the following major bills:

- Budget Bills (House Bill 859 and Senate Bill 1215). A $26.0 billion General Funds spending plan. Included a $2.2 billion lump-sum appropriation for human services and a $1.2 billion lump-sum appropriation to any state agency;
- Emergency Budget Act of FY2011 (Senate Bill 3660). Authorized the Governor to require reserves of up to roughly $1.6 billion, which could not be spent unless released by the Governor or upon passage of new revenue sources.[11] Authorized the Governor to borrow from Other State Funds for up to 18 months. Extended the lapse period until December 31, 2010. Authorized issuance of bonds based on proceeds of tobacco litigation settlement, expected to raise roughly $1.2 billion. Required all non-emergency personnel to take 12 furlough days;
- FY2011 Budget Implementation Act (Senate Bill 3662);
- Tax Amnesty (Senate Bill 377). Allowed anyone owing taxes between 2002 and 2009 to pay them between October 1, 2010 and November 8, 2010 without penalty or interest. Expected to raise $250 million;[12] and
- Sales Tax Holiday (Senate Bill 3658). Reduced the sales tax on school clothing and supplies from 6.25% to 1.25% from August 6, 2010 to August 15, 2010. Expected to cost between $20.6 million and $67.1 million.[13]

The Emergency Budget Act also included a plan to reform the State's budgeting process. Prior to publication of the Governor's FY2012 recommended budget, the Governor and all constitutional officers are required to establish priorities and goals and develop benchmarks to assess each agency's performance. The Civic Federation has repeatedly urged the State to develop a performance measurement system to determine spending priorities.[14]

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[11]Total reserves authorized by the Emergency Budget Act were one-third of outstanding vouchers and statutory transfers that had not been executed as of June 30, 2010. That total was $4.712 billion, according to the State Comptroller.

[12] State of Illinois, $900 Million General Obligation Bonds, Taxable Build America Bonds, *Official Statement*, July 14, 2010, p. 24. Projected net proceeds of the amnesty have been reduced by $222 million to $28 million because of the continued coupling of Illinois' inheritance tax to the federal inheritance tax.

[13] Tim Landis, "Retailers Looking Forward to August Sales Tax Holiday," *The State Journal-Register*, July 16, 2010.

[14] See, most recently: Civic Federation, *State of Illinois Recommended Operating and Capital Budgets: Analysis and Recommendations*, April 26, 2010, p.15; Civic Federation, *Fiscal Rehabilitation Plan for the State of Illinois*, February 22, 2010, p. 88.

The following chart shows final votes and dates of major legislation related to the FY2011 enacted budget.

State of Illinois FY2011 Budget and Related Bills Enacted as November 18, 2010							
Bill Number	Description	Senate Vote/Date		House Vote/Date		Enacted	Public Act Number
SB 1946	Pension Reform	48-6	3/24/10	92-17	03/24/10	04/14/10	P.A. 96-889
HB 859	Appropriations	31-26	5/7/10	66-50	05/25/10	07/01/10	P.A. 96-956
SB1215	Appropriations	36-22	5/27/10	68-44	05/26/10	07/01/10	P.A. 96-957
SB3660	Emergency Budget Act	32-23	5/27/10	67-50	05/25/10	07/01/10	P.A. 96-958
SB3662	Budget Implementation Act	33-23	5/27/10	69-48	05/25/10	07/01/10	P.A. 96-959
SB3658	Sales Tax Holiday	42-8	5/27/10	65-51	05/06/10	07/07/10	P.A. 96-1012
SB377	Tax Amnesty	53-1	5/27/10	102-14	05/25/10	08/16/10	P.A. 96-1435

Source: Illinois General Assembly, Commission on Government Forecasting and Accountability, Budget Summary FY2011, p.ii; Illinois General Assembly website at http://www.ilga.gov/legislation/default.asp (last visited on October 8, 2010).

Subsequent Developments—July 2010 to November 2010

On July 1, 2010, Governor Quinn signed most components of the General Assembly's budget plan.[15] The Governor announced reduction and item vetoes of $155.2 million. In addition, roughly $43 million in planned re-appropriations were eliminated from the FY2011 budget because the funds had already been spent by the end of FY2010.[16] These actions reduced the FY2011 enacted General Funds budget to $25.8 billion. The Governor also established reserves of $891 million under authority granted by the Emergency Budget Act.

After the FY2011 budget was enacted, the Governor signed an agreement with the State's largest labor union that could affect the FY2011 budget.[17] The agreement with Council 31 of the American Federation of State, County and Municipal Employees (AFSCME) prohibits the State from laying off workers or closing state facilities through June 30, 2012. It extends an agreement made with AFSCME in January 2010, after the union won a lawsuit to prevent the State from imposing layoffs. Under the new agreement, the union must specify $50 million in personnel savings and will attempt to identify as much as $100 million in savings. The savings could include a deferral of scheduled pay raises in FY2011 if not enough savings can be found in other areas. Under the previous agreement, the union agreed to defer until June 1, 2011 half of the 2% pay increase scheduled for July 1, 2010 and half of the 2% increase scheduled for January 1, 2011. Employees are scheduled to receive wage increases of 1% on January 1, 2011; 2% on June 1, 2011; 4% on July 1, 2011; and 1.25% on January 1, 2012.

The Illinois Senate met on November 4, 2010 to consider the pension borrowing plan that had been approved by the House in May, but no vote was taken on the issue. Pension borrowing is expected to be addressed in the General Assembly's veto session, which begins on November 16.[18] Governor Quinn has urged the legislature to consider a tax increase during the veto session; a plan to expand gambling is also expected to be debated.[19]

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[15] Senate Bill 3658 was signed on July 7 and Senate Bill 377 was signed on August 16.
[16] Communication between the Civic Federation and the Governor's Office of Management and Budget, November 10, 2010.
[17] Chris Wetterich, "AFSCME, state need to find $90 million in savings," *The State Journal-Register*, October 7, 2010.
[18] Illinois Issues blog, "Senate again skips pension borrowing vote," November 4, 2010, http://illinoisissuesblog.blogspot.com/2010/03/education-cuts-or-tax-increase.html (last visited on November 8,

REVENUES

Governor Pat Quinn's recommended budget for FY2011 was based on total revenues of $52.8 billion.[20] This total included $27.4 billion in General Funds revenue, which are the sources of funding that legislative leaders and the Governor have the most discretion over during the annual appropriation process. The other components of the budget consist of Other State Funds, accounts for activities funded by earmarked revenue sources that may only be used for special purposes, and Federal Funds, funds from the federal government (other than those designated for General Funds) that support a variety of state programs.

The enacted budget for FY2011 was based on updated General Funds revenue estimates totaling $27.7 billion, an increase of 2.1% over year-end estimates for FY2010, which totaled $27.1 billion. This moderate increase would mark the first year of growth in the State's General Funds revenue since FY2008.

The following section provides an overview of the enacted General Funds revenue projections for FY2011, compares the estimates to year-end totals for FY2010 and explains some minor changes in revenue estimates from the recommended budget.

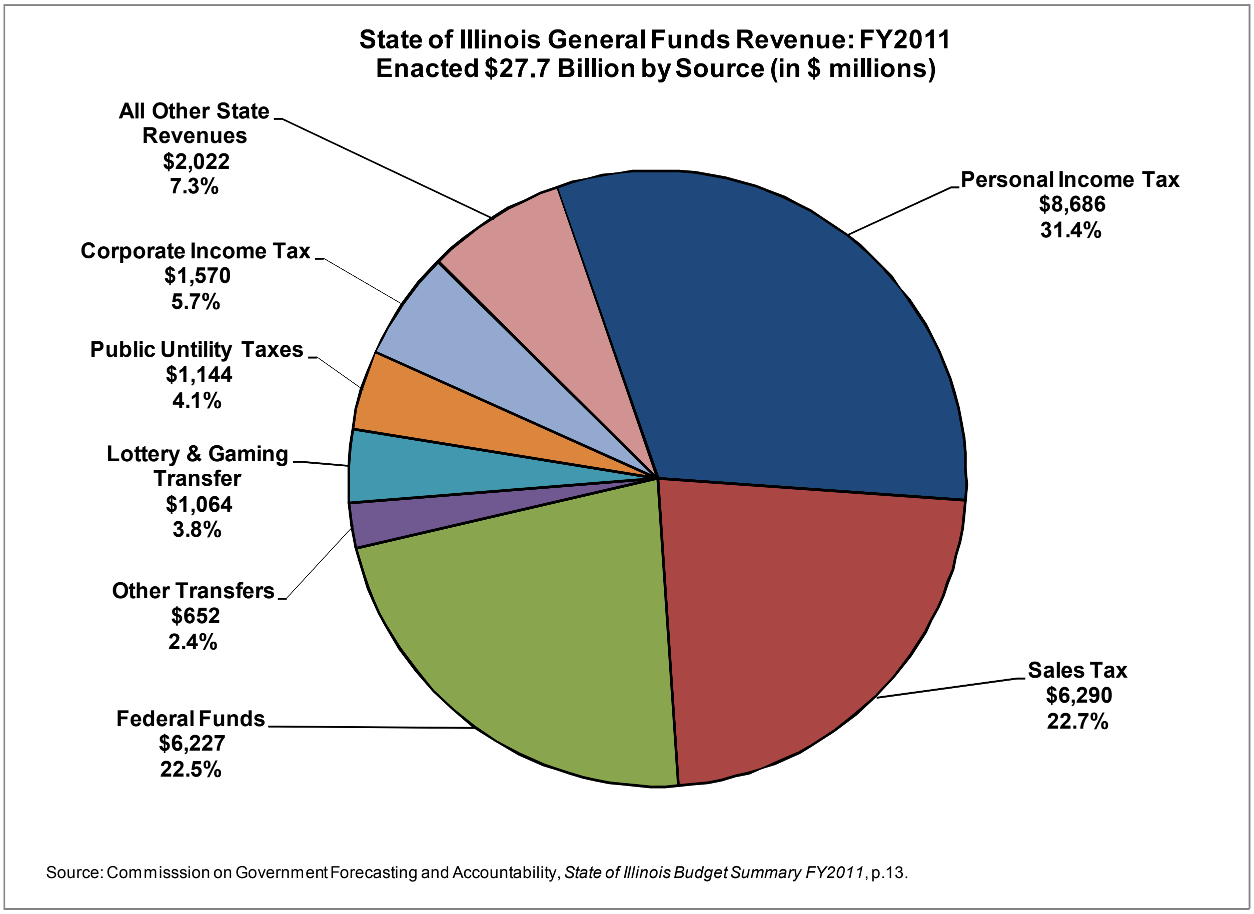
Total General Funds Revenue

Three major sources of revenue – income taxes, sales taxes and federal revenues – account for 82.3% of total General Funds revenue. The State estimates General Funds available to pay for operating expenditures in FY2011 will total $27.7 billion, of which $10.2 billion, or 37.1%, is attributed to the personal and corporate income taxes combined. Sales tax is projected to total $6.3 billion, or 22.7% of total General Funds. Federal funds make up $6.2 billion, or 22.5%, of General Funds revenue. The remaining sources are other state fees and taxes. The following chart shows total FY2011 General Funds revenue projections by source.

2010). During the veto session, the General Assembly considers bills vetoed by the Governor as well as new legislation.

[19] Dave McKinney, "Quinn: Put state income tax hike first," *Chicago Sun-Times*, November 8, 2010.

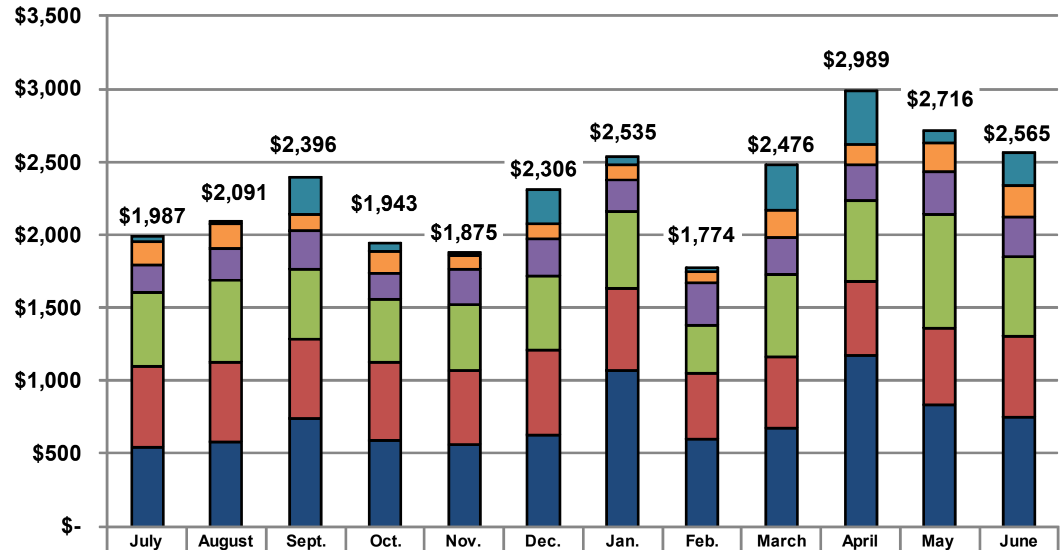
[20] Illinois State FY2011 Budget, p. 2-9.



Monthly Revenue Estimates

Collections of the various revenues that make up the General Funds vary on a monthly basis throughout the fiscal year. Depending on the pace of expenditures, this can lead to the need for short-term cash flow borrowing or increased delay in payments to vendors and other service providers. The State expects the highest total monthly revenue collections in April 2011, totaling nearly $3.0 billion, and the lowest in February 2011, totaling $1.7 billion. The average monthly General Funds revenue projected for the year is $2.3 billion. The following chart shows the monthly projections for all General Funds sources by month for FY2011.

State of Illinois Monthly General Funds Cash Flow Projections by Source: FY2011 (in $ millions)



	July	August	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	March	April	May	June
Total Monthly Revenues	$1,987	$2,091	$2,396	$1,943	$1,875	$2,306	$2,535	$1,774	$2,476	$2,989	$2,716	$2,565
Net Corporate Income Tax	$39	$20	$259	$54	$21	$229	$58	$28	$306	$368	$91	$223
Operating Transfers In	$160	$166	$113	$158	$95	$106	$100	$74	$189	$145	$193	$217
All Other State Revenue	$185	$217	$258	$178	$241	$256	$219	$295	$254	$243	$292	$278
Federal Funds	$509	$560	$483	$427	$447	$508	$527	$324	$565	$551	$779	$546
Sales Tax Revenue	$556	$546	$548	$542	$515	$583	$561	$452	$492	$510	$526	$553
Net Personal Income Tax	$538	$582	$735	$584	$556	$624	$1,070	$601	$670	$1,172	$835	$748

Source: State of Illinois, $1.3 billion General Obligations notes, *Official Statement,* July 12, 2010, p. 28.

Although some individual sources of revenue are volatile and total monthly revenues fluctuate during the year, overall quarterly revenue collection is relatively stable and grows slightly in the fourth quarter. The following chart shows the estimated total quarterly receipts as a percentage of projected total General Funds revenue for FY2011.

State of Illinois: FY2011 General Funds Quarterly Revenue (in $ millions)				
Fiscal Quarter	**Q1**	**Q2**	**Q3**	**Q4**
General Funds Revenue	$ 6,474	$ 6,124	$ 6,785	$ 8,270
% of Total General Funds	23.4%	22.1%	24.5%	29.9%

Source: State of Illinois, 1.3 billion General Obligations Notes, *Official Statement,* July 12, 2010, p. 28.

Despite these relatively stable quarterly revenue estimates, the State sold $1.3 billion in short-term bonds on July 12, 2010.[21] These bonds are due to be paid back in the fourth quarter of the fiscal year. However, this short-term borrowing was authorized under the failure of revenue provisions of the Illinois Short-Term Borrowing Act rather than the cash flow provisions.[22] The notice from the Governor proposing the borrowing explained that the loan was needed to make up for revenue shortfalls in FY2010 and a growing backlog of bills, which strained the State's cash balances at the end of FY2010 and depleted revenues in the beginning of FY2011. For more details on the State's deficit and unpaid bills, see the Budget Deficit and Unpaid Bills section of this report on page 18.

[21] Stat e of Illinois, $1.3 billion General Obligation Notes, *Official Statement,* July 12, 2010.
[22] 30 ILCS 340

Year-to-Year Comparison

The enacted FY2011 budget estimates that General Funds revenue will total $27.7 billion, an increase of $557 million, over the year–end estimates for FY2010 which totaled of $27.1 billion.[23] Although the increase is a moderate 2.1 %, this projection would mark the first year-over-year increase in General Funds revenues since FY2008.[24] The drop in revenues and projected stabilization in FY2011 coincide with the beginning and end of the 18-month national economic recession, which began in December 2007 and ended in June 2009, according to the National Bureau of Economic Research.[25] Although this extended period of economic downturn has technically ended, only moderate gains are projected in the three largest state sources of revenue: personal income tax, corporate income tax and the sales tax. The State did not enact an increase in the income tax rates as part of the enacted FY2011 budget, despite a suggested one-percentage point increase recommended by the Governor as a surcharge to fund education.[26]

Overall state-source revenues, including transfers, projected for the enacted FY2011 budget totaled $21.4 billion, or a $250 million increase over FY2010. Estimated income tax receipts, including both corporate and personal income tax, increased from $9.9 billion in FY2010 to $10.3 billion in FY2011, or 3.9%. The growth in corporate income tax totaled $210 million or 15.4% and personal income tax increased $175 million, or 2.1%. The gains reflect modest natural growth in the tax base as the overall economy is expected to continue a slow recovery.[27]

Federal sources of General Funds revenue are expected to increase by $307 million, or 5.2%, from $5.9 billion in FY2010 to $6.2 billion in FY2011. This increase is due to shifting Medicaid expenditures from FY2010 to FY2011 and shifting Medicaid expenditures in FY2011 from Other State Funds to General Funds.[28] Under the Medicaid program, the State pays for medical services for eligible low-income recipients and is reimbursed by the federal government for a specified percentage of its expenditures.

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[23] Commission on Government Forecasting and Accountability, *State of Illinois Budget Summary FY2011*, p. 13.
[24] Ibid., p. 26.
[25] The National Bureau of Economic Research, *Report of the Business Cycle Dating Committee*, September 10, 2010. http://www.nber.org/cycles/sept2010.pdf (last visited November 8, 2010.)
[26] Jamey Dunn, "Education cuts of a tax increase," *Illinois Issues blog*, March 10, 2010. http://illinoisissuesblog.blogspot.com/2010/03/education-cuts-or-tax- increase.html (last visited on October 29, 2010).
[27] Commission on Government Forecasting and Accountability, *State of Illinois Budget Summary*, p. 15.
[28] State of Illinois, $900 million General Obligation Bonds, Taxable Build America Bonds, *Official Statement*, July 14, 2010, pp. 21, 24, 25.

The following chart compares FY2010 General Funds revenue estimates from the end of FY2010 to the projected revenues used for the FY2011 enacted budget plan.

State of Illinois General Funds Revenue: FY2010 Year-End Estimated and FY2011 Enacted Budget Projections (in $ millions)				
	Estimated FY2010	Enacted FY2011	$ Change	% Change
Base Revenues				
State Sources				
Income Taxes (Net)	$ 9,871	$ 10,256	$ 385	3.9%
Personal (Net)	$ 8,511	$ 8,686	$ 175	2.1%
Corporate (Net)	$ 1,360	$ 1,570	$ 210	15.4%
Sales Taxes	$ 6,308	$ 6,290	$ (18)	-0.3%
Public Utility Taxes	$ 1,089	$ 1,144	$ 55	5.1%
Cigarette Taxes	$ 355	$ 350	$ (5)	-1.4%
Liquor Taxes	$ 159	$ 161	$ 2	1.3%
Vehicle Use	$ 30	$ 26	$ (4)	-13.3%
Tax Amnesty Proceeds	$ -	$ 250	$ 250	NA
Inheritance Taxes (Gross)	$ 243	$ 56	$ (187)	-77.0%
Insurance Taxes & Fees	$ 322	$ 350	$ 28	8.7%
Corporate Franchise Fees & Taxes	$ 208	$ 205	$ (3)	-1.4%
Interest on State Funds and Investments	$ 26	$ 35	$ 9	34.6%
Cook County Intergov. Transfer	$ 244	$ 243	$ (1)	-0.4%
Other State Sources	$ 431	$ 346	$ (85)	-19.7%
State Source Revenue	**$ 19,286**	**$ 19,712**	**$ 426**	**2.2%**
Transfers-In				
Lottery	$ 625	$ 636	$ 11	1.8%
Proceeds from 10th Riverboat License	$ 48	$ -	$ (48)	NA
Riverboat Gaming Taxes	$ 383	$ 428	$ 45	11.7%
Other Transfers	$ 836	$ 652	$ (184)	-22.0%
Subtotal State Sources	**$ 21,178**	**$ 21,428**	**$ 250**	**1.2%**
Federal Sources	$ 5,920	$ 6,227	$ 307	5.2%
Total Base Revenues	**$ 27,098**	**$ 27,655**	**$ 557**	**2.1%**

Source: Commission On Government Forecasting and Accountability, *State of Illinois Budget Summary FY2011,* p.13.

The State anticipates several changes to these estimated revenues since the FY2011 enacted budget was approved. Most significant are a statutory change in the State personal income tax refund rate, lower anticipated tax amnesty receipts and a reduction in the federal Medicaid reimbursement rate, as discussed below.

As part of the Emergency Budget Act for FY2011, the General Assembly reduced the proportion of personal income tax that is set aside to pay for anticipated refunds. The budget table above includes personal income tax receipts net of a refund rate of 9.75%. The actual refund rate enacted was lowered to 8.75%. This change is expected to increase net personal income tax revenues by $96 million and reduce the amount transferred to the fund used to pay for tax refunds by the same amount.[29]

The tax amnesty program, which allows delinquent taxes from periods between June 30, 2002, and June 30, 2009 to be paid without penalty, will not raise as much revenue as originally estimated. The program ran from October 1, 2010, to November 8, 2010, and is now expected to generate $100 million.[30] This is a 60.0% decrease from the $250 million estimate included in the enacted budget revenues.

The State of Illinois will also receive less federal Medicaid funding than the total included in the enacted budget for FY2011. On August 3, 2010, Congress passed and President Obama signed a bill extending enhanced Medicaid payments that were contained in the American Recovery and Reinvestment Act of 2009 but at a lower funding level than assumed in the State's enacted budget estimates.[31] The scaled-back benefits in the new law will lead to a total reduction of approximately $125 million in projected federal Medicaid General Funds revenue, according to the Governor's Office of Management and Budget.[32]

Enacted Revenue Estimates Compared to Governor's Recommended Budget

The FY2011 enacted budget is based on General Funds revenue projected to be $211 million or 0.8%, greater than the estimates included in the Governor's FY2011 budget recommendation. There were no changes in any of the major State source revenues such as income taxes or sales taxes. The State enacted a tax amnesty program to run from October 1, 2010 through November 8, 2010, originally estimated to generate revenues totaling $250 million not included in the proposed budget.[33] Vehicle Use Tax also increased in the enacted budget by $26 million. These increases were mostly offset by a $222 million decline in the Inheritance Tax, a 79.9% decrease from the Governor's recommended budget. The drop in Inheritance Tax was due to a coupling of the Illinois tax base tax with the Federal base that the proposed budget assumed would be ended in FY2011 but was not.[34]

Federal sources of General Funds revenue projected for the enacted budget increased by $195 million to $6.2 billion, up 3.2% from the total included in the Governor's recommended budget. This increase is attributed to a total increase in Medicaid reimbursements of $383 million from payments moved from FY2010 to FY2011, net of $188 million in reduced Medicaid reimbursements associated with reduced FY2011 Medicaid appropriations that will be reallocated to fund group health insurance payments.[35]

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[29] Commission on Government Forecasting and Accountability, State of Illinois Budget Summary FY2011, p. 13.
[30] Commission on Government Forecasting and Accountability, *State of Illinois Budget Summary FY2011*, p. 14.
[31] Senate Amendment 4575 to H.R. 1586, Teacher Jobs and State Fiscal Relief, August 3, 2010.
[32] Communication between Civic Federation Staff and Governor's Office of Management and Budget, September 17, 2010.
[33] Public Act 96-1435
[34] State of Illinois, $1.3 billion General Obligation Notes, *Official Statement*, July 12, 2010, p. 20.
[35] Ibid.

APPROPRIATIONS

This analysis focuses on General Funds, the largest component of the operating budget and the part of the budget over which the State has the most discretion and control.[36] The State incurs an operating deficit when expenditures from General Funds exceed General Funds revenues.

Between FY2009 and FY2011, the State's General Funds appropriations—the budget used to support the regular operating and administrative expenses of most state agencies—are expected to decline even as total spending from General Funds increases. Higher expenses for legislatively required pension contributions and debt-service payments will more than offset reductions in annual appropriations.

Appropriations by Fund

The FY2011 enacted General Funds budget of $25.8 billion is 2.0% below the FY2010 enacted General Funds budget of $26.4 billion. Enacted Other State Funds and Federal Funds were substantially unchanged from FY2010 to FY2011. The total enacted budget declined by 1.1% from $54.1 billion in FY2010 to $53.5 billion in FY2011.

State of Illinois Total Appropriations: FY2010 Enacted-FY2011 Enacted (in $ millions)

	FY2010 Enacted	FY2011 Enacted	$ Change	% Change
General Funds	$ 26,354	$ 25,814	$ (540)	-2.0%
Other State Funds	$ 17,533	$ 17,554	$ 21	0.1%
Federal Funds	$ 10,208	$ 10,146	$ (62)	-0.6%
Total	**$ 54,095**	**$ 53,514**	**$ (581)**	**-1.1%**

Source: Email communication between the Civic Federation and the Governor's Office of Management and Budget, November 4, 2010.

[36] The other components of the budget consist of Other State Funds, accounts for activities funded by earmarked revenue sources that may only be used for special purposes, and Federal Funds, funds from the federal government (other than those designated for General Funds) that support a variety of state programs.

The next table compares Governor Quinn's FY2011 recommended budget to the FY2011 enacted budget. For FY2011, the Governor recommended General Funds appropriations of $24.8 billion. The General Assembly passed a General Funds budget totaling $26.0 million. The Governor vetoed $155.2 million of the legislature's appropriations. In addition, roughly $43 million in planned re-appropriations were eliminated from the FY2011 budget because the funds had already been spent by the end of FY2010.[37]

The resulting FY2011 enacted budget of $25.8 billion is 4.2% higher than the Governor's recommended budget. The total enacted budget for FY2011 at $53.5 billion is 3% higher than the Governor's recommended total budget of $52.0 billion.

State of Illinois Total Appropriations: FY2011 Recommended-FY2011 Enacted (in $ millions)				
	FY2011 Recommended	FY2011 Enacted	$ Change	% Change
General Funds	$ 24,777	$ 25,814	$ 1,037	4.2%
Other State Funds	$ 17,436	$ 17,554	$ 118	0.7%
Federal Funds	$ 9,740	$ 10,146	$ 406	4.2%
Total	**$ 51,953**	**$ 53,514**	**$ 1,561**	**3.0%**

Source: Email communication between the Civic Federation and the Governor's Office of Management and Budget, November 4, 2010; Illinois State FY2011 Budget, p. 2-26.

Unspent appropriations are subtracted from total appropriations to calculate net appropriations, or the amount actually expected to be spent. For FY2011 unspent appropriations from General Funds reflect $891 million in reserves imposed by the Governor under the Emergency Budget Act of FY2011.[38] The Emergency Budget Act authorized the Governor to require reserves of up to roughly $1.6 billion, which cannot be spent unless released by the Governor or upon passage of new revenue sources.[39] Unspent appropriations from General Funds in FY2010 are currently estimated at $913.2 million but will not be determined until the end of the lapse period.[40] The lapse period, the period of time in the current fiscal year in which the State may pay bills from the previous fiscal year, ends on December 31, 2010 for FY2010.

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[37] Communication between the Civic Federation and the Governor's Office of Management and Budget, November 10, 2010.
[38] Public Act 96-958.
[39] Total reserves authorized by the Emergency Budget Act were up to one-third of total outstanding vouchers and statutory transfers that had not been executed as of July 1, 2010. The total was $4.712 billion, according to the State Comptroller.
[40] Email communication between the Civic Federation and the Governor's Office of Management and Budget, November 4, 2010.

The next table compares FY2010 estimated General Funds net appropriations with FY2011 enacted General Funds appropriations. After subtracting unspent appropriations, net appropriations decline by $518 million, or 2.0%, from an estimated $25.4 billion in FY2010 to an enacted $24.9 billion in FY2011.

State of Illinois General Funds Appropriations: FY2010 Estimated-FY2011 Enacted (in $ millions)				
	FY2010 Estimated	FY2011 Enacted	$ Change	% Change
Appropriations	$ 26,354	$ 25,814	$ (540)	-2.0%
Less Unspent Appropriations	$ (913)	$ (891)	$ 22	-2.4%
Net Appropriations	**$ 25,441**	**$ 24,923**	**$ (518)**	**-2.0%**

Source: State of Illinois, $900 Million General Obligation Bonds, Taxable Build America Bonds, *Official Statement*, July 14, 2010, p. 30; email communication between the Civic Federation and the Governor's Office of Management and Budget, November 4, 2010.

The FY2011 enacted General Funds budget of $25.8 billion is 4.2% higher than Governor Quinn's FY2011 recommended budget of $24.8 billion. After unspent appropriations, enacted net appropriations at $24.9 million are 2.6% greater than the Governor's recommended net appropriations at $24.3 million.

State of Illinois General Funds Appropriations: FY2011 Recommended-FY2011 Enacted (in $ millions)				
	FY2011 Recommended	FY2011 Enacted	$ Change	% Change
Appropriations	$ 24,777	$ 25,814	$ 1,037	4.2%
Less Unspent Appropriations	$ (496)	$ (891)	$ (395)	79.6%
Net Appropriations	**$ 24,281**	**$ 24,923**	**$ 642**	**2.6%**

Source: Illinois State FY2011 Budget, p. 2-10; State of Illinois, $900 Million General Obligation Bonds, Taxable Build America Bonds, *Official Statement*, July 14, 2010, p. 30; email communication between the Civic Federation and the Governor's Office of Management and Budget, November 4, 2010.

General Funds Appropriations by Agency

The FY2011 General Funds budget passed by the General Assembly included a total of approximately $3.5 billion in lump-sum appropriations to be allocated by the Governor.[41] Of the total, $2.2 billion was earmarked by the legislature for human services and the remainder was to be spent at the Governor's discretion.

The following table shows General Funds appropriations by major agency, after allocation of the lump sums and after the reserves that the Governor plans to impose under the Emergency Budget Act. [42] The totals at the bottom of each table are after unspent appropriations.

The Department of Human Services has the largest General Funds spending decline from FY2010, with appropriations reduced by $514.8 million, or 12.9%, from an estimated $4.0 billion in FY2010 to an enacted $3.5 billion in FY2011. According to the Governor's Office of Management and Budget, reductions in Human Services will affect state operations at local

[41] Public Act 96-956.
[42] State of Illinois, Governor's Office of Management and Budget, Governor's Office of Management and Budget Announces Spending Allocations for State Agencies, August 4, 2010, http://www2.illinois.gov/budget/Pages/default.aspx (last visited on October 26, 2010).

agency offices and state institutions and grants to non-Medicaid programs in mental health, developmental disabilities and rehabilitative services.[43]

The major agencies combined have a General Funds budget reduction of $541.9 million, or 2.2%, from an estimated $24.4 billion in FY2010 to a total of $23.8 billion in the FY2011 enacted budget. Four major agencies—the Departments of Healthcare and Family Services (HFS), Veterans' Affairs, Transportation and State Police—have General Funds budget increases. HFS, which administers the State's Medicaid program, shifted expenditures from General Funds to Other State Funds in FY2010.[44]

State of Illinois General Funds Appropriations by Major Agency: FY2010 Estimated-FY2011 Projected (in $ millions)				
	FY2010 Estimated	FY2011 Enacted	$ Change	% Change
Aging	$ 652.0	$ 627.8	$ (24.2)	-3.7%
Agriculture	$ 34.5	$ 30.1	$ (4.4)	-12.8%
Central Management Services	$ 88.0	$ 73.7	$ (14.3)	-16.3%
Children and Family Services	$ 962.1	$ 954.5	$ (7.6)	-0.8%
Commerce and Economic Opportunity	$ 46.7	$ 43.1	$ (3.6)	-7.7%
Natural Resources	$ 49.1	$ 46.4	$ (2.7)	-5.5%
Corrections	$ 1,154.0	$ 1,134.9	$ (19.1)	-1.7%
Human Services	$ 3,986.0	$ 3,471.2	$ (514.8)	-12.9%
Healthcare and Family Services	$ 7,223.9	$ 7,637.9	$ 414.0	5.7%
Public Health	$ 147.2	$ 139.3	$ (7.9)	-5.4%
Revenue	$ 128.0	$ 127.5	$ (0.5)	-0.4%
State Police	$ 264.9	$ 268.5	$ 3.6	1.4%
Transportation	$ 74.1	$ 79.0	$ 4.9	6.6%
Veterans' Affairs	$ 54.0	$ 68.2	$ 14.2	26.3%
State Board of Education	$ 7,270.8	$ 6,996.8	$ (274.0)	-3.8%
Board of Higher Education	$ 2,221.0	$ 2,115.5	$ (105.5)	-4.8%
Major Agencies	**$ 24,356.3**	**$ 23,814.4**	**$ (541.9)**	**-2.2%**
All Other Agencies	**$ 1,084.7**	**$ 1,309.0**	**$ 224.3**	**20.7%**
Unallocated Governor Lump Sum	$ -	$ (183.7)	$ (183.7)	NA
Total*	**$ 25,441.0**	**$ 24,939.7**	**$ (501.3)**	**-2.0%**

*FY2011 total is slightly higher than other numbers in this section because of adjustments after the August 4, 2010 news release by the Governor's Office of Management and Budget.

Source: State of Illinois, Governor's Office of Management and Budget, "Governor's Office of Management and Budget Announces Spending Allocations for State Agencies," news release, August 4, 2010, http://www2.illinois.gov/budget/Pages/default.aspx (last visited on October 26, 2010); email communication between the Civic Federation and the Governor's Office of Management and Budget, November 4, 2010.

The next table compares the Governor's FY2011 recommended General Funds budget by department with the FY2011 enacted General Funds budget. It should be noted that FY2011 recommended appropriations are before unspent appropriations, while FY2011 enacted appropriations are after unspent appropriations. The Governor's recommended General Funds budget totaled $24.8 billion, less than 1% below the enacted budget. However, the allocation of appropriations among departments shows notable differences. The Governor had proposed a $6.1

[43]State of Illinois, Governor's Office of Management and Budget, Governor's Office of Management and Budget Announces Spending Allocations for State Agencies, August 4, 2010, http://www2.illinois.gov/budget/Pages/default.aspx (last visited on October 26, 2010).
[44]State of Illinois, $900 Million General Obligation Bonds, Taxable Build America Bonds, *Official Statement*, July 14, 2010, p. 21.

billion General Funds budget for the State Board of Education, down $1.2 billion, or 17.0%, from an estimated $7.3 billion in FY2010. The FY2011 enacted budget restored much of that funding, bringing the Board of Education's General Funds budget back up to $7.0 billion. The Governor had proposed to reduce General Funds spending on Human Services by less than $100 million, from an estimated $3.986 in FY2010 to $3.887 billion in FY2011. The enacted budget reduces the Human Services budget by $415.7 million, or 10.7%, from the Governor's recommendation to $3.5 billion.

State of Illinois General Funds Appropriations by Major Agency: FY2011 Recommended-FY2011 Projected (in $ millions)*				
	FY2011 Recommended	FY2011 Enacted	$ Change	% Change
Aging	$ 613.8	$ 627.8	$ 14.0	2.3%
Agriculture	$ 32.8	$ 30.1	$ (2.7)	-8.2%
Central Management Services	$ 74.8	$ 73.7	$ (1.1)	-1.5%
Children and Family Services	$ 994.6	$ 954.5	$ (40.1)	-4.0%
Commerce and Economic Opportunity	$ 44.1	$ 43.1	$ (1.0)	-2.3%
Natural Resources	$ 46.9	$ 46.4	$ (0.5)	-1.1%
Corrections	$ 1,186.6	$ 1,134.9	$ (51.7)	-4.4%
Human Services	$ 3,886.9	$ 3,471.2	$ (415.7)	-10.7%
Healthcare and Family Services	$ 7,999.9	$ 7,637.9	$ (362.0)	-4.5%
Public Health	$ 130.6	$ 139.3	$ 8.7	6.7%
Revenue	$ 134.5	$ 127.5	$ (7.0)	-5.2%
State Police	$ 255.4	$ 268.5	$ 13.1	5.1%
Transportation	$ 83.3	$ 79.0	$ (4.3)	-5.2%
Veterans' Affairs	$ 65.2	$ 68.2	$ 3.0	4.6%
State Board of Education	$ 6,081.1	$ 6,996.8	$ 915.7	15.1%
Board of Higher Education	$ 2,117.2	$ 2,115.5	$ (1.7)	-0.1%
Major Agencies	**$ 23,747.7**	**$ 23,814.4**	**$ 66.7**	**0.3%**
All Other Agencies	**$ 1,027.3**	**$ 1,309.0**	**$ 281.7**	**27.4%**
Unallocated Governor Lump Sum	$ -	$ (183.7)	$ (183.7)	NA
Total**	**$ 24,775.4**	**$ 24,939.7**	**$ 164.7**	**0.7%**

*FY2011 recommended appropriations are before unspent appropriations, while FY2011 enacted appropriations are after unspent appropriations. Unspent appropriations totaled $496 million in the FY2011 recommended budget and are projected at $891 million in the FY2011 enacted budget.
**FY2011 total is slightly higher than other numbers in this section because of adjustments after the August 4, 2010 news release by the Governor's Office of Management and Budget.

Source: Illinois State FY2011 Budget, pp. 2-17 to 2-26; State of Illinois, Governor's Office of Management and Budget, *Governor's Office of Management and Budget Announces Spending Allocations for State Agencies,* August 4, 2010, http://www2.illinois.gov/budget/Pages/default.aspx (last visited on October 26, 2010).

Expenditures from General Funds

In addition to appropriations, General Funds are used to make statutorily required transfers to other funds. These transfers out include amounts dedicated to debt service and payments to local governments and Other State Funds.

The State has typically used General Funds to make pension contributions required under the funding schedule in Illinois' 1995 pension reform law. In FY2010, the State made its required contributions to Illinois' five retirement systems by issuing $3.5 billion in Pension Obligation Bonds. The pension payment for FY2011, certified at $4.2 billion, is not currently included in General Funds appropriations. The Illinois Senate is expected to consider a pension-borrowing plan that was previously passed by the House of Representatives during the veto session that begins on November 16, 2010.[45] Under state law, pension contributions are covered by continuing appropriations if not otherwise provided for in the budget.[46]

Total transfers out of General Funds increase by $1.2 billion in the enacted budget, or 38.3%, from $3.2 billion in FY2009 to $4.4 billion in FY2011. Debt service payments are increase by $1.5 billion, or 134.3%, while other transfers out are decline by $259 million, or 12.4%.

State pension contributions increased by $1.7 billion, or 67.2%, from $2.5 billion in FY2009 to $4.2 billion in FY2011. No pension contributions are shown from General Funds in FY2010, when the State issued bonds to make the required payments. The pension reform law enacted in April 2010 reduces benefits for new employees.[47] The Governor's Office has estimated that the new law could lower required contributions in FY2011 by $360 million.[48] However, the table does not include any such reductions because the retirement systems have as yet not officially amended their necessary funding requirements based on the new law. The last line in the table shows the trend in total spending from General Funds. Net appropriations before pension contributions are projected to decline by $2.4 billion, or 8.7%, from $27.3 billion to $24.9 billion. Yet because of growth in pension and debt service payments, total spending would increase by $526 million, or 1.6%, from $33.0 billion in FY2009 to $33.5 billion in FY2011. The following table shows the State's budget plans for the use of General Funds over the past two years.

State of Illinois General Funds Expenditures: FY2009-FY2011 (in $ millions)

	FY2009 Actual	FY2010 Estimated	FY2011 Enacted	$ Change FY2009-FY2011	% Change FY2009-FY2011
Appropriations	$ 27,796	$ 26,354	$ 25,814	$ (1,982)	-7.1%
Less Unspent Appropriations	$ (507)	$ (913)	$ (891)	$ (384)	75.7%
Net Appropriations before Pension Contributions	**$ 27,289**	**$ 25,441**	**$ 24,923**	**$ (2,366)**	**-8.7%**
Pension Contributions*	$ 2,486	$ -	$ 4,157	$ 1,671	67.2%
Net Appropriations After Pension Contributions	**$ 29,775**	**$ 25,441**	**$ 29,080**	**$ (695)**	**-2.3%**
Legislatively Required Transfers	$ 2,082	$ 2,242	$ 1,823	$ (259)	-12.4%
Debt Service Transfers for Capital Projects	$ 636	$ 670	$ 645	$ 9	1.4%
Debt Service on FY2010 Medicaid Borrowing	$ -	$ 63	$ 183	$ 183	NA
Pension Obligation Bond Debt Service	$ 466	$ 564	$ 1,754	$ 1,288	276.4%
Total Transfers Out	**$ 3,184**	**$ 3,539**	**$ 4,405**	**$ 1,221**	**38.3%**
Total General Funds Expenditures	**$32,959**	**$28,980**	**$33,485**	**$ 526**	**1.6%**

*In FY2010, pension contributions were paid from proceeds of sale of $3.5 billion In Pension Obligation Bonds.

Source: State of Illinois, $900 Million General Obligation Bonds, Taxable Build America Bonds, *Official Statement*, July 14, 2010, p. 30; email communication between the Civic Federation and the Governor's Office of Management and Budget, November 4, 2010.

[45]Illniois Issues blog, November 4, 2010, http://illinoisissuesblog.blogspot.com/2010/11/senate-again-skips-pension-borrowing.html (last visited on November 8, 2010). During the veto session, the General Assembly considers bills vetoed by the Governor as well as new legislation.

[46]State Pension Funds Continuing Appropriation Act (40 ILCS 15/0.1).

[47] Public Act 96-889.

[48]Office of the Governor, *Notice of Proposed Short Term Borrowing*, June 1, 2010, p. 2 (filed with the Secretary of the Senate).

BUDGET DEFICIT AND UNPAID BILLS

The State faced FY2011 with a total General Funds budget deficit projected at roughly $13 billion.[49] This section reviews changes in the deficit projection and examines the State's practice of financing the deficit by delaying payments to vendors.

Projected Year-End FY2011 Deficit

Illinois' $13 billion deficit going into FY2011 consisted of an operating shortfall of approximately $7 billion and an accumulated deficit from prior years of approximately $6 billion.[50] Since Governor Quinn presented his FY2011 recommended budget in March 2010, the total projected deficit has declined slightly to $12.3 billion, according to the Governor's Office of Management and Budget (GOMB).[51]

The total deficit for FY2011 is now projected at $12.3 billion because the accumulated deficit has grown to $6.5 billion and the operating shortfall is now forecast at $5.8 billion. The accumulated deficit from FY2010 increased because of lower than expected revenues and reduced savings from debt refunding. Meanwhile, the operating shortfall in FY2011 is projected to decline somewhat because of enacted budget cuts and expected revenue increases.

The next table shows the calculation of the year-end FY2011 deficit. Total expenditures from General Funds are subtracted from total General Funds resources to obtain the FY2011 operating shortfall. This is added to the accumulated deficit from prior years to get the total deficit.

State of Illinois FY2011 Projected Budget Deficit (in $ millions)	
Resources	
State Source Revenues	$19,712
Federal Source Revenues	$6,227
Subtotal Revenues	**$25,939**
Statutory Transfers In	$1,716
Total Resources	**$27,655**
Expenditures	
Appropriations	$25,831
Less Unspent Appropriations	($891)
Subtotal Net Appropriations Before Pension Contributions	**$24,940**
Pension Contributions	$4,157
Statutory Transfers Out	$4,406
Total Expenditures	**$33,503**
Operating Shortfall	**($5,848)**
Budget Fund Balance at Start of Year	**($6,475)**
Total Budget Deficit at End of Year	**($12,323)**

Source: State of Illinois, $900 Million General Obligation Bonds, Taxable Build America Bonds, *Official Statement* , July 14, 2010, p.30.

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[49] Illinois State FY2011 Budget, The Governor's Letter of Transmittal, March 10, 2010.
[50] See The Civic Federation, *State of Illinois FY2011 Recommended Operating and Capital Budgets: Analysis and Recommendations*, April 26, 2010, p. 22.
[51] State of Illinois, $900 Million General Obligation Bonds, Taxable Build America Bonds, *Official Statement*, July 14, 2010, p. 30.

The projected size of the FY2011 deficit will change over time because of changes in factors that affect the operating shortfall. For example, since GOMB made the projection above, Congress voted to reduce the amount of Medicaid funding that Illinois and other states will receive through June 30, 2011 under the American Recovery and Reinvestment Act of 2009.[52] That action is expected to cut General Funds revenues in Illinois by approximately $125 million, thus increasing the projected operating shortfall to $6.0 billion and the projected total deficit to $12.4 billion.

In addition, revenues from the State's tax amnesty program are now estimated to be below initial projections. The program allows anyone owing taxes from 2002 to 2009 to pay them without penalties or interest. When the program was being debated in the General Assembly, lawmakers were told that it would generate approximately $250 million. The Commission on Government Forecasting and Accountability has estimated the amount at $100 million.[53]

The projected deficit would decline if budgeted expenditures were reduced to account for the impact of the new pension reform law.[54] The Governor's Office has estimated that the law, which reduces pension benefits for new employees, could save the State $360 million on retirement system contributions in FY2011.[55] The impact of the new law has not been included in the budget plan because the retirement systems have not yet officially certified the revised contribution levels, as required by state statute.

Unpaid Bills

Illinois finances its deficit through borrowing. The next section of this report discusses the FY2011 enacted budget's provisions for issuing debt and borrowing from Other State Funds to close the General Funds operating shortfall. Delaying payments to state vendors and providers of state services is essentially another form of borrowing and is the way the State has dealt with its accumulated deficit from prior years.

As the State moved into FY2011, it was developing a national reputation for failing to pay human service agencies on time.[56] A report in October 2010 by the Urban Institute ranked Illinois as the worst state in the country for late payments to nonprofit human service organizations.[57] Of the non-profit groups surveyed in Illinois, 60% said delayed payments were a major problem, compared with a nationwide average of 24%. In Illinois, 54% said they had to reduce their staffs in 2009 because of financial problems and 31% said they had to reduce programs or services.

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[52] See The Civic Federation, Institute for Illinois' Fiscal Sustainability blog, "Medicaid Update: Illinois' Stimulus Funding Less Than Budgeted," September 23, 2010, http://civicfed.org/iifs/blog/medicaid-update-illinois%E2%80%99-stimulus-funding-less-budgeted (last visited on October 26, 2010).
[53] Doug Finke, "Tax amnesty program starts today in Illinois," *The State Journal-Register*, October 1, 2010.
[54] Public Act 96-889.
[55] Office of the Governor, *Notice of Proposed Short Term Borrowing*, June 1, 2010, p. 2 (filed with the Secretary of the Senate).
[56] Michael Powell, "Illinois Stops Paying Its Bills, But Can't Stop Digging Hole," *The New York Times*, July 3, 2010.
[57] Elizabeth T. Boris, Erwin de Leon, Katie L. Roeger and Milena Nikolova, *National Study of Nonprofit Government Contracting*, Urban Institute, October 7, 2010, p. 35. The report included agencies with contracts at the local, state and federal level, but 66% of the contracts held by respondents in Illinois were with the State.

The State ended FY2010 on June 30, 2010 with $4.7 billion in unpaid bills, according to the Comptroller's Office.[58] An additional $1.7 billion in unpaid bills were presented for payment in the two months ending August 31, 2010. FY2010 bills that required payment from FY2011 revenues thus totaled $6.4 billion, a record high for any lapse period.

The lapse period is the period in the current fiscal year in which bills from the past fiscal year can be paid.[59] Under Illinois law, state agencies may continue to use the previous year's spending authority to pay for last year's bills during the first two months of the current fiscal year.[60] With the State's fiscal year ending on June 30, this usually means that the State has until August 31 to pay bills from the prior fiscal year.

For FY2010, however, the law was amended by the Emergency Budget Act of 2011, which extended the lapse period for FY2010 through December 31, 2010.[61] Bills had to be approved by state agencies and submitted to the State Comptroller's Office by August 31, 2010. As of the end of September, the State still had $2.0 billion in bills remaining from FY2010, as well as $3.5 billion in new bills from FY2011. This backlog consisted of both unpaid bills to vendors and legislatively required transfers to local governments that had not been made.

The Governor's budget plan for FY2011 assumes that pension contributions will be made through borrowing rather than from General Funds. As of the publication date of this report, the General Assembly had not approved pension borrowing legislation. If such legislation is passed, the level of unpaid bills at the end of FY2011 would remain unchanged from the year-end FY2010 level of $6.4 billion. However, if pension contributions must be made from General Funds and no additional revenues are approved, the backlog of bills could increase by roughly $4 billion.

Illinois is also behind on payment of income tax refunds to businesses.[62] As of June 30, 2010, unpaid but approved corporate income tax refunds stood at $690.9 million, the highest level on record, according to the Illinois Department of Revenue. These liabilities are not accounted for in the State budget. The Governor's Office is forecasting a refund backlog of roughly $1.4 billion by the end of FY2011.[63]

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[58] Illinois State Comptroller, "State Bill Backlog Continues to Grow," *Comptroller's Quarterly*, October 2010, pp. 1-2.
[59] See The Civic Federation, Institute for Illinois' Fiscal Sustainability blog, "What is the Lapse Period and Why Should We Care," October 6, 2010, http://civicfed.org/iifs/blog/what-lapse-period-and-why-should-we-care (last visited on October 27, 2010).
[60] State Finance Act (30 ILCS 105/25).
[61] Public Act 96-958.
[62] See The Civic Federation, Institute for Illinois' Fiscal Sustainability blog, "State of Illinois Owes $730 Million in Corporate Refunds," August 19, 2010, http://civicfed.org/iifs/blog/state-illinois-owes-730-million-corporate-tax-refunds (last visited on October 27, 2010).
[63] Email communication between the Civic Federation and the Governor's Office of Management and Budget, September 16, 2010.

BORROWING FOR OPERATIONS

The State of Illinois' FY2011 enacted budget includes authorization to borrow $2.2 billion to pay for a portion of the State's $5.8 billion operating shortfall. The State approved borrowing an estimated $1.2 billion through the securitization of its tobacco settlement proceeds and an additional $1.0 billion from interfund borrowing. The approved borrowing for operations is $2.5 billion less than the "voucher payment notes," a generic borrowing plan included in the Governor's FY2011 proposed budget, which totaled $4.7 billion.[64]

However, a proposal to borrow an additional $3.7 billion to pay the State's required contribution to its retirement systems in FY2011 is still under consideration in the Senate and has already passed the House of Representatives.[65] If authorized, total borrowing for operations in FY2011 would increase to $5.9 billion or $1.2 billion more than originally proposed by the Governor in the FY2011 recommended budget.[66]

Although paying down the State's operating shortfall using debt can prevent the State's backlog of unpaid bills from continuing to grow in FY2011, it increases the strain on future budgets as the principal amounts plus interest are repaid. Borrowing for operations is a one-time revenue source and ensures that the same imbalance between expenditures and revenues will exist in subsequent fiscal years when the borrowed funds are no longer available.

The following section describes the borrowing for operations approved in the FY2011 enacted budget and compares the proposed FY2011 pension borrowing to the pension-related debt sold by the State in FY2010.

Interfund Borrowing

The Emergency Budget Act of FY2011 authorizes the Governor to transfer funds from the Special Funds of the State to pay for General Funds appropriations for up to 18 months. The legislation creates an irrevocable continuing appropriation to repay any transfers from General Funds in the future.[67] The State estimates it will borrow $964 million through interfund borrowing in FY2011 as part of the enacted budget.[68]

In the past, the State has transferred excess resources from the over 600 special funds that exist outside the General Funds budget as one-time revenue sources. Special Funds rely on specific fees, grants and statutorily required transfers from General Funds to pay for programs, provide grants or pay liabilities of the State outside the regular operating budget. In the past the amounts transferred to the General Funds annually were considered excess funding available to be spent on other State operations other than the designated purpose of the Special Funds. However, the funds taken out in FY2011, unlike other recent years, are loans that must be repaid. The State is also taking much more out of Special Funds than has been withdrawn in recent years. The following chart shows the State's total Special Funds transfers to the General Funds between

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[64] Voucher Payment Notes were simply described as, "a series of notes to pay specific vouchers during the fiscal year." Illinois State FY2011 Budget, p. 2-10.
[65] SB3514.
[66] Illinois State FY2011 Budget, p. 2-10.
[67] Emergency Budget Act of FY2011 (P.A. 096-0958).
[68] State of Illinois, $1.3 Billion General Obligation Notes, *Official Statement*, July 12, 2010, p. 26.

FY2003 and FY2010 compared to the amount the State plans to borrow from Special Funds for operations in FY2011.

State of Illinois Special Fund Transfers FY2003-FY2011 (in $ millions)	
Year	**Total**
FY2003	$ 165.0
FY2004	$ 522.3
FY2005	$ 505.8
FY2006	$ 305.1
FY2007	$ 314.5
FY2008	$ 34.3
FY2009	$ 27.7
FY2010	$ 287.2
FY2011 (proj.)	$ 964.0

Source: Commission on Government Forecasting and Accountability, State of Illinosi Budget Summary, pp. 12, 215.

Under the interfund borrowing authority, the State must also repay the amount of interest to the Special Funds that would have accrued had the money not been taken out of the account as determined by the State Treasurer. No individual fund may be reduced below the total appropriation for the fund for the next 12 months. The legislation prohibits the Governor from making additional transfers if the aggregate balance of all the Special Funds falls below the total short-term and long-term general obligation debt service owed by the State in the next 12 months.

The law also requires that the Governor's Office of Management and Budget prepare a detailed report on the interfund borrowing, including transfers made, transfers repaid and total fund balances to the legislative leaders and the Commission on Government Forecasting and Accountability (COGFA) on a quarterly basis. There is no requirement that these reports be distributed to the public, but COGFA typically produces several updates each year in its monthly briefing on the State's Special Funds. In October, the end of the State's first fiscal quarter, $309.4 million had been borrowed from the Special Funds through interfund transfers.[69]

Tobacco Settlement Securitization

The Emergency Budget Act of FY2011 establishes the Railsplitter Tobacco Settlement Authority.[70] This new bonding authority is authorized to sell some or all of the future revenues due to the Tobacco Settlement Fund. The State receives annual revenues to this fund from the settlement of its lawsuit against the tobacco industry. Illinois received a total of $9.1 billion in 1998 to settle its part of a multistate civic liabilities lawsuit against the tobacco industry.[71] Under the agreement, the State will receive annual installment payments from cigarette producers through 2025. The State estimates the payment for FY2011 to total $324 million, which is in line with the average payment the State has received in recent years.[72]

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[69] Commission on Government Forecasting and Accountability, *Monthly Briefing October 2010*, pp. 4-5.
[70] Emergency Budget Act of FY2011 (P.A. 096-0958).
[71] Illinois Economic and Fiscal Commission, *Illinois Cigarette Tax and Tobacco Settlement*, November 2002, p. 15. http://www.ilga.gov/commission/cgfa2006/Upload/IllinoisCigaretteTax.pdf (last visited on November 8, 2010)
[72] Illinois State FY2011 Budget, p-2-28.

Over the next three years, the Railsplitter Authority is authorized to sell up to $1.75 billion in debt secured by these payments. The bonds (also referred to as revenue notes) sold by the authority can have a term of no longer than 19 years. The revenue generated from the sale will be transferred to the General Funds after the requisite borrowing costs are paid. The State estimates that it will use $1.2 billion in revenues generated by the tobacco securitization in FY2011 to pay down its operating shortfall.[73] It is expected that the State will sell $1.5 billion total in notes to cover the borrowing expenses and other costs associated with the authority.[74] The structure of the authority shelters the State from the need to pledge its General Fund revenues in support of the sale of these bonds. Instead, the bonding authority will secure the pledged revenue stream on behalf of the State and take on any future liability for repayment of the notes sold. This type of debt sale avoids stressing General Funds resources in future budgets by using revenues outside the operating budget to repay the loan. However, these bonds are one-time revenues and will not be available for operations in the next fiscal year, leading to a continued operating shortfall in FY2012 and beyond.

Currently the annual tobacco settlement payments are used to pay for appropriations outside of the General Funds budget. Tobacco settlement payments to the State are deposited in the Tobacco Settlement Recovery Fund and included as appropriations of Other State Funds in the annual budget. The bonding authority is also authorized to deposit funds into the Tobacco Settlement Residual Account to pay for expenditures previously funded by the tobacco settlements from FY2011 through FY2013. If the current balances of the fund run out in future years and additional funds from the bond sale are not made available, annual appropriations previously funded by the tobacco settlement payments will need to receive funding from General Funds, establish a new revenue source or be eliminated entirely.

Proposed Pension Obligation Notes

The Governor's proposed FY2011 budget did not specifically include issuing additional General Obligation debt to pay for the State's required contribution to its retirement systems. However, the generic "voucher payment notes" included in the proposed budget plan later would be fleshed out to include pension borrowing as the largest part of the plan, encompassing $3.7 billion of the total $4.7 billion borrowing for operations proposal. As of the date of this publication, the General Assembly has not approved legislation authorizing the new pension borrowing.

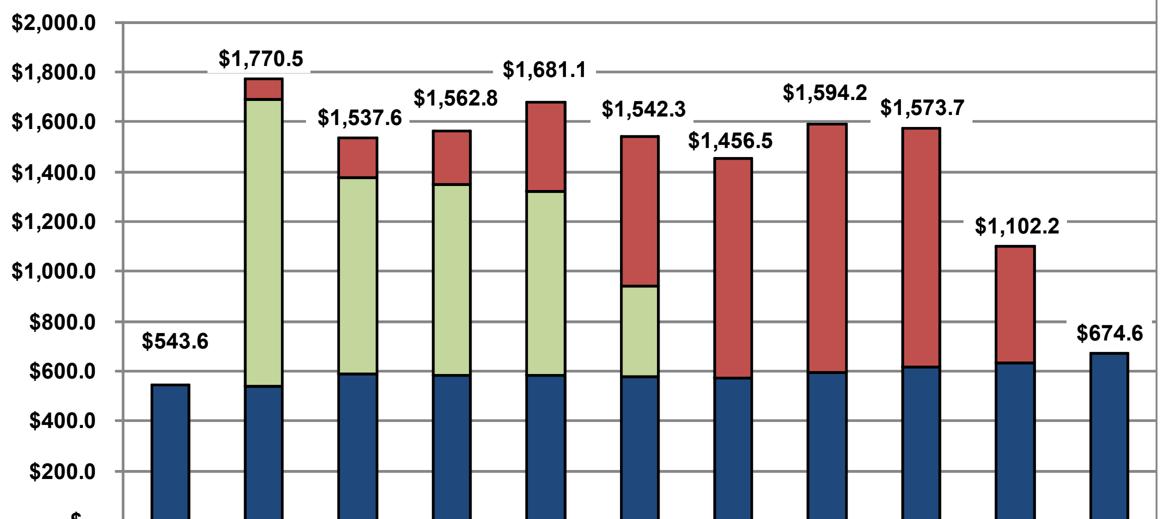
If approved, this would be the second year in a row that the State issued pension-related debt rather than making its required payment to the retirement systems out of operating revenues. In FY2010, the State sold $3.5 billion in Pension Obligation Bonds (POBs) to make its annual pension payment, effectively removing the cost from the operating budget. This allowed the State to use General Funds revenue to pay for other state services, rather than funding the pension systems. If borrowing to make the pension payment is not approved, State law dictates that pension contributions are covered by continuing appropriations if not otherwise provided for in the budget.[75] The legislation authorizing the sale of eight-year POBs was approved by the House of Representatives on May 25, 2010.[76] The bill also calls for the retirement systems to

[73] State of Illinois, $1.3 Billion General Obligation Notes, *Official Statement*, July 12, 2010, p. 26.
[74] 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 November 11, 2010)
[75] State Pension Funds Continuing Appropriation Act (40 ILCS 15/0.1).
[76] SB3514.

recertify the amount the State is required to pay in FY2011 to reflect pension reforms passed in the spring session that reduce benefits for new employees. The total is expected to decrease to roughly $3.7 billion if recertified. The bill authorizing the POBs for FY2011 did not advance in the Senate during the spring session or in a special session held on November 4, 2010. If the bill is approved when the General Assembly reconvenes later this month, the State will have sold a total of $17.2 billion of pension-related debt over the last decade. Selling the new bonds would also keep the State's average annual debt service due on its POBs above $1.5 billion until FY2020.

The following chart shows the projected debt service for the proposed $3.7 billion in new FY2011 POBs, the existing debt service from the $3.5 billion five-year POBs sold in FY2010 and the $10 billion long-term POBs sold in FY2003.

State of Illinois: Projected New And Existing Pension Obligation Bond Debt Service FY2010-FY2020 (in $ millions)



	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020
Total	$543.6	$1,770.5	$1,537.6	$1,562.8	$1,681.1	$1,542.3	$1,456.5	$1,594.2	$1,573.7	$1,102.2	$674.6
Series 2011 (proj.)	$-	$81.4	$162.8	$212.8	$360.6	$601.8	$882.0	$999.0	$959.0	$469.0	$-
Series 2010	$-	$1,147.2	$784.7	$763.6	$738.0	$361.9	$-	$-	$-	$-	$-
Series 2003	$543.6	$541.9	$590.1	$586.4	$582.5	$578.6	$574.5	$595.2	$614.7	$633.2	$674.6

Sources: Commission on Government Forecasting and Accountability, State of Illinois Budget Summary FY2011, p. 159; Email communication Between Civic Federation staff and the Governor's Office of Management and Budget, May 3, 2010.

The graph above illustrates the back-loaded nature of the POBs proposed for FY2011. The estimates included were provided by the Governor's Office of Budget and Management in May 2010, but the actual debt service would depend on market conditions at the time of sale. However, the structure shows that in order to make the annual debt service for the new bonds affordable, the State plans to pay only interest on the new POBs until FY2015. After the FY2010 POBs are fully repaid, the State would begin to pay down the principal of the FY2011 bonds. By not paying principal in the early years of the FY2011 POBs, the interest cost charged for the new debt will be dramatically higher than the FY2010 bonds. The FY2010 POBs cost the State a total of $381.7 million[77] in interest over five years, whereas the FY2011 bonds are projected to cost a total of $1.0 billion in interest for a similar amount of principal and only a slightly longer term.[78]

Selling the POBs will lead to increased debt service that must be paid out of General Funds revenues through FY2019. Borrowing for operational costs, such as the annual pension payment, is a one-time revenue source and only temporarily pays down the State's operating shortfall in the current fiscal year. Selling POBs ensures that a similar imbalance between available revenues and operating expenditures will exist in FY2012, when the borrowed funds are no longer available to make the annual pension payment.

POLICY AND FISCAL RECOMMENDATIONS

Governor Pat Quinn made several policy and fiscal proposals in connection with his recommended FY2011 budget. The General Assembly passed some of the Governor's proposals and passed some proposals that originated in the legislature. The following chart shows major policy and fiscal proposals, the Civic Federation's position and any final action reflected in the enacted budget.

State of Illinois FY2011 Budget: Policy and Fiscal Proposals

Proposal	Source	Civic Federation Position	Enacted Budget FY2011
Two-tiered pension system that reduces benefits for new employees, with long-term savings estimated to total $67 billion over 35 years.	**The Governor** referred to a plan for a two-tiered pension system in the FY2011 recommended budget but provided no specifics. The proposal was subsequently introduced in the **General Assembly** as Senate Bill 1946.	The Civic Federation **supported** the proposed two-tiered pension system as the first step toward comprehensive pension reform but **opposed** the partial pension holiday granted to the Chicago Public Schools in the law and urged the State to also apply the reforms to all police and fire pension funds and apply all of the reforms to the General Assembly and Judges systems. The Federation **continues to advocate for further pension reforms in Illinois.***	The General Assembly **passed** the two-tiered pension proposal and the Governor **signed** it into law (Public Act 96-889).
Increase personal income tax rate from 3% to 4% and **corporate income tax rate** from 4.8% to 7.2%.	The Governor stated his support for the tax increase, but the proposal was not included in his FY2011 recommended budget.	The Civic Federation **opposed** the tax increase because it was aimed primarily at reversing spending cuts rather than paying down the deficit or other growing state liabilities.	**No action** was taken by the General Assembly.
Decrease local governments' share of state income tax proceeds from 10% to 7%.	**The Governor** proposed the reduction in his FY2011 recommended budget.	The Civic Federation had **reservations** about shifting costs to other governments.	**No action** was taken by the General Assembly.
Ten-day sales tax holiday on certain clothing and school supplies to benefit families with schoolchildren.	The Governor proposed the sales tax holiday in his FY2010 recommended budget but not in his FY2011 recommended budget. The plan was introduced in the General Assembly as Senate Bill 3658.	The Civic Federation **opposed** the sales tax holiday proposed by the Governor in his FY2010 budget because the State could not afford to lose the revenues.	The General Assembly **passed** the sales tax holiday and the Governor **signed** it into law (Public Act 96-1012).
Tax amnesty allowing delinquent taxpayers to pay back taxes from June 30, 2002 to July 1, 2009 without penalties or interest.	Introduced in the **General Assembly** as Senate Bill 377.	The Civic Federation did not take a position.	The General Assembly **passed** the tax amnesty and the Governor **signed** it into law (Public Act 96-1435).
Budget reform requiring the establishment of spending priorities and performance measurement standards for state agencies.	Introduced in the **General Assembly** as Senate Bill 3839 and then incorporated into Senate Bill 3660.	The Civic Federation has long **supported** performance measurement as a way to help governments set spending priorities.	The General Assembly **passed** the budget reform provision and the Governor **signed** it into law (Public Act 96-958).

*Note: Additional pension reforms supported by the Civic Federation include tying the contributions of employers and employees to the actual financial needs of local pension funds, prohibiting all pension holidays, and reducing non-vested pension benefits for current employees.

[77] Commission on Government Forecasting and Accountability, *State of Illinois Budget Summary FY2011*, p. 159.
[78] Email communication between Civic Federation staff and the Governor's Office of Management and Budget, May 3, 2010.