The Institute for Illinois' Fiscal Sustainability

AT THE CIVIC FEDERATION

A FISCAL REHABILITATION PLAN FOR THE STATE OF ILLINOIS:

An Analysis of the State's Fiscal Crisis and Actionable Recommendations for Governor Pat Quinn and the Illinois General Assembly

February 22, 2010

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

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TABLE OF CONTENTS

EXECUTIVE SUMMARY

This report describes the basis of the State of Illinois' fiscal crisis and presents the Civic Federation's plan for rehabilitating the State's finances. The plan proposes measures to substantially reduce the current budget deficit in FY2011 and to place the State on better fiscal footing over the long term through fundamental reforms of expenditures and revenues.

Illinois' Fiscal Crisis

Illinois is facing a financial crisis that is expected to result in a deficit of at least $12.8 billion going into fiscal year 2011, which begins on July 1, 2010. As in other states, the economic recession that started in December of 2007 has contributed significantly to Illinois' poor fiscal health.

However, Illinois also entered the recession in worse fiscal condition than most other states because of a failure to deal with its structural deficit, a situation in which a government's growth in expenditures consistently outpaces its growth in revenues. One of the biggest problems has been Illinois' historically underfunded retirement systems, which have put increasing pressure on the State's operating budget.

The Civic Federation Plan

After considering actions taken by other states and proposals from other civic organizations and lawmakers, the Civic Federation has concluded that the scope of the State's fiscal crisis requires a combination of remedies. The problem is too large to be solved solely by budget cuts or tax increases.

The Civic Federation is deliberately proposing this plan as a comprehensive package. Without pension reforms and spending cuts included in this plan, the Civic Federation opposes any new revenue increases.

The Civic Federation offers the following proposal:

- The State must first enact reforms of its retirement systems. These reforms must include additional employee contributions and reduced benefits for new State employees.
- Expenditures must be cut by at least $2.1 billion. General Funds spending should be rolled back to FY2007 levels, with the exception of Medicaid and General State Aid to elementary and secondary education. These areas will be kept at FY2010 levels to prevent loss of federal stimulus funds and protect critical funding to local school districts.
- Employee contributions to the retirement systems and the State's group health insurance plan must be increased. Along with other changes detailed in the report, these measures are expected to save the state more than $400 million.
- The Civic Federation opposes any revenue increases until pension reforms are undertaken and at least $2.5 billion in budget cuts and savings have been made.
- The state income tax rate should be increased from 3% to 5 % for individuals and 4.8% to 6.4% for corporations. This increase is expected to raise about $6.0 billion in new revenues.
- The State should repeal the income tax exemption for federally taxed portions of retirement and Social Security income. This step is expected to raise $1.6 billion at the personal income tax rate of 5%.

- The State should enact a $1 a pack increase in cigarette taxes and end specific business tax deductions or credits that are outdated and economically inefficient, such as the income tax credit for research and development.
- If this budget plan were enacted, the State would pay down more than $10 billion or nearly 84% of its $12.8 billion deficit in FY2011.
- Because the remaining $2.1 billion budget gap would not be closed until FY2012, the State should continue to spend at FY2007 levels until the backlog of bills associated with the deficit are paid off.
- All other new revenue in FY2012 and beyond will be needed to make the required statutory pension contribution, which will increase in future years.

The Civic Federation also supports and recommends that the State consider longer-term proposals, including reducing non-vested pension benefits for current state employees; shifting state Medicaid spending from institutional care for the elderly and disabled to home- and community-based care; and consolidating the State's hundreds of special purpose funds to allow for maximum flexibility in allocating resources to meet policy priorities. The Federation recommends that the State study the feasibility of extending the sales tax to consumer services to broaden Illinois' tax base as a means of additional revenue and reducing the unsustainably high sales tax rate in Cook County. The Civic Federation also supports examining the merits of adopting a constitutional amendment authorizing a graduated income tax.

Major Budget Trends

The Civic Federation's plan was based on the following findings on the State's fiscal crisis:

- The State will enter FY2011 with an estimated $12.8 billion deficit. The FY2011 deficit is primarily a result of an estimated $5.7 billion deficit carried over from FY2010 as well as a statutorily required contribution of $4.1 billion to the retirement systems to be made from General Funds instead of pension note proceeds.
- The State has an estimated total of $25.4 billion in outstanding long-term debt, an increase of $17.0 billion or 200.9% from FY2001, with more than half of the existing debt consisting of pension obligation bonds. Required debt service in FY2011 is estimated at $2.7 billion, up 162% since FY2001.
- Between FY2010 and FY2033, the State is expected to pay a total of $22.7 billion in debt service on outstanding pension obligation bonds.
- The State has run a General Funds deficit every year since FY2002, usually because of a deficit carrying over from the prior fiscal year.
- The unfunded liabilities of the State's five retirement systems currently stand at $62.4 billion and the combined funded ratio of 50.6%, as of June 30, 2009.
- Statutorily required state pension contributions are projected to increase by an annual average of 12.2% from FY2010 through FY2045, from $4.0 billion to $21.4 billion, to meet the funding requirement of 90% by 2045.
- Total state expenditures for elementary and secondary education have increased by 51.4% to $11.0 billion in FY2009 from $7.2 billion in FY2001. During the same period, total state expenditures increased by 33.9% and inflation grew by 22.6%.
- Total Medicaid spending has increased an estimated 72.6% to approximately $14.5 billion in FY2009 from $8.4 billion in FY2001. State-source General Funds expenditures on Medicaid were estimated at $4.4 billion in FY2009, up 35.6% from $3.2 billion in FY2001.

- State employee health insurance costs have increased an estimated 92.9% to $2.1 billion in FY2010 from $1.1 billion in FY2001.
- Inflation-adjusted General Funds revenues declined by an estimated 5.1% from FY2001 to FY2010.
- Inflation-adjusted General Funds revenues declined by an estimated 6.9% from FY2008 to FY2010 due to reductions in economically sensitive revenues such as income taxes and sales taxes.
- Inflation-adjusted total revenue**s** increased by an estimated 22.2% from FY2001 to $54.7 billion in FY2010.
- General Funds revenues, the revenue source over which the State has most discretion, declined to an estimated 51.5% of total revenues in FY2010 from 66.4% in FY2001. Other State Funds and Federal Funds increased to an estimated 48.4% of total revenues from 33.8% over the same period.
- Inflation-adjusted General Funds expenditures decreased by an estimated 3.8% from FY2001 to FY2010. FY2010. However, FY2010 projected General Funds expenditures do not include the State's required pension contribution of $3.5 billion, which is being made from borrowed funds. Inflation-adjusted General Funds expenditures increased by 9.6% from FY2001 to FY2009.
- The number of authorized full-time equivalent state jobs is expected to decline 20.4% to 55,701 positions in FY2010 from 69,970 in FY2001, and payroll expenditure per employee has risen in line with the rate of inflation.

THE STATE OF ILLINOIS' FISCAL CRISIS

The State of Illinois is facing a financial crisis that is expected to result in a deficit of at least $12.8 billion going into fiscal year 2011, which begins on July 1, 2010. As in other states, the economic recession that started in December of 2007 has contributed significantly to Illinois' poor fiscal health. Personal income taxes—the largest revenue source for the State's general operations—are projected to drop by 21.4% or $2.6 billion from the end of FY2008 through the end of FY2010.

However, Illinois also entered the recession in worse condition than most other states.[1] For years, the State has failed to come to terms with its structural deficit, a situation in which a government's growth in expenditures consistently outpaces its growth in revenues. Instead of fixing the problem, the State has put off paying its bills and used one-time revenue sources such as borrowing to mask the shortfall. One of the biggest problems has been its historically underfunded retirement systems. At times, Illinois has made the pension contributions required by law and diverted funds from other state needs. In other years, the State has made reduced pension payments or borrowed to pay for its contributions, both of which shift costs into the future.

The combination of long-term financial mismanagement and a severe recession left Illinois with a $3.95 billion backlog of unpaid bills going into FY2010. So far this year, the State has made only modest budget cuts and taken no steps to increase regular revenues, relying instead on borrowing, federal aid and other one-time revenue sources. The result is expected to be an increase of almost $2 billion in the backlog of unpaid bills by the end of FY2010.[2] Illinois has received the second-lowest debt rating of any state from the three major credit-rating agencies, ranking only ahead of California, and all three rating agencies have expressed concerns about the State's willingness or ability to deal with its financial problems.[3]

This report provides a detailed description of the budgetary trends that led to Illinois' current financial condition. Appendix 1 supplies additional information on the data used in the report. To evaluate potential approaches to fixing the State's problems, the report reviews actions taken by several other states and solutions proposed by other Illinois civic organizations and by lawmakers. After examining different options for solving the State's budget crisis, the report concludes by describing the plan recommended by the Civic Federation.

The urgency of the situation has become apparent across Illinois, with many residents, public employees, social service agencies and local governments facing substantial difficulties because of the State's financial problems Budget cuts have led to reductions in state-funded services for some of Illinois' lowest income citizens.[4] Illinois' backlog of unpaid bills has risen to

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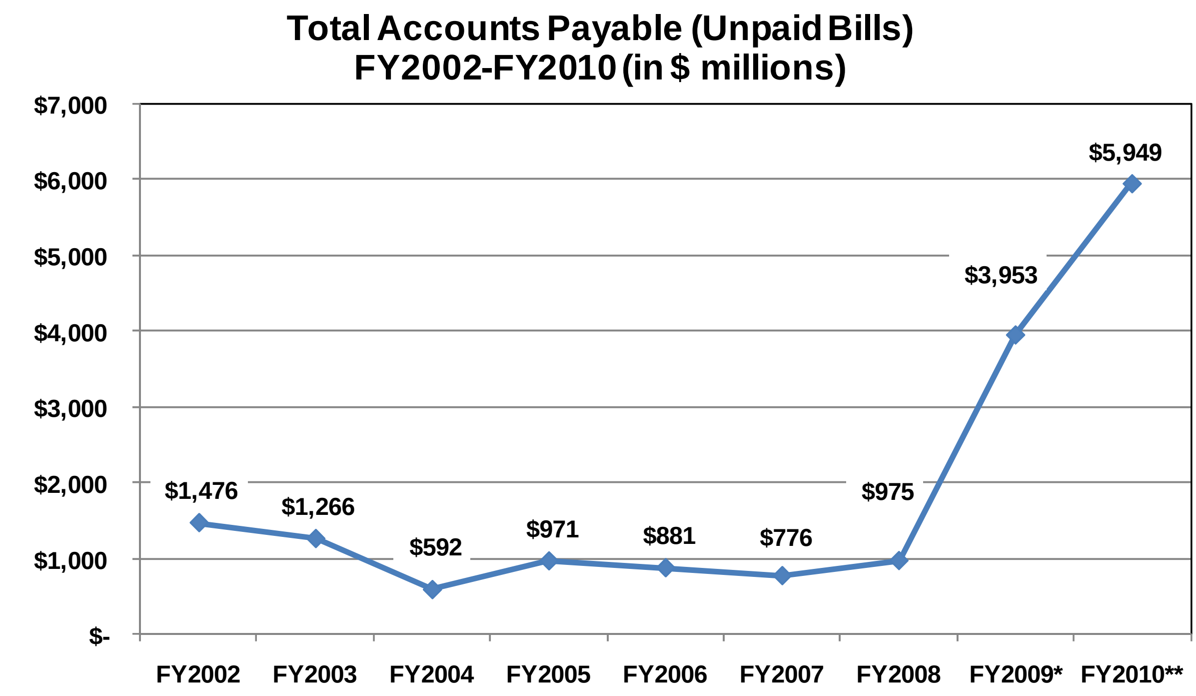
[1] The Pew Center on the States, *Beyond California: States in Fiscal Peril*, November 2009, pp. 47-49, at http://downloads.pewcenteronthestates.org/BeyondCalifornia.pdf (last visited on February 12, 2010).
[2] State of Illinois, $3.466 Billion General Obligation Bonds Taxable Series of January 2010, *Official Statement*, January 7, 2010, p. 22.
[3] Bloomberg.com, "Muni Bond Sales Rise Almost 30%, Led by larger Hawaii Offering," February 12, 2010, at http://www.bloomberg.com/apps/news?pid=20602095&sid=abSS7MjkbvVs (last visited on February 12, 2010).
[4] Paul Swiech, "With State Payments Still Late, Human Service Agencies Consider Cuts," *The Pantagraph*, January 13, 2010, at http://www.pantagraph.com/news/local/article_880c2030-000d-11df-933f-001cc4c002e0.html (last visited on January 22, 2010).

unprecedented levels and the lag time in paying bills has nearly doubled from a year earlier.[5] Some social service agencies that rely on state funding are facing severe financial stress.[6] Record payment delays are also affecting grants to local school districts and payments to universities, local governments and transit districts.[7] Because the State is taking so long to pay health insurance claims for state employees, some doctors are reportedly requiring patients who work for the State to pay for their treatment in advance.[8]

The chart below shows the trend in unpaid bills from the end of FY2002 through FY2010. The latest projection of $5.9 billion in unpaid bills at the end of the current fiscal year represents 20.4% of total estimated General Funds expenditures of $29.2 billion.[9]



*Estimated, **Projected.
Source: State of Illinois Budget Book FY2003-FY2010,
State of Illinois, $3.446 Billion General Obligation Bonds Taxable Series of January 2010, *Official Statement*, January 7, 2010, p.22; Illinois State Budget, various fiscal years.

At the end of December of 2009, the backlog of unpaid bills at the Illinois Office of the Comptroller stood at $5.1 billion, up from $1.8 billion at the same time a year earlier.[10] The

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[5] Illinois Office of the Comptroller, "Fiscal Position Continues Downward Slide," *Comptroller's Quarterly*, January 2010, p. 1, at http://www.ioc.state.il.us/ioc-pdf/CQJanuary10.pdf (last visited on January 25, 2010).
[6] AARP Illinois, "State $200 Million Behind in Payments to Agencies Providing Care to Thousands of Older Illinoisans," news release, December 10, 2009, at http://www.aarp.org/community/portfolio/journals/getBlogEntryByMonth.jsp?membername=AARPIL&monthNum=11&year=2009 (last visited on January 22, 2010).
[7] Illinois Office of the Comptroller, Illinois Office of the Comptroller, "Fiscal Position Continues Downward Slide," *Comptroller's Quarterly*, January 2010, p. 2.
[8] Dean Olsen, "Payment Squeeze Continues to Cut into Social Service Budgets," *The State Journal-Register*, January 15, 2010, at http://www.behealthyspringfield.com/sections/local-news/payment-squeeze-continues-to-cut-into-social-service-budgets (last visited on January 25, 2010).
[9] State of Illinois, $3.466 Billion General Obligation Bonds Taxable Series of January 2010, *Official Statement*, January 7, 2010, p. 22.

delay in paying bills was as long as 92 business days at the end of December, compared with at most 48 days a year earlier. Transfers to Other State Funds from General Funds were delayed as much as 122 days at the end of December. According to the Comptroller's Office, both the bills backlog and the payment delays were at record levels for this point in the fiscal year.[11] In addition to the $5.1 billion in unpaid bills at the Comptroller's Office, the Department of Healthcare and Family Services was holding an estimated $1.4 billion in Medicaid and group health insurance claims that could not be paid because funds were not available. The State has been taking nearly eight months to pay some group health insurance claims, leading to the need for employees to front the entire cost of treatment to doctors and wait to receive reimbursement from the State.[12]

Some social service agencies have said they will be forced to lay off workers and shut their doors if they do not get paid. In December, AARP Illinois and the Illinois Association of Community Care Program Home Care Providers announced that the State owed $200 million to 175 social-service agencies for the elderly.[13] If overdue bills were not paid, dozens of agencies would have to curtail home and community-based services, causing seniors to be placed in more expensive nursing homes, the two organizations said in a news release. Private agencies that serve children and young adults are also facing severe financial stress, according to the Illinois Human Services Coalition.[14] As of mid-December, the agencies represented by the Child Care Association of Illinois were owed roughly $23.5 million, the coalition said in a news release. Because the State has not paid its bills, child-service agencies have turned to bank loans to meet their expenses and are incurring borrowing costs that will not be recouped.[15] A survey of youth-service agencies conducted over the holidays by the Illinois Collaboration on Youth found that 22 programs were at risk of closing within the next one to three months because they have not been paid.[16]

Local school districts have also faced problems because of delayed payments. Delays in paying out categorical grants to school districts and other educational grant recipients, including pre-school programs, accounted for more than $1 billion of the $5.1 billion backlog at the Comptroller's Office at the end of December.[17] Categorical grants are grants given to districts for a specific purpose and must be used in a specific way. Chicago Public Schools could be owed

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[10] Illinois Office of the Comptroller, Illinois Office of the Comptroller, "Fiscal Position Continues Downward Slide," *Comptroller's Quarterly*, January 2010, p.1.
[11] Ibid, p.1.
[12] Illinois Department of Central Management Services, "Notice Regarding QCHP and QCDP Claim Payment Delay," at http://cms.illinois.gov/cms/download/pdfs_benefits/Claim_Payment_Delay.pdf (last visited on January 25, 2010).
[13] AARP Illinois, "State $200 Million Behind in Payments to Agencies Providing Care to Thousands of Older Illinoisans," news release, December 10, 2009, at http://www.aarp.org/community/portfolio/journals/getBlogEntryByMonth.jsp?membername=AARPIL&monthNum=11&year=2009 (last visited on January 22, 2010).
[14] Illinois Human Services Coalition, "Human Services Groups Urge Governor, Treasurer, and Comptroller to Agree to Short-Term Borrowing to Speed Payments to Vendors," news release, December 17, 2009, at http://childcareillinois.wordpress.com/2009/12/17/illinois-human-services-coalition-urges-governor-quinn-treasurer-giannoulias-and-comptroller-hynes-to-agree-to-short-term-borrowing-to-pay-state-vendors/ (last visited on January 25, 2010).
[15] Phone communication between the Civic Federation and Marge Berglind, CEO of the Child Care Association of Illinois, January 25, 2010.
[16] Email communication between the Civic Federation and Amanda Bogdanski, Illinois Collaboration on Youth's Youth Network Council, January 27, 2010.
[17] Illinois Office of the Comptroller, "Fiscal Position Continues Downward Slide," *Comptroller's Quarterly*, January 2010, p. 2.

as much as $200 million, a spokeswoman said.[18] The Oswego School District 308 said in a news release on January 6, 2010 that it had received only about $39,000 of its promised $14.3 million in categorical grants.[19] The amounts paid by the State to District 308 were $700 for the free and reduced food programs and $38,500 for drivers' education. Grants still unpaid included money for transportation, special education and reading improvement. The district said it would need to obtain bank loans to meet its cash flow needs, incurring interest costs on the borrowing. The district also expects to limit programs funded by categorical grants.

State universities and community colleges were owed more than $775 million at the end of December of 2009.[20] The State is $431 million behind in payments to the University of Illinois, or about six months worth of the university's total appropriated state support of more than $760 million.[21] In response, the University of Illinois has cut employees' pay, frozen hiring and required that furlough days be taken. University officials have said that a tuition hike of at least 9% is likely for next year.[22] On February 9, 2010, officials of the University of Illinois and other public universities in the State wrote a letter to Governor Pat Quinn and Comptroller Dan Hynes, urging that the financial crisis be resolved and that they be given a reliable schedule for the payment of the State's appropriation.[23]

Payments owed to local government and transit districts totaled over $478 million at the end of December of 2009.[24] The State owes Chicago area transit agencies $250 million, according to the Regional Transportation Authority.[25] The RTA is borrowing as much as $260 million to help the CTA, Metra and Pace meet their expenses, at a cost of more than $5 million in interest. RTA officials said service cuts might be necessary if payment problems continue into the summer. In a letter to the Governor, the RTA said it was nearing a crisis point regarding funding for current expenses.[26]

The backlog of bills was reduced somewhat by the sale of $3.5 billion in pension bonds on December 15, 2009. Approximately $843 million of the proceeds went the State's General

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[18] Ray Long and Michelle Manchir, "Illinois Budget Woes: State's Unpaid Bills Hit a Record $5 Billion, and the Cries of Pain Are Getting Louder," *Chicago Tribune*, January 11, 2010, at http://www.chicagotribune.com/news/elections/chi-state-budget-woesjan11,0,5766450.story (last visited on January 25, 2010).

[19] Oswego Community Unit School District 308, "State's Inability to Pay its Bills Leaves School Districts Holding the Bag," January 6, 2010, news release, at http://www.oswego308.org/news/default.aspx?ArticleId=790 (last visited on January 25, 2010).

[20] Illinois Office of the Comptroller, "Fiscal Position Continues Downward Slide," *Comptroller's Quarterly*, January 2010, p. 2.

[21] Presentation to the Civic Federation Board of Directors by Stanley Ikenberry, President of the University of Illinois, February 9, 2010, at http://www.uillinois.edu/president/speeches/2010/Feb9.CivicFederation.cfm (last visited on February 10, 2010).

[22] Jodi S. Cohen, "U. of I. to Increase Tuition at Least 9 Percent," *Chicago Tribune*, January 21, 2010, at http://www.chicagotribune.com/news/local/chicago/ct-met-0122-u-of-i-tuition-20100121,0,6314357.story (last visited on January 26, 2010).

[23] http://www.uillinois.edu/president/media/JointStatement/PresChan.Letter.pdf (last visited on February 10, 2010).

[24] Illinois Office of the Comptroller, "Fiscal Position Continues Downward Slide," *Comptroller's Quarterly*, January 2010, p. 2.

[25] Richard Wronski, "RTA's Unpaid Bills In $250 Million Dollar Range," Chicago Tribune, January 22, 2010, at http://www.chicagotribune.com/news/local/chicago/ct-met-0122-rta-unpaid-bills-20100121,0,116059.story (last visited on January 25, 2010).

[26] Richard Wronski, "RTA Says It Is Nearing 'Crisis Point' on State Funding," *Chicago Tribune*, February 18, 2010, at http://www.chicagobreakingnews.com/2010/02/rta-says-it-is-nearing-crisis-point-on-state-funding.html (last visited on February 18, 2010).

Funds.[27] The $843 million was used to reimburse the General Funds for payments made to the retirement systems. Governor Pat Quinn has tried unsuccessfully to win support for a series of short-term borrowing plans to ease the cash squeeze, including plans to borrow $900 million and $500 million.[28] A bill that was approved on January 12, 2010 by the Illinois House of Representatives would allow the State to borrow $250 million to bring in federal Medicaid matching funds and pay off some of its overdue bills to medical providers.[29] However, the state has not enacted this bill or taken out these loans.

By the end of January, the State had enough revenue to reduce the backlog of bills to $3.1 billion, of which the Comptroller's office said $1.3 billion were more than 60 days overdue.[30] However, the total has grown since then and is expected to reach $5.9 billion by the end of the fiscal year on June 30, 2010. The total of the State's unpaid bills reportedly stood at $3.8 billion as of February 18, 2010.[31]

[27] Ray Long and Michelle Manchir, "Illinois Budget Woes: State's Unpaid Bills Hit a Record $5 Billion, and the Cries of Pain Are Getting Louder," *Chicago Tribune*, January 11, 2010, at http://www.chicagotribune.com/news/elections/chi-state-budget-woesjan11,0,5766450.story (last visited on January 25, 2010).

[28] Rick Pearson, "Illinois Borrows to Stay Afloat," *Chicago Tribune*, November 2, 2009, at http://www.chicagotribune.com/news/elections/chi-quinn-borrowing-091102,0,5321305.story (last visited on January 26, 2010); Monique Garcia, "Dan Hynes Blocks Gov. Quinn's Borrowing Plans," *Chicago Tribune*, December 6, 2010, at http://www.chicagotribune.com/news/elections/chi-hynes-quinn-budget-05dec06,0,1921517.story (last visited on January 26, 2010).

[29] Senate Bill 1425 at http://www.ilga.gov/legislation/fulltext.asp?DocName=09600SB1425ham002&GA=96&SessionId=76&DocTypeId=SB&LegID=42694&DocNum=1425&GAID=10&Session= (last visited on January 26, 2010).

[30] Communication between Civic Federation staff and the staff of the Illinois State Comptroller's Office, January 26, 2010.

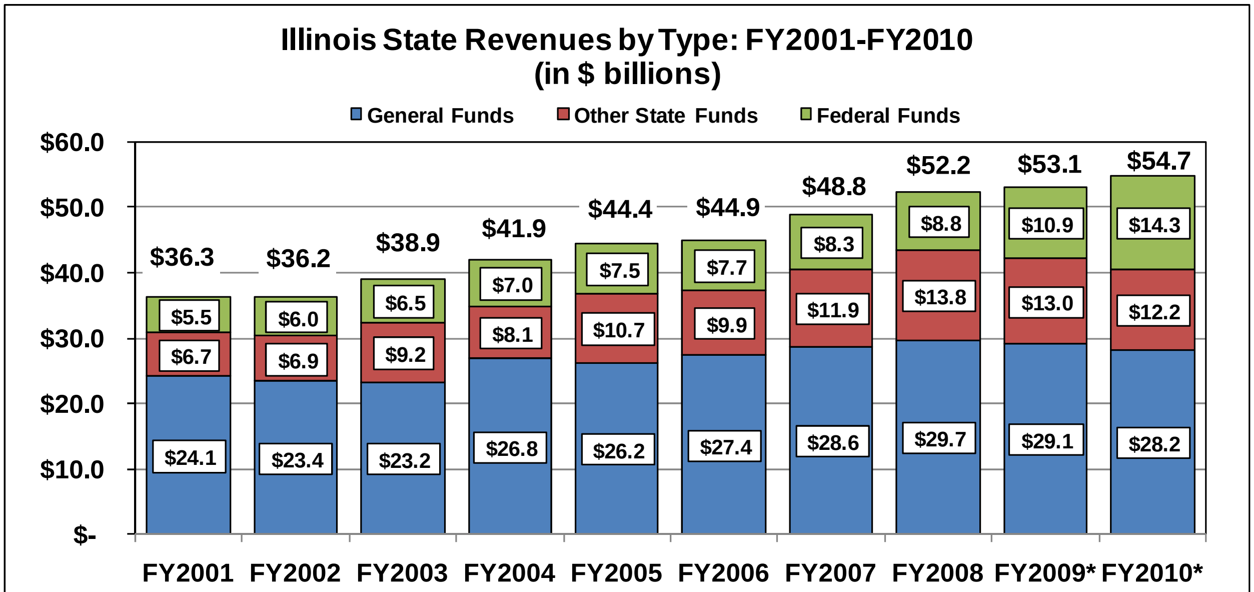
[31] John Keilman, "Nonprofit groups hang by a thread waiting for state funds," *Chicago Tribune*, February, 18, 2010 at http://www.chicagotribune.com/news/local/northnorthwest/ct-met-broke-agencies-0218-20100218,0,3365141.story (last visited February, 19, 2010).

REVENUES

The State of Illinois reports three categories of revenue each year: General Funds, Federal Funds, and Other State Funds (or Special State Funds). General Funds are used for general operations such as education, public safety and health and human services and are the funds over which the State has the most control and discretion. Other State Funds consist mainly of Special State Funds, which are accounts for activities funded by earmarked revenue sources that may only be used for special purposes. Federal Funds support a variety of state programs financed with federal revenues.

Total Revenue

Illinois' revenues are projected to rise from $36.3 billion in FY2001 to $54.7 billion in FY2010, an increase of $18.4 billion or 50.7%. The primary contributors to the increase in resources were revenues from the federal government and Medicaid hospital assessments.[32]



* General Funds revenues include FY2009 year-end estimates and FY2010 projected revenues. FY2009 and FY2010 Other State Funds and Federal Funds are March 2009 estimates.

Source: State of Illinois budget books and official statements, various dates, see Appendix 2, Table A.

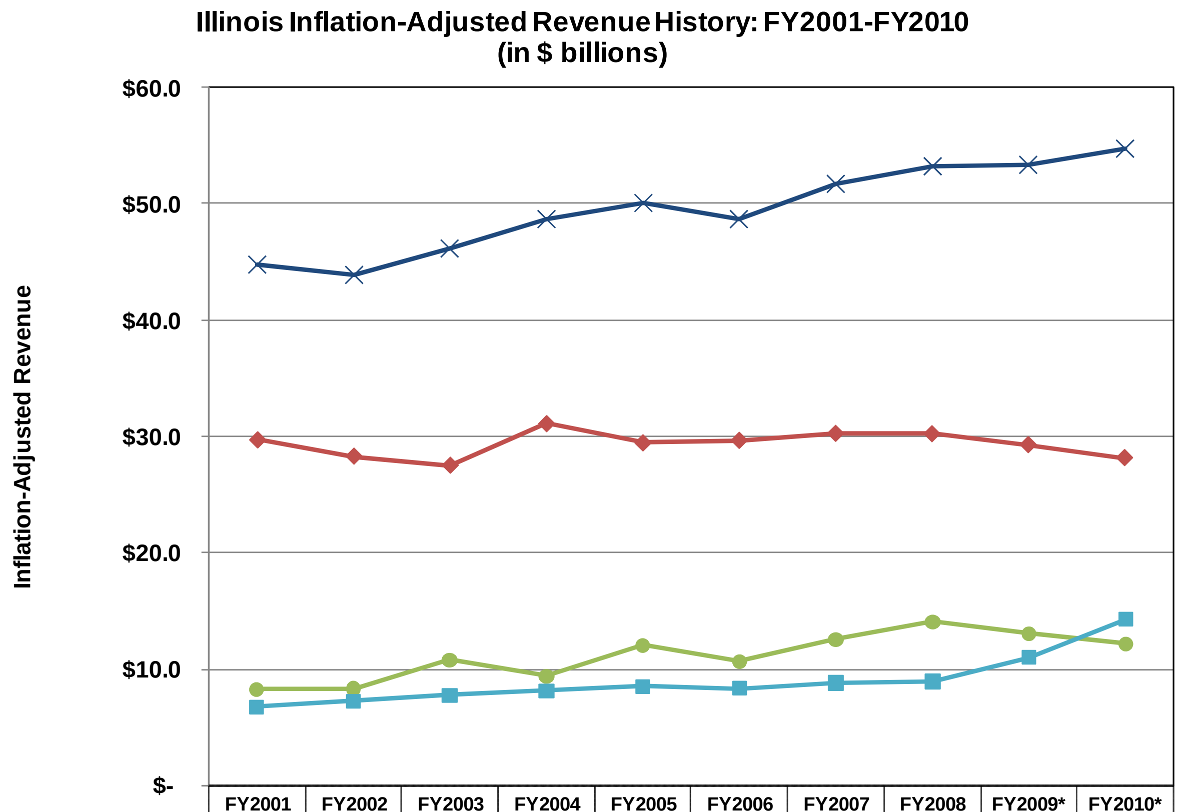
[32] Medicaid provider assessments are assessments on hospitals and nursing facilities that help bring additional federal funds to the State. The current Medicaid provider assessment is contained in Public Act 95-0859.

Federal receipts including those designated for the General Funds grew from $9.8 billion in FY2001 to $21.2 billion in FY2010, an increase of $11.5 billion or 117.3%. In FY2001, the State received $73 million through Medicaid provider assessments from nursing facilities. As a result of adding hospital assessments to the Medicaid provider assessments through a series of authorizations since 2004, all Medicaid provider assessments are expected to generate $1.6 billion in FY2010, a ten-year increase of $1.5 billion. The following chart illustrates how General Funds, Other State Funds, and Federal Funds contributed to the growth in total state revenues.

General Funds revenues are projected to rise from $24.1 billion to $28.2 billion between FY2001 and FY2010. General Funds consist of revenues from personal and corporate income taxes, sales taxes, other undedicated state-source taxes and fees, and a portion of federal revenues. The State has the most discretion over the appropriations of General Funds, which constituted 66.4% of the total revenue in FY2001, but constitute 51.5% of the total revenue for the FY2010 budget. During the ten years of analysis, the Other State Funds experienced an 81.4% increase and Federal Funds a 162.1% increase. Other State Funds represent an increasing proportion of total revenues and account for 29.8%, or $5.5 billion of the $18.4 billion growth in total revenue. In FY2001, these revenues totaled $6.7 billion and made up 18.6% of the total budget, but total $12.2 billion in FY2010, or 22.3% of the total budget. Federal Funds have grown from $5.5 billion in FY2001 to $14.3 billion in FY2010, an $8.8 billion increase. This increase accounts for 48.0% of the growth in total revenue.

Inflation-Adjusted Total Revenue

After adjusting for inflation, total revenues are 22.2% higher than in FY2001.[33] Inflation-adjusted General Funds revenues have actually declined by 5.1%, while Other State Funds have grown by 47.1% and Federal Funds by 112.5% after adjusting for inflation. The following chart illustrates General Funds, Other State Funds, and Federal Funds contributions to inflation-adjusted growth in total revenues.



	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009*	FY2010*
General Funds	$29.7	$28.3	$27.5	$31.1	$29.5	$29.7	$30.3	$30.3	$29.3	$28.2
Other State Funds	$8.3	$8.4	$10.9	$9.4	$12.1	$10.7	$12.6	$14.1	$13.1	$12.2
Federal Funds	$6.7	$7.2	$7.7	$8.1	$8.5	$8.3	$8.8	$8.9	$11.0	$14.3
Total Revenues	$44.8	$43.9	$46.1	$48.7	$50.0	$48.7	$51.6	$53.3	$53.4	$54.7

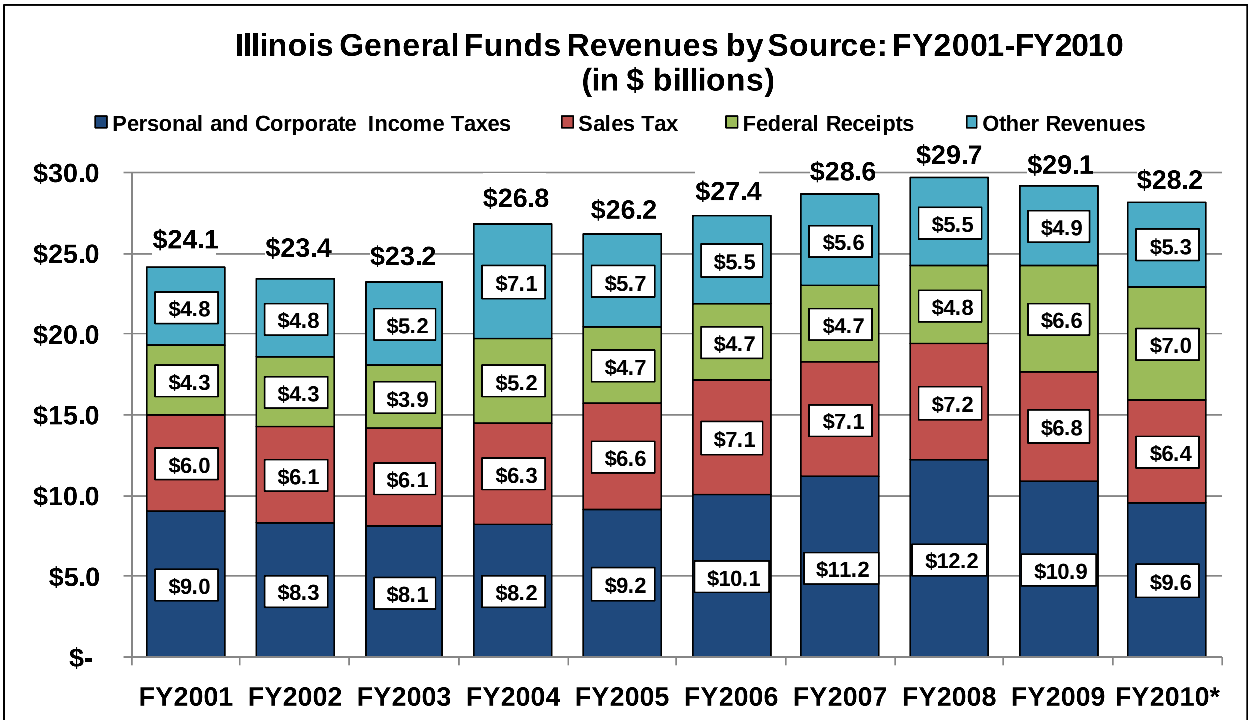
Note: FY2010 CPI includes July-December 2009 data. Prior years are expressed as 2009 dollars.
*General Funds revenues include FY2009 year-end estimates and FY2010 revenues as enacted. FY2009 and FY2010 Total Revenues, Other State Funds and Federal Funds are March 2009 estimates.
Source: State of Illinois budget books and official statements, various dates, see Appendix 2, Table A and Table B.

After adjusting for inflation, Other State Funds and Federal Funds are the sole contributors to growth in total revenues. Of the total $7.6 billion inflation-adjusted growth in Federal Funds, part of the $5.4 billion growth between FY2008 to FY2010 can be attributed to recovery funds received from the federal government to stabilize state budgets through the American Recovery and Reinvestment Act of 2009. After adjusting for inflation, Other State Funds show year-to-year volatility, but have increased by $3.9 billion since FY2001. Inflation-adjusted General Funds remained almost completely level from FY2005 until FY2010, when revenue projections plunged to a seven-year low in real dollars.

[33] Inflation adjustments were made using the U.S. Consumer Price Index for All Urban Consumers: see Appendix 2, Table B: Consumer Price Index

General Funds Revenue

General Funds revenues totaled $24.1 billion in FY2001 and are projected to total $28.2 billion in FY2010. While General Funds revenues have grown by $4.1 billion or 17.0% between FY2001 and FY2010, FY2009 and FY2010 revenues are lower than FY2008 as a result of the economic recession that began in December of 2007.[34] The following chart provides an illustration of nominal dollar General Funds revenue trends, detailing personal and corporate income tax revenues, sales tax revenues, federal revenues, and other General Funds revenues.



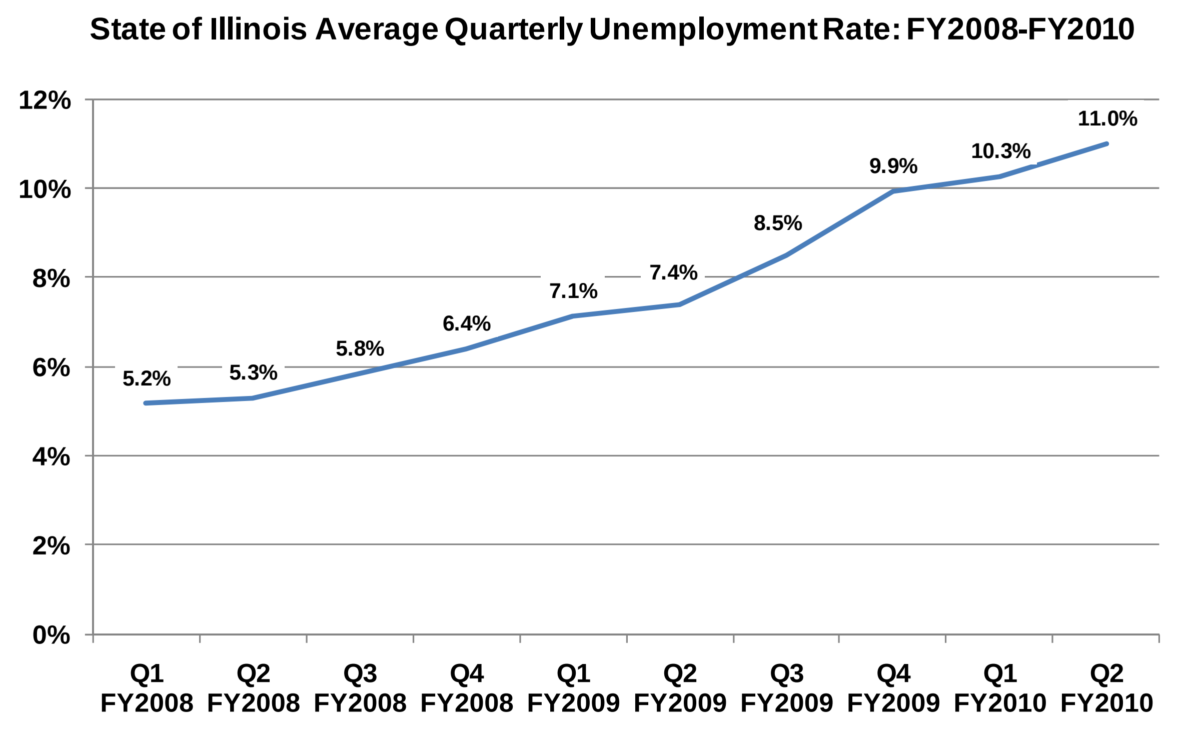
* FY2010 revenues are projections as of December 15, 2009.

Source: State of Illinois budget books and official statements, various dates, see Appendix 2, Table C.

As a result of reduced consumer spending, sales tax revenues are expected to drop to a six-year low in FY2010. General Funds revenues in the FY2010 enacted budget included $6.4 billion from sales taxes, which is a projected increase of $436 million or 7.3% from FY2001. Personal and corporate income taxes generate about a third of General Funds revenues and have grown by $538 million or 6.0% since FY2001. These income taxes generated $9.0 billion in FY2001, reached a high of $12.2 billion in FY2008, and are now projected to total $9.6 billion in FY2010. When the FY2010 budget was enacted in July of 2009, personal income taxes were expected to generate $9.2 billion and corporate income taxes were expected to generate $1.1 billion. However, since the budget was enacted, personal income tax estimates have dropped to $8.4 billion due in part to the impact of a continuing increase in unemployment rates that began in the second quarter of FY2009.[35] Personal income tax revenue is projected to be the lowest generated by the State during the previous five years and total General Funds revenues are projected to fall to a four-year low.

[34] National Bureau of Economic Research, "Determination of the December 2007 Peak in Economic Activity," December 1, 2008.
[35] Official Statement, State of Illinois General Obligation Bonds, $3,466 million, January 7, 2010.

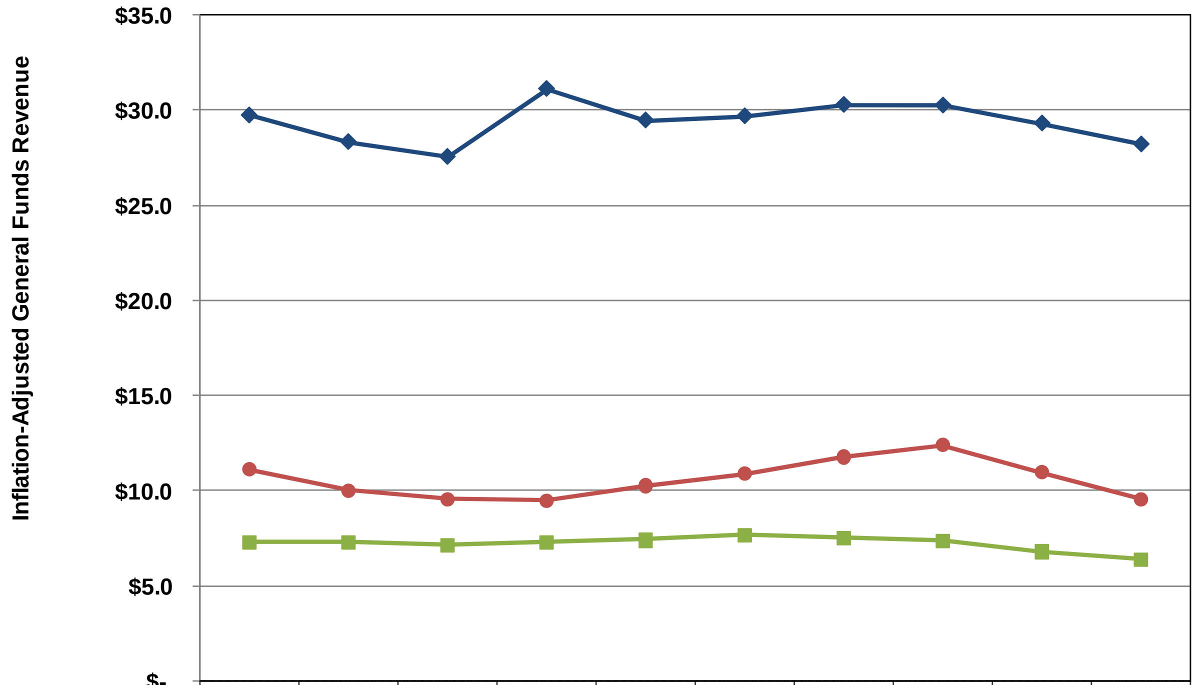
The State's unemployment rate, which has doubled since the start of FY2008, is one of the economic factors that impacts personal income tax revenue. The following chart shows state unemployment rates climbing from 7.1% during the first quarter of FY2009 to 10.3% during the first quarter of FY2010. Illinois' personal income has declined due to the increasing unemployment rate as well as other effects of the national economic recession that began in December 2007. As a result, personal income tax receipts fell 11.7% in FY2010's first quarter to $2.1 billion from $2.4 billion in the first quarter of FY2009.



Source: Commission on Government Forecasting and Accountability, Monthly Briefings: July 2008 - January 2010.

Personal and corporate income taxes as well as the state sales tax make up more than half of General Funds revenue. Not only have these sources declined nominally since FY2008, but after adjusting for inflation, these revenues have experienced declines since FY2001.[36] The following chart provides a comparison of inflation-adjusted growth in these revenue sources.

Illinois Inflation-Adjusted General Funds Revenue History: FY2001-FY2010 (in $ billions)



	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010*
Total General Funds Revenues	$29.7	$28.3	$27.5	$31.1	$29.5	$29.7	$30.3	$30.3	$29.3	$28.2
Personal & Corporate Income Taxes	$11.1	$10.0	$9.6	$9.5	$10.3	$10.9	$11.8	$12.4	$11.0	$9.6
Sales Taxes	$7.3	$7.3	$7.2	$7.3	$7.4	$7.7	$7.5	$7.4	$6.8	$6.4

Note: FY2010 CPI includes July-December 2009 data. Prior years are expressed as 2009 dollars. Total General Funds Revenues include Pension Obligation Bond Reimbursement Transfers of $300 million in FY2003 and $1.5 billion in FY2004.
*FY2010 revenues are projections as of December 15, 2009.
Source: State of Illinois budget books and official statements, various dates, see Appendix 2, Table B and Table C.

After adjusting for inflation, total General Funds revenues decreased by 5.1%, sales tax revenues have decreased by 13.0% and personal and corporate income tax revenues have declined by 14.1% since FY2001. As a result, the State's General Funds constitute a declining proportion of total revenues, thereby reducing the amount of discretion the State has over appropriating revenues.

Other State Funds

Other State Funds are comprised of special funds that are appropriated for limited and specific purposes. The State experienced the largest percent increase in Other State Funds revenue in FY2003 with an increase of 37.0% or $2.6 billion from FY2002. That same fiscal year, the State transferred $165.0 million from Other State Funds to General Funds through statute. Ever since, the General Revenue Fund has benefitted from growth in Other State Funds through annual

[36] Inflation adjustments were made using the U.S. Consumer Price Index for All Urban Consumers: see Appendix 2, Table B: Consumer Price Index.

statutory transfers of excess moneys from special funds. These transfers to the largely discretionary General Funds provide the General Assembly with more options to resolve budget deficits.

Primarily, these transfers have been made through three statutory mechanisms: fund sweeps, chargebacks, and transfers of fee increases. Fund sweeps are specific amounts from particular funds transferred in a fiscal year pursuant to statute. Chargebacks, which were in effect from FY2004 through FY2007, were transfers from any non-exempt special fund to General Funds that equaled the lesser of 8% of the revenues deposited into the fund during the fiscal year, or 75% of the fiscal year's July 1 balance. The chargebacks were used to reimburse General Funds for expenses associated with providing indirect services such as accounting, legal, personnel and other support services to special funds-supported programs. General Funds have benefitted from transfers from special funds that received increased revenues due to fee increases. General Funds also received a transfer of $5.5 million in FY2004 from savings realized pursuant to Executive Order 2003-10, which consolidated certain state government operations. In addition, several special funds were repealed in FY2006 and the $343,900 remaining in the repealed funds was transferred into General Funds.[37] The following table provides a summary of the $2.2 billion that has been transferred from special funds to General Funds over the past eight fiscal years.

Illinois Special Transfers to General Funds: FY2003-FY2010
(in $ millions)

	FY2003	FY2004	FY2005*	FY2006*	FY2007	FY2008	FY2009	FY2010	Total
Fund Sweeps	$ 165.0	$ 158.5	$ 259.9	$ 129.1	$ 188.3	$ -	$ -	$ 351.7	$ 1,252.5
Chargebacks	$ -	$ 269.5	$ 208.2	$ 140.4	$ 98.0	$ -	$ -	$ -	$ 716.1
Fee Increase Transfers	$ -	$ 88.8	$ 37.7	$ 35.3	$ 28.2	$ 34.3	$ 27.7	$ -	$ 252.0
Executive Order 2003-10	$ -	$ 5.5	$ -	$ -	$ -	$ -	$ -	$ -	$ 5.5
Repealed Funds	$ -	$ -	$ -	$ 0.3	$ -	$ -	$ -	$ -	$ 0.3
Total	**$ 165.0**	**$ 522.3**	**$ 505.8**	**$ 305.1**	**$ 314.5**	**$ 34.3**	**$ 27.7**	**$ 351.7**	**$ 2,226.5**

*Includes chargebacks and fee increase transfers of $263,938,498 that were not executed due to pending court cases regarding the constitutionality of the transfers. $250.0 million of these pending transfers were later redirected to the Hospital Provider Fund, the Long-term Care Provider Fund and the Drug Rebate Fund pursuant to Public Act 94-774, 30 ILCS 105/8n (2006).

Sources: Illinois General Assembly, Commission on Government Forecasting and Accountability, *State of Illinois Budget Summary Fiscal Year 2010*, November 2009; Fund Sweeps: 30 ILCS 105/8.41 (2002); 30 ILCS 105/8.42 (2007); 30 ILCS 105/8.43 (2006); 30 ILCS 105/8g(x) (2009); 30 ILCS 105/8.44 (2007); 30 ILCS 105/8.45 (2006); 30 ILCS 105/8.49 (2009); Chargebacks: 30 ILCS 105/8h (2010); Fee Increases: 30 ILCS 105/8j (2006); Repealed funds: 30 ILCS 105/8g(y) (2009).

The majority of special transfers to General Funds have been created through fund sweeps, which increased General Funds by $351.7 million in FY2010. Chargebacks accounted for a significant portion of special transfers during the years they were authorized, totaling $716.1 million over four years. If chargebacks occurring in FY2007 had continued through FY2010, General Funds would have realized an additional $98.0 million from special funds in FY2010.

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[37] Public Act 94-0091 repealed the following funds: Keep Illinois Beautiful Fund; Metropolitan Fair and Exposition Authority Reconstruction Fund; New Technology Recovery Fund; Illinois Rural Bond Bank Trust Fund; ISBE School Bus Driver Permit Fund; Solid Waste Management Revolving Loan Fund; State Postsecondary Review Program Fund; Tourism Attraction Development Matching Grant Fund; Patent and Copyright Fund; Credit Enhancement Development Fund; Community Mental Health and Developmental Disabilities Services Provider Participation Fee Trust Fund; Nursing Home Grant Assistance Fund; By-product Material Safety Fund; Illinois Student Assistance Commission Higher EdNet Fund; DORS State Project Fund; School Technology Revolving Fund; Energy Assistance Contribution Fund; Illinois Building Commission Revolving Fund; Illinois Aquaculture Development Fund; Homelessness Prevention Fund; DCFS Refugee Assistance Fund; Illinois Century Network Special Purposes Fund; and Build Illinois Purposes Fund.

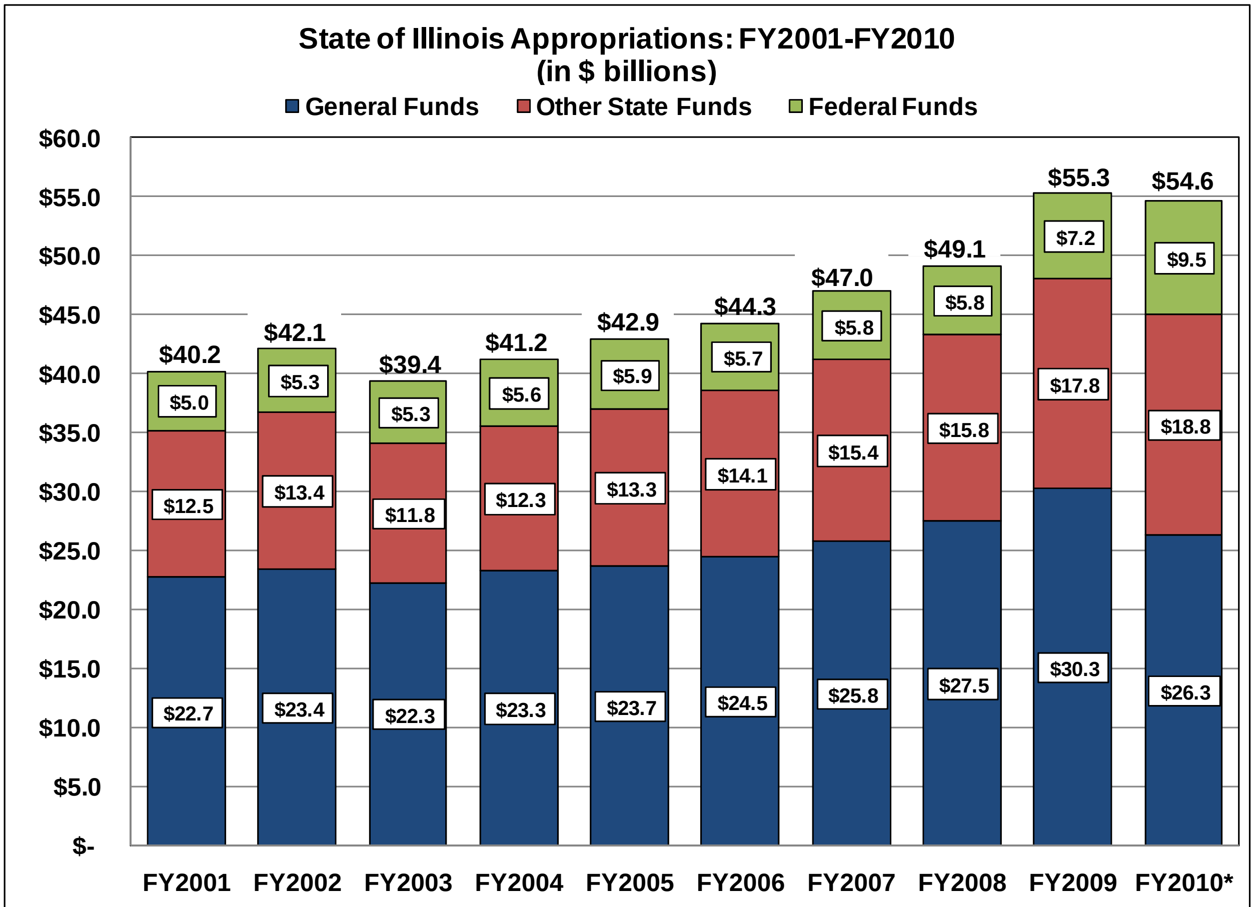
APPROPRIATIONS

The Illinois General Assembly makes annual appropriations for state government operations from General Funds, Other State Funds, and Federal Funds. General Funds are used for general operations such as education, public safety and health and human services and are the funds over which the State has the most control and discretion. Other State Funds consist mainly of Special State Funds, which are accounts for activities funded by earmarked revenue sources that may only be used for special purposes. Federal Funds support a variety of state programs financed with federal revenues.

The State makes the majority of its expenditures from these annual appropriations made by the General Assembly. This section describes the history of these appropriations and the expenditures made from these appropriations, including details on education and Medicaid expenditures. The information in this section examines actual appropriations and expenditures for FY2001 through FY2009, as well as estimated FY2010 appropriations.

Total Appropriations

The annual appropriations passed by the General Assembly and approved by the Governor for the State of Illinois have grown from $40.2 billion in FY2001 to $54.6 billion in FY2010, an increase of $14.4 billion. Total appropriations experienced steady growth between FY2001 and FY2010, and have increased by 35.7%, while the inflation rate increased by 23.3%.[38] The following chart provides a history of General Funds, Other State Funds, and Federal Funds appropriated to operate state government between FY2001 and FY2010.



*Estimated
Source: State of Illinois, various dates, see Appendix 3, Table A.

Appropriations increased every year except FY2003 and FY2010. In FY2003, appropriations dropped as a result of a fiscal crisis in the State that followed a recession during FY2001 and FY2002.[39] Additionally, appropriations fell from $55.3 billion in FY2009 to $54.6 billion in FY2010, a decrease of $0.7 billion or 1.2%. However, FY2010 appropriations include no contribution from General Funds to the State's retirement systems. Instead, the State financed that portion of the statutorily required contribution under the 1995 pension funding reform law[40]

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[38] Inflation rates were calculated using the U.S. Consumer Price Index for All Urban Consumers: see Appendix 2, Table B: Consumer Price Index.

[39] This eight-month recession began in March 2001 and lasted until November 2001. National Bureau of Economic Research, Business Cycle Dating Committee, July 17, 2003, http://www.nber.org/cycles/july2003.html (last visited January 25, 2010).

[40] Public Act 88-593 established a 50-year schedule of retirement systems funding requirements. More information on retirement systems funding is contained in the Personnel: Pensions section of this report.

from the proceeds of the sale of $3.5 billion in new FY2010 pension bonds.[41] As a result, it is difficult to compare FY2010 appropriations to appropriations in other years.

Appropriations from General Funds rose from $22.7 billion in FY2001 to $26.3 billion in FY2010, an increase of $3.6 billion or 15.8%. However, FY2010 General Funds appropriations were actually lower than in FY2009 because the State made budget cuts and borrowed to pay for the General Funds portion of the retirement system contribution. General Funds appropriations in FY2009 were $30.3 billion, which is $7.6 billion or 33.3% higher than in FY2001. When looking at the growth in appropriations between FY2001 and FY2009, growth in General Funds accounts for about half of the growth in total appropriations, while the General Funds also make up about half of the total amount appropriated.

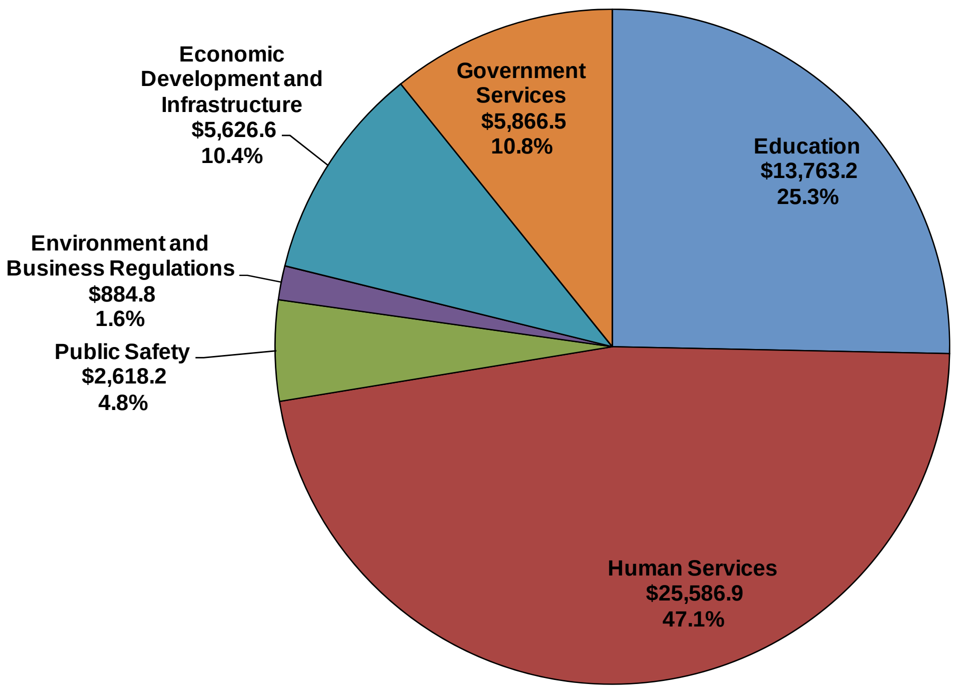
Other State Funds appropriations have grown from $12.5 billion in FY2001 to $18.8 billion in FY2010, and make up approximately one-third of total appropriations. Since FY2001, appropriations from Other State Funds increased by 50.7% or $6.3 billion.

Appropriations from Federal Funds, which exclude federal-source General Funds appropriations, have experienced growth since FY2001, and increased from $5.0 billion to $9.5 billion over ten years. Federal Funds appropriations remained level between FY2001 and FY2008, ranging between $5.0 billion and $5.9 billion. Due to the availability of federal recovery funds, appropriations from Federal Funds soared to $7.2 billion in FY2009 and $9.5 billion in FY2010, which is an increase of $4.5 billion or 88.5% since FY2001. In FY2010, 17.4% of appropriations were from Federal Funds, up from 11.8% of appropriations in FY2008 and 12.5% of appropriations in FY2001. Programs in the Department of Commerce and Economic Opportunity as well as elementary and secondary education benefited from the majority of the recent Federal Funds increase.

[41] 30 ILCS 330/7.2 (2009).

The General Assembly appropriates General Funds, Other State Funds, and Federal Funds to specific operations and services in state government. In FY2010, nearly half of the $54.6 billion was appropriated for providing human services, including Medicaid, community-based services for senior citizens, child welfare services, mental health and developmental disability services, and public health programs. The following chart provides an overview of how state funds have been appropriated and allocated for FY2010.

State of Illinois All Funds Appropriations by Purpose: FY2010
(in $ millions)*

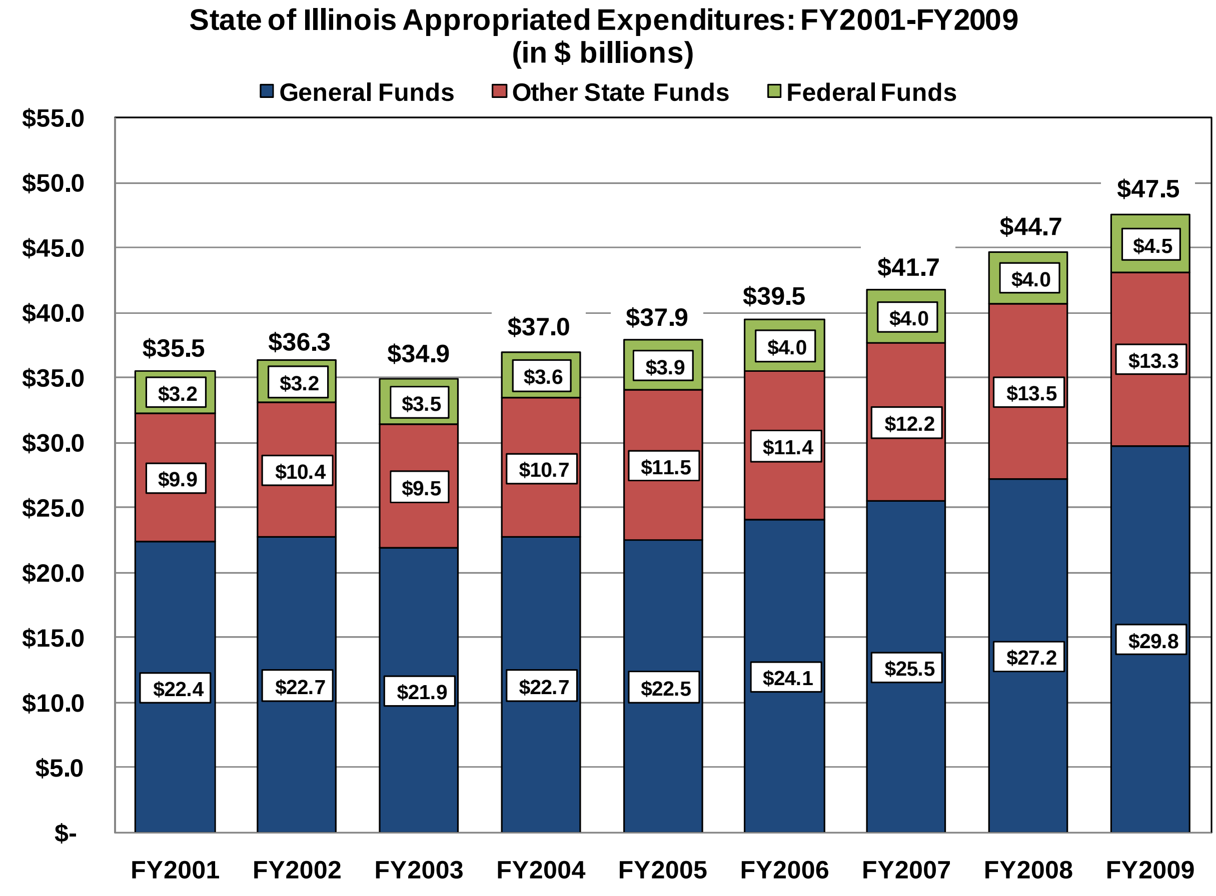


*Appropriations are as enacted and allocated. Total does not add to $54.6 billion because the Governor has not allocated all lump sum appropriations.
Sources: Commission on Government Forecasting and Accountability, *State of Illinois Budget Summary FY2010,* pp.183-191; Governor's Office of Management and Budget, Notice of Delegation, August 11, 2009; Governor's Office of Management and Budget, Supplemental Notice of Delegation, September 16, 2009.

Human services programs received 47.1% of the total amount appropriated, or $25.6 billion. Education, including funding for elementary and secondary education as well as public universities and community colleges, were appropriated $13.8 billion, or 25.3% of the total appropriation. State government operations and services including the General Assembly, the courts, the Department of Revenue, elections, and the Treasurer's Office were appropriated $5.9 billion, or 10.8% of all appropriations. Economic development and infrastructure spending made up 10.4% of the total appropriations. These programs, including transportation, employment, agriculture, and commerce-related programs and services were allocated $5.6 billion for FY2010. Public safety funding for the state police, the Department of Corrections, and emergency management was allocated $2.6 billion. Finally, regulatory activities, including environmental, business, and human rights administration were allocated 1.6% of the appropriations, or $884.8 million. While these programs and services were allocated $54.6 billion in General Funds, Other State Funds and Federal Funds, the State typically does not spend the entire amount appropriated. As a result, the proportion of actual expenditures that each program or service spends may be different from the proportion that was appropriated for each purpose.

Total Expenditures from Appropriations

The State pays for government operations from the funding authorized in annual appropriations acts. The level of appropriations authorized is typically higher than actual year-end expenditures. There are typically several hundred million in General Funds appropriations that remain unspent at the end of the year because expenses do not reach budgeted levels and checks issued by the State have not been cashed by the payee. In addition, expenditures of Other State Funds and Federal Funds do not usually reach the level appropriated. This may occur because the State must spend special funds and federal funds for specific purposes, or because the State enacts appropriations bills without knowing the precise level of available federal funding. Total expenditures from appropriations have increased from $35.5 billion in FY2001 to $47.5 billion in FY2009. The following chart provides appropriated expenditures by fund type from FY2001 to FY2009.[42]



Source: State of Illinois, various dates, see Appendix 3, Table B.

The State's expenditures have grown by $12.0 billion or 33.9% over the past nine years. Expenditures from General Funds have increased from $22.4 billion in FY2001 to $29.8 billion in FY2009, an increase of 33.0% or $7.4 billion. This increase in General Funds accounted for 61.4% of the total increase in expenditures. In FY2001, 63.1% of the State's total expenditures were from General Funds and General Funds accounted for 62.7% of total expenditures in FY2009.

[42] FY2010 expenditures were not available to include in this report. The State releases estimated expenditures as part of the Governor's budget proposal. Actual expenditures are not available until the fiscal year has ended.

Other State Funds expenditures accounted for 28.2% of the increase in total expenditures, rising from $9.9 billion in FY2001 to $13.3 billion in FY2009. Expenditures from Other State Funds made up between 27% and 31% of total expenditures between FY2001 and FY2009. This $3.4 billion or 34.2% increase in Other State Funds is primarily a result of increases in Other State Funds expenditures for the Department of Healthcare and Family Services for Medicaid and state employee group insurance.

Federal Funds expenditures, which exclude federal-source General Funds expenditures, steadily increased from $3.2 billion in FY2001 to $4.0 billion in FY2008. Due to the availability of federal recovery funds, expenditures from Federal Funds rose to $4.5 billion in FY2009, which is an increase of $1.3 billion or 39.2% since FY2001. In FY2009, 9.4% of expenditures were from Federal Funds, up from 8.9% of expenditures in FY2008 and 9.0% of expenditures in FY2001.

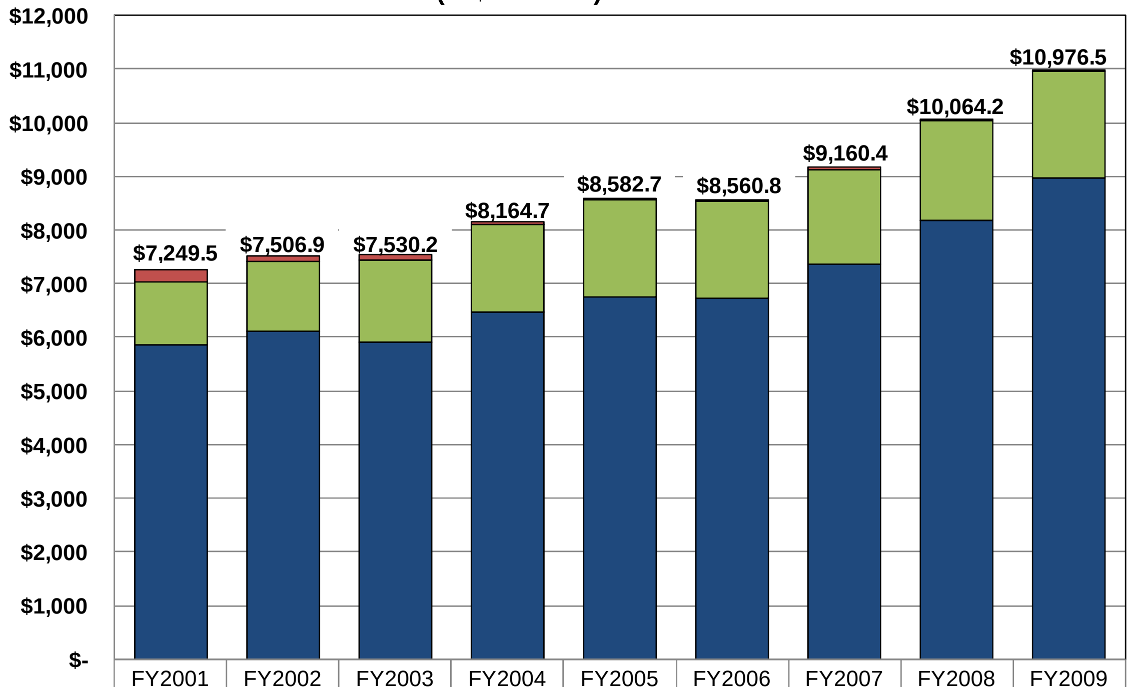
Education

Education, including elementary, secondary, and higher education, is the State's largest area of spending. In FY2010, the State estimates it will spend 27.6% of total appropriations and 41.8% of appropriations from General Funds on education.

Elementary and Secondary Education

Funding for elementary and secondary education is appropriated to the Illinois State Board of Education, which provides funding to more than 800 school districts in the State of Illinois. Expenditures for elementary and secondary education steadily increased by $3.7 billion or 51.4% between FY2001 and FY2009, whereas total state expenditures increased by 33.9% and inflation increased by 22.6% during the same period.[43] The next chart illustrates expenditures for elementary and secondary education for FY2001 through FY2009.[44]

State of Illinois Total Expenditures for Elementary and Secondary Education: FY2001-FY2009 (in $ millions)



	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009
Other State Funds	$218.9	$99.8	$96.4	$69.2	$18.1	$38.3	$29.7	$27.8	$26.1
Federal Funds	$1,164.7	$1,300.3	$1,534.9	$1,636.3	$1,806.2	$1,792.8	$1,770.3	$1,856.6	$1,991.1
General Funds	$5,865.9	$6,106.9	$5,898.9	$6,459.2	$6,758.4	$6,729.7	$7,360.4	$8,179.8	$8,959.3

Source: State of Illinois, various dates, see Appendix 3, Table C.

Expenditures for elementary and secondary education rose from $7.2 billion in FY2001 to $11.0 billion in FY2009. Expenditures steadily increased each year until FY2009, which experienced an increase of 17.9% over FY2008. This increase was primarily a result of $1.0 billion in receipts from federal recovery funds, which were appropriated from both General Funds and

[43] Inflation rates were calculated using the U.S. Consumer Price Index for All Urban Consumers: see Appendix 2, Table B: Consumer Price Index.
[44] FY2010 expenditure data is not available.

Federal Funds. Appropriations are estimated to be $12.2 billion in FY2010, an increase of $5.0 billion or 68.5% from FY2001 expenditures.

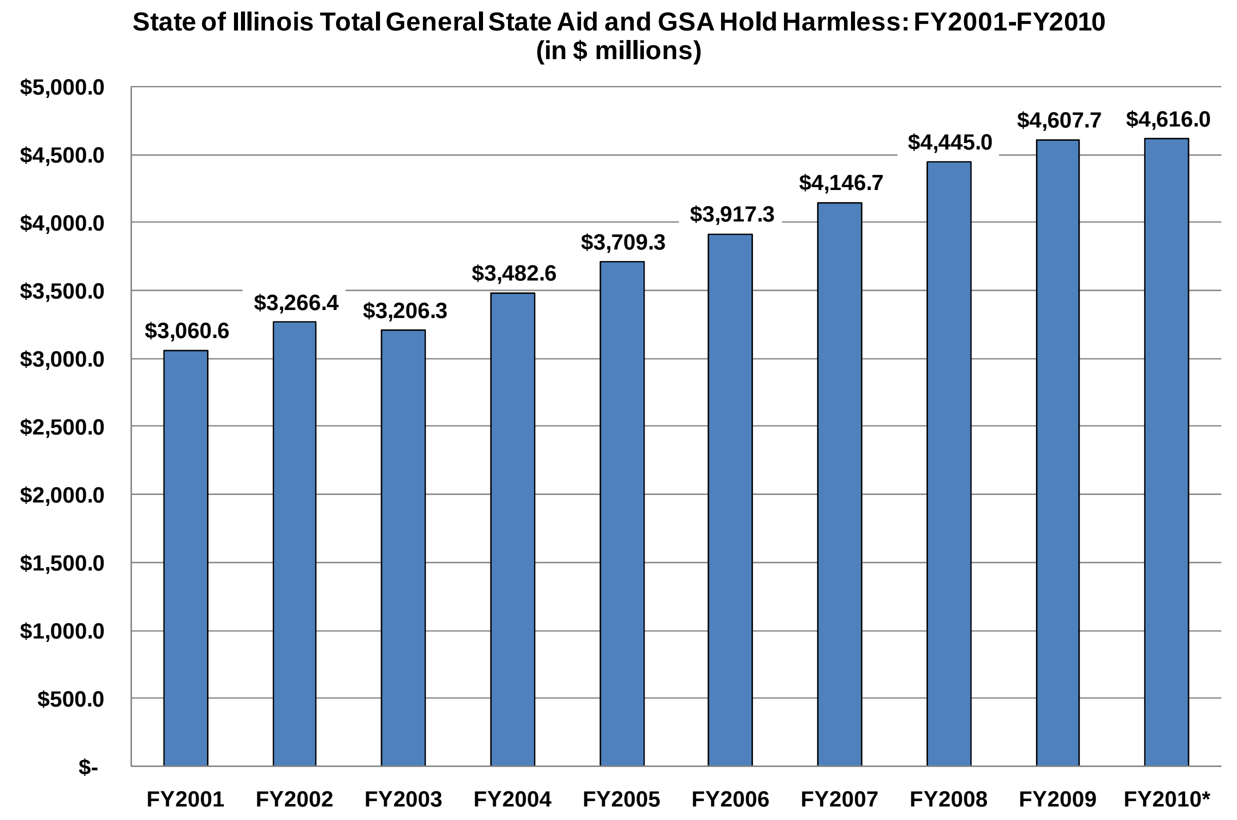
General Funds support for elementary and secondary education has increased from $5.9 billion in FY2001 to $9.0 billion in FY2009, an increase of $3.1 billion or 52.7%. The $779.5 million increase since FY2008 can be attributed to spending from federal recovery funds. Appropriations for elementary and secondary education for FY2010 provided $8.8 billion from General Funds. Despite the $188.7 million or 2.1% decrease in General Funds from FY2009, the appropriations for FY2010 do not include the $2.1 billion statutorily required contribution to the Teachers' Retirement System. The contribution has been financed with the proceeds of the sale of pension bonds.[45]

Other State Funds have experienced variation between FY2001 and FY2009 and currently make up less than 1% of expenditures for elementary and secondary education. Estimated FY2010 appropriations from Other State Funds total $43.7 million, while FY2001 expenditures from Other State Funds were $218.9 million, the highest during the ten-year period.

Federal Funds support has increased from $1.2 billion to $2.0 billion between FY2001 and FY2009, an increase of $826.4 million or 71.0%. Appropriations in FY2010 include $3.4 billion from Federal Funds. The recent increases in Federal Funds are due to the availability of federal recovery funding in FY2010.

[45] 30 ILCS 330/7.2 (2009).

About half of the appropriations for elementary and secondary education fund General State Aid, which provides funding to every school district largely based on the number of pupils, the amount of local property tax base, and the poverty level of the districts' students. These payments to school districts are based on a foundation level of funding that is set in statute annually. The foundation level for General State Aid increased from $4,425 per pupil in FY2001 to $6,119 in FY2010, an increase of 38.3% or $1,694 per pupil. The increase in the foundation level is the primary driver of total expenditures for General State Aid. In addition, if the payment level yields less than a district's payment in FY1997-98, a separate payment is made to hold those districts harmless. The following chart provides the total amount spent on General State Aid over the past ten years, including estimated FY2010 expenditures.



*Estimated
Source: State of Illinois, various dates, see Appendix 3, Table D.

State expenditures on General State Aid have increased from $3.1 billion in FY2001 to $4.6 billion in FY2010, an increase of $1.6 billion or 50.8%. Increases in the foundation level account for approximately 75% of the increase in total General State Aid expenditures. In FY2009 and FY2010, a portion of the General State Aid funding came from federal recovery funds.

Separately from General State Aid grants, the State provides funding to the Teachers' Retirement System at annually increasing levels pursuant to the requirements of Public Act 88-593, the 1995 pension funding reform legislation. After an initial phase-in period that ended in FY2010, the law requires the State to make contributions that are sufficient to achieve a 90% funding ratio by 2045. With the exception of the use of pension bond proceeds in FY2004 and pension holidays taken in FY2006 and FY2007,[46] expenditures for the Teachers' Retirement System have conformed to the law. As a result, contributions to the Teachers' Retirement System from General Funds have increased from $732 million in FY2001 to $1.6 billion in FY2009. This increase in contributions of 98.3% is primarily attributable to the law's requirement to phase in additional contributions to pay off unfunded liabilities. The FY2010 required contribution of $2.1 billion will be made from the proceeds of the sale of pension bonds instead of General Funds.[47]

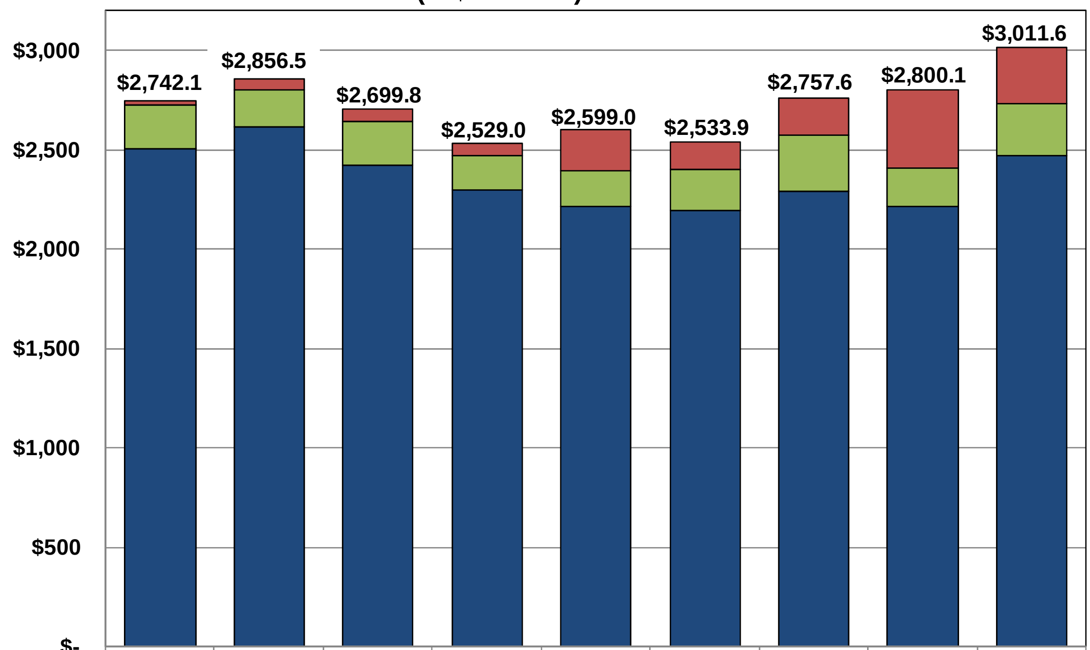
The State also makes grants to school districts that must be used for specific purposes. Categorical grants provide the majority of funding for services mandated by state and federal programs, such as special education. Targeted grants provide funding for specific populations and purposes to school districts throughout the State.

[46] Public Act 93-0002 authorized the State to use the proceeds of 30-year pension obligation bonds instead of General Funds to make retirement system contributions. Pension holidays for FY2006 and FY2007 are authorized in 40 ILCS 5/16−158(b-3) (2009).
[47] 30 ILCS 330/7.2 (2009).

Higher Education

Nearly 10% of the General Funds budget supports higher education. State funding for higher education provides resources to the State's nine public universities and 48 community colleges as well as funding for scholarships through the Student Assistance Commission. Public universities benefit from more than half of the State's higher education spending. Between FY2001 and FY2009, support for higher education increased from $2.7 billion to $3.0 billion. The following chart shows the history of state expenditures for higher education.

State of Illinois Total Expenditures for Higher Education: FY2001-FY2009 (in $ millions)



	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009
Other State Funds	$20.4	$56.6	$59.6	$62.9	$205.6	$132.3	$186.1	$394.3	$279.0
Federal Funds	$221.0	$186.4	$219.8	$170.2	$180.2	$208.4	$286.1	$194.4	$266.6
General Funds	$2,500.6	$2,613.6	$2,420.4	$2,295.9	$2,213.2	$2,193.2	$2,285.4	$2,211.4	$2,466.0

Source: State of Illinois, various dates, see Appendix 3, Table E.

Between FY2001 and FY2009, funding for higher education increased by $269.5 million or 9.8%, while inflation rose by 22.6%. Following a nine-year high of $3.0 billion in FY2009, appropriations for higher education in FY2010 are expected to decline by $185.8 million or 6.2% from FY2009 spending levels. However, FY2010 expenditures will not include a contribution to the State Universities Retirement System from General Funds, while the expenditures in FY2009 included a $235.2 million contribution from General Funds. Instead, the State will fund the General Funds portion of the statutorily required contribution from the proceeds of the pension note sale.[48]

Since FY2001, approximately 85% of higher education spending has come from General Funds. Nearly a third of the General Funds spending goes to the University of Illinois. Over the past nine years, General Funds support for higher education has declined by 1.4% or $34.6 million while total state expenditures from General Funds have increased by 33.0%. In FY2001 and FY2009, the State spent $2.5 billion from General Funds on higher education. General Funds

[48] 30 ILCS 330/7.2 (2009).

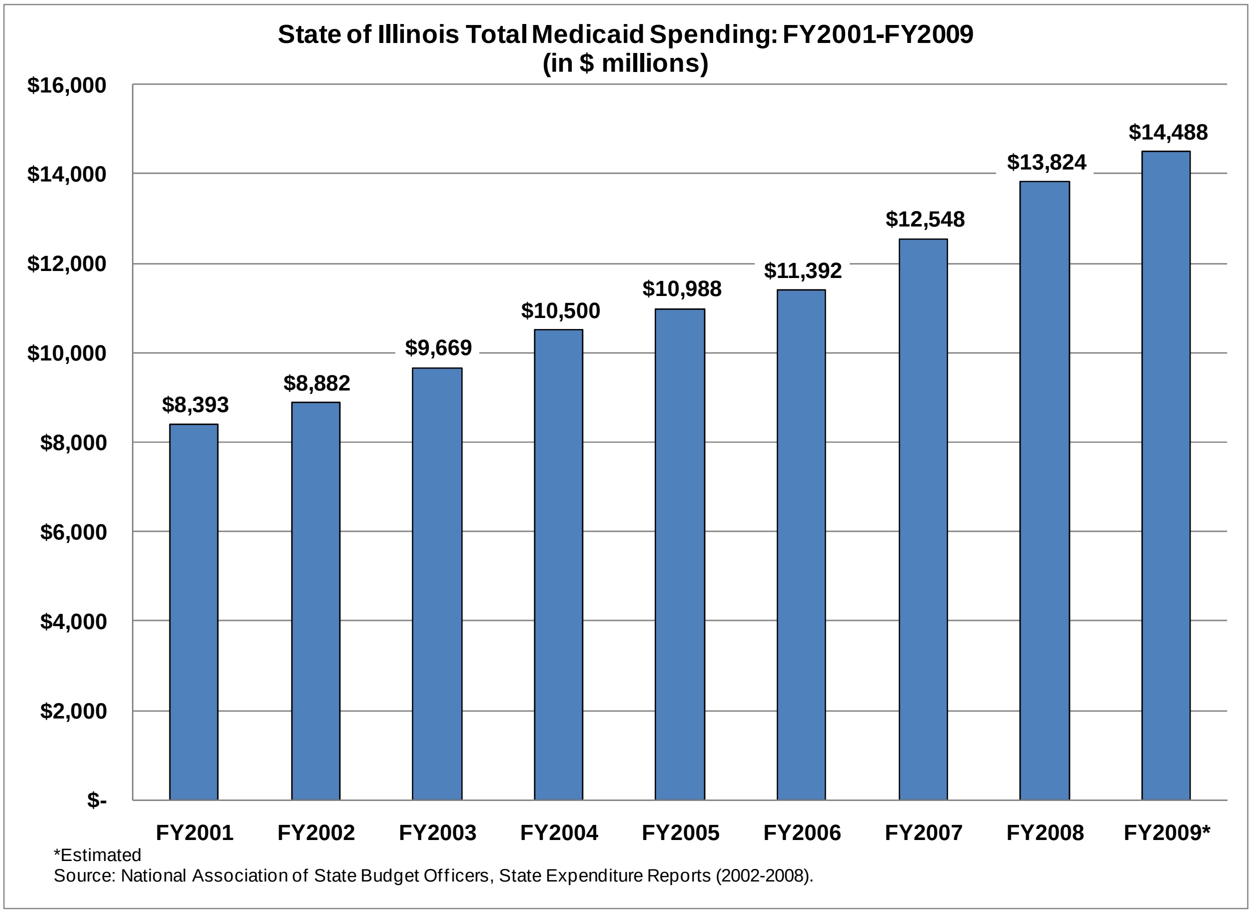
expenditures for higher education remained mostly flat between FY2004 and FY2008. The State's utilization of Other State Funds[49] for contributions to the State Universities Retirement System has accounted for General Funds declines in recent years, while institutional expenditures have remained flat. Higher education appropriations from General Funds are $2.2 billion in FY2010, but they included no General Funds contribution to the retirement system.

As a result of their utilization for the retirement system contribution, expenditures of Other State Funds have increased from $20.4 million in FY2001 to $279.0 million in FY2009. Higher education was allocated $162.8 million from Other State Funds in FY2010. Federal Funds have increased from $221.0 million in FY2001 to $266.6 million in FY2009, an increase of $45.6 million or 20.6%. Appropriations from Federal Funds are $431.4 million in FY2010, an increase of $210.4 million or 95.2% from FY2001 expenditures. This Federal Funds increase of $164.8 million over FY2009 expenditures was primarily due to additional appropriations of federal student loan funds. The actual increase from FY2009 to FY2010 may not reach $164.8 million because actual expenditures from Federal Funds may not reach the level appropriated for FY2010.

[49] The State Pensions Fund is a special fund that contains the proceeds from the sale of unclaimed property. The fund is used to pay down the unfunded liabilities of the state retirement systems, but not in lieu of statutorily required contributions. However, the statute allows a portion of the statutorily required contribution to the State Universities Retirement System to come from the State Pensions Fund in fiscal years 2005, 2006, 2007, 2008, 2009, and 2010. See 30 ILCS 105/8.12 (2008).

Medicaid

Medicaid, the joint federal-state program to finance health care services for low-income people, has been a fast-growing component of the Illinois budget. This section describes the Illinois program and explains its recent growth.[50] Illinois Medicaid spending increased 64.7% between FY2001 and FY2008, rising from $8.4 billion to $13.8 billion.[51] For FY2009, expenditures were projected to grow 4.8% to $14.5 billion.



Medicaid financing is extremely complex. As a program involving several state agencies, Medicaid has no specific designation in the state budget. The Department of Healthcare and Family Services (HFS) is the agency responsible for Medicaid spending in Illinois, but roughly 20% of expenditures are made by other state agencies and local governments.

Medicaid is jointly funded by states and the federal government. A state spends money for health care services and is then reimbursed by the federal government for a portion of the expenditures. The reimbursement rate has typically varied from 50% to 83%, depending on a state's wealth. However, the American Recovery and Reinvestment Act of 2009 temporarily raised federal reimbursement rates. Illinois is currently being reimbursed at a rate of 61.88%, up from 50.32% before the federal stimulus law.[52] The enhanced reimbursement, which started in October of

[50] For a more detailed look at the Medicaid program, see The Civic Federation, *The Illinois Medicaid Program: An Issue Brief*, May 22, 2009, at http://civicfed.org/sites/default/files/civicfed_295.pdf .

[51] National Association of State Budget Officers, *Fiscal Year 2008 State Expenditure Report*, Fall 2009, p. 47, and *Fiscal Year 2002 State Expenditure Report*, Fall 2003, p.49.

[52] Department of Healthcare and Family Services, Highlights of the American Recovery and Reinvestment Act of 2009, http://www.hfs.illinois.gov/recovery/ (last visited on January 7, 2010).

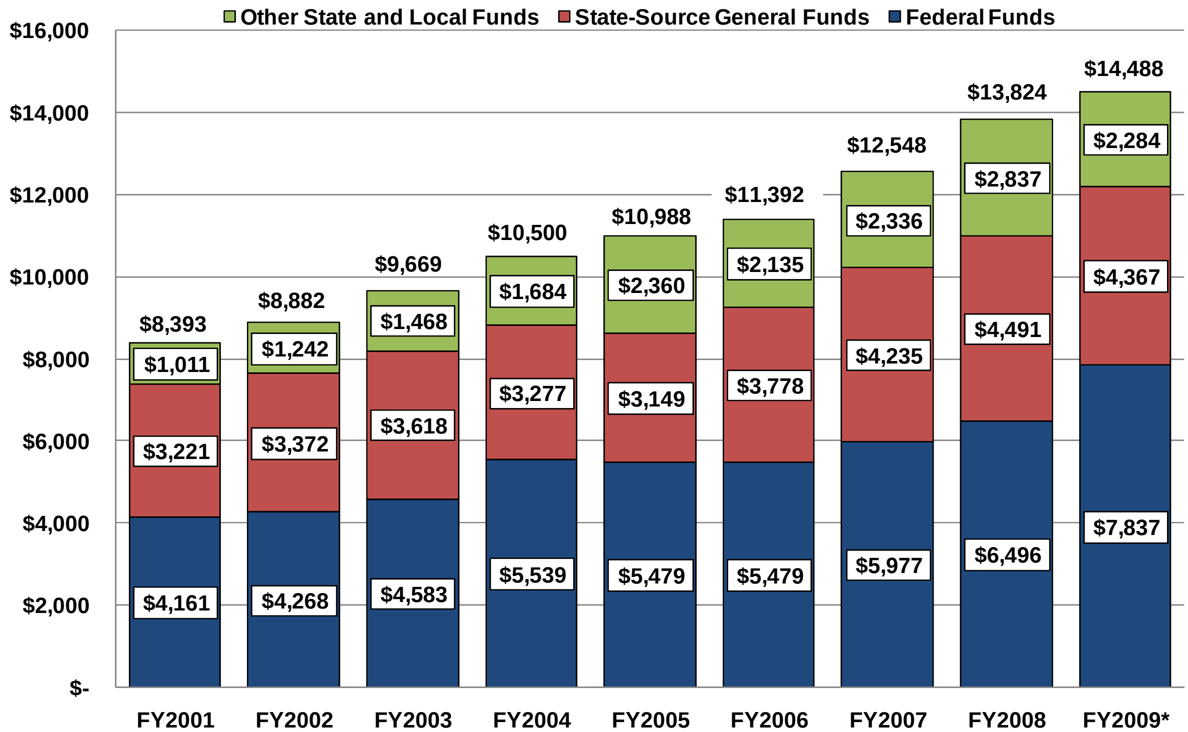
2008, is scheduled to end on December 31, 2010. The stimulus plan was expected to increase federal Medicaid funding to Illinois by $2.9 billion over the 27-month period. To receive the enhanced reimbursement, states must not decrease Medicaid eligibility and are required to meet federal prompt payment standards for doctors, hospitals and nursing homes. This is a major issue in Illinois, where State law permits the State to budget an insufficient amount of Medicaid appropriations for a given fiscal year with the knowledge that remaining bills can be paid from a future year's appropriation.[53] The State has repeatedly carried over substantial Medicaid liabilities in order to balance its budget.[54]

Like other states, Illinois also uses contributions from local governments and health care providers to help bring in more federal assistance. Cook County, for example, receives federal Medicaid funding for its health system through an intergovernmental transfer agreement with the State. Hospitals and nursing homes pay assessments to the State that are used to trigger additional federal funding. To maximize federal assistance before the stimulus program ends, the General Assembly approved legislation in the fall to accelerate hospital payments from the first six months of calendar year 2010 into the last six months of calendar year 2010. This will double the hospital assessment payments in the last six months of 2010 that are subject to the enhanced federal reimbursement rate.

[53] 30 ILCS 105/25 (2007).
[54] Illinois State Comptroller, *Fiscal Focus*, July 8, 2008, p. 7, at http://www.apps.ioc.state.il.us/ioc-pdf/FFWeb0708.pdf (last visited on February 12, 2010).

The table below shows the sources of Illinois Medicaid spending from FY2001 through FY2009. State-source General Funds accounted for an estimated 30.1% of total spending in FY2009, down from 38.4% in 2001. During the same period, the share of federal funding rose to 54.1% from 49.6% and of other state and local funding to 15.8% from 12.0%. The funding changes are largely due to the federal stimulus program and a new hospital assessment program that brought in more than $1.5 billion in FY2009.[55] According to HFS, payments from the federal government to the Medicaid program represent the third largest revenue source for the State General Revenue Fund, behind income and sales taxes.[56]

State of Illinois Medicaid Spending by Funding Source: FY2001-FY2009 (in $ millions)



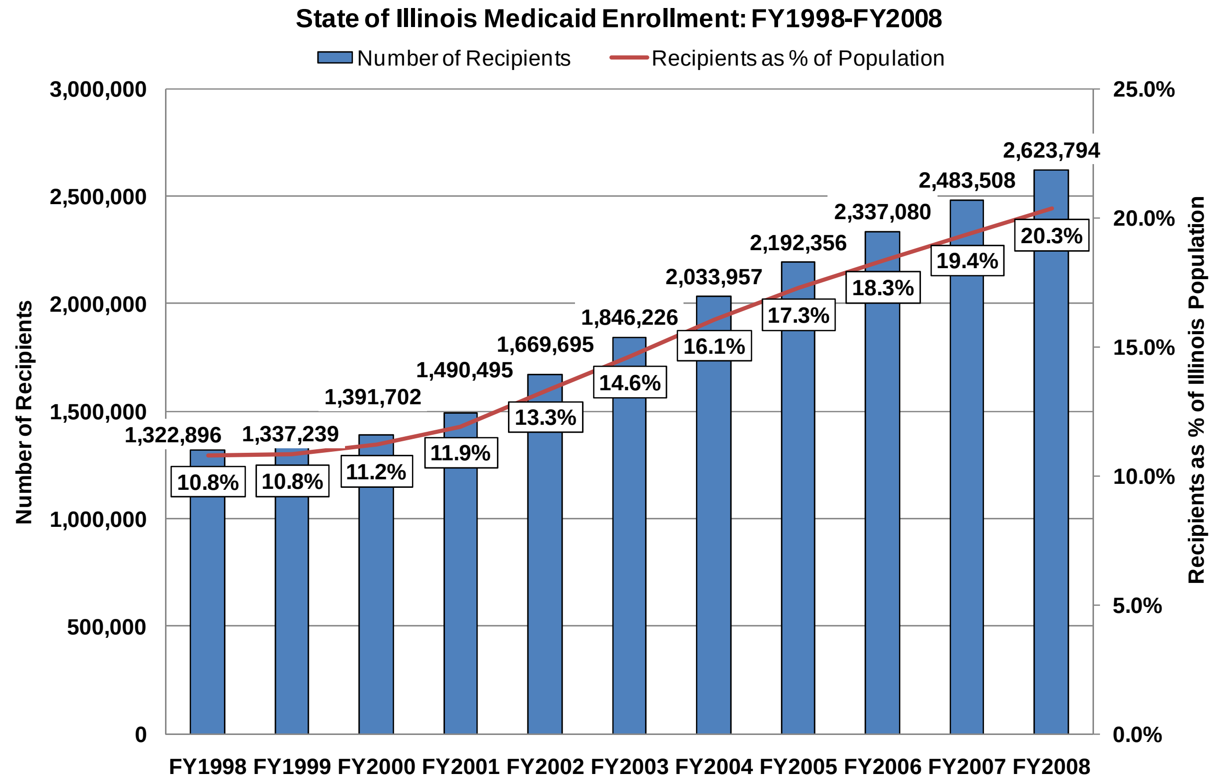
*Estimated
Source: National Association of State Budget Officers, State Expenditure Reports (2002-2008).

Medicaid spending in Illinois and other states largely reflects rising costs throughout the U.S. health care system. National health spending increased an average of 7% a year from 1998 to 2008, and health care accounted for 16.2% of gross domestic product in 2008.[57] Medicaid costs also rise as more people qualify for coverage due to economic downturns, loss of employer-sponsored health insurance and demographic shifts such as the aging population. The federal government determines which groups of people must be eligible and which services must be covered, but states can make their programs more generous by expanding eligibility and benefits.

The latest comparative data available show that Illinois, the nation's 5th largest state in population, ranked 7th in Medicaid spending in FY2007 and 5th in Medicaid enrollment in

[55] Public Act 095-0859 and Illinois Hospital Association, Statement to the Governor's Taxpayer Action Board, undated, pp. 3-4.
[56] Illinois Department of Healthcare and Family Services, Presentation to Taxpayer Action Board Medicaid Subcommittee, April 10, 2009, p. 21. The General Revenue Fund is the biggest fund in the State's General Funds.
[57] Robert Pear, "Health Spending Rises in 2008, but at Slower Rate," *New York Times*, January 5, 2010.

FY2006.[58] Medicaid enrollment in Illinois roughly doubled, to 2.6 million participants from 1.3 million, between 1998 and 2008. During the same period, the state's population increased 5.1%, from 12.3 million to 12.9 million.[59] Nearly half a million of the new Medicaid recipients were children from families whose income was below 133% of the federal poverty level, a population that had long been eligible for the program.[60] Illinois also expanded eligibility for the aged and disabled population between FY2001 and FY2003 by raising income limits. This program expansion resulted in roughly 136,000 new recipients, many of whose expenses were considerably higher than average. The FamilyCare program, which raised income limits for the parents of poor children, added about 170,000 new participants.



Source: Commission on Government Forecasting and Accountability, State of Illinois Budget Summary FY2010, p. 127; Email communication between the Civic Federation and the Commission on Government Forecasting and Accountability, December 21, 2009. U.S. Census Bureau, population estimates, various dates.

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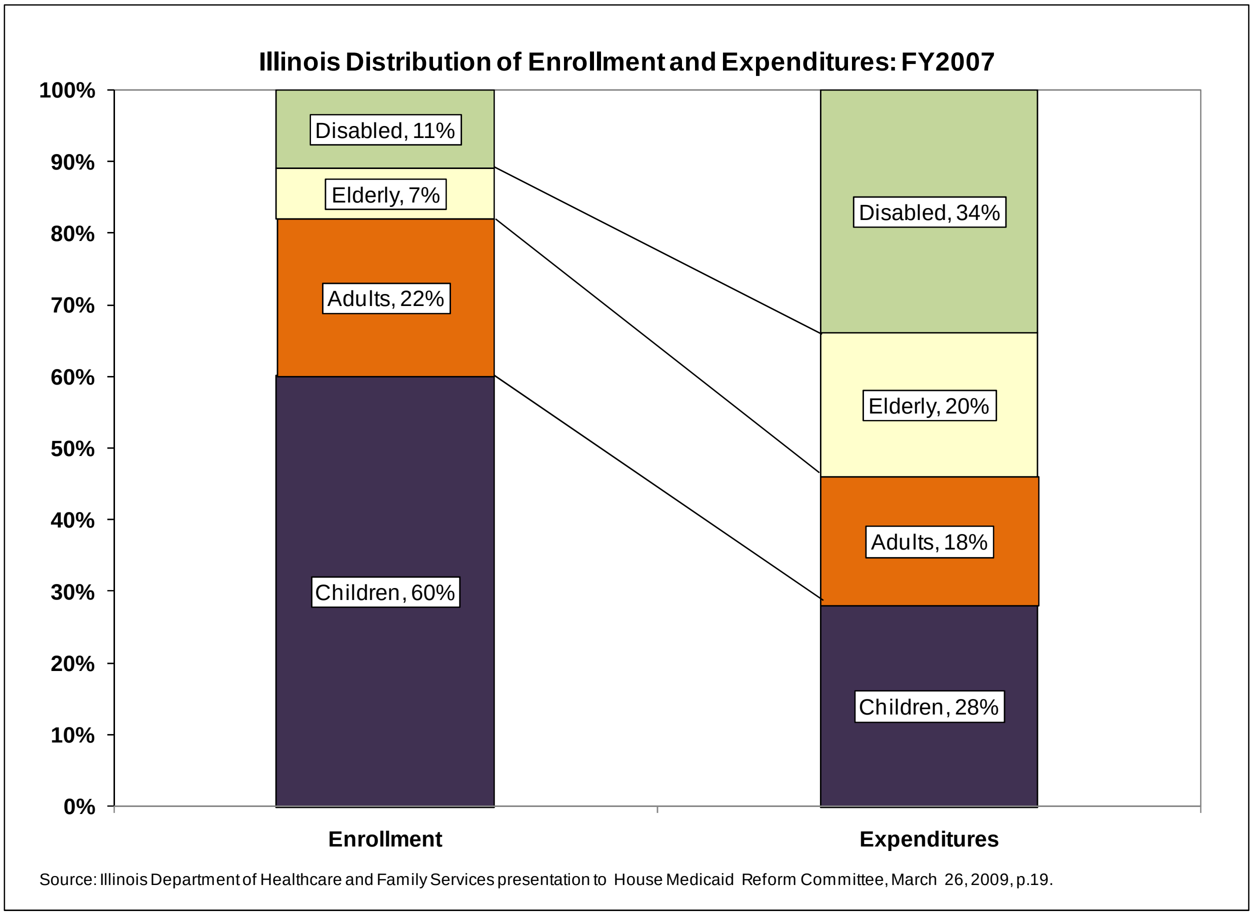
[58] The Kaiser Family Foundation, state healthfacts.org, http://www.statehealthfacts.org/comparecat.jsp?cat=4 (last visited on January 7, 2010).

[59] U.S. Census Bureau , State and Local County Quick Facts – Illinois, at http://quickfacts.census.gov/qfd/states/17000.html ; Population Estimates, at http://www.census.gov/popest/archives/2000s/vintage_2001/CO-EST2001-12/CO-EST2001-12-17.html (last visited on February 3, 2010).

[60] Illinois Department of Healthcare & Family Services, Response to Questions from the Taxpayer Action Board Medicaid Subcommittee, May 5, 2009, p. 4. The federal poverty level is currently $22,050 for a family of four.

In Illinois as in other states, most Medicaid recipients are children, parents and pregnant women, but the bulk of spending is used to aid the elderly and disabled. As shown in the table below, about 82% of Illinois recipients in FY2007 were children and non-disabled adults. However, the elderly and disabled accounted for 54% of expenditures.[61]



The next table shows that Illinois generally spends less per Medicaid recipient than the national average, according to the latest available comparative data.[62] The table also indicates that the State spends far more per person on disabled and elderly Medicaid recipients, who also account for the largest share of total expenditures.

Illinois Medicaid Cost per Recipient Type and National Rank: FY2006

Recipient	Cost	Rank*
Children	$ 1,400	45
Elderly	$ 5,037	49
Disabled Adults	$ 13,933	23
Other Adults	$ 1,981	45
Average	$ 4,129	42

*Includes states and District of Columbia.
Source: The Kaiser Family Foundation, statehealthfacts.org, Medicaid Payments per Enrollee.

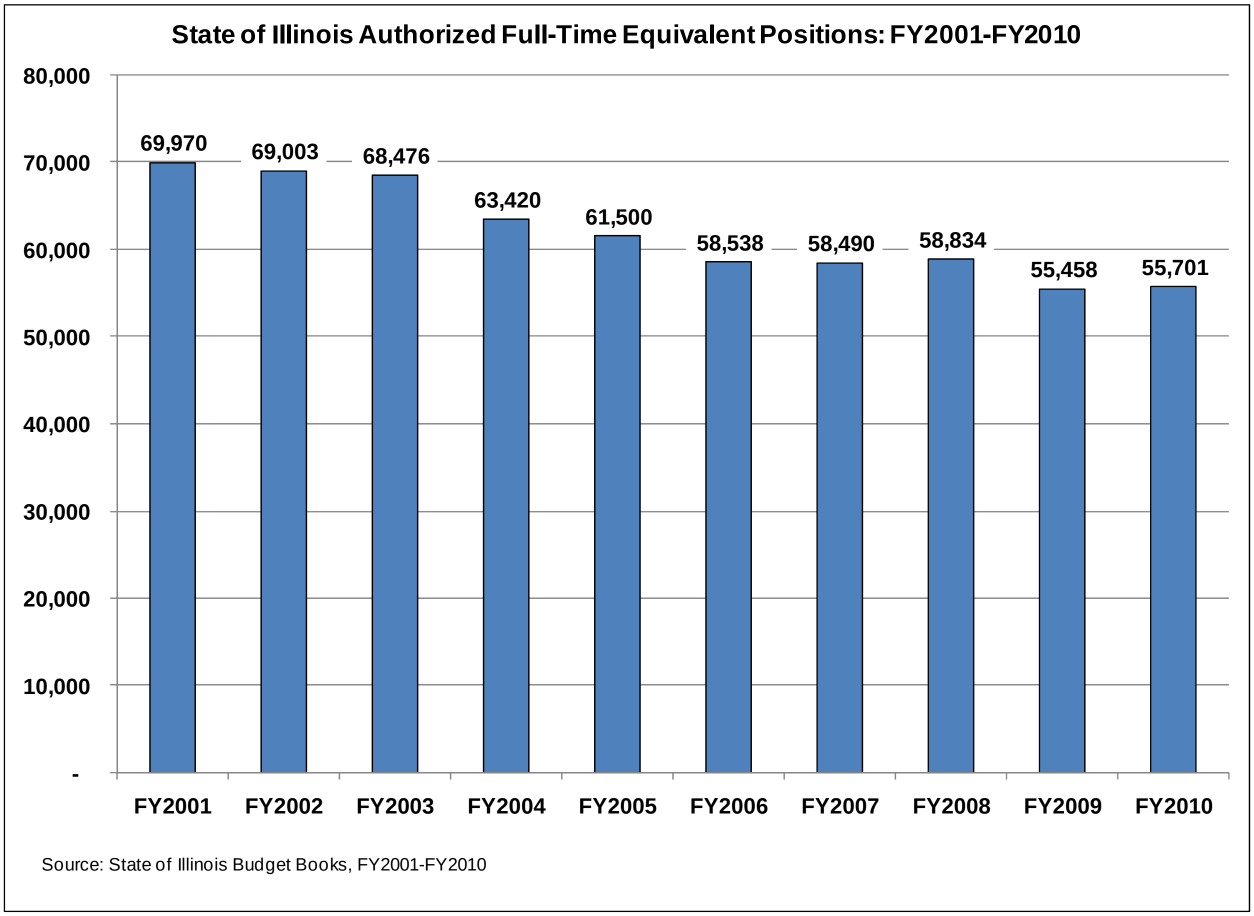
[61] Illinois Department of Healthcare and Family Services, Presentation to Taxpayer Action Board Medicaid Subcommittee, April 10, 2009, p. 15.
[62] The Kaiser Family Foundation, statehealthfacts.org, Medicaid Payments per Enrollee, http://www.statehealthfacts.org/comparecat.jsp?cat=4 (last visited January 7, 2010).

PERSONNEL

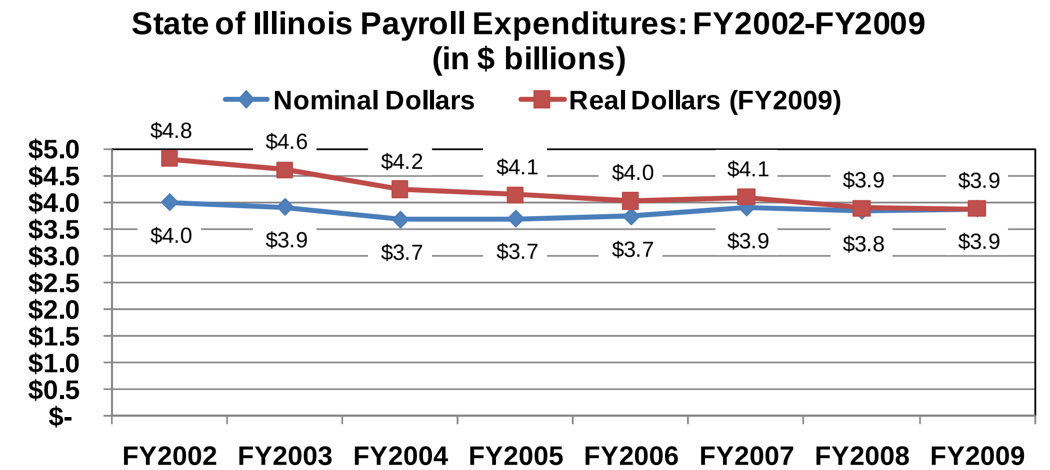
This section describes the State's personnel-related expenditures and liabilities, including payroll costs, group health insurance liabilities and pension obligations.

State Employee Payroll

Between FY2001 and FY2010, the number of authorized full-time equivalent (FTE) positions reported in the State's budget books fell from 69,970 FTE positions to 55,701 FTE positions. This represents a 20.4% or 14,269 drop in the number of FTEs that the State is authorized to hire to carry out government operations and services. Not all state services and operations are carried out 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. The next exhibit shows changes in the number of authorized FTE positions in the ten-year period between FY2001 and FY2010.



Expenditures for state employee salaries totaled $4.0 billion in FY2002 and $3.9 billion in FY2009.[63] Even though FTE positions have decreased, the cost of paying each employee grew due to salary increases. Between FY2002 and FY2009, salaries have grown with the rate of inflation. After adjusting payroll expenditures for inflation to FY2009, the cost declined by 19.4% between FY2002 and FY2009, while FTE positions declined by 19.6% during the same period. The following chart compares state employee payroll expenditures in nominal dollars with expenditures expressed in FY2009 dollars between FY2002 and FY2009.



Note: Payroll expenditures are not available for FY2001 and FY2010. Excludes the following higher education-related payroll: public universities, the Illinois Board of Higher Education, the Illinois Student Assistance Commission, the Illinois Community College Board, the Illinois Math and Science Academy, the State Universities Civil Service System and Retirement System. Real dollars are expressed as FY2009 dollars.
Sources: Illinois State Comptroller, Fiscal Focus, January 2008; Civic Federation estimates based on data obtained from Illinois State Comptroller, Expenditures Control Panel, http://www.ioc.state.il.us (last visited February 8, 2010); Appendix 1, Table B.

The FTE positions and spending described above exclude institutions of higher education. While some state expenditures for higher education cover payroll, universities also use funds they collect themselves, such as student tuition, to pay for employee salaries. In FY2009, of the $3.0 billion the State spent on higher education, approximately $1.2 billion was allocated for helping universities fund payroll costs.

Payroll is not the State's only employee-related expenditure. The State also incurs the cost of funding employee health insurance and pensions.

State Employee Health Insurance

The State's Group Health Insurance Program covers over 346,000 government employees, retirees and their dependents and represents a major and rapidly growing cost in the state budget. This section describes the health insurance program and examines provisions of the program that affect its cost.[64]

[63] Payroll expenditure data for FY2001 and FY2010 are not available.
[64] For a more comprehensive look at the State's health insurance program, see The Civic Federation, *State of Illinois Employee Health Insurance Plans: Analysis and Recommendations for Cost Containment,* April 16, 2007, at http://www.civicfed.org/civic-federation/publications/state-illinois-employee-health-insurance-plans-analysis-and-recommenda (last visited on January 11, 2010).

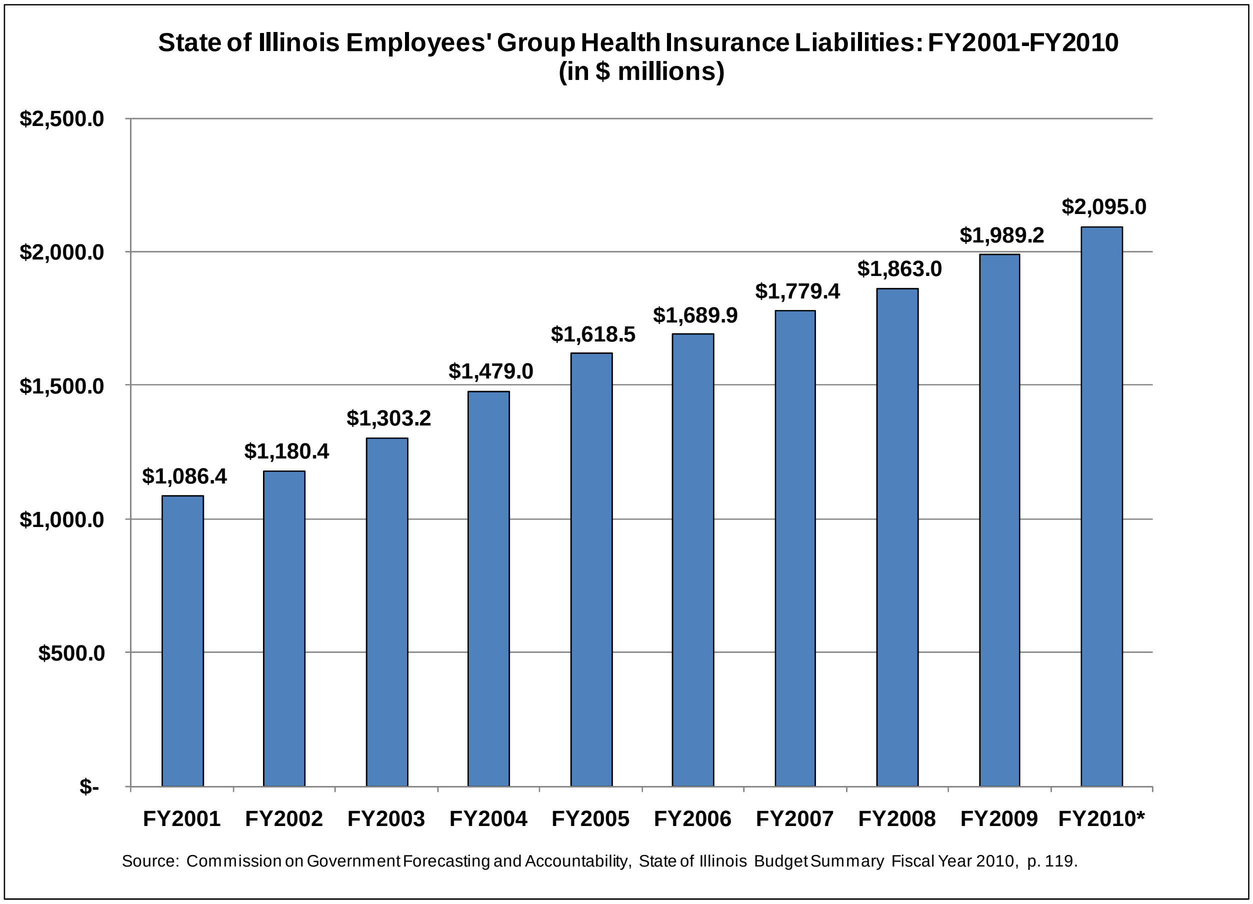
In FY2010, the State's health insurance program was estimated to have 346,518 members, up slightly from 346,451 in the previous fiscal year.[65] Membership increased by 1.7% from 340,702 in FY2001.

State of Illinois Employees' Group Health Insurance: Total Membership FY2001-FY2010			
Year	Members	Year	Members
FY2001	340,702	FY2006	346,085
FY2002	348,134	FY2007	346,476
FY2003	348,909	FY2008	346,679
FY2004	343,180	FY2009	346,451
FY2005	347,767	FY2010*	346,518

Source: Commission on Government Forecasting and Accountability and Illinois Economic and Fiscal Commission, *Liabilities of the State Employees' Group Insurance Program*, various fiscal years.

[65] Commission on Government Forecasting and Accountability, *State of Illinois Budget Summary Fiscal Year 2010*, November 2009, p. 117, at http://www.ilga.gov/commission/cgfa2006/Upload/FY2010budgetsummary.pdf (last visited on January 11, 2010).

Costs of the program are paid by the State and by employee contributions. The Illinois Department of Healthcare and Family Services (HFS), which administers the program, estimated the program's total liabilities at $2.095 billion in FY2010.[66] That amounts to an increase of 92.9% from $1.086 billion in FY2001.[67] Program liabilities grew 6.8% between FY2008 and FY2009 and 5.3% between FY2009 and FY2010, according to HFS.



In his FY2010 budget proposal, Governor Quinn recommended that $2.1 billion be appropriated for the group insurance program, including about $1.1 billion in General Funds.[68] The Governor subsequently revised his plan to include more than $1.3 billion in General Funds for group insurance.[69] Using the lump sums appropriated by the General Assembly, Governor Quinn allocated $700 million to group insurance and said in July of 2009 that the program remained underfunded by $600 million.[70] In December, the State said that it had transferred $300 million from Medicaid appropriations to group insurance.[71]

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[66] Ibid, p. 118. The Commission on Government Forecasting and Accountability (COGFA) publishes both the HFS estimate of group insurance liabilities and its own estimate. For FY2010, COGFA's estimate is $2.124 billion.
[67] Ibid, p. 119.
[68] Commission on Government Forecasting and Accountability, Liabilities of the State Employees' Group Health Insurance Program Fiscal Year 2010, March 2009, p. 4, at http://www.ilga.gov/commission/cgfa2006/Upload/FY2010%20State%20Employees'%20Group%20Insurance%20Program%20MAR%2009.pdf (last visited on January 11, 2010).
[69] State of Illinois, Governor's Allocation Plan: Department of Healthcare and Family Services, at http://www2.illinois.gov/budget/Documents/478-HFS.pdf (last visited on January 11, 2010).
[70] State of Illinois, Governor's Allocation Plan Overview, July 31, 2009, at http://www2.illinois.gov/budget/Documents/FY10%20Allocation%20Plan.pdf (last visited on January 11, 2010).
[71] State of Illinois, $3,466,000,000 General Obligation Bonds Taxable Series of January 2010, *Official Statement*, January 7, 2010, p. 19.

Increases in the State's health insurance costs reflect the nationwide escalation in insurance premiums. Since 1999, average annual premiums for family coverage by public and private employers have increased by 131%, according to a recent survey by the Kaiser Family Foundation.[72] Illinois' costs also depend on the types of insurance plans offered and the contributions required from employees.

Illinois offers three different health insurance plans. The most expensive is the Quality Care Health Plan (QCHP), a traditional, self-insured indemnity or fee-for-service plan, in which participants are free to choose their doctors. The State also offers two less expensive managed care plans: the Open Access Plan (OAP), a modified preferred provider organization using significant monetary incentives to encourage the use of network providers; and Health Maintenance Organizations (HMOs), in which coverage is restricted to network providers and referrals must be directed by a primary care physician. As shown in the table below, most participants—225,220 or 65.0%—are enrolled in the less costly managed care plans. Membership in the QCHP plan has been decreasing since the mid-2000s, while membership in the managed care plans has been rising.[73]

State of Illinois Employees' Group Health Insurance Average Annual Cost Per Participant and Total Enrollment by Type of Plan: FY2009-FY2010

	FY2009 Average Cost per Participant	FY2010 Average Cost per Participant	FY2009 Total Participants	FY2010 Total Participants
QCHP	$ 6,108	$ 6,409	123,680	121,297
HMO	$ 4,517	$ 4,844	184,463	186,170
OAP	$ 4,415	$ 4,670	38,308	39,051

Source: Commission on Government Forecasting and Accountability, Liabilities of the State Employees' Group Health Insurance Program FY2010, March 2009, p. 11.

However, the State's retirees prefer the traditional indemnity plan. In FY2009, 69.7% of retirees were enrolled in the indemnity plan, compared with 35.0% of total participants.[74] In Illinois, retirees with at least 20 years of service are not required to pay health insurance premiums; the total cost of coverage (not including deductibles and copayments) is covered by the State.[75]

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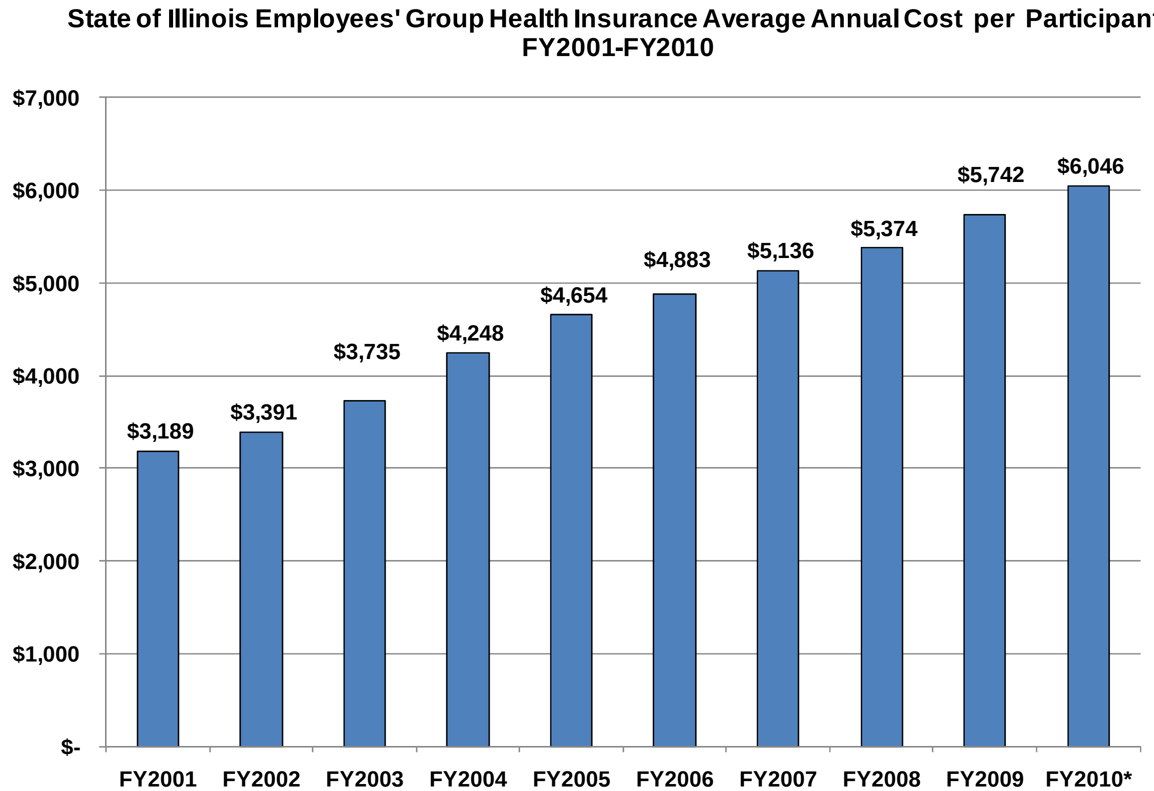
[72] The Kaiser Family Foundation and Health Research & Educational Trust, *Employer Health Benefits 2009 Summary of Findings,* September 15, 2009, at http://www.kff.org/insurance/ehbs091509nr.cfm (last visited on January 11, 2010).

[73] Commission on Government Forecasting and Accountability, *Liabilities of the State Employees' Group Health Insurance Program Fiscal Year 2010, March 2009,* p.7, at http://www.ilga.gov/commission/cgfa2006/Upload/FY2010%20State%20Employees'%20Group%20Insurance%20Program%20MAR%2009.pdf (last visited on January 11, 2010).

[74] Ibid, p.7.

[75] 5 ILCS 375/10 (2010).

The next table shows that estimated average participant costs have increased 89.6% between FY2001 and FY2010, from $3,189 per member to $6,046 per member. In FY2010, average participant costs are expected to increase 5.3% from $5,742 to $6,046.[76]



*Estimated.
Source: Commission on Government Forecasting and Accountability, Budget Summary Fiscal Year 2010 and Liabilities of the State Employees' Group Health Insurance Program, various years.

The insurance liabilities discussed above do not reflect the State's cost of future benefits owed to retirees and their dependents. Non-pension benefits paid to employees after employment ends are referred to as other post-employment benefits (OPEB). Retired State of Illinois employees and their dependents are entitled to OPEB, including health, dental, vision and life insurance.[77] The State does not prefund this obligation; instead, it pays out only what is claimed in the current year. As of June 30, 2007, the State's accrued liability associated with OPEB was $23.9 billion.[78]

Pensions

The State's historic underfunding of the Illinois retirement systems is a growing source of pressure on its operating budget. This section describes the pension systems and presents an overview of the funding problems.

The State funds five 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. Employees also contribute to the systems, with

[76] Commission on Government Forecasting and Accountability, *Liabilities of the State Employees' Group Health Insurance Program Fiscal Year 2010, March 2009*, p. 11.
[77] State of Illinois Comprehensive Annual Financial Report for FY2008, p. 124, July 10, 2009, at http://www.apps.ioc.state.il.us/ioc-pdf/CAFR_2008.pdf (last visited on January 20, 2010).
[78] Ibid, p. 149.

contributions ranging from 4% to 12.5% of salary depending on the system and whether or not the employee participates in the federal Social Security program.[79] As of June 30, 2008, there were a total of 708,990 participants in the systems.[80]

Members of Illinois Retirement Systems: Enrollment as of June 30, 2008			
Pension Fund	Members	Annuitants	Total
Teachers	265,735	91,497	357,232
Universities	159,795	45,346	205,141
State Employees	87,916	56,111	144,027
Judges	982	956	1,938
General Assembly	257	395	652
Total	**514,685**	**194,305**	**708,990**

Source: Illinois State Budget FY2010, p. 4-1.

The financial health of retirement systems is measured by the extent to which their assets cover their estimated liabilities, as determined by actuarial calculations. Estimated pension liabilities are the total benefits earned by employees on the date of the estimate. Unfunded liabilities are liabilities that are not covered by assets held by the systems' investment funds. A funded ratio shows the percentage of liabilities that are covered by assets.

As shown in the table below, Illinois' retirement systems had total unfunded liabilities estimated at $62.4 billion and a combined funded ratio of 50.6% as of June 30, 2009.[81]

State of Illinois Retirement Systems Funded Ratios and Unfunded Liabilities: FY2009* (in $ millions)				
Pension Fund	Accrued Liability	Net Assets	Unfunded Liability	Funded Ratio
Teachers	$ 73,027.5	$ 38,026.0	$ 35,001.2	52.1%
Universities	$ 26,316.2	$ 14,282.0	$ 12,034.2	54.3%
State Employees	$ 25,298.3	$ 11,000.0	$ 14,298.3	43.5%
Judges	$ 1,548.5	$ 616.8	$ 931.7	39.8%
General Assembly	$ 245.2	$ 71.6	$ 173.6	29.2%
Total	**$126,435.4**	**$ 63,996.4**	**$ 62,439.0**	**50.6%**

*Based on June 30, 2009 assets with asset smoothing

Source: Commission on Government Forecasting and Accountability, *Monthly Briefing* , December 2009, p.19.

The figures in the table above reflect legislation approved by the General Assembly in July of 2009 that requires the retirement systems to account for unexpected investment gains or losses over a five-year period rather than recognizing them all at once.[82] The method, known as asset smoothing is used by major Chicago area local pension funds and by most other states.[83] Because of the substantial decline in the stock market during much of FY2009, the use of asset smoothing will result in lower reported unfunded liability levels and higher funded ratios in the

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[79] State of Illinois, $400,000,000 General Obligation Bonds Series A of September 2009, *Preliminary Official Statemen*t, September 9, 2009, p 42.

[80] State of Illinois FY2010 Budget, p. 4-1.

[81] Commission on Government Forecasting and Accountability, Monthly Briefing, December 2009, p. 19, at http://www.ilga.gov/commission/cgfa2006/Upload/1209revenue.pdf (last visited on February 9, 2010).

[82] Public Act 96-0043.

[83] Pew Center on the States, *The Trillion Dollar Gap*, February 2010, p. 5, http://downloads.pewcenteronthestates.org/The_Trillion_Dollar_Gap_final.pdf (last visited on February 19, 2010).

short term. Under the previous method of calculating asset values, COGFA in December of 2009 estimated total retirement system unfunded liabilities at $77.8 billion and a combined funded ratio of 38.5% as of June 30, 2009.[84]

Although Illinois' pension funding problems have been exacerbated by recent market conditions, the State for decades has skimped on contributions to its pension funds.[85] At the end of FY1995, the systems' unfunded liabilities stood at $19.5 billion.[86] To help deal with chronic underfunding, lawmakers enacted a pension funding reform law, Public Act 88-593, which took effect in 1995 and established a 50-year schedule of funding requirements. After a phase-in period of 15 years, the law required State contributions at a level percentage of payroll beginning in FY2010 sufficient to achieve a 90% funded ratio by 2045. The retirement systems calculate and certify the amounts needed each year to meet the requirements of this funding schedule.

The pension reform law imposed specific requirements for state funding, but it did not require the State to make adequate contributions to keep unfunded liabilities from growing until approximately 2034.[87] 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.

In addition, the State passed legislation that provided for several years of pension holidays, allowing it to avoid making even the full payment that would have been required under the pension reform law.[88] The only year in which the State has contributed enough to keep the unfunded liability from growing was in FY2004, following the sale of $10 billion in 30-year pension obligation bonds in FY2003 to boost the retirement systems' assets. The State used $7.3 billion of the proceeds from the bond sale to reduce unfunded liabilities, while the rest (after costs of issuing the bonds) was used to cover contributions to the retirement systems, freeing up nearly $2 billion to offset budget deficits.[89]

In FY2010, the State's total projected pension contribution is $4.0 billion. The General Funds portion of the contribution will be paid for through the issuance of $3.5 billion in five-year bonds. The State will be paying debt service on these bonds through FY2015 and on the previous $10 billion bond issue through FY2033. Debt service on the two bond issues totals $22.7 billion.[90] More information on pension borrowing costs is contained in the Debt Trends section of this report.

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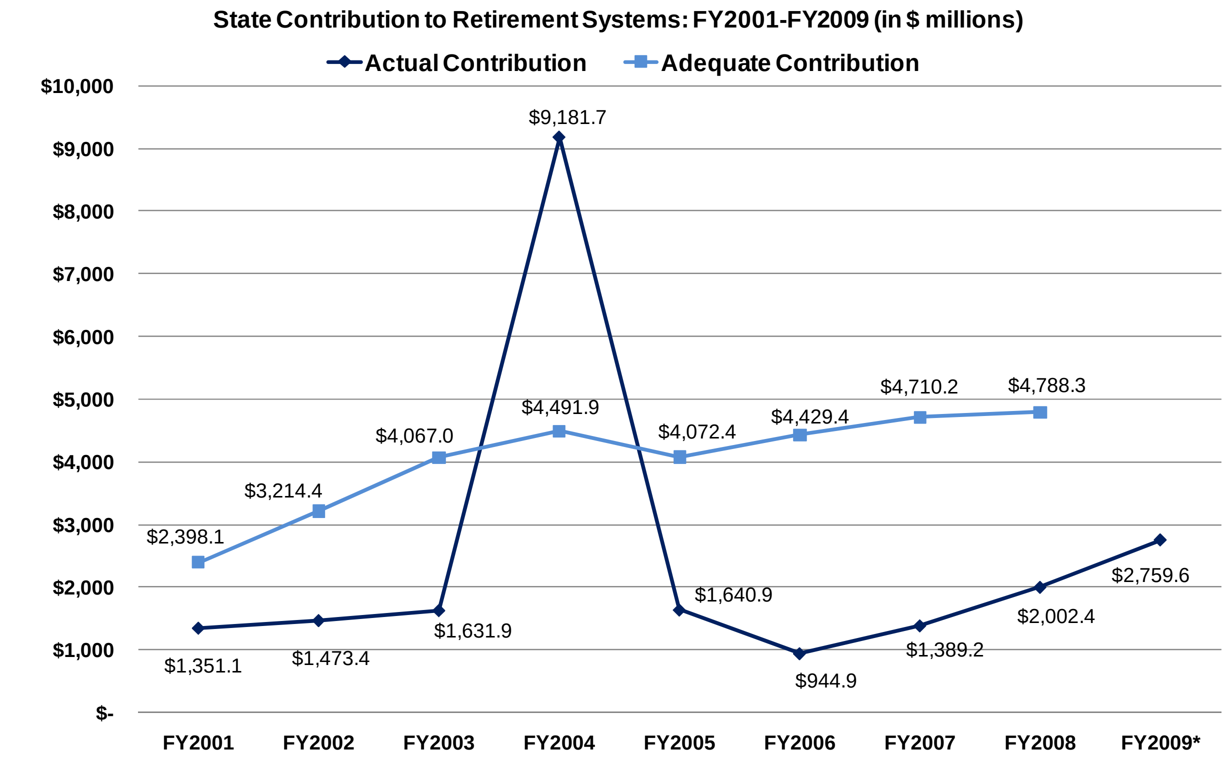
[84] Commission on Government Forecasting and Accountability, *Monthly Briefing*, December 2009, p. 18.
[85] For a more comprehensive look at the history of Illinois pension funding, see The Civic Federation, *State of Illinois Retirement Systems: Funding History and Reform Proposals*, September 30, 2008 at http://civicfed.org/sites/default/files/civicfed_279.pdf (last visited on January 14, 2010).
[86] Commission on Government Forecasting and Accountability, Report on the 90% Funding Target of Public Act 88-0593, January 2006, p. 7, at http://www.ilga.gov/commission/cgfa2006/Upload/Funding_PA_88-0593.pdf (last visited on December 6, 2009).
[87] Ibid, p.25 (December 22, 2005 letter to the Commission on Government Forecasting and Accountability from John Filan, Director of the Governor's Office of Management & Budget).
[88] Public Act 94-0004 reduced contributions a total of $2.3 billion in FY2006 and FY2007 from the payment required under the pension reform law. Governor Rod Blagojevich had proposed a $215 million reduction from the payment required in FY2005, but the final budget restored the full payment amount.
[89] James B. Burnham, "Risky Business? Evaluating the Use of Pension Obligation Bonds," Government Finance Review, June 2003, p.13.
[90] State of Illinois, $3.466 Billion General Obligation Bonds Taxable Series of January 2010, *Official Statement*, January 7, 2010, p. 36, Table 16.

The table below shows actual state contributions to the retirement systems from 2001 through 2009 and compares them to contributions—normal cost plus interest on the unfunded liability—that would have been adequate to prevent growth in the unfunded liability.[91]

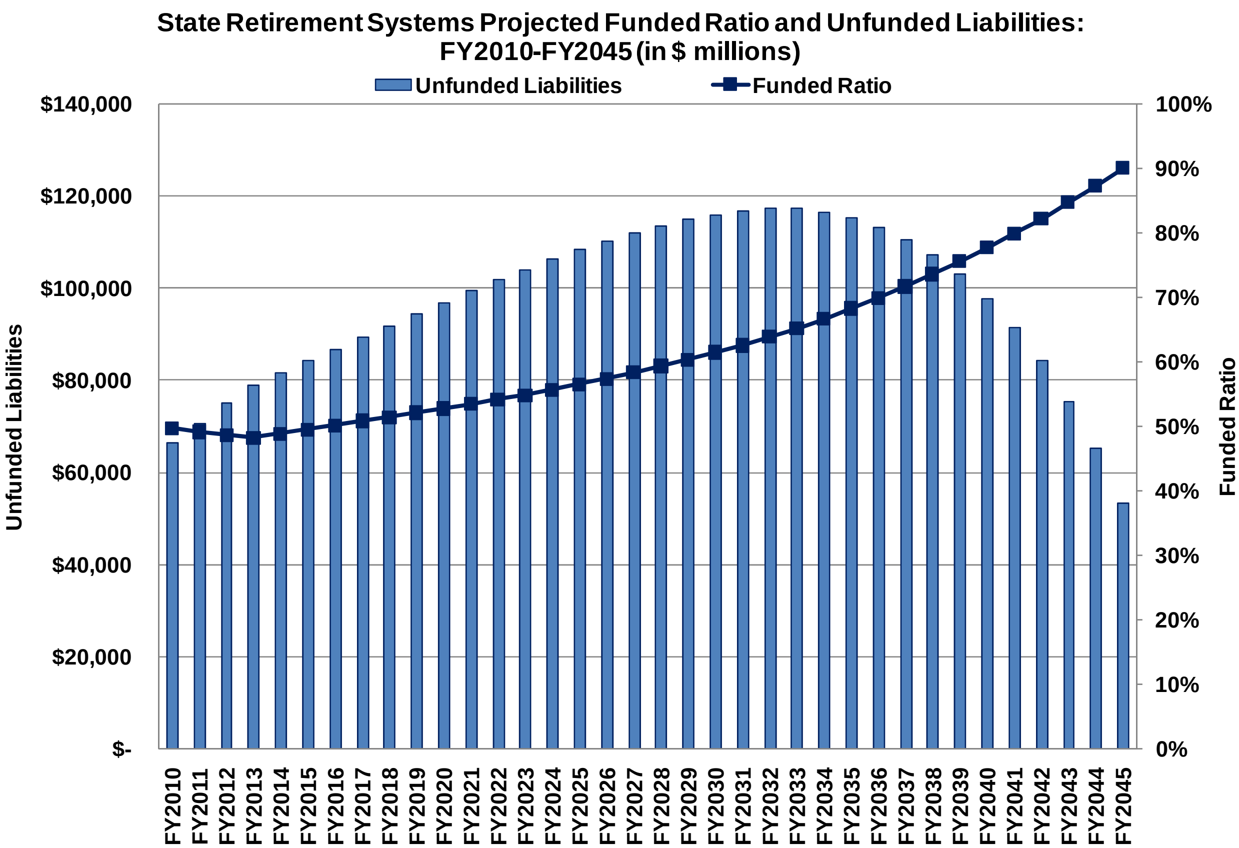


*Data not available for FY2009 adequate contribution.
Source: Commission on Government Forecasting and Accountability, *Pensions,* February 2009, pp.11 and 81; *State of Illinois Budget Summary FY 2010*, p.95. Adequate contribution calculated by adding actual contribution to difference between actual and adequate contribution.

Inadequate state contributions accounted for $12.6 billion, or approximately one third, of the $38.3 billion growth in unfunded liability from FY2001 through FY2008, according to COGFA.[92] Other major factors included lower than expected investment returns and benefit increases.

[91] 2009 data on the adequate contribution to prevent unfunded liability growth are not available.
[92] Commission on Government Forecasting and Accountability, *Pensions*, February 2009, p. 81.

As shown in the next table, the systems' unfunded liability is not projected to decline until 2034, after peaking at $117.2 billion a year earlier.[93]



Source: Commission on Government Forecasting and Accountability, *Monthly Briefing*, January 2010, p.13. See Appendix 4, Table A.

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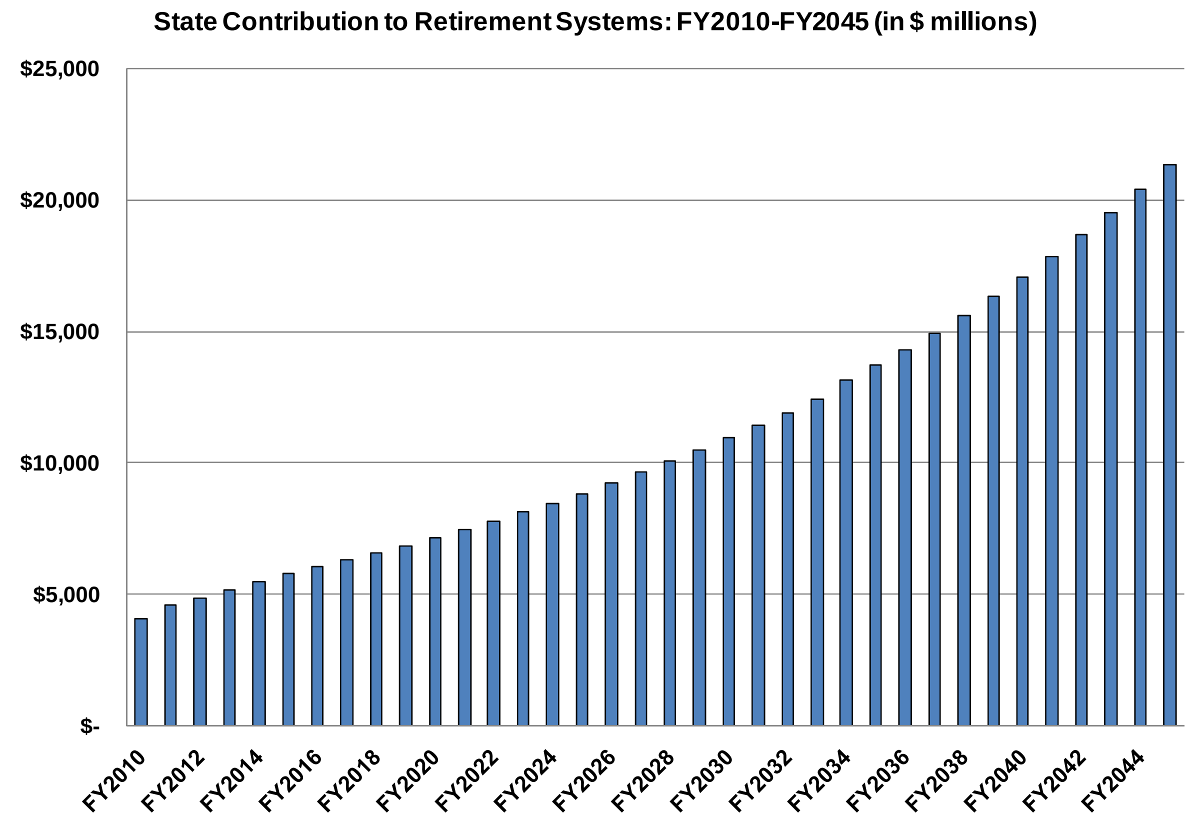
[93] Commission on Government Forecasting and Accountability, Monthly Briefing, January 2010, p. 13, at http://www.ilga.gov/commission/cgfa2006/Upload/0110revenue.pdf (last visited on February 11, 2010).

State pension contributions are projected to increase by an annual average of 12.2% from FY2010 through FY2045, from $4.0 billion to $21.4 billion, to meet the statutory funding requirement of 90%.[94] This projected increase is shown in the next graph, which reflects the new asset smoothing requirement discussed above.



Source: Commission on Government Forecasting and Accountability, *Monthly Briefing*, January 2010, p.13. See Appendix 4, Table B.

The State's FY2011 contribution is projected at $4.6 billion, of which an estimated $4.1 billion is expected to come from General Funds.[95] In FY2010, the State borrowed $3.5 billion to make its General Funds pension contribution, so the payment in FY2011 will represent a new $4.1 billion burden on General Funds.

COMPARISON OF GENERAL FUNDS REVENUES AND EXPENDITURES

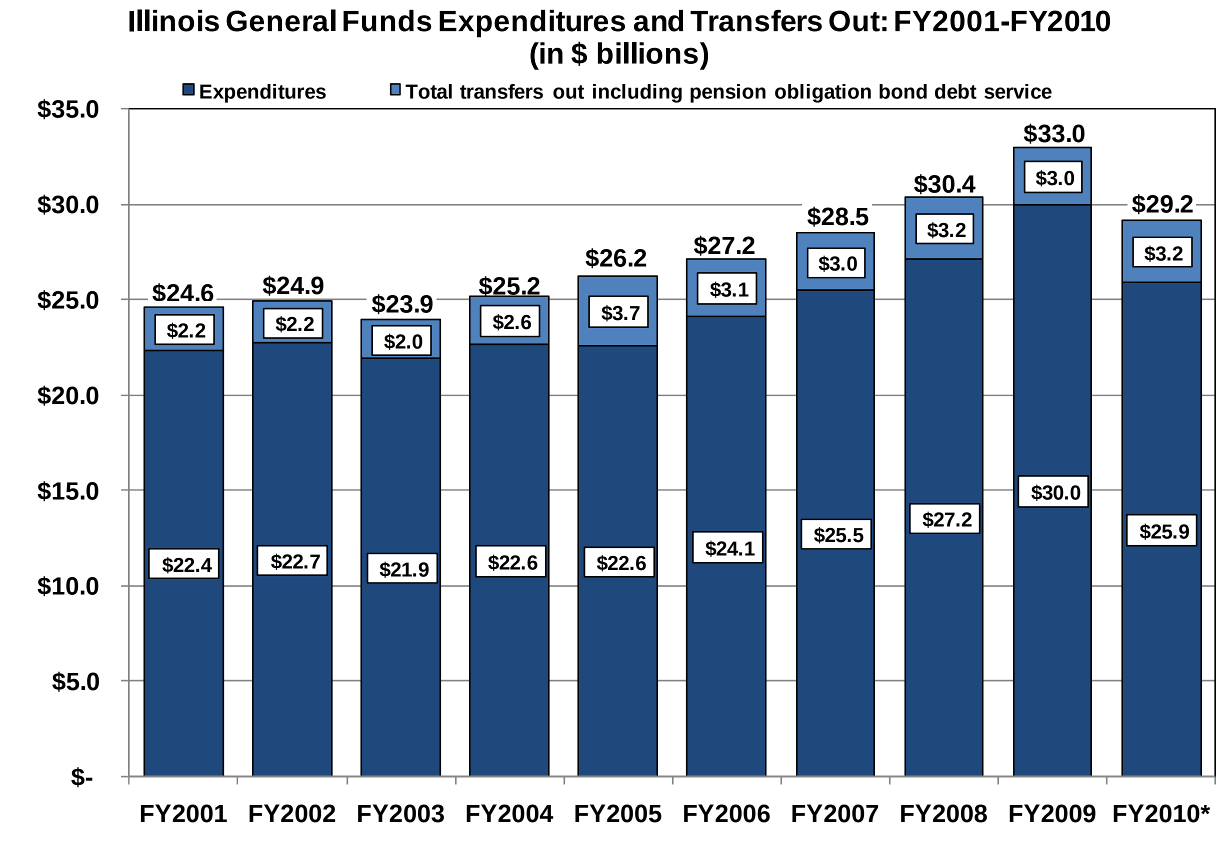
The State of Illinois' budget is balanced when General Funds revenues are sufficient to meet expenditures not funded through special purpose funds or federal funds. The following section provides an overview of General Funds utilization and a comparison of this utilization with available revenues.

General Funds Utilization: Expenditures and Transfers Out

In addition to the General Funds expenditures described in the Appropriations section, General Funds are also used to make statutorily required transfers to other funds. Unlike expenditures

[94] Ibid, p. 13, and Civic Federation calculation.
[95] Ibid, p. 13. General Funds contribution is a Civic Federation calculation based on November 2009 communication with Commission on Government Forecasting and Accountability.

made from appropriations authorized in annual budget acts, these transfers are made pursuant to statute. When comparing General Funds revenues and expenditures, it is important to include these transfers out of the General Funds, which contribute to the General Funds deficits and surpluses. Transfers out include amounts dedicated to debt service (including pension obligation bond payments) and other statutorily required funding transfers. The following chart outlines the 18.6% growth in total General Funds utilization since FY2001, from $24.6 billion to $29.2 billion. The largest year-to-year change in expenditures occurred in FY2010, when General Funds expenditures will drop by $3.8 billion or 11.2% from FY2009. However, FY2010 expenditures include no General Funds contribution to the retirement systems because the contribution will be made from the proceeds of the sale of $3.5 billion in pension bonds. This reduction followed a $2.6 billion or 8.6% increase from FY2008 to FY2009, which was primarily a result of increased Medicaid spending to pay down the backlog of unpaid Medicaid bills in order to comply with federal recovery requirements.



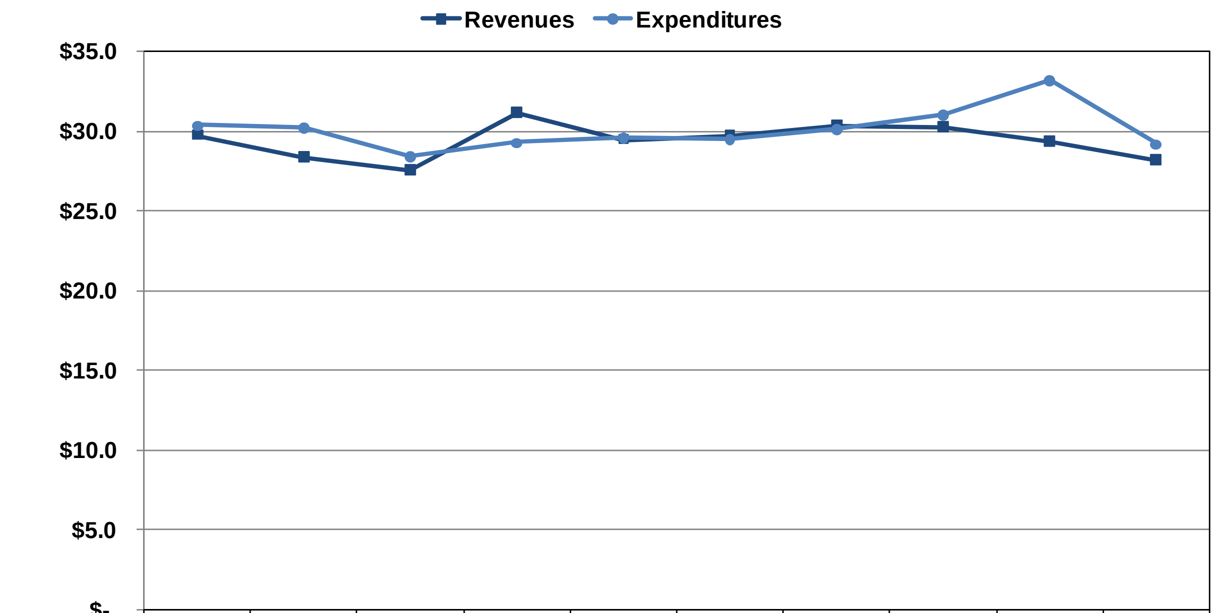
*FY2010 are estimates as of December 15, 2009.
Sources: State of Illinois, various dates, see Appendix 5.

Total expenditures of General Funds in FY2001 included $22.4 billion expenditures from appropriations as well as $2.2 billion in transfers out. Starting in FY2005, pension obligation bond debt service payments ranging from $467 million to $495 million were also transferred out of General Funds. As a result, total transfers out have increased by 46.3% since FY2001 and are expected to account for $3.2 billion of the total $29.2 billion General Funds expenditures in FY2010. Of the $4.6 billion total increase in General Funds expenditures, the increase in transfers out has contributed $1.1 billion or 25.5% of the total increase.

Inflation-adjusted General Funds Comparison

The following analysis examines revenues and expenditures from FY2001 through FY2010 converted to 2009 dollars in order to explore growth without variations due to inflation. Over the last ten years, inflation-adjusted General Funds revenues have declined faster than inflation-adjusted expenditures (including transfers out and pension bond debt service), which resulted in a budget gap by FY2008. While General Funds revenues have declined since FY2008 after adjusting for inflation, expenditures increased sharply in FY2009 and are expected to decline in FY2010. However, FY2010 expenditures include no General Funds contribution to the retirement systems. Instead, the contribution is financed from the proceeds of the sale of $3.5 billion in pension bonds.[96] The following chart compares General Funds revenues and expenditures after adjusting for inflation.

Illinois Inflation-adjusted General Funds Revenues and Expenditures: FY2001-FY2010 (in $ billions)



	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010*
Revenues	$29.7	$28.3	$27.5	$31.1	$29.5	$29.7	$30.3	$30.3	$29.3	$28.2
Expenditures	$30.3	$30.2	$28.4	$29.2	$29.5	$29.5	$30.1	$31.0	$33.2	$29.2

Notes: FY2010 CPI includes July-December 2009 data. Prior years are expressed as 2009 dollars. See Appendix 2, Table B.
Total expenditures include all General Funds expenditures and transfers out, including those transfers out made for pension obligation bond debt service.
Total General Funds Revenues include Pension Obligation Bond Reimbursement Transfers of $300 million in FY2003 and $1.5 billion in FY2004.
FY2010 revenues do not include proceeds from the sale of $3.5 billion pension notes and expenditures do not include retirement system contributions.
*FY2010 is projected as of December 15, 2009.
Source: State of Illinois, various dates, see Appendix 2, Table C and Appendix 5.

After adjusting for inflation, General Funds revenues declined by 5.1% between FY2001 and FY2010 while General Funds expenditures have decreased by 3.8%. Revenues remained relatively flat between FY2005 and FY2009, while expenditures gradually increased from FY2003 to FY2009. As a result, expenditures caught up with and eventually exceeded revenues in FY2008, FY2009 and FY2010.

[96] The pension bonds authorized in 30 ILCS 330/7.2 (2009) were not the first time that statutorily required pension contributions were amended in order to reduce General Funds expenditures. The State passed legislation authorizing partial pension funding holidays for FY2006 and FY2007. Public Act 94-0004 reduced contributions a total of $2.3 billion in FY2006 and FY2007 from the payment required under the pension reform law.

FY2010 General Funds expenditures will decrease by 12.1% from FY2009. This decline resulted in the first reduction in General Funds expenditures since FY2006. However, as discussed above, FY2010 projected expenditures of $29.2 billion do not include General Funds contributions to the retirement systems. The most recent estimates show FY2010 General Funds expenditures surpassing revenues by $1.0 billion due to the decline in General Funds revenue projections from $29.3 billion to $28.2 billion since the appropriations were first enacted in July of 2009. Additional General Funds spending pressures in FY2011 include an estimated retirement system contribution of $4.1 billion and $803 million in debt service on the pension bonds used to pay the FY2010 contribution. Once these costs are added to General Funds expenditures in FY2011, the gap between revenues and expenditures going into the next fiscal year will be larger than the gap in FY2009.

DEBT TRENDS

This section examines historic trends in long-term and short-term debt issued by the State of Illinois and the amount of debt service owed by the State on an annual basis. It shows that Illinois' outstanding long-term debt has more than tripled in size in just over a decade, from $8.4 billion in FY2001 to more than $25.4 billion going into FY2011. Debt service has become a much larger drain on the State's financial resources over this period. The State in recent years has also depended on larger and more frequent short-term loans to buttress the operating budget and carry forward deficits from one year to the next.

General Obligation and Revenue Bonds

Under the General Obligation Bond Act,[97] the State is authorized to issue General Obligation Bonds (G.O. Bonds) to fund a variety of capital investments including roads, schools, mass transit, environmental projects and other facilities. G.O. 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 G.O. Bond Act was amended in recent years to allow for debt-funded payments to the State's retirement systems. In 2003, the State approved $10 billion in Pension Obligation Bonds (POB) to pay for unfunded liabilities in the State's retirement systems. The amount was increased in FY2010 by $3.5 billion to make the annual payment that would have come from the State's General Funds. These POB issuances have been used to justify reducing the annual contribution to the pension system and in the case of FY2010 as the source for the State's annual pension contribution. This action allowed the legislature to use more General Funds for other expenditures. The FY2010 POBs will be paid back over the next five years. The original FY2003 POBs were financed over 30 years and the last bonds will be retired in FY2033.

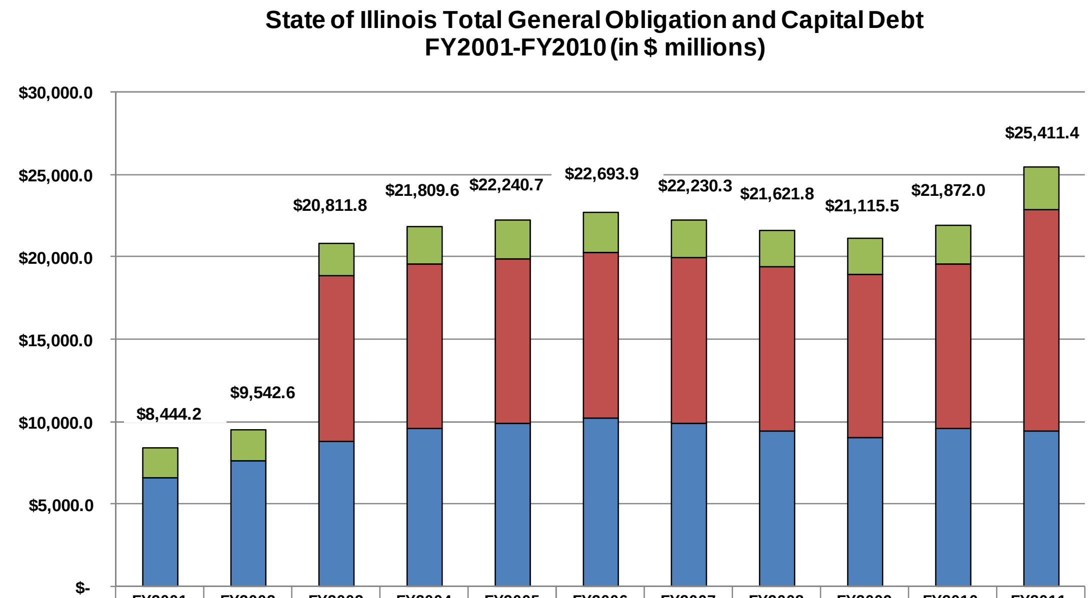
As part of the capital budget approved by the Governor and General Assembly in FY2010, the State will initially sell $5.8 billion in new G.O. Bonds to support capital projects. The State appropriated a total of $12.6 billion in new projects in the capital budget to be funded by borrowing. However, additional borrowing must be authorized by a two-thirds vote of the General Assembly before additional bonds above the $5.8 billion can be sold. The State issued the first $300 million in new bonds in April 2009, $400 million in September of 2009 and $1 billion in February 2010. Of the new authorization, $4.1 billion remains to be issued.

[97] 30 ILCS 330/1 (2001)

Illinois has also issued several types of revenue bonds to fund capital projects. Unlike G.O. Bonds, revenue bonds are not guaranteed by the full faith and credit of the State but rather pledge a portion of specific State revenues. The State currently pays directly for two types of revenue bonds. The Metropolitan Exposition and Auditorium Authorities bond program was supported by the issuance of Civic Center Bonds, the last of which were sold in 1992. In FY2009, there were $100.0 million in Civic Center Bonds outstanding and the State will make its final payment on this debt in FY2021. Although originally financed in part by horse racing taxes, these bonds are now fully repaid out of General Funds.[98]

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 legislature on several occasions since Governor James Thompson's inaugural program in the late 1980s. At the end of fiscal year 2009, the State had nearly $2.1 billion worth of outstanding Build Illinois bonds.[99] The State approved selling an additional $810 million in Build Illinois Bonds as part of the FY2010 capital budget. Two series of Build Illinois Bonds were sold in December 2009. Series A increased the outstanding principal owed by $154.9 million, and Series B totaled $375 million.

The State of Illinois currently has an estimated total of $25.4 billion in outstanding debt going into FY2011. This is a $17.0 billion, or 200.9%, increase over FY2001. The existing debt includes $13.4 billion from the State's two issuances of POBs in FY2003 and FY2010. The remaining $12.0 billion comes from the three different types of capital purpose debt: G.O. capital debt, Build Illinois debt and Civic Center debt. The following graph shows the increase in total long-term State debt between FY2001 and FY2011.



	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011
Build Illinois/Civic Center	$1,844.2	$1,912.7	$1,999.2	$2,253.3	$2,347.7	$2,442.5	$2,304.6	$2,208.9	$2,163.7	$2,309.0	$2,593.6
Pension Bonds	$-	$-	$10,000.0	$10,000.0	$10,000.0	$10,000.0	$10,000.0	$9,950.0	$9,900.0	$9,950.0	$13,366.0
GO Debt	$6,600.0	$7,629.9	$8,812.6	$9,556.3	$9,893.0	$10,251.4	$9,925.7	$9,462.9	$9,051.8	$9,613.0	$9,451.8

Source: State of Illinois Budgets FY2005-FY2010.
State of Illinois General Obligation Bonds, Taxable Build America Bonds, Series 2010-1, *Official Statement* , January 28, 2010, p. 36, 40.

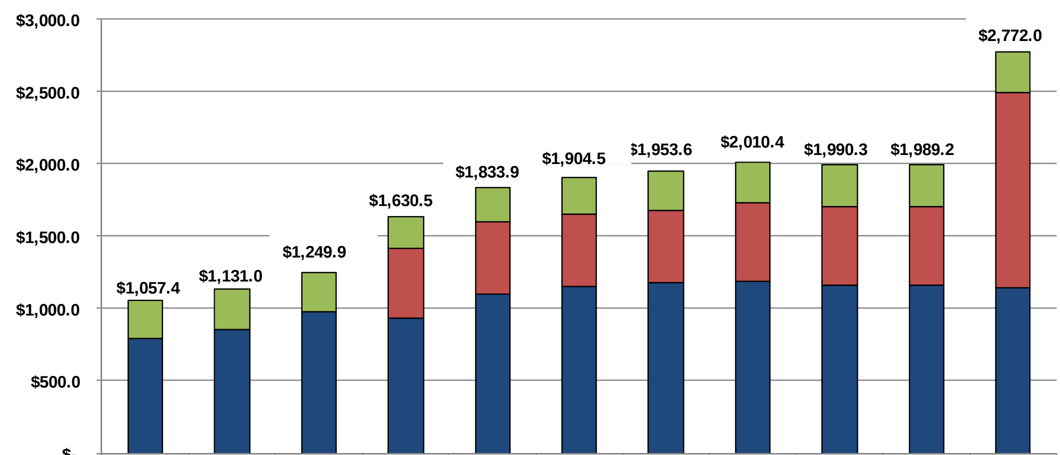
[98] 30 ILCS 355, Metropolitan Civic Center Support Act, 1987.
[99] State of Illinois Budget FY2010, p. 61.

Illinois' total G.O. debt has increased dramatically in FY2003 due to the issuance of $10 billion in Pension Obligation bonds in 2003. Likewise, the new capital borrowing and pension borrowing approved in FY2010 have contributed to another less drastic but significant increase in outstanding state debt of $4.3 billion or 20.3% from FY2010 to FY2011. Total debt could increase before the end of FY2010 depending on whether the state issues any of the remaining $4.1 billion of G.O. Bonds or $280.1 million in Build Illinois Bonds authorized in FY2010 but not yet sold.

Debt Service

The State's debt service schedule sets forth the principal and interest amounts due for outstanding bonds on an annual basis. In FY2011, the State estimates its required debt payment will total $2.7 billion for all outstanding G.O. Bonds, POBs and revenue bonds that it appropriates funds to directly.[100] This is a 162% increase in annual debt service cost owed by the State since FY2001, or $1,714.6 million. The largest increases to annual debt service came in FY2004 and FY2011, the years immediately following the sale of new POBs. The following chart shows the total debt service for existing Pension Obligation bonds, G.O. capital bonds and other capital bonds.

State of Illinois Capital Purpose and Pension Bonds Total Debt Service (Principal + Interest) FY2001-FY2011 (in $ millions)

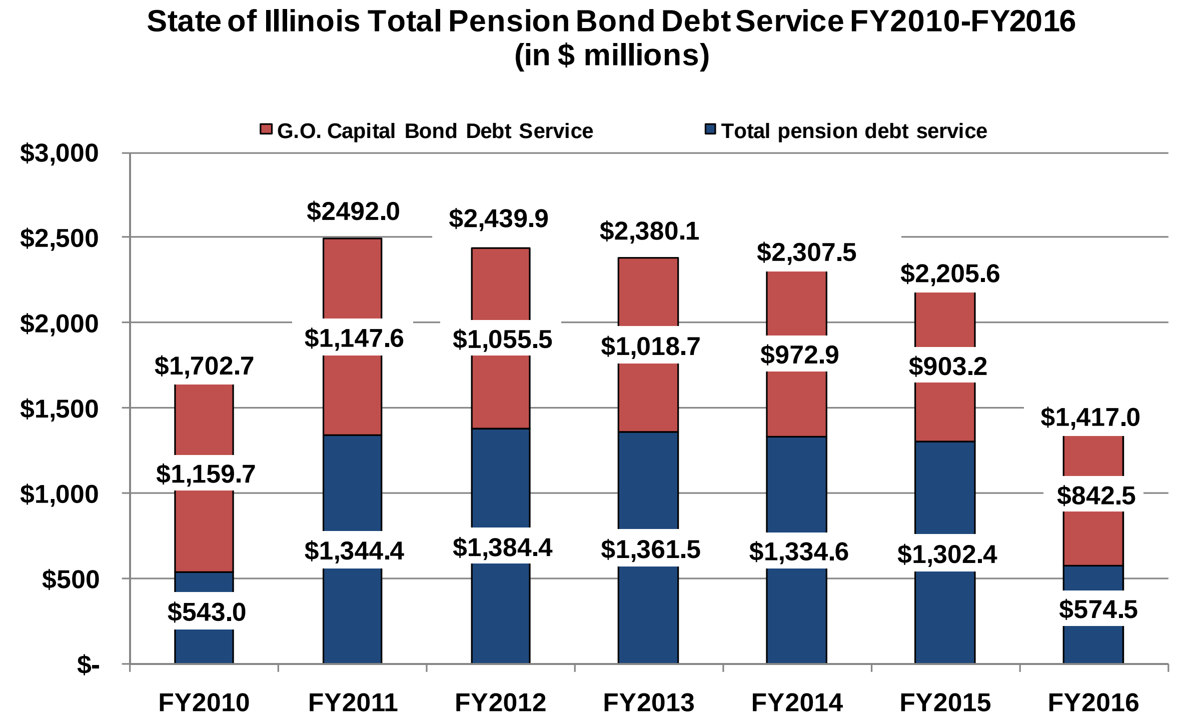


	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011
Build Illinois/Civic Center	$267.4	$279.0	$275.9	$218.5	$234.5	$255.0	$278.0	$280.0	$286.0	$286.0	$280.0
Pension Bonds	$-	$-	$-	$481.0	$496.2	$496.0	$496.0	$546.0	$544.0	$543.6	$1,344.4
GO Bonds	$790.0	$852.0	$974.0	$931.0	$1,103.2	$1,153.5	$1,179.6	$1,184.4	$1,160.3	$1,159.7	$1,147.6

Source: State of Illinois Budgets FY2005-FY2010.
State of Illinois General Obligation Bonds, Taxable Build America Bonds, Series 2010-1, *Official Statement*, January 28, 2010, p. 36, 40.

Prior to enacting the FY2010 capital and operating budget, total debt service payments for principal and interest were projected to decline from FY2009 through FY2033, from $1.9 billion to $1.2 billion, falling to $89 million in 2034 and retiring all debt by FY2035.[101] However, because of the new capital borrowing and pension borrowing approved in FY2010, the State will pay dramatically higher debt service over the next five years. The following chart compares G.O. Bonds debt service for capital projects to POB debt service between FY2010 and FY2016.

[100] State of Illinois General Obligation Bonds, Taxable Build America Bonds, Series 2010-1, *Official Statement*, p. 36, 41.
[101] State of Illinois Budget FY2010, p. 12-10



Source: State of Illinois, $3.466 Billion General Obligation Bonds Taxable Series of January 2010, *Official Statement*, January 7, 2010, pg. 3 and Table 16.

Although the new capital budget was accompanied by a series of new fees and taxes to pay for increases in debt service, no new revenue was passed to account for the increased POB debt service. The State will owe an annual payment of $802.5 million in FY2011 to repay the five-year pension bonds. This amount decreases slightly each year until the last payment of $723.8 is made in FY2016 on the $3.5 billion bond sale.[102]

Between FY2010 and FY2033, the State of Illinois will pay a total of $22.7 billion in debt service for the total outstanding POB principal of $13.4 billion on all POBs combined. It will also pay $14.8 billion in total debt service for $9.4 billion in G.O. bonds for capital purposes.[103] The State will also continue to expend 3.8% of its sales tax receipts annually through FY2034 to pay a total debt service of $3.7 billion on $2.5 billion in total outstanding Build Illinois revenue bonds.

Short-Term Debt

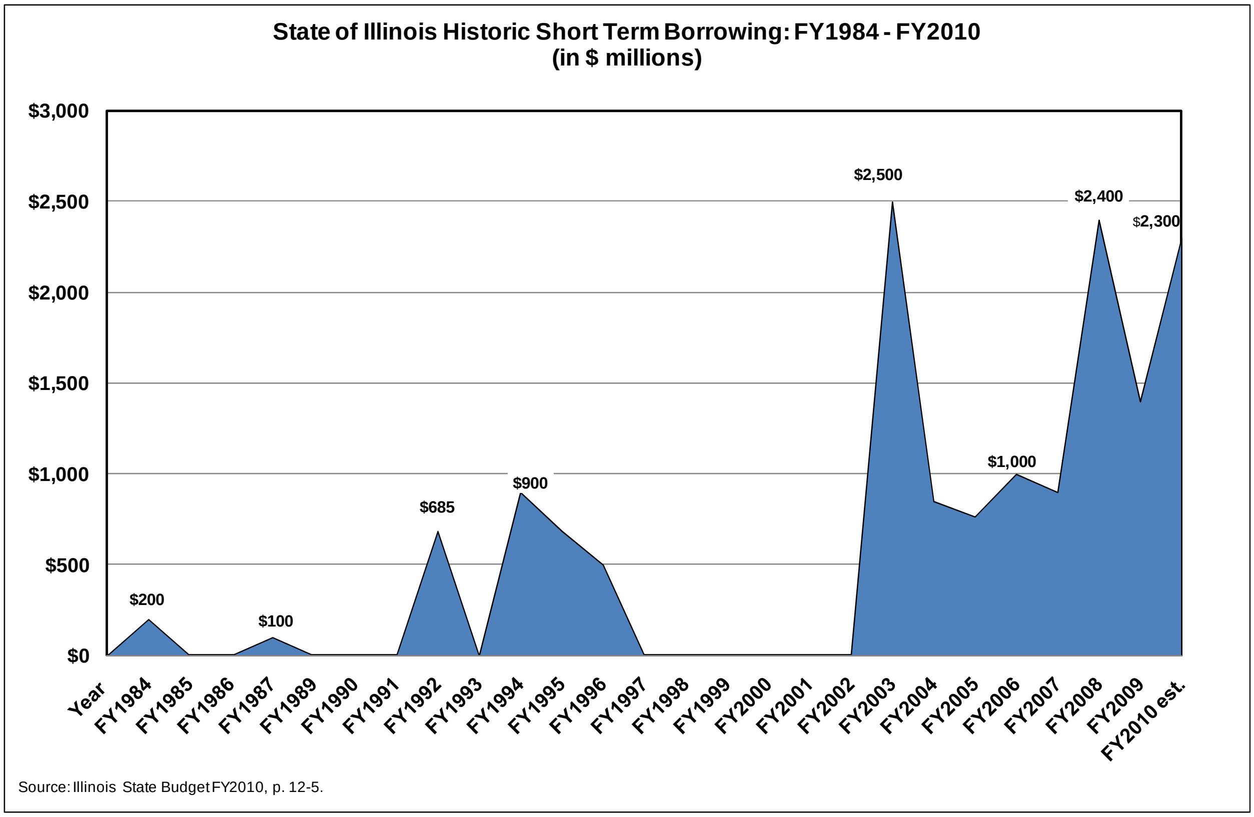
Short-term debt is a financial obligation that must be satisfied within one year. An increasing trend in short-term debt may be a warning sign of future financial difficulties. The amount of short-term debt issued is good a measure of budgetary solvency, or government's ability to generate enough revenue over the course of a normal budgetary period to meet its expenditures

[102] State of Illinois, $3.466 Billion General Obligation Bonds Taxable Series of January 2010, *Official Statement*, January 7, 2010.
[103] State of Illinois General Obligation Bonds, Taxable Build America Bonds, Series 2010-1, *Official Statement*, p. 36.

and prevent deficits. The State of Illinois Short Term Borrowing Act governs the State's ability to access short-term capital.[104]

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.[105] The second scenario, which applies to the $1 billion in short-term notes that were issued at the close of the FY2009 budget, allows the State to borrow up to 15% of the total appropriations for any year if there is a failure in revenue.[106] This type of short-term borrowing must be paid back within 12 months of issuance.

The following exhibit shows the upward trend in frequency and total amount of short-term certificates from FY1984 through FY2010.



Prior to FY2003, and since 1984, Illinois had not issued more than $900 million in short term certificates in any given fiscal year and had never authorized short-term borrowing in more than three consecutive fiscal years. Since then the State has increased both the frequency and volume of its issuance of short-term debt. On average, the State has had $1.8 billion in short-term notes outstanding at any given time since FY2003. 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.

[104] 30 ILCS 340 (2004).
[105] 30 ILCS 340/1 (2004).
[106] 30 ILCS 340/1.1 (2004).

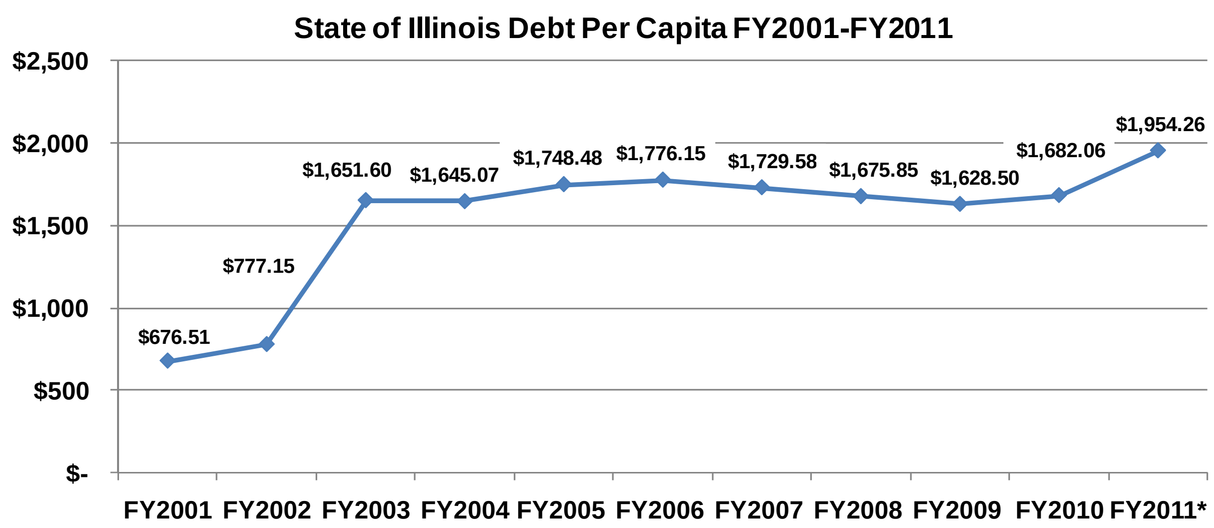
Halfway through FY2009, in December of 2008, the State issued $1.4 billion in short-term debt to pay down some of the State's outstanding liabilities. These notes were due to be repaid by the end of FY2009. However, the State declared a failure of revenue for FY2009 as part of the FY2010 budget and sold $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 September of 2009. The combined total of $2.3 billion in outstanding short-term borrowing must be repaid before the end of the current fiscal year. The following chart shows the amount and year of the State's short-term debt issuances since FY1984.

Short-Term Debt Certificates Issued: FY1984 - FY2010 (in $ millions)		
Year	**Total Short-Term Debt**	
FY1984	$	200.0
FY1987	$	100.0
FY1992	$	685.0
FY1994	$	900.0
FY1995	$	687.0
FY1996	$	500.0
FY2003	$	2,500.0
FY2004	$	850.0
FY2005	$	765.0
FY2006	$	1,000.0
FY2007	$	900.0
FY2008	$	2,400.0
FY2009	$	1,400.0
FY2010 est.	$	2,300.0

Source: Illinois State Budget FY2010, p. 12-5.

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 FY2001 and FY2011, existing debt per capita nearly tripled from $676.51 in FY2001 to a projected $1,954.26 in FY2011, or 188.9% using the same population total reported from FY2010. The majority of the increase in debt per capita can be attributed to the sales of POBs in FY2003 and FY2010, which were not part of the State's debt burden in FY2001. The following exhibit shows total Illinois' debt per capita including G.O. Bonds for capital purposes, POBs, Build Illinois Bonds and Civic Center Bonds.



Based on General Obligation Bond Debt, Pension Obligation Bonds, Build Illinois Bonds and Civic Center Bonds
Source: State of Illinois Sources, see Appendix 6 Table A
*FY2011 projected as of January 28, 2010, however total debt is expected to increase before the end of FY2010 due to additional refunding and capital bond sales.

Bond Ratings

The State of Illinois' G.O. bond ratings have been reduced two levels by each of the three major rating agencies since FY2009. This makes the State's debt the second lowest rated among all states, just one level above California. All three agencies also characterize the outlook for Illinois' ratings as "negative." The following chart shows the reduction in rating since FY2009.

	Moody's Investors Services	Standard & Poor's	Fitch Ratings
FY2009	Aa3	AA	AA
FY2010	A2	A+	A

Source: State of Illinois General Obligation Bonds, Taxable Build America Bonds, Series 2010-1, Official Statement, p. 55.

Debt ratings are one of the factors that weigh heavily in determining the interest rate the State must pay to issue debt. Consequently, the decline in the State's rating will lead to an overall increase in debt service costs for Illinois. However, the State does not provide current interest rate estimates or estimated increases in debt service cost due to this change.

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 pay its bills, the FY2010 budget's reliance on one-time revenue sources to pay for ongoing operational expenses and the projected increase in the State's deficit by at least $2 billion by the end of the current fiscal year. 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 increases to make up for past underfunding and losses in the pension funds due to the recession.

GENERAL FUNDS 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.[107] Similarly, the General Assembly is required to pass a balanced budget.[108] A balanced General Funds budget requires enough revenue to meet expenditures and transfers out. 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.

In practice, there are various ways to make sure the requirement is technically met on paper without actually balancing expenditures and revenues. One technique is to adjust projected revenues to match expenditures. Another method is to budget an insufficient amount of Medicaid appropriations to cover costs in a given year, knowing that remaining bills will be paid through the following's year's appropriation.[109] State officials can relieve pressure on General Funds by passing legislation to reduce state pension contributions or by borrowing to make pension contributions. The Governor may declare a shortfall in revenues, which permits the State to issue short-term debt that does not have to be repaid until the following fiscal year. The State may also defer unpaid bills into the first two months of the next fiscal year, paying them with the available cash from next year's revenues. Ultimately, these measures enable the State to end the year with a positive cash balance, even when expenditures and obligations outpace revenues. This section describes the history of the State's General Funds budget deficits, the current condition of the FY2010 budget deficit and factors that will contribute to a larger projected deficit for FY2011.

[107] Constitution of the State of Illinois, Article VIII, Section 2(a).
[108] Ibid, Section 2(b).
[109] Illinois State Comptroller, *Fiscal Focus*, July 2008, p. 7, at http://www.apps.ioc.state.il.us/ioc-pdf/FFWeb0708.pdf (last visited on February 12, 2010).

General Funds Surplus and Deficit History: FY2001 through FY2010

Even when the General Funds budget is balanced for the fiscal year, an operating budget deficit from a prior year may carry over and create a deficit. The prior year's deficit typically carries over in the form of unpaid bills (accounts payable) that have been deferred to the following fiscal year. To manage these deferred bills, the State lengthens its bill payment cycle. A deficit and the resulting backlog of bills will continue to carry forward until the State uses budget surpluses to catch up on the backlog of bills, consequently offsetting the prior year deficits. The State of Illinois has run a General Funds deficit every year since FY2002, usually because of a deficit carrying over from the prior fiscal year. The following table provides a history of General Funds surpluses and deficits between FY2001 and FY2010.

Illinois General Funds Surplus (Deficit) History: FY2001-FY2010
(in $ millions)

	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010*
Fiscal Year's Surplus (Deficit)	$ (477)	$ (1,520)	$ 271	$ 684	$ (64)	$ 183	$ 156	$ (699)	$ (2,839)	$ (1,996)
Prior Year Carryover	$ 632	$ 155	$ (1,365)	$ (1,094)	$ (410)	$ (473)	$ (291)	$ (135)	$ (834)	$ (3,673)
Total Surplus (Deficit)	**$ 155**	**$ (1,365)**	**$ (1,094)**	**$ (410)**	**$ (474)**	**$ (290)**	**$ (135)**	**$ (834)**	**$ (3,673)**	**$ (5,669)**

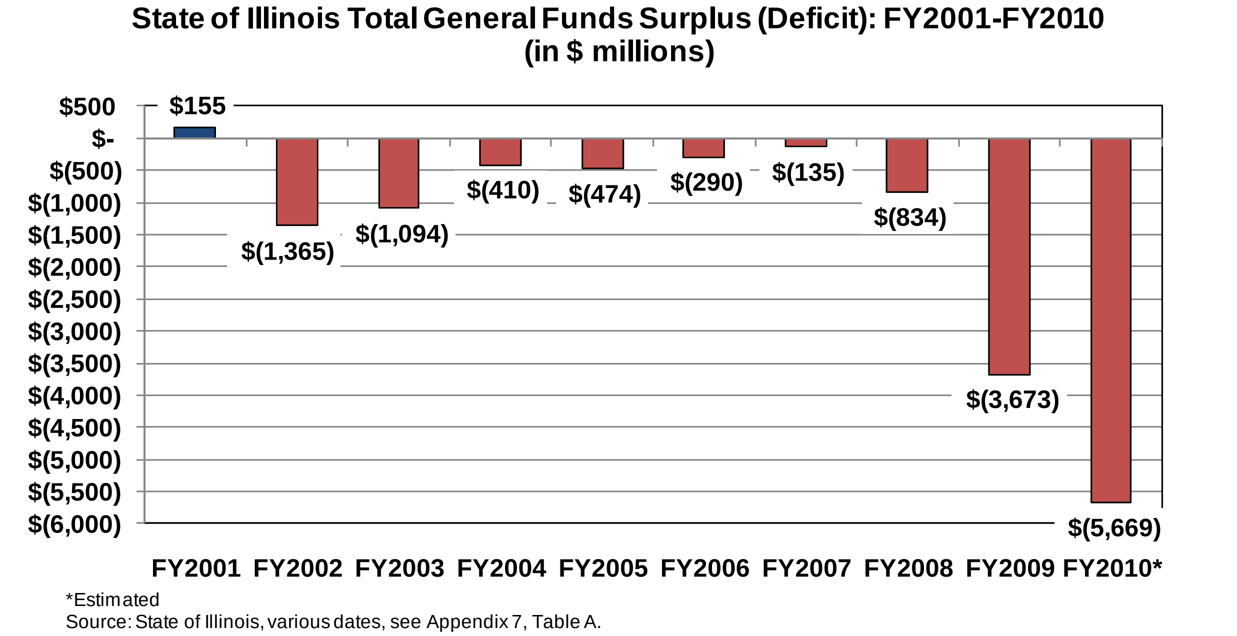
*Estimated

Source: State of Illinois, various dates, see Appendix 7, Table A.

Budgets in four out of the last ten of the State's fiscal years, which run July 1 to June 30, have produced a General Funds surplus. However, the General Funds budget deficits carrying forward from prior years have resulted in year-end deficits in nine out of the last ten years. FY2001, the lone fiscal year ending in surplus over the past ten years, actually had a budget deficit of $477 million, but benefited from a $632 million surplus from the prior fiscal year. The $155 million FY2001 year-end surplus carried over to FY2002, but went toward reducing the $1.5 billion budget deficit that arose that year in part due to an economic recession.[110] Budgets in FY2003, FY2004, FY2006 and FY2007 actually resulted in a surplus, but those fiscal years ended in deficit because the State used the surpluses to pay down the backlog of bills that originated from the FY2002 budget deficit.

[110] This eight-month recession began in March 2001 and lasted until November 2001. National Bureau of Economic Research, Business Cycle Dating Committee, July 17, 2003, http://www.nber.org/cycles/july2003.html (last visited January 25, 2010).

By FY2008, budget surpluses had reduced the $1.5 billion FY2002 deficit to $135 million. However, another economic recession began during FY2008 in December of 2007, resulting in an FY2008 budget deficit of $699 million. Both the year-end deficit of $834 million and the economic recession carried over to FY2009, resulting in an FY2009 General Funds budget deficit of $2.8 billion and a total General Funds deficit of $3.7 billion. As a result, FY2010 started with a $3.7 billion deficit carried over from FY2009, equivalent to 11.1% of total FY2009 expenditures. The estimated budget deficit for FY2010 is $2.0 billion, which would result in a total General Funds deficit of $5.7 billion at the end of the year. The following chart illustrates the FY2001 General Funds surplus and the deficit that has been accumulating since FY2002.



These General Funds deficits do not take into account the growing unfunded liabilities of the State's retirement systems. The State's historic underfunding of its retirement systems is a source of pressure on its operating budget. In addition to carrying a deficit in eight of the past nine fiscal years, the only year in which the State has contributed enough to its retirement systems to keep the unfunded liability from growing was in FY2004, due to the sale of $10 billion in 30-year pension obligation bonds.[111] Historically, the General Funds budget deficit could have been greater if the State had chosen to make pension contributions from General Funds that were adequate to keep unfunded liabilities from growing.

Fiscal Year 2010 Deficit

The State began FY2010 with a $3.7 billion deficit from the previous fiscal year. This deficit was carried forward by deferring $3.95 billion in unpaid bills to FY2010. As enacted in July of 2009,

[111] Public Act 93-0002 authorized the State to use the proceeds of 30-year pension obligation bonds instead of General Funds to make retirement system contributions. $7.3 billion of the proceeds from the bond sale were used to reduce unfunded liabilities, while the rest (after issuance costs) was used to cover contributions to the retirement systems, freeing up nearly $2 billion to offset FY2004 budget deficits. In addition to not contributing enough to the retirement systems to keep unfunded liability from growing, FY2006 and FY2007 relied on decreasing statutorily required pension contributions in order to reduce General Funds expenditures. Public Act 94-0004 reduced contributions a total of $2.3 billion in FY2006 and FY2007 from the payment required under the pension reform law.

the FY2010 budget would have used $29.3 billion in General Funds revenues to pay for $28.0 billion in total expenditures and repay $1.0 billion in short-term debt that had been issued in FY2009. This budget would have used the remaining surplus of $279 million to pay down the backlog of bills by that amount. In December of 2009, the FY2010 budget was revised to reflect new revenue and expenditure projections and other adjustments. As shown in the chart below, the deficit is now projected to increase by at least $2.0 billion to $5.7 billion at the end of FY2010. This $5.7 billion year-end deficit is equivalent to 20.1% of total General Funds revenues projected for FY2010.

FY2010 General Funds Budget Surplus (Deficit) (in $ millions)		
	Enacted July 2009	**Revised December 2009**
Revenues		
State Sources	$ 19,947	$ 19,081
Federal Sources	$ 7,131	$ 6,951
Statutory Transfers-In	$ 2,221	$ 2,171
Total Revenues	**$ 29,299**	**$ 28,203**
Expenditures		
Appropriations	$ (26,085)	$ (26,310)
Unspent Appropriations	$ 951	$ 400
Subtotal Expenditures	**$ (25,133)**	**$ (25,910)**
Statutory Transfers Out		
Legislatively Required Transfers to Other Funds	$ (2,321)	$ (2,724)
Pension Obligation Bond Debt Service	$ (520)	$ (520)
Subtotal Statutory Transfers Out	**$ (2,842)**	**$ (3,244)**
Total Expenditures and Transfers Out	**$ (27,975)**	**$ (29,154)**
Budget Operating Surplus (Deficit)	**$ 1,324**	**$ (951)**
Short-term Borrowing Proceeds, net of Repayment	**$ (1,045)**	**$ (1,045)**
Budget Basis Surplus (Deficit) for FY2010	**$ 279**	**$ (1,996)**
Carry Forward of FY2009 Year-end Deficit	**$ (3,673)**	**$ (3,673)**
Total Year-end Deficit FY2010	**$ (3,394)**	**$ (5,669)**

Source: State of Illinois, $3.466 Billion General Obligation Bonds Taxable Series of January 2010, *Official Statement,* January 7, 2010, page 22.

The most recent projections include several adjustments to revenues and expenditures that worsen the State's budget position by $2.3 billion since the FY2010 budget was enacted. Revenue projections dropped by $1.1 billion because of a $767 million decline in General Funds personal income tax revenues, a $50 million decline in gaming tax collections and a change in Medicaid appropriations resulting in a $180 million drop in federal revenues. In addition, the General Assembly appropriated an additional $205 million for Monetary Award Program scholarships and the estimated appropriations that will not be spent during the fiscal year declined, resulting in a $777 million increase in expenditures. Debt service savings of approximately $561 million that were expected in the enacted budget will only be partially realized due to a delay in refinancing bonds. This delay, as well as other adjustments affecting transfers out of General Funds, will increase this year's deficit by an additional $502 million. As a result of these adjustments, instead of paying down bills by the end of FY2010 by $279 million as originally budgeted, the State is planning to increase its backlog of bills by at least $2.0 billion, ending the year with $5.9 billion in unpaid bills in order to carry forward the $5.7 billion deficit and maintain a year-end positive cash balance.

In addition to the $5.7 billion General Funds budget deficit, Governor Pat Quinn has stated that vital programs remain underfunded in the FY2010 budget. The Governor's estimated funding shortfalls totaled $1.6 billion in July of 2009, which would be reduced to $1.4 billion if $180.0 million were utilized from contingency reserve funds. The following chart shows four major budget areas identified by the Governor as underfunded.

Programs Identified by the Governor as Vital and Underfunded: FY2010 (in $ millions)			
	Governor's Revised Budget Recommendation	Governor's Allocation of Enacted Appropriations	Governor's Shortfall Estimate
Medicaid	$ 7,533.9	$ 6,914.9	$ 600.0
Group health coverage for state employees, retirees & dependents	$ 1,312.0	$ 700.0	$ 600.0
Pre K-12 education	$ 7,452.7	$ 7,307.9	$ 145.0
College scholarships	$ 440.6	$ 220.0	$ 225.0
Subtotal			**$ 1,570.0**
Use of contingency reserve funds			$ (180.0)
Total Unmet Needs			**$ 1,390.0**

Source: State of Illinois, Governor's Office of Management and Budget, *Governor's Allocation Plan* , July 31, 2009, http://www.illinois.gov/publicincludes/statehome/gov/documents/FY10%20Allocation%20Plan.pdf (last visited on November 24, 2009).

The estimated shortfall for both Medicaid and state employee and retiree group insurance was $600.0 million. The Governor estimated that elementary and secondary education funding falls short by $145.0 million. Since the Governor identified these programs, he has signed legislation amending the spending bill to provide an additional $205.0 million for MAP scholarships, which would cover the majority of his original estimate of the college scholarship shortfall.[112] Additionally, $300.0 million in Medicaid appropriations was shifted from General Funds to Federal Funds during the middle of FY2010, freeing up funds that the Governor intends to use for group insurance.[113] After adjusting for mid-year appropriations changes, the shortfall estimate drops to $885 million. The Governor is expected to seek additional funding from the General Assembly before the end of the fiscal year for the remaining $885 million. If the General Assembly approves funding for these programs, the FY2010 deficit could increase to $6.6 billion.

Two-Year Budget Gap: FY2010-FY2011

The two-year budget deficit going into FY2011 starts with the $5.7 billion gap projected to be carried forward from the current fiscal year. The State must then fill a budget hole resulting from the loss of one-time revenues, assuming that these revenues are not reinstated in FY2011. These one-time revenue sources consist of the proceeds from the sale of the five-year pension bonds, federal recovery funds and sweeps from Other State Funds. Additional required expenditures would also increase the deficit, including debt service on the pension bonds and an increase in the State's required pension contribution. The chart below shows that the anticipated two-year budget gap going into FY2011 totals $12.8 billion. This deficit represents known FY2011 fiscal

[112] The Governor signed Public Act 96-0792 on October 19, 2009. The legislation amends the FY2010 spending bill, Public Act 96-0042, to provide an additional $205.0 million for college scholarships.
[113] State of Illinois, $3.466 Billion General Obligation Bonds Taxable Series of January 2010, Official Statement, January 7, 2010.

pressures, but not further revenue or expenditure adjustments that may affect the budget in FY2011.

Total Two-Year Budget Deficit FY2010-FY2011 (in $ millions)	
Carry-forward of FY2010 Deficit	$ 5,669
Borrowing for Pension System Contribution	$ 3,466
Increase in Statutory Pension Contribution	$ 659
Pension Note Repayment	$ 803
Statutory Transfer of Pension Bond Debt Service	$ 345
Reduction in Federal Recovery	$ 1,537
Fund Sweeps Included in Revenue	$ 352
FY2011 Total Budget Gap	**$ 12,831**

Sources: See Appendix 7, Table B.

The $12.8 billion FY2011 budget gap is primarily a result of the $5.7 billion FY2010 carry-forward as well as a statutory retirement system contribution of $4.1 billion that would be made from General Funds instead of pension obligation note proceeds. In addition to the retirement system contribution, approximately $803 million must be paid in FY2011 for the pension obligation bonds issued in FY2010. State statute also requires that debt service payments be transferred out of General Funds in advance of the payment, resulting in an additional $345 million in known General Funds spending pressures in FY2011.[114] With the exception of the enhanced federal Medicaid reimbursement rate extending through half of FY2011, the State also will no longer benefit from most federal recovery funding next year.[115]

[114] 30 ILCS 330/15 (2009) and phone communication between the Civic Federation and Illinois State Comptroller's Office, February 8, 2010.
[115] E-mail communication between the Civic Federation and the Governor's Office of Management and Budget, January 27, 2010.

THE RECESSION AND OTHER STATE BUDGETS

This section describes the fiscal condition of four states: California, Indiana, Wisconsin and Virginia in their most recently enacted fiscal year and summarizes these states' strategies for closing their budget gaps. The following chart summarizes enacted total and general fund appropriations and estimated deficit before adoption of the most recent enacted budget. [116] The Civic Federation selected Indiana and Wisconsin because of their geographic proximity and economic similarity to Illinois. The Federation selected Virginia and California to demonstrate how states financially better and worse off than Illinois, respectively, have dealt with the effects of the recession.

The Federation also notes that Indiana, Wisconsin and Indiana utilize a two year, or biennial, budget process. Illinois and California budget on an annual basis.

Total and General Fund Appropriations, Estimated Deficits and Gap Closing Measures for Selected States: Most Recent Enacted Budgets (in $ billions)

State	Fiscal Year(s)	Total All Funds Appropriation	Total Enacted General Fund Appropriation	Estimated Operating Deficit Before Adoption of the Most Recent Budget*	Enacted Gap Closing Measures
Illinois	FY2010	$54.3	$26.1	$11.6	Borrowing of $3.5 billion in pension obligation bonds; layoffs; furloughs; delays in salary increases for unionized employees
California	FY2010	$109.7	$84.6	$60.0	Increase in sales tax and personal income tax; Increases to higher education related fees and transportation/motor vehicle related fees; furloughs; cuts to state employee benefits; targeted cuts; reorganize agencies; withdrawal from surplus funds; borrowing property tax funds from local governments; other measures
Indiana	FY2010 FY2011	$26.9 $26.9	$13.6 $14.1	$1.5	Across the board percentage cuts; targeted cuts
Virginia	FY2009 FY2010	$38.6 $38.6	$15.9 $15.9	$6.6	Increases to user fees, court related fees, and transportation/motor vehicle related fees; layoffs; furloughs; pension holiday; targeted cuts; reductions to local aid; withdrawal from rainy day fund; other measures
Wisconsin	FY2010 FY2011	$31.0 $31.0	$13.4 $14.1	$6.6	Increase in taxes on personal income on very high earners and cigarettes; salary reductions; other personnel reductions; new surcharge on nursing licenses; limited increase higher education related fees; layoffs; furloughs; across the board percentage cuts; targeted cuts; reorganization of agencies; and other measures

*Projected deficit figures for Indiana, Virginia and Wisconsin reflect the projected deficit for the biennium.
Sources: See Appendix 8

[116] For this section, the Civic Federation used the most up-to-date publically available information provided by each state. Information for Illinois is current as of January 22, 2010. For more information about Illinois' enacted budget please see: the Civic Federation's analysis of the FY2010 Enacted budget at: http://civicfed.org/iifs/publications/state-illinois-enacted-fy2010-budget-review-operating-and-capital-budgets-enacted-. Information for Virginia is current as of as of January 19, 2010 and was provided by the Senate Finance Committee. Appropriations information for Indiana is current as of June of 2009 and has not changed since the budget's approval by the Indiana General Assembly. Indiana's estimated deficit figure was provided on June 2, 2009. Appropriation information for Wisconsin was current as of August of 2009 and has not changed from the figures reported as of that date. Wisconsin's estimated deficit figure was provided in June 29, 2009. Information for California was current as of October of 2009. California's estimated deficit figure was provided in July of 2009.

California

California, with a population of 37.0 million, originally enacted a total budget for FY2010 of $119.2 billion in February of 2009.[117] The State faced a $42 billion general fund deficit before the enactment of the February FY2010 spending plan.[118] The legislature addressed the deficit through $36 billion in legislative actions. [119] Additionally, the legislature proposed $6 billion in budget solutions that Californians voted on in a special election in May of 2009, but these solutions failed to pass.[120] The $36 billion in legislative actions included $14.9 billion in appropriations reductions, $12.5 billion in revenue adjustments, $8.0 billion in additional federal funding from the American Recovery and Reinvestment Act (ARRA) and $402.0 million in other budget adjustments.[121] Appropriations reductions occurred in the areas of elementary and secondary education, higher education, public assistance, Medicaid, corrections, transportation, personnel and other areas.[122] The State legislature also enacted increases in the State sales tax and personal income tax and increases in vehicle registration fees to make up for insufficient revenue.[123]

Estimates by the State's Department of Finance released in May of 2009 revealed substantial revenue shortfalls and the State subsequently adopted an additional $23.7 billion in budget adjustments to close the gap. [124] The legislature revised the total appropriation to $109.7 billion and total general fund appropriation to $84.6 billion.[125] These proposed adjustments included $18.0 billion in appropriations reductions, $3.5 billion from one-time revenue transfers into the general fund and $2.2 billion in borrowing.[126] In November 2009, the State's Legislative Analyst's Office (LAO) reported to the National Conference of State Legislatures that it had revised personal income tax, general sales tax and corporate income tax projections downward since the adoption of the July budget package.[127]

Regular structural deficits precipitated California's dire fiscal situation going into FY2010. Modest efforts to reduce expenditures, such as reforms to its procurement process, failed to adequately address California's problem of overspending.[128] The State resorted to short-term gap closing measures that worsened the State's structural deficit including deficit bonding, short-term borrowing and non-routine fund transfers.[129]

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[117] United States Census Bureau, "Population, population change and estimated components of population change: April 1, 2000 to July 1, 2009," http://www.census.gov/popest/national/files/NST_EST2009_ALLDATA.csv, (last visited on January 6, 2009); California State Budget 2009-2010, pp. 1 and 39, http://www.ebudget.ca.gov/BudgetSummary/BSS/BSS.html, (last visited on February 4, 2010).
[118] California State Budget 2009-2010, p. 1.
[119] California State Budget 2009-2010, p. 1.
[120] California State Budget 2009-2010, p. 1.
[121] California State Budget 2009-2010, p. 4.
[122] California Legislative Analyst's Office, "2009-10 California Spending Plan," p. 4, http://www.lao.ca.gov/laoapp/PubDetails.aspx?id=2122, (last visited on February 4, 2010).
[123] National Governors Association and National Association of State Budget Officers, "Fiscal Survey of the States: December 2009," pp. 63 and 67, http://www.nasbo.org/Publications/FiscalSurvey/tabid/65/Default.aspx, (last visited on February 4, 2010).
[124] California State Budget 2009-2010, p. 1; and California Legislative Analyst's Office, "2009-10 California Spending Plan," p. 4.
[125] California Legislative Analyst's Office, "2009-10 California Spending Plan," p. 1.
[126] California Legislative Analyst's Office, "2009-10 California Spending Plan," p. 4.
[127] National Conference of State Legislatures, "State Budget Update: November 2009," pp. 19, 23 and 27, http://www.ncsl.org/?tabid=19251, (last visited on February 4, 2010).
[128] *Governing*, "Measuring Performance," March 2008, p. 42.
[129] Pew Center on the States, "California – Grading the States 2008," p. 8, http://www.pewcenteronthestates.org/states_card.aspx?abrv=CA, (last visited on February 4, 2010).

In the wake of the recession, California's fiscal situation has dramatically deteriorated. The LAO projected general fund revenues are not expected to reach pre-recession (FY2008) levels until FY2015.[130] In February of 2009 Standard & Poor's downgraded the State's $46 billion in general obligation bonds from "A+" to "A," making California the state with the lowest rated debt in the United States at the time Standard & Poor's released its rating.[131] The following July, Moody's and Fitch Ratings also downgraded California's debt, to "Baa1" and "BBB" respectively.[132] The Moody's rating was three notches above speculative or "junk" status and the Fitch rating was two notches about speculative status.[133]

In November of 2009, the LAO reported that although State is showing some signs of economic recovery, the State will face a $20.7 billion deficit going into FY2011.[134] The LAO attributed the State's growing deficit going into FY2011 to the State's failure to implement the solutions adopted in July 2009, particularly in the areas of corrections and Medi-Cal, the State's Medicaid program.[135] Despite these challenges, the LAO reported that California's revenue outlook is "stable" and that revenues will continue to grow in the coming fiscal years.[136] The LAO also projects that FY2010 general fund revenue collections will not be to be lower than FY2009 levels.[137]

Indiana

Illinois' neighbor to the east, Indiana, has a population of 6.4 million and total two-year budget appropriation of $26.9 billion for both FY2011 and FY2010. The State encountered an estimated deficit of $1.5 billion before enacting its biennial budget.[138] The legislature budgeted $14.1 billion in FY2011 general fund appropriations and $13.6 billion in FY2010 general fund appropriations.[139] Indiana used across the board and targeted cuts to close its budget gap.[140] Some of the areas of spending affected by cuts included higher education, Medicaid,

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[130] National Conference of State Legislatures, "State Budget Update: November 2009," p. 44.
[131] Jordan Rau and Patrick McGreevy, *Los Angeles Times*, "California bond rating drops lower than any other state's," February 4, 2009, http://articles.latimes.com/2009/feb/04/local/me-budget4, (last visited on February 4, 2010).
[132] Jim Christie, *Reuters*, "Fitch cuts cash-strapped California's debt rating," July 6, 2009, http://www.reuters.com/article/idUSN0614503820090706, (last visited on February 4, 2010); and Ciara Linnane, *Reuters*, "Moody's cuts California rating on budget crisis," July 14, 2009, http://www.reuters.com/article/idUSTRE56D79T20090714, (last visited on February 4, 2010).
[133] Jim Christie, *Reuters*, "Fitch cuts cash-strapped California's debt rating," July 6, 2009; and Ciara Linnane, *Reuters*, "Moody's cuts California rating on budget crisis," July 14, 2009.
[134] National Conference of State Legislatures, "State Budget Update: November 2009," p. 40.
[135] National Conference of State Legislatures, "State Budget Update: November 2009," p. 40.
[136] National Conference of State Legislatures, "State Budget Update: November 2009," pp. 35 and 40.
[137] National Conference of State Legislatures, "State Budget Update: November 2009," p. 36.
[138] United States Census Bureau, "Population, population change and estimated components of population change: April 1, 2000 to July 1, 2009"; Indiana List of Appropriations FY2010-FY2011, p. 1, http://www.in.gov/sba/2543.htm, (last visited on February 4, 2010); National Conference of State Legislatures, "State Budget Update: July 2009," p. 14 and 17, http://www.ncsl.org/documents/fiscal/StateBudgetUpdateJulyFinal.pdf, (last visited on February 4, 2010); Indiana Governor Mitch Daniels, "A State Budget Hoosiers Can Afford," Presentation to Indiana State Agency Heads, p. 2, http://www.in.gov/sba/files/SS_Gov_Present_20090602.pdf, (last visited on February 4, 2010).
[139] State of Indiana List of Appropriations FY2010-FY2011, p. 1.
[140] National Governors Association and National Association of State Budget Officers, "Fiscal Survey of the States: December 2009," p. 43; Telephone Communication between the Civic Federation and Director of the Office of Fiscal and Management Analysis at the Indiana Legislative Services Agency Diane Powers, January 25, 2009.

underperforming programs and other spending areas.[141] The State also received an additional $4 billion in federal funding through ARRA.[142] The legislature left $1.3 billion in unallocated revenues in case of a revenue shortfall and projected a combined reserve of $1 billion at the end of the biennium to replace funding from ARRA.[143]

Prior to the recession, Indiana made efforts to implement performance measurements into its management and decision making processes. The State transitioned to using a four-year fiscal outlook for making financial decisions and began building performance measurement into the budget process.[144] Agencies produce quarterly performance reports and the executive branch utilizes PROBE (Program Results: An Outcome-Based Evaluation) for program evaluation at the state level.[145] PROBE utilizes 18 standard yes or no questions to evaluate state programs over the course of 15 months.[146] The state releases reports with the programs' responses to the 18 questions and explanations and evidence for the responses.[147] The reports contain recommendations for improving performance and the State plans on integrating PROBE results into its budget process.[148]

The State also took measures to stabilize its budget. The State also made payments owed to school districts and local governments, which at one point totaled $780 million, and planned to pay off a remaining $265 million in back payments by the end of the FY2008-FY2009 biennium.[149] The State also implemented a long-term transportation plan by using proceeds from its $3.8 billion lease of the Indiana Toll Road for a 30-year transportation plan that will be fully funded over a ten-year period.[150]

In November of 2009, the State's Office of Fiscal and Management Analysis of the Legislative Services Agency reported to the National Conference of State Legislatures that its revenue outlook for FY2010 is "concerned."[151] As of November of 2009, collections for personal income taxes, general sales taxes, and corporate income taxes have come in below previous estimates and general fund revenue collections are projected to be lower than FY2009 levels.[152]

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141 National Governors Association and National Association of State Budget Officers, "Fiscal Survey of the States: December 2009," p. 6; Indiana List of Appropriations FY2010-FY2011, p. 1; Telephone Communication between the Civic Federation and Director of the Office of Fiscal and Management Analysis at the Indiana Legislative Services Agency Diane Powers, January 25, 2009.
142 National Governors Association and National Association of State Budget Officers, "Fiscal Survey of the States: December 2009," p. 7; Indiana List of Appropriations FY2010-FY2011, p. 7.
143 Indiana List of Appropriations FY2010-FY2011, p. 8.
144 Pew Center on the States, "Government Performance Project – Indiana," p. 1, http://www.pewcenteronthestates.org/states_card.aspx?abrv=IN, (last visited on February 4, 2010).
145 Pew Center on the States, "Government Performance Project – Indiana," p. 1.
146 Pew Center on the States, "Government Performance Project – Indiana," p. 6.
147 Pew Center on the States, "Government Performance Project – Indiana," p. 6.
148 Pew Center on the States, "Government Performance Project – Indiana," p. 6.; Indiana Department of Government Efficiency and Financial Planning, "2009-11 Budget Supplement: Program Performance Measures," http://www.in.gov/omb/files/Program_Performance_Measures_Supplement.pdf. For more information on Indiana's use of PROBE, please see: http://www.in.gov/omb/2344.htm.
149 Pew Center on the States, "Government Performance Project – Indiana," p. 8.
150 Pew Center on the States, "Government Performance Project – Indiana," p. 2.
151 National Conference of State Legislatures, "State Budget Update: November 2009," p. 35.
152 National Conference of State Legislatures, "State Budget Update: November 2009," pp. 19, 23, 27 and 36.

Wisconsin

Illinois' neighbor to the north, Wisconsin, has a population of 5.7 million and total FY2011 budget appropriation of $31.0 billion and total FY2010 budget appropriation of $31.0 billion.[153] The State budgeted $14.1 billion in FY2011 general fund appropriations and $13.4 billion in FY2010 general fund appropriations.[154] The State had a total projected deficit of $6.6 billion for the biennium.[155] Wisconsin has a biennial budget structure and the deficit figure reflects the deficit for FY2010 and FY2011 combined.

The State enacted various budget adjustments to close the biennial budget gap, including increases for taxes on cigarettes and personal income for very high earners; personnel expenditure reductions from layoffs, furlough days and salary reductions; limited increases to higher education related fees and a new surcharge on nursing licenses; across the board percentage and targeted expenditure cuts; reorganization of state agencies; and other measures.[156] Enacted expenditure reductions totaled approximately $3 billion and mostly consisted of salary reductions for state employees.[157] Expenditure reductions affected the areas of children and family services, Medicaid, transportation, personnel and other areas.[158] The State also received $2.2 billion in federal funding from ARRA to support its operations.[159] The legislature left a required statutory balance of $65 million for the biennium.[160]

Wisconsin's fiscal situation was precarious before the onset of the recession. In the five years prior to 2008, the State had a negative general fund balance.[161] In the three years prior to 2008, the State lacked the revenue necessary to fund its budget-stabilization fund.[162] The State addressed budget gaps with various strategies including the use of one-time revenues, carrying

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[153] 2009-2011 Budget Summary Information, p. 1, http://www.legis.state.wi.us/lfb/2009-11Budget/Act%2028/2009_07_22_2009-11%20budget%20summary%20information%20%28Act%2028%29.pdf, (last visited on February 4, 2010); and United States Census Bureau, "Population, population change and estimated components of population change: April 1, 2000 to July 1, 2009."
[154] Wisconsin Legislative Fiscal Bureau, "Comparative Summary of Budget Recommendations (2009 Act 28)," p. 23, Table 1, http://www.legis.state.wi.us/lfb/2009-11Budget/Act%2028/table1.pdf.
[155] Wisconsin Governor Jim Doyle Veto Message for FY2010-FY2011 Enacted Budget, June 29, 2009, p. 1, http://www.doa.state.wi.us/debf/pdf_files/2009-11VetoMessage.pdf, (last visited on February 4, 2010).
[156] Wisconsin Governor Jim Doyle Veto Message for FY2010-FY2011 Enacted Budget, June 29, 2009, pp. i, xviii, xix and 30; Wisconsin Office of the Governor Press Release, "Governor Doyle Signs State Budget Invests in Stronger Wisconsin, First On-Time Budget since 1977," June 29, 2009, http://www.wisgov.state.wi.us/journal_media_detail.asp?locid=19&prid=4373, (last visited on February 4, 2010); Wisconsin Legislative Fiscal Bureau, Comparative Summary of Budget Recommendations (2009 Act 28), Table 3, http://www.legis.state.wi.us/lfb/2009-11Budget/Act%2028/table3.pdf.
[157] Pew Center on the States, "Beyond California States in Fiscal Peril," November 2009, p. 51, http://archive.stateline.org/images/2009_Nov_11-BeyondCalifornia/BeyondCalifornia.pdf, (last visited on February 4, 2010).
[158] Wisconsin Legislative Fiscal Bureau, Comparative Summary of Budget Recommendations (2009 Act 28), Table 3; Wisconsin Governor Jim Doyle Veto Message for FY2010-FY2011 Enacted Budget, June 29, 2009, pp. i and iii.
[159] Pew Center on the States, "Beyond California States in Fiscal Peril," November 2009, p. 51.
[160] Communication between the Civic Federation and Wisconsin Legislative Fiscal Bureau Director Bob Lang, February 9, 2010.
[161] Pew Center on the States, "Government Performance Project – Wisconsin," p. 7, http://www.pewcenteronthestates.org/states_card.aspx?abrv=WI, (last visited on February 4, 2010).
[162] Pew Center on the States, "Government Performance Project – Wisconsin," p. 7. Note:
Wisconsin law, specifically Chapter 16.518, directs that if tax revenues exceed projected revenues in any fiscal year, 50% of the surplus is to be automatically transferred to the stabilization fund. The state does not make this transfer if the balance of the fund equals or exceeds 5% of estimated general purse funds for that fiscal year. For more information about Wisconsin's Budget Stabilization fund please see: http://www.legis.state.wi.us/LRB/pubs/wb/02wb4.pdf.

forward balances in the general fund, selling state assets, increasing fees and charges, refinancing debt and borrowing for operating costs.[163] Although these strategies allowed the State to end the year with a positive cash balance, it only served to pass forward the budget's structural deficit to subsequent fiscal years.

In November 2009, the State's Legislative Fiscal Bureau reported to the National Conference of State Legislatures that its revenue outlook was "concerned."[164] It also reported that revenue collections from personal income taxes, corporate income taxes and excise taxes were on target and that collections from sales taxes had come in below previous estimates.[165] However in FY2010, general fund revenue collections are not expected to be lower than that of FY2009 due to increased revenues from changes in taxation.[166]

Virginia

Throughout the FY2009-FY2010 biennium, Virginia has had to close a cumulative revenue shortfall of $6.6 billion.[167] The Commonwealth,[168] which has a population of 7.9 million, had total enacted appropriations of $38.6 billion for both FY2010 and FY2009 and total general fund appropriations of $15.9 billion for both FY2010 and FY2009.[169] In order to reduce its budget gap, the Commonwealth enacted increases in user fees, court related fees and transportation/motor vehicle related fees; decreases in appropriations for personnel through layoffs, furloughs, and a pension holiday; other decreases in appropriations through targeted cuts and reductions to local aid; and transfers into the general fund from its Revenue Stabilization Fund ("rainy day fund"). [170] Over the course of the biennium, the Commonwealth has withdrawn and not repaid a cumulative amount of approximately $900.0 million from its rainy day fund, which totaled approximately $1.2 billion at its peak in FY2008.[171]

Virginia's budget process and policies prior to the recession positioned the Commonwealth to weather the current economic downturn by facilitating the Commonwealth's ability to prioritize its funding. The budget process employs a performance accountability system, Virginia Performs, which assists the Commonwealth in prioritizing its funding and making strategic cuts.[172] The Commonwealth uses this system to analyze data for the following categories: economy, education, health and family, public safety, natural resources, transportation and government and citizens. The system uses specific measurements for each category and compares the Commonwealth's sub-regions and itself to other states. Citizens can access

[163] Pew Center on the States, "Government Performance Project – Wisconsin," p. 7.
[164] National Conference of State Legislatures, "State Budget Update: November 2009," p. 35.
[165] National Conference of State Legislatures, "State Budget Update: November 2009," pp. 21, 26, 29 and 34.
[166] National Conference of State Legislatures, "State Budget Update: November 2009," p. 37.
[167] Telephone communication between the Civic Federation and Deputy Staff Director of the Senate Finance Committee of the Virginia General Assembly Richard Hickman, January 19, 2010.
[168] Four U.S. states refer to themselves as "commonwealths:" Virginia, Kentucky, Massachusetts and Pennsylvania.
[169] United States Census Bureau, "Population, population change and estimated components of population change: April 1, 2000 to July 1, 2009;" Telephone communication between the Civic Federation and Deputy Staff Director of the Senate Finance Committee of the Virginia General Assembly Richard Hickman, January 19, 2010.
[170] National Governors Association and National Association of State Budget Officers, "Fiscal Survey of the States: December 2009," p. 43; Telephone communications between Deputy Staff Director of the Senate Finance Committee of the Virginia General Assembly Richard Hickman and the Civic Federation, January 19, 2010 and January 25, 2010.
[171] Telephone communication between the Civic Federation and Deputy Staff Director of the Senate Finance Committee of the Virginia General Assembly Richard Hickman, January 25, 2010.
[172] *Governing*, "Measuring Performance," March 2008, p. 90. For more information about Virginia Performs, please see: http://vaperforms.virginia.gov/.

Virginia Performs data on the program's website. The Governor and state agencies use Virginia Performs goals and performance data to guide their budget and decision making processes.[173] Every year, the Commonwealth's Council on Virginia's Future uses data from Virginia Performs to produce a statutorily required report assessing the Commonwealth's current service performance, productivity improvement and progress against long-term objectives.[174] The report provides recommendations and analysis intended to guide policymakers' decision making.[175] Additionally, budget requests by each executive branch agency justify its budget according to its strategic plan and must include proposed performance measures and targets to evaluate the impact of funding on the agency's outcomes.[176]

The Commonwealth has also made efforts to create a structural balance in the budget prior to the recession. The Commonwealth has made payments and repayments on its mandatory Revenue Stabilization Fund in order to maintain adequate reserves in case of shortfalls in revenue.[177] In order to reduce expenditures, the Commonwealth operates a procurement system integrated with the federal General Services Administration, which provides the State with easy access to federal contract discounts.[178]

In June of 2009, Standard & Poor's assigned Virginia's $133.9 million in new general obligation bonds a long-term rating of "AAA" with a stable outlook and affirmed the "AAA" rating of the Commonwealth's outstanding bonds.[179] Standard & Poor's attributed the credit rating to Virginia's "strong financial position" evidenced by its "good reserves, long history of proactive and conservative financial management, and manageable debt burden."

Recent revenue data shows that Virginia will continue to face revenue shortfalls through FY2010. As of November 2009, collections for personal income taxes, general sales taxes, corporate income taxes and recordation revenues had fallen short of original estimates and had subsequently been revised downwards.[180] General fund revenue collections are expected to be lower than FY2009 levels and the Commonwealth reported that Virginia's revenue outlook as of November 2009 was "concerned."[181]

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[173] Pew Center on the States, "Government Performance Project – Virginia," p. 5, http://www.pewcenteronthestates.org/states_card.aspx?abrv=VA, (last visited on February 4, 2010).
[174] Council on Virginia's Future, "The Virginia Report," 2009, p. iii.
[175] Council on Virginia's Future, "The Virginia Report," 2009, p. iii.
[176] Pew Center on the States, "Government Performance Project – Virginia," p. 7.
[177] *Governing*, "Measuring Performance," March 2008, p. 90.
[178] *Governing*, "Measuring Performance," March 2008, p. 90.
[179] Jeff Clabaugh, *Washington Business Journal*, "S&P rates Virginia bonds AAA," June 9, 2009, http://washington.bizjournals.com/washington/stories/2009/06/08/daily29.html, (last visited on February 4, 2010).
[180] National Conference of State Legislatures, "State Budget Update: November 2009," pp. 21, 26, 29 and 34.
[181] National Conference of State Legislatures, "State Budget Update: November 2009," pp. 35 and 37.

RECENT STATE BUDGET PROPOSALS

This section provides a brief review of several proposals to balance the state budget. Most of these proposals were recommendations made for the FY2010 budget during the spring of 2009. Going into FY2010, the two-year budget gap totaled $11.6 billion, of which approximately $4.3 billion was due to a shortfall in the FY2009 budget and $7.3 billion was due to a gap in the FY2010 budget. However, not all of these proposals seek to close the entire gap. The proposals outlined here include proposals of independent organizations as well as a legislative proposal that was approved by the Illinois State Senate and a task force convened by the Governor.[182] The following chart provides an overview of the proposals outlined in this section.

Recent State Budget Proposals		
Date	**Proposal**	**Recommended Budget Measures**
February 2009, November 2009 & January 2010	**Civic Committee of the Commercial Club of Chicago** "Facing Facts 2009," "Minority Report of the Governor's Pension Modernization Task Force" and IllinoisIsBroke.com	Reduce state expenditures and reform pension and retiree health care benefits. Only after those measures are taken, consider increasing taxes and use the additional revenue only to pay down debt, unfunded retirement system liability and other unfunded obligations.
March 2009	**Center for Tax and Budget Accountability** "Moving Forward"	Approve a progressive income tax. If a constitutional amendment to allow for this change to the tax structure is not passed, implement increased refundable tax credits and dependent exemptions. Expand the sales tax base to services and additional spending on capital projects.
May 2009	**Budget and Tax Policy Initiative at Voices for Illinois Children** "The Time is Now"	Increase the personal income tax to 5% while increasing the standard personal exemption, the earned income tax credit and potentially instituting a child tax credit.
May 26, 2009 & January 19, 2010	**Illinois Policy Institute** "2010 Budget Solutions" and "Mission: Possible"	Reduce expenditures, including employee compensation and transfers to local governments. Implement administrative reforms. Use future savings from a spending cap to fund retirement system contributions, but borrow to make the contribution in the meantime.
May 31, 2009	**House Bill 0174, 96th General Assembly** as passed by the Illinois State Senate	Increase the income tax rate, expand the sales tax base to certain services, increase the standard personal exemption, increase the property tax credit and increase the earned income tax credit. One-third of the additional revenue generated would be used to fund elementary and secondary education and 16.7% would be used to fund higher education.
June 2009	**State of Illinois Taxpayer Action Board** "Final Report"	Explore opportunities for reforms and savings in the areas of expenditure reductions, Medicaid, pensions, personnel costs, elementary and secondary education, incarceration, and state administrative functions.

Sources: See Appendix 9

Civic Committee of the Commercial Club of Chicago

The Civic Committee of the Commercial Club of Chicago formed a State Finance Task Force in the spring of 2006 to evaluate the State's finances and recommend needed budgetary reforms,

[182] See Appendix 9: Citations for Recent State Budget Proposals Chart for a list of the sources and website addresses used in this section.

especially in the areas of pensions and retiree health care for State workers. This Task Force published a report of its findings, *Facing Facts*, in December of 2006. Since that time, the Civic Committee has published a number of additional reports detailing the State's fiscal crisis and pressing for reforms.

In February of 2009, the Civic Committee's State Finance Task Force published "Facing Facts 2009: An Updated Report on the State of Illinois' Fiscal Crisis," recommending reforms in State pension benefits as well as an increase in employee contributions to the pension funds. In addition, the report proposed to reform retiree health benefits by ending the State's role as guarantor of benefits. The State could instead make a fixed contribution to a trust fund, and offer retiree health benefits based on the amount available in the trust fund.

The report included several recommendations to reform the State's Medicaid program, including seeking a federal waiver to structure a more cost-effective Medicaid program that provides an incentive to deliver health care more efficiently, and paying Medicaid providers within 60 days. In addition, the report recommended shifting all children and non-disabled, non-elderly adults into managed care. The report also proposed to reduce or cap revenue sharing and grants to local units of government in order to reduce State expenditures, and to make improvements to processes and controls in State purchasing and contracting.

The report stated that only after these and other reforms and cuts have been made should a tax increase even be considered. The proceeds from such a tax increase should be earmarked to pay down debt, unfunded pension liabilities and other unfunded obligations, rather than to expand or create programs.

In November of 2009, the Civic Committee submitted a Minority Report to the Governor's Pension Modernization Task Force, Civic Committee Minority Report - November 2009, which recommended substantial reforms to the State's pension plans. The report called for the creation of a second-tier, defined benefit pension plan – applied to both new employees and current employees prospectively – that would increase the retirement age, reduce cost-of-living adjustments, change current provisions for the calculation of pension benefits, etc.[183] Such a second-tier could reduce the current unfunded pension liability by an estimated $20 billion, and could significantly reduce the State's annual pension cost going forward.

In addition to proposing solutions to the State's fiscal crisis, the Civic Committee undertook an initiative in January 2010 to raise public awareness about the State's fiscal condition. The campaign includes a website, IllinoisIsBroke.com, outlining the State's budget deficit and how unfunded pension and retiree health care liabilities contribute to the State's fiscal crisis. The website states that in order to close the deficit with income taxes alone, Illinois would need to raise the personal income tax from 3% to 8.2% and the corporate income tax from 4.8% to 13.1%.

Center for Tax and Budget Accountability

In "Moving Forward: To Counter the Current Recession, Illinois State Government Should Maintain or Enhance Spending -- Even if it Means Progressive Tax Increases -- Rather Than Cut

[183] The Civic Committee's Minority Report states that the Pension Protection Clause of the Illinois Constitution (Article XIII, Section 5) does not protect non-vested benefits of current employees. The Report states that the clause only protects an employee's contractually vested rights, so benefits of current employees may be altered prospectively.

its Budget," the Center for Tax and Budget Accountability outlined a plan to improve the State's fiscal condition with a progressive income tax. This March 2009 report recommended that the State not reduce expenditures because it would take money out of local economies and reduce economic activity, which would worsen the economic climate and increase job loss. Instead, the report stated that a progressive income tax would work better than spending cuts during a recession because wealthy individuals have a lower marginal propensity to consume. According to the report, since wealthy individuals spend less of their overall income on consumption and save more of their overall income, a tax increase targeted to wealthy individuals would result in little or no change to their consumption patterns.

Since a progressive income tax would require a constitutional amendment, the report suggested that in the meantime, the State use other measures within the existing tax structure to create more progressivity. The CTBA mentioned using refundable income tax credits and dependent exemption increases for taxpayers in lower tax brackets. The report also recommended that the sales tax base be expanded to include services in order to modernize the State's tax system and achieve fiscal soundness. The regressivity of the sales tax could be countered with refundable tax credits for lower-income taxpayers.

In addition, the report suggested that the State approve a recurring revenue stream for capital spending in order to generate additional economic activity. The report also stated that Illinois could leverage additional local and federal funds to help pay for additional infrastructure spending.

Budget and Tax Policy Initiative at Voices for Illinois Children

The Budget and Tax Policy Initiative at Voices for Illinois Children released a report in May 2009 calling for an income tax increase. "The Time is Now: Choosing Fiscal and Social Responsibility for Illinois" provided two plans to generate revenue in order to solve the State's fiscal problems. The plans involved adjustments to Illinois' 3% personal income tax rate, the $2,000 personal income tax standard exemption, Illinois' earned income tax credit of 5% of the federal credit, as well as the implementation of a child tax credit.

The first plan would raise the personal income tax rate to 5%, increase the standard income tax exemption to $3,650, increase the earned income tax credit to 15% of the federal credit, and implement a child tax credit equal to 25% of the federal credit. The second plan offered by the report would raise the personal income tax rate to 5%, increase the standard exemption to $4,000 and increase the earned income tax credit to 20% of the federal credit.

Illinois Policy Institute

The Illinois Policy Institute recommended a variety of expenditure reduction measures to help the State's fiscal situation in its May 2009 report, "2010 Budget Solutions." The report recommended holding spending for elementary and secondary education, higher education, healthcare, and human services at FY2009 levels. Other budget areas would be cut by 5%, 10% or 15%. Other recommended cuts included reducing personnel costs through salary reductions, hiring freezes and requiring higher contributions to health benefit plans from employees and retirees.

The report also recommended several Medicaid reforms, including implementation of managed care, moving long-term care from institutions to community care, expanding pharmaceutical purchasing pools, following preferred drug lists, publishing anonymous Medicaid claims data to identify cost savings and health outcomes, requesting a federal waiver to facilitate greater program flexibility and reducing eligibility after federal recovery mandates expire.

Administrative reforms were also proposed, including the establishment of a commission to implement reforms in state procurement and another to make recommendations regarding program consolidation or elimination. The report proposed to eliminate transfers from General Funds to special funds, which primarily support public transportation funding. In addition, the report proposed to reduce revenue sharing payments to local governments. Changes in the education system were also recommended, including the establishment of more charter schools, freezing special education categorical grants and consolidating school districts. The report stated that federal recovery funds should not be allocated to a program unless it is created and appropriated by the General Assembly with a sunset for the program when the federal recovery funds are no longer available.

The report also proposed to limit growth in expenditures to the rate of inflation plus population growth. In a later report published in January 2010, the Illinois Policy Institute reiterated its support of an expenditure limitation. The new report, "Mission: Possible," recommended that the savings from the budget freeze be used to fund the statutory pension systems contribution, which goes toward normal pension costs and paying down unfunded liability, as well as debt service on the 2003 pension obligation bonds and the 2010 pension bonds. Until the level of savings realized from the proposal reaches the amount of the pension contribution (FY2017 under current law), the report recommended that the State issue debt each year to make up the difference. This debt would total $17.8 billion over the six years and would account for between 80.7% of the contribution in FY2011 to 6.5% of the contribution in FY2016. The report notes that pension reforms, including increasing current employee contributions, would reduce the statutory contribution and the amount of borrowing required under the proposal.

House Bill 174

The Illinois State Senate passed House Bill 174 on May 31, 2009. House Bill 174 is a modified version of Senate Bill 750, the Education Investment and Revenue Reform Act. The passage of the bill followed Governor Pat Quinn's FY2010 budget proposal that included an increase to the state personal income tax from 3% to 4.5%, the corporate income tax from 4.8% to 7.2%, and the standard personal income tax exemption from $2,000 to $6,000. As passed by the Senate, the bill would make changes to the tax structure and use the additional revenue generated to fund education. Specifically, the personal and corporate income tax rates would be increased to 5%, the standard personal income tax exemption would be raised to $3,000 and the earned income tax credit would be raised to 15% of the federal credit. The bill would also expand the state sales tax base to include 39 consumer services. Property tax relief through increasing the residential real property tax credit from 5% to 10% and making the property tax credit refundable was also included in the bill. In addition, the bill would increase the limitation on the education expense credit from $500 to $1,000.

Under the bill, elementary and secondary education would benefit from a third of the additional revenue generated by these tax changes and higher education would receive 16.7% of the additional revenue. The remaining revenue would be used for other state government operations. While the bill would not mandate that the foundation level for General State Aid be raised to the level recommended by the Education Funding Advisory Board, it states that it is the intention of the General Assembly that the foundation level be raised to that amount by FY2014.

State of Illinois Taxpayer Action Board

In March of 2009, Governor Pat Quinn appointed the Taxpayer Action Board (TAB) to identify opportunities to improve the State's fiscal condition. In a final report in June of 2009, the Board did not make recommendations, but presented potential reform opportunities for the State's consideration. The menu of opportunities in the report included options that would be achievable in the short-term and in the long-term. In the short-term, opportunities to make across the board spending reductions and spending freezes were presented for further exploration.

In addition to expenditure reductions and freezes, the report presented other options that could be achievable in one year that TAB estimated could save between $420 million and $525 million. These other short-term opportunities included Medicaid reforms such as promoting cost-effective care management strategies that focus on the health of the person, promote prevention and provide a medical home, deemphasize institutional care in long-term care and enhance pharmacy cost containment efforts. The report also mentioned short-term reforms in the corrections system, including incarcerating fewer low-risk offenders and modernizing information technology. In addition, the report identified operational reforms the State could look at including managing real estate and facilities as part of an asset portfolio and minimizing the costs associated with boards and commissions.

The report also recommended that the State explore opportunities for long-term savings, such as enacting a second tier of pension benefits for new employees, reforming employee and retiree health benefits, consolidating school districts, improving procurement processes, and reviewing local government revenue sharing.

FY2011 BUDGET SCENARIOS

As explained in the previous two sections, there are many approaches in theory and practice to solving the current fiscal crisis. The following section discusses some of the most prominent ideas and concludes with a detailed description of the Civic Federation's recommendation for the State of Illinois FY2011 budget. This section focuses on General Funds, which are the State's operating funds and the funds over which the State has the most control and discretion. The budget deficit or surplus is based on the balance between General Funds revenues and expenditures.

The Civic Federation Fiscal Rehabilitation plan would accomplish the goal of reducing the deficit while upholding important budgetary principles. The following table provides a comparison between the Civic Federation Plan and the other plan concepts discussed in this section.

Deficit Reduction Plan Comparison				
Principle	Budget Cuts Only	Budget Cuts and Borrowing	Revenue Increases Only	Civic Federation Plan
Does not use borrowing to fund operating deficits	Yes	No	Yes	Yes
Provides funding for critical services	No	No	Yes	Yes
Creates incentives to find government efficiencies	Yes	Yes	No	Yes
Does not harm local governments	No	No	Yes	Yes
Does not reduce funding for programs eligible for federal recovery funds	No	No	Yes	Yes
Properly funds statutorily-required contributions to the pension systems	No	No	Yes	Yes
Does not create an economically prohibitive environment	No	No	No	Yes
Reduces the future structural deficit	Yes	Yes	Yes	Yes

The Civic Federation plan would uphold all of these principles while substantially reducing the deficit. The plan would not issue debt to pay for operations in FY2011 but would fund critical services and encourage government efficiencies. Local governments would not be harmed under the plan, nor would the State jeopardize federal recovery funds. In addition, the Civic Federation Plan would pay the statutorily required retirement system contribution. The plan's balanced approach would not drastically impact economic activity by making unreasonable spending cuts or tax increases. Overall, the plan would reduce the State's structural deficit going forward.

Budget Cuts Only

The estimated deficit of $12.8 billion going into FY2011 represents 44.0% of projected FY2010 General Funds expenditures of $29.2 billion. If current revenue sources remain flat and no new revenues are approved, cutting $12.8 billion from the budget would leave $16.4 billion for General Funds expenditures in FY2011.

In addition to the debt service for the FY2010 pension bonds included in the $12.8 billion deficit number, the State is legally obligated to pay $1.7 billion for debt service in FY2011,[184] reducing

[184] The total debt service payment from General Funds for FY2011 is $2.5 billion, which includes $803 million for the FY2010 pension bonds and existing G.O. Bond and POBs but excludes Build Illinois and Civic Center debt service.

the available amount of General Funds after the cuts to $14.6 billion. This would be a 49.8% cut in General Funds spending for the State in FY2011.

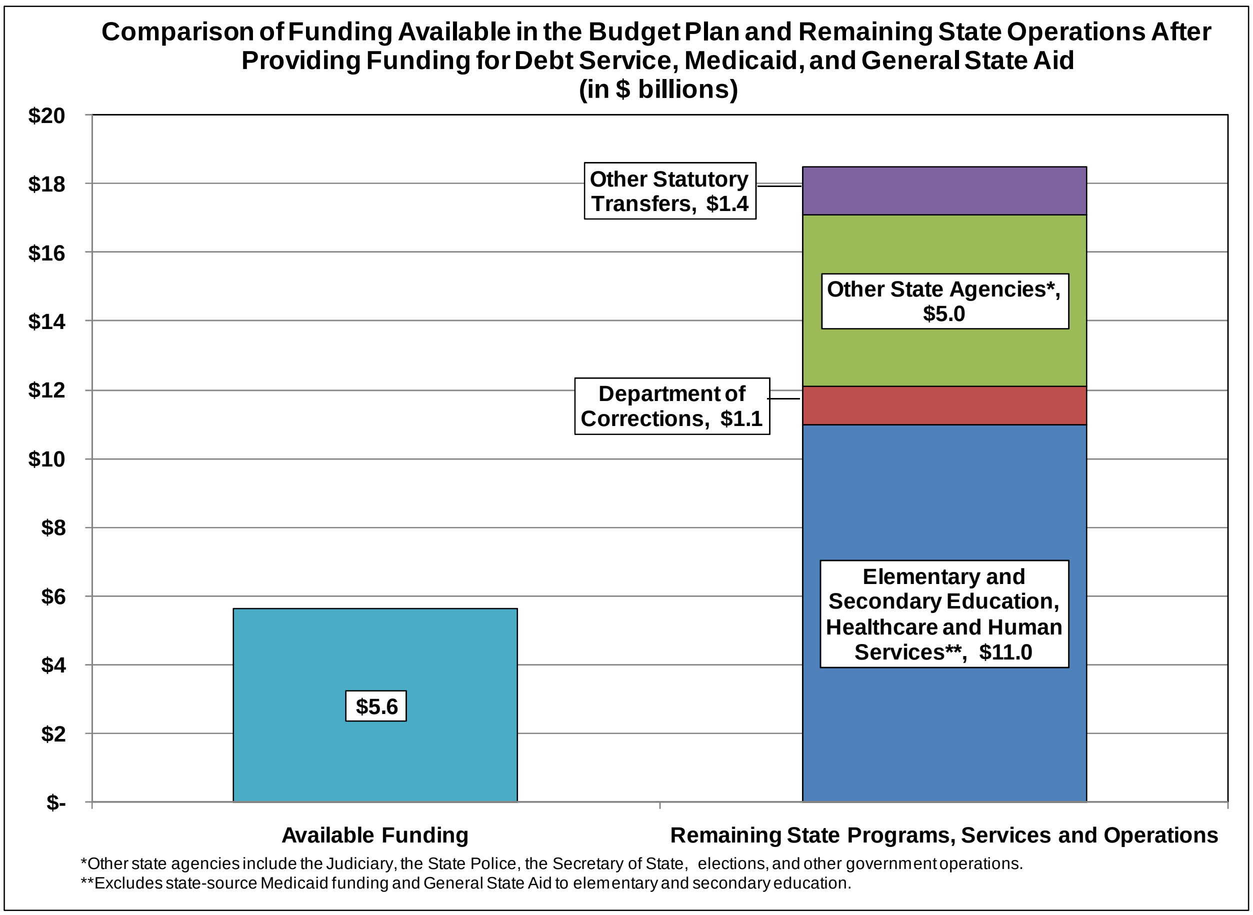
In FY2010, the State is expected to spend $4.7 billion in state-source General Funds for Medicaid and $4.6 billion for General State Aid for elementary and secondary education.[185] States are scheduled to receive enhanced federal reimbursement for Medicaid under the American Recovery and Reinvestment Act of 2009 through December 31, 2010. To receive the enhanced reimbursement, states must not decrease Medicaid eligibility and are required to meet federal prompt payment standards for certain healthcare providers. Reducing education funding might also jeopardize a state's access to additional stimulus funds to be issued FY2011.[186] The per pupil General State Aid funding levels are also critical to local school district budget and if cut it could trigger property tax increases and budget cuts for essential services. Other portions of the State education budget, however, may be targets for reductions.

If critical expenditures for Medicaid and education were maintained at current FY2010 levels, after cutting $12.8 billion from the budget and paying debt service the State would be left with $5.6 billion or 19.2% of FY2010 General Funds expenditures to fund all other General Funds supported operations.

[185] Medicaid FY2010 state-source General Funds expenditures were estimated by using the 7% annual growth rate assumed by the Governor's Taxpayer Action Board for total Medicaid liabilities. This growth rate was applied to the FY2009 number previously cited in the Medicaid section of this report.

[186] The Illinois State Board of Education is in the process of applying for up to $400 million in additional federal stimulus grants that if received would require local districts to maintain current funding levels. For more information see: http://www.isbe.state.il.us/racetothetop/default.htm .

Elementary and secondary education, healthcare and human services account for an additional $11.0 billion above the General State Aid and state-source General Funds Medicaid expenditures listed above.[187] The State spends $1.1 billion to run the Department of Corrections. Another $5.0 billion was appropriated in FY2010 to run other State agencies such as the Department of Transportation, the Secretary of State and judicial agencies. The State also makes other statutory transfers from General Funds, accounting for $1.4 billion of expenditures in FY2010. The State would have to reduce all of these services by a combined 69.5% in order to operate on the remaining $5.6 billion. It is beyond the scope of this report to estimate the effects on the state economy of such cuts. The following chart compares the FY2010 General Funds expenditures for the state programs and services that remain after debt service, Medicaid and General State Aid for elementary and secondary education are funded with the remaining $5.6 billion that would be available in the budget plan for these programs under this scenario.



A cuts-only solution to the State's fiscal crisis would also most likely end or significantly reduce subsidies to local governments. In FY2009, the State distributed $1.2 billion to local governments as their share of the State's net income tax receipts, according to the Illinois State Comptroller's office.[188] However, if this source of revenue were eliminated, it is likely that local

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[187] State of Illinois, $1.0 Billion General Obligation Bonds Taxable Build America Bonds, Series 2010-1, *Official Statement*, January 28, 2010, pp. 13 and 22. The numbers have been updated to reflect an additional appropriation of $205 million for college scholarships authorized after the FY2010 budget was enacted, as discussed earlier.
[188] Illinois State Comptroller, Expenditures by Fund, at http://www.wh1.ioc.state.il.us/Expert/Exp/EEControl.cfm?Control=Fund&Reset=Y&GroupBy=Agcy&SortName=No, (last visited on February 3, 2010).

governments would raises new revenues through other taxes to make up the shortfall or implement severe service cuts.

Fixing the State's budget crisis through spending cuts alone is an appealing prospect for many taxpayers. However, the magnitude of the looming deficit suggests that a cuts-only solution would fundamentally alter the scope of State government and eliminate vital services. Local governments would be likely to attempt to make up the funding shortfall by increasing revenues at the local level.

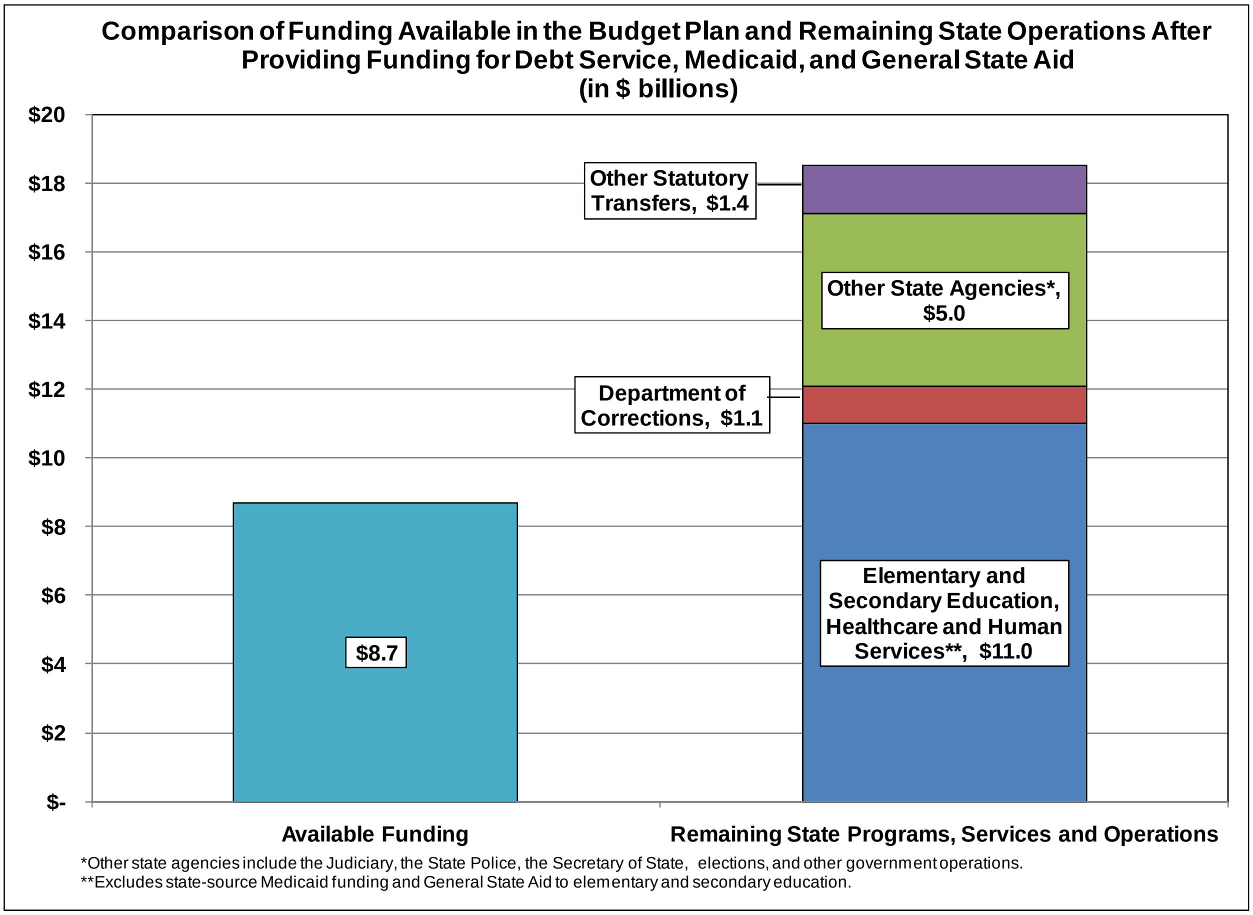
Budget Cuts and Borrowing

Another way to deal with the State's fiscal crisis would be to borrow to make pension contributions while cutting spending.

Under the cuts and borrowing proposal, the State would borrow to cover the state's required pension contribution, including normal cost. Normal cost is an operating expense, which would be pushed into future years through borrowing. Borrowing for pensions under the General Obligation Bond Act is currently the only mechanism the State has to pay for current operations using long-term debt. The State may borrow short-term funds but must pay these loans back within one year or less. This allows the State to carry forward portions of a deficit from one year to the next but prevents the State from resolving current deficits by pushing current obligations off into future years. By borrowing to make the State's annual pension payment, the significant portions of General Funds that would have been used for the retirement systems can be shifted back over to the operating budget to increase spending in other areas. However, the debt repayment for the pension loans increases future operating expense and can have a negative effect on future budgets.

Next year's General Funds pension contribution is projected to be about $4.1 billion. After subtracting this amount from the estimated $12.8 billion deficit going into FY2011, the State would be left with an $8.7 billion shortfall. Closing this gap would require budget cuts amounting to 30.0% of estimated FY2010 General Funds expenditures.

Similar to the "Budget Cuts Only" scenario, this level of General Funds cuts would need to take into consideration the minimal level of funding for debt service, Medicaid and General State Aid to elementary and secondary education when making these very deep cuts into the General Funds budget.



As discussed in the Debt Trends section of this report, the State's debt burden has more than tripled since FY2001 and now totals more than $25.4 billion. The State already owes $13.7 billion in principal for previous pension borrowing and will pay a total of $22.7 billion in debt service for these pension obligation bonds (POBs) through FY2034.

The state has the second lowest debt rating among all states, which makes it even more costly to borrow to pay for pensions. POBs are also taxable, unlike other municipal debt, which often attracts investors interested in the additional federal tax benefits despite lower returns than other investments.

The Government Finance Officers Association (GFOA) has expressed concerns about whether states such as Illinois can generate investment returns from retirement systems' assets that exceed the interest rate paid on its POBs. According to a GFOA report, "pension bonds increase the overall level of financial risk for the plan sponsor. Investments must be made in equities, high-yield debt, or highly leveraged portfolios (such as hedge funds) if returns are to exceed borrowing costs. While studies suggest that over sufficiently long periods of time (30 years is a frequent assumption) equities will outperform bonds by 4 percent to 5 percent that performance comes with increased risk, which is magnified in the short term."[189]

If the State continues to borrow to make its pension contributions, it will most likely increase the State's total cost of funding its pensions. Continued borrowing to pay for the operating budget pushes current expenses off into the future and limits the State's ability to borrow for critical infrastructure maintenance. Moreover, the State's increased annual cost for debt service on these bonds would further burden a general Funds budget to small to pay for essential government operations.

Revenue Increases Only

Another approach to addressing the fiscal crisis relies completely on new revenues through increased taxes to close the budget gap. This approach is based on a belief that the State is spending too little already and that any further cuts would cause severe harm to the most vulnerable populations, such as low-income residents, children and seniors.

Illinois' state-source General Funds come from two major sources, income taxes and sales taxes. The Illinois Constitution requires that the State charge a flat income tax. The personal income tax is currently levied at 3% and the corporate income tax is levied at 4.8%. The corporate income tax rate must not exceed the personal income tax rate by more than an 8 to 5 ratio.[190] The State also collects a 2.5% personal property replacement tax, which is an additional tax on corporate income that is passed to local governments.[191]

Based on projections for FY2010, if Illinois increased the income tax to the highest rate charged by a flat tax state, which is 6% in Tennessee, the State would receive an additional $8.4 billion in tax receipts in FY2011. The highest flat rate charged by any state for the corporate income tax is 9.9% in Pennsylvania. After deducting the personal property replacement tax, if Illinois matched this total rate by taxing corporate income at 7.4%, it would increase revenues by an additional $596 million. However, even after raising the income tax rates to the highest in the country, the State would still have a budget deficit of at least $3.9 billion. The State would need to raise the personal income tax rate to 7.6% to cover the total budget deficit through the personal income tax.

Increasing the State's flat tax rate would disproportionately affect lower-income residents who have less discretionary income. However, creating a graduated personal income tax would require a successful voter referendum to amend the Illinois Constitution. Since the earliest a voter referendum could be considered would be on the November 2010 ballot, most of the new revenue from the approval of implementing a graduated tax would not be available to balance the budget in FY2011.

As discussed in The Recession and Other State Budgets section of this report, many states have raised their sales tax rate to cope with the loss of revenues and budget deficits. However, Illinois already charges the seventh highest rate in the country on sales of general merchandise at

[189] Government Finance Officers Association, "Risky Business: Evaluating the use of Pension Obligation Bonds," June 2003, at http://www.gfoa.org/downloads/GFRJune03.pdf (last visited on February 17, 2010).
[190] Constitution of the State of Illinois, Article IX, Section 3(a).
[191] The personal property replacement tax is levied on corporations at a rate of 2.5% and partnerships and S-corporations at a rate of 1.5%. This tax makes up for the revenue lost by local governments and school districts after the personal property tax was abolished.

6.25%.[192] The City of Chicago has the highest composite sales tax rate of any major metropolitan area in the country at 10.25% including local, county and other sales taxes levies in the city.

Since the current sales tax rate is prohibitively high, some have suggested that the State broaden the base by extending the sales tax to consumer services as well as general merchandise. According to the Federation of Tax Administrators, there are 168 different categories of services taxed by states nationally. Currently, Illinois only taxes 17 of these services, of which 12 are in the household utilities category. Illinois ranks 47 among all 50 states for service categories taxed and in the Midwest region Illinois is also the lowest behind Wisconsin – 76, Ohio – 68, Michigan – 26 and Indiana – 24.

National trends show a migration in total household spending by consumers from goods to services. Over the last 30 years, consumer spending on general merchandise has fallen as a percentage of total spending from 39% to 32%, while spending on services has increased from 31% to 45%.[193] The sales tax on general merchandise is also believed to be more prone to volatility as it relies heavily on large purchases such as automobiles, while spending on services seems less vulnerable to recessionary trends.

Several agencies in Illinois have studied applying a sales tax on services in Illinois. The Illinois Department of Revenue published the most recent report on expanding the State's sales tax base to cover services in December 2009. The Department of Revenue reports that if taxed at the current state-only rate of 5% a sales tax on services could generate between $3.7 and $6.6 billion. In August 2009, the Commission on Government Forecasting and Accountability (COGFA) published a report titled, "Service Taxes, 2009 Update." In that report, the Commission estimated that, if the State expands the sales tax base to include services, a 6.25% tax rate (5% state; 1.25% local) would generate $3.6 billion to $7.6 billion. The conservative lesser estimate, also called the refined estimate, excluded business-to-business transactions, feasibility reductions and reductions for service already taxed.

Several issues would have to be addressed prior to implementing a sales tax on consumer services. The State must study whether current sales tax laws could be amended to apply to consumer services only—excluding business-to-business transactions. Historically Illinois has sought to tax only the final sale of products and not the business inputs that contribute to the production of goods. It follows that any new sales tax on services would avoid the compounding effects of taxation on multiple levels. The State should not commit itself to depending on these taxes until more is known about the actual revenue possible and the specific services that could be taxed.

Having the highest income tax rate in the country could slow recovery and growth in the State if businesses avoid expansion in Illinois or flee the State due to massive tax increases. Even if the state increased income taxes to the highest levels in the nation, it still would not have enough new revenue to relieve the fiscal crisis. Coupling a very high income tax increase and extending the sales tax to services could balance the State's budget, but with overall highest tax rates across all major categories the residents of Illinois would suffer huge reductions in household income to merely maintain the current state expenditure levels. By reducing the deficit solely through

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[192] Of the total 6.25%, the State only keeps 5% and passes on 1% to municipal governments and 0.25% to county governments.
[193] Center on Budget and Policy Priorities, "Expanding Sales Taxation of Services: Options and Issues," July 2009.

revenue increases, the State would not have an incentive to find efficiencies and savings in government operations.

THE CIVIC FEDERATION PLAN

This section describes the FY2011 deficit-reduction plan developed by the Civic Federation after analyzing the State's fiscal condition, reviewing actions by other states and considering proposals by other organizations. This plan confronts a severe financial crisis by attempting to balance the sacrifices required from state employees, beneficiaries of state programs, businesses and taxpayers. As explained in this report, the State's financial system is in such critical condition that a solution will require a combination of budgetary reforms, deep spending cuts and increases in revenues.

The plan proposes measures to substantially reduce the $12.8 billion budget deficit going into FY2011 and to place the State on better fiscal footing over the long term through fundamental reforms of expenditures and revenues.

The Civic Federation is deliberately proposing this plan as a comprehensive package. Without pension reforms and spending cuts included in this plan, the Civic Federation opposes any new revenue increases.

The State must reform its budgetary policies to create a sustainable long-term budget for Illinois. The Civic Federation recommends that the State of Illinois adhere to the following principles as part of its overall financial plan for FY2011:

- Pension reforms must be enacted to make the State's retirement systems' liabilities more manageable over the long term, including increased employee contributions and a two-tier pension system with reduced benefits for new employees;
- Spending cuts and increased employee healthcare and pension contributions of at least $2.5 billion must be made to help balance the budget; and
- One-time revenues, such as proceeds from borrowing and asset leases or sales, should not be used to pay for operations.

The Civic Federation offers the following specific proposals that will reduce the deficit while undertaking reasonable budgetary reforms:

Pension Reform

Creation of a Second Tier of Pension Benefits for New Hires

The Civic Federation proposes that the State change the current pension benefit structure for new hires. By creating a second tier of pension benefits for new employees, the State will take an important step towards resolving its mounting retirement systems funding problems.

As Governor Pat Quinn recommended in his FY2010 budget proposal, the State must create a modified retirement benefit structure for new hires. Some of the proposed pension benefit reforms for new hires include increasing the retirement age, reforming the benefit formulas and making the annual Cost of Living Adjustment less generous. Over 35 years, the Governor's proposed reforms were projected to reduce the State's pension liabilities by $162 billion.

The Civic Committee of the Commercial Club of Chicago has taken the position that the protection of employees' contractually vested benefits under the Illinois Constitution does not prevent the alteration of benefits earned prospectively by current employees.[194] In light of Illinois' financial crisis, the Civic Federation believes that the State should consider altering pension benefits of current employees, as discussed at greater length on page 87.

Increasing Current Employee Pension Contributions – $179.4 million

The Civic Federation supports increasing the pension contributions for current state employees. Recognizing that current employees will receive generous pension benefits upon retirement, the State must take action to ensure the burden of paying for these benefits is equitably distributed among beneficiaries and taxpayers.

Part of the pension reform should be to keep employee contributions the same for both new and existing employees. Despite current employees receiving more extensive, and therefore expensive, pension benefits, the State cannot afford to give new employees a reduced rate if the retirement system is to be properly funded.

Currently, the State projects $17.3 billion in annual payroll expense for members of the State's five retirement systems in FY2011.[195] If the employee contribution were increased by 1% of payroll, the State could save at least $179.4 million in its annual pension contribution cost.

[194] The Civic Committee of the Commercial Club of Chicago, *Minority Report to the Pension Modernization Task Force*, November 2009, p. 72 and pp.76-77.

[195] Commission on Government Forecasting and Accountability, "Monthly Briefing," January 2010, p. 13.

Budget Cuts

Reduce spending to FY2007 levels – $2.114 billion

Although the budgeted expenditures approved for FY2010 are reduced by roughly $500 million from FY2009, the State needs a much more significant reduction in spending before raising any new revenues to balance its budget. Reducing FY2011 spending to actual expenditure levels in FY2007, with some exceptions for Medicaid and General State Aid for elementary and secondary education, would produce an estimated budget cut of $2.1 billion from FY2010 expenditures. FY2007 was chosen because it represents spending levels before the start of the recession in FY2008 when the current deficit began to mount. The following chart shows the calculation of these cuts.

General Funds Budget Reduction to FY2007 (in $ billions)	
FY2010 Expenditures	$ 29.2
Add back retirement system contribution	$ 3.5
Adjusted FY2010 Expenditures	**$ 32.6**
FY2007 Expenditures	$ 28.5
Add back reduction due to pension holiday	$ 1.1
Increase State-source Medicaid to FY2010 levels	$ 0.4
Increase GSA to Elementary and Secondary Education to FY2010 Levels	$ 0.5
Adjusted FY2007 Expenditures	**$ 30.5**
Difference Between FY2007 and FY2010	**$ (2.1)**

This spending rollback in FY2011 will amount to a 7.2% cut from the total General Fund expenditures in FY2010. Although the difference between General Funds expenditures in FY2010 and FY2007 is only $682 million, the calculation of the cuts adjusts both the FY2010 and FY2007 expenditure numbers to account for State pension contributions that should have been—but were not—made from General Funds in both years. Also adjusted were the FY2007 numbers to keep Medicaid state-source General Funds expenditures and General State Aid to elementary and secondary education at FY2010 levels. That brings the adjusted difference between FY2010 and FY2007 expenditures to $2.1 billion including making the full pension payment from the General Funds and protecting critical services.[196]

Total Medicaid expenditures are expected to grow by as much as 7% in FY2011, according to the Taxpayer Action Board, which was appointed by Governor Quinn in March of 2009 to identify opportunities for budget savings.[197] To ensure that state Medicaid funding is adequate to prevent loss of federal recovery funds, the State should step up efforts to reduce fraud and abuse in the Medicaid program. The U.S. Government Accountability Office (GAO) reported in April of 2009 that improper payments totaled $18.6 billion, or 10.5% of federal Medicaid expenditures

[196] The Department of Children and Family Services (DCFS) is operating under a federal consent decree (B.H., et al., vs. McEwen, No. 88-5599, N.D. Ill filed June 29, 1988) that requires the department to provide certain core services to protect children. If cutting DCFS' budget would violate the terms of the decree, the cuts recommended above would have to come from other areas of the budget.

[197] State of Illinois, Taxpayer Action Board, *Final Report*, June 2009, p. 29, at http://www2.illinois.gov/budget/Documents/TABreport.pdf (last visited on January 27, 2010).

in FY2008.[198] Federal agencies are required to report on improper payments under the Improper Payments Information Act of 2002.[199] An improper payment is defined under the act as a payment that should not have been made or that was made in an incorrect amount and includes any payment to an ineligible recipient, any payment for an ineligible service, any duplicate payment, payments for services not received and any payment that does not account for credit for applicable discounts.[200] Another GAO report, published in September of 2009, found substantial evidence of fraudulent, wasteful and abusive purchases of prescription drugs through the Medicaid programs in five states, including Illinois.[201] For example, the GAO found that 65,000 Medicaid recipients in the five states visited six or more doctors to obtain 10 of the most frequently abused prescription drugs. In one case in Illinois, a Medicaid recipient received 3,200 pills used to treat attention-deficit/hyperactivity disorder over two years, an amount equivalent to a six-year supply, according to the GAO.

The State may also be able to obtain savings from increasing its use of health maintenance organizations (HMOs) for Medicaid recipients. The State plans to begin a pilot program in October of 2010, making health maintenance organization coverage mandatory for roughly 40,000 elderly and disabled Medicaid recipients in Northeastern Illinois, excluding Chicago. The program represents the first time that HMO enrollment would be required for Medicaid recipients. The State is targeting the elderly and disabled population because their service needs are costly and complex; state officials believe that effectively managing their care could reduce unnecessary hospitalizations and excessive prescription drug costs. Advocates for the disabled have expressed concerns that HMOs, which will be paid a set fee per patient, might restrict needed services in order to profit from the program. Total savings to taxpayers are estimated at nearly $200 million over the first five years.[202] However, this figure includes both state spending and federal reimbursements.[203] The net savings to the State would amount to roughly $20 million a year. This program should be expanded if the State can ensure that recipients are getting better care and that services are being delivered in a more cost-effective way.

<u>Miscellaneous cuts – $51.0 million</u>

Beyond the broad cuts described above, the following programs and subsidies should be eliminated in FY2011 to reduce unnecessary spending by the State. The following spending cuts listed by order of magnitude will not dramatically change the State's budget but are evidence of nonessential appropriations still included in the FY2010 budget:

1) Eliminate state subsidy for coal development and marketing: $23.8 million
2) Eliminate compensation for appointed members of state boards and commissions: $6.6 million

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[198] U.S. Government Accountability Office, *Improper Payments*, Testimony before the Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate, April 22, 2009, p. 12, at http://www.gao.gov/docsearch/locate?searched=1&o=0&order_by=date&search_type=publications&keyword=GAO-09-628T&Submit=Search (last visited on January 27, 2010). Numbers are for federal fiscal year 2008, ending September 30.

[199] Pub. L. No. 107-300, 116 Stat. 2350 (November 26, 2002).

[200] GAO, *Improper Payments*, p.1.

[201] GAO, *Medicaid: Fraud and Abuse Related to Controlled Substances Identified in Selected States*, September 2009, p. 7, at http://www.gao.gov/new.items/d09957.pdf (last visited on January 27, 2010).

[202] Illinois Department of Healthcare and Family Services, "Proposals Sought for Integrated Care Program," news release, February 8, 2010.

[203] Email communication between the Civic Federation and the Department of Healthcare and Family Services, February 17, 2010.

3) Eliminate General Funds subsidies of salaries of local assessors, supervisors of assessment and coroners: $4.5 million
4) Eliminate state college tuition waivers granted by members of General Assembly: $13.5 million
5) Eliminate agricultural research grants to public universities: $2.2 million
6) End state subsidy for DuQuoin State Fair: $407,000

Increase Employee Healthcare Contribution – $200 million

The Civic Federation previously supported the Governor's FY2010 budget proposal to cut the State's cost for employee health insurance by $200 million by increasing premiums paid by employees and retirees. The Governor's proposal would have increased premiums for employees who choose to participate in the State's most costly health insurance program, which is a traditional indemnity or fee-for-service plan.[204] According to the Commission on Government Forecasting and Accountability, participants in this plan paid an average monthly premium of $79.15, or 12.0% of the total premium in FY2009. This would have risen to $309.56 a month, or 44.4% of the total premium in FY2010 under the Governor's proposal. The monthly premium for non-Medicare eligible retirees in the plan would have increased from $12.98 to $582.71, which would have been 62.7% of the total premium in FY2010.[205]

Income Tax Increases

Personal Income Tax Increase – $5.7 billion

Contingent on the spending cuts and pension reforms described above, the Civic Federation supports an increase in the personal income tax to pay for the FY2011 retirement system contribution, future pension costs and other outstanding liabilities. Based on FY2010 projections and the 8.3% drop in the State's personal income tax receipts from FY2009 to FY2010, an increase from the current rate of 3% to 5% could generate an additional $5.7 billion in FY2011. The Federation also recommends that the State not increase the pass-through to local governments from the income tax increase. **This increase is conditional on the revenues being used to pay for the State's outstanding liabilities including its woefully underfunded pension systems and must be linked to deeper spending cuts as well as the implementation of substantive reforms that will reduce costs and liabilities in the future.**

Corporate Income Tax – $331.0 million

The Civic Federation supports a moderate increase in the corporate income tax rate contingent on the budget cuts and pension reforms described above. The State currently taxes corporate income at 4.8% but also collects a 2.5% personal property replacement tax, which is an additional tax on corporate income that is passed on to local governments. An increase from 4.8% to 6.4% for the corporate income tax was estimated to generate a total of $500 million in FY2010, but after a 33.8% loss in corporate tax revenues between FY2009 and FY2010, the State can only expect to collect roughly $331.0 million. The corporate income tax rate must not exceed the personal income tax rate by more than an 8 to 5 ratio.[206] This change would remain within that ratio. The new revenue generated from this tax combined with the personal income tax is necessary not only to pay down the current deficit, but also to account for future increases in the State's required pension payment that continues to grow each year. The statutorily required retirement system contribution will increase by an average of $455.3 million annually for the next 5 years.

[204] See Personnel: State Employee Health Insurance on p. 34, for more information.

[205] Commission on Government Forecasting and Accountability, "Liabilities of the State Employees' Group Health Insurance Program: Fiscal Year 2010," March 2009, p. 14.

[206] Constitution of the State of Illinois, Article IX, Section 3(a).

Tax Retirement Income – $1.6 billion

Only after the spending cuts and pension reforms described above are enacted by the State, the Civic Federation supports applying the proposed tax rate of 5% to federally taxable portions of retirement and social security income. Based on available data, this could increase State revenue by at least $1.6 billion in FY2011.[207]

The FY2007 Tax Expenditure Report issued by the Illinois Comptroller in 2008 compared other states' tax treatment of retiree income, concluding, "Illinois provides one of the most favorable treatments of retirement income for its retirees."[208] For example, Illinois is one of three states that fully exempt private pension income from taxation.[209] According to the Comptroller's report, "public pension income is fully exempt in ten states, including Illinois, with 26 states providing partial exemptions and five fully taxing this income."[210] If the additional 2-percentage point increase were approved, the tax on retirement income would increase to $1.6 billion for FY2011.[211] This estimate is based on the most recent data available, FY2008, for all federally taxed retirement and social security income earned by Illinois residents.

Illinois exempts from taxation all retirement income that is subject to the federal income tax, including IRA, disability, Social Security and railroad retirement income. At the federal level, the threshold to pay taxes on Social Security income is $25,000 for single filers and $32,000 for joint filers. For single filers with incomes between $25,000 and $34,000 and joint filers with incomes between $32,000 and $44,000, the amount of benefits subject to tax is the lesser of one-half the retirement benefits or one-half of the total income over the threshold. Above those levels, 85% of benefits are subject to federal tax.[212]

Illinois income tax is calculated based on the taxpayer's federal adjusted gross income. The Illinois Federally Taxed Retirement and Social Security Subtractions allow Illinois taxpayers to subtract most retirement income from this tax base when computing taxable income for state purposes.

Taxing retirement income will raise equity concerns that flow from the flat rate structure of the Illinois income tax. Flat rate income tax systems provide for the same rate for all taxpayers regardless of ability to pay. Thus, they proportionately have a greater financial impact on lower income earners. This issue could be addressed through adoption of a graduated income tax structure that affects higher income earners at proportionally greater rates than lower income earners. This would require the approval of a state constitutional amendment to authorize a graduated personal income tax.

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207 Illinois Comptroller's FY2008 Tax Expenditure Report, p. 7, (November 2009) at http://www.apps.ioc.state.il.us/ioc-pdf/2008_Tax_Expenditure_Report.pdf (last visited on February 18, 2010).

208 Illinois Comptroller's FY2007 Tax Expenditure Report, p. 3 (August 2008) at http://www.apps.ioc.state.il.us/ioc-pdf/TaxExpRptFY2007Web.pdf (last visited on February 18, 2010).

209 Ibid p. 5.

210 Ibid.

211 This calculation is based upon the FY2008 Tax Expenditure Report released by the Illinois Comptroller's Office at http://www.apps.ioc.state.il.us/ioc-pdf/2008_Tax_Expenditure_Report.pdf (last visited on February 18, 2010).

212 State of Illinois Office of the Comptroller, Tax Expenditure Report FY2007, August 2008, pp. 3-4, at http://www.apps.ioc.state.il.us/ioc-pdf/TaxExpRptFY2007Web.pdf, (last visited on January 28, 2010).

Other Tax Changes

Business tax changes – $181 million

The Civic Federation supports efforts to end outdated and economically inefficient corporate tax deductions or credits. The Federation supported six specific business tax changes proposed by the Governor as part of his FY2010 budget recommendation:

1) Restrict cost of collection discounts – $57.0 million
   Retailers currently are allowed to take a discount of 1.75% of the tax receipts collected if they file returns and pay sales taxes owed on time. The discount is intended to be an incentive for prompt payment of the tax and to compensate businesses for administrative costs. However, automation of records has dramatically reduced the administrative costs associated with collection. As a result, 24 states offer no discount; the remaining 26 states offer vendor discounts in varying amounts. In the FY2010 budget proposed by the Governor, the State would have capped the cost of collection discount at 0.75%. Although the measure was not included in the enacted budget, the Civic Federation continues to support this restriction.
2) Eliminate Manufacturer's Purchase Credit – $20 million
   The Manufacturer's Purchase Credit (MPC) is earned when a manufacturer purchases manufacturing or graphic arts machinery and equipment that qualify for the existing sales/use tax exemptions. The credit may be used to pay state sales or use taxes on future purchases of these types of equipment. The MPC is equal to an amount that is half of the 6.25% state sales tax. In FY2010, the Governor proposed eliminating this credit, which would generate an estimated $20.0 million per year. Although the Civic Federation supported the repeal of this exemption, it was renewed as part of the FY2010 enacted budget. The Civic Federation continues to support the repeal of this credit.
3) Limit graphic arts sales tax exemption – $10.0 million
   The state extended the state graphic arts sales tax exemption beyond businesses primarily engaged in graphic arts production to include other industries using graphic arts machinery and equipment. The Civic Federation supported limiting this exemption in FY2010 but the exemption was renewed as part of the FY2010 enacted budget. The Civic Federation continues to support the repeal of this exemption.
4) Include Puerto Rico and Outer Continental Shelf – $57.0 million
   The State proposed in FY2010 that Illinois treat U.S. territories and the Outer Continental Shelf as part of the United States. Currently, Illinois defines the "United States" as excluding U.S. territories and possessions, in keeping with the federal Internal Revenue Service rules. The State defends this proposal as preventing situations in which corporations do not account for activity in subsidiaries located outside the 50 states and the District of Columbia, thereby reducing income subject to Illinois tax. The Civic Federation supports this proposal as part of the FY2011 budget.
5) Repeal research and development credit – $27.0 million
   The Research and Development credit provides taxpayers an income tax credit for businesses that increase research activities. It is equal to 6.5% of qualifying research expenditures and repealing the credit is expected to generate approximately $27.0 million. The credit was enacted in 1990, temporarily repealed in 2003 and restored in 2004. The State argues that there is little or no evidence that the credit has actually increased research and development. Furthermore, only a small number of companies apply for the credit annually. The Civic Federation supports repealing this credit as part of the FY2011 budget.

6) Apply state insurance rate to insurance from out of state underwriters – $10.0 million
Currently, large entities can purchase insurance directly from an underwriters not licensed in Illinois and thus avoid playing the state insurance tax. This proposal would eliminate the disparity and require such entities to pay the Illinois insurance tax at the same rate paid by entities purchasing insurance from underwriters licensed in Illinois. The Civic Federation supports this proposal as part of the FY2011 budget.

Increase Cigarette Tax – $350 million
The Civic Federation supported the Governor's proposal as part of his FY2010 budget to increase the state tax on cigarettes incrementally from 98 cents per pack to $1.48 per pack in FY2010 and then to $1.98 per pack in FY2011. This proposal was expected to raise $175 million during the first year after it was enacted. However, since the General Assembly took no action on this proposal and the State's fiscal crisis has worsened dramatically, the Civic Federation recommends increasing the cigarette tax to the full amount of $1.98 per pack. Based on last year's estimates and accounting for revenue reductions due to the effect of higher prices, the State could expect an additional $350 million in revenue to fund public health expenses in FY2011.

Long-Term Reforms
The Civic Federation believes that the State should take other steps that, while not resulting in savings in FY2011, will reduce government costs and promote more efficient delivery of services in the long run.

- Reduction of Non-Vested Pension Benefits of Current Employees:
  Consider the possibility of reducing the non-vested pension benefits of current state employees. As suggested by the Civic Committee of the Commercial Club of Chicago, it is likely that the Illinois Constitution's protection of employees' contractually vested benefits does not apply to benefits earned in the future. When faced with adverse financial circumstances, many private-sector employers have changed their pension plans to make them less costly. The Civic Federation believes that there is mounting evidence that a judge could find the State to be insolvent. If the State is found to be insolvent under the classical cash flow definition of insolvency, which is the inability to pay debts as they come due, it is not only the pension rights of non-vested employees that will be in jeopardy. All obligations of the State, whether vested or not, will be competing for funding with the other essential responsibilities of State government. Even vested pension rights are jeopardized when a government is insolvent.
- Sales Tax on Consumer Services:
  Study the feasibility of extending the sales tax to consumer services to broaden Illinois' tax base as a means of additional revenue and reducing the unsustainably high combined sales tax rate in Cook County.
- Graduated Income Tax:
  Consider the merits of adopting a constitutional amendment authorizing a graduated personal income tax. Such a constitutional change would have the benefit of affording comprehensive rather than piecemeal relief to taxpayers in certain income brackets.
- Pension Board Reform:
  Require balance on pension boards between employees, management and taxpayers. Board seats should be set aside for members with professional expertise or certification in financial asset investment, and all members who do not already possess such expertise should be required to receive some relevant financial training on an annual basis.

- Community Care:
  Shift state Medicaid spending from institutional care for the elderly and disabled to home- and community-based care. Such a shift would be in line with court rulings and with the preferences of many advocates for the disabled.
- Eliminate State Employee Indemnity Plan:
  Eliminate the State's traditional indemnity or fee-for-service employee group health insurance plan and end the practice of not charging premiums for retirees with 20 or more years of service. Illinois' health plan is more generous than those of most states, largely because of these two features.
- Consolidate Special Purpose Funds:
  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.
- Performance Measurements:
  Develop a performance measurement system to determine priorities. Ideally, spending cuts from the state budget should be based on a careful assessment of program and service performance rather than an across-the-board approach, but Illinois does not have a fully effective performance evaluation system in place that would permit careful executive assessments.
- Long-term Financial Planning:
  Develop a long-term financial plan. Internally, the State of Illinois employs many of the techniques of a long-term financial planning process, including the projection of multi-year revenue trends and modeling of various revenue and expenditure options. However, the State does not develop a formal plan that is shared with and/or reviewed by key policymakers and stakeholders.

APPENDIX 1: METHODOLOGY

To maintain consistency, this report primarily relies on data obtained from the State of Illinois. The main sources are the budget books that are published annually as part of the Governor's budget recommendation and the Official Statements issued in connection with bond offerings. Not all data were available from these sources and the Civic Federation calculated some data using available information.

This report contains actual year-end state revenues, appropriations, expenditures, debt, surplus and deficit information from State of Illinois budget books and Official Statements, except for FY2009 and FY2010. FY2009 revenue data combine the most recent information available from the December 2009 estimates from State of Illinois Official Statements and March 2009 estimates from the State of Illinois FY2010 budget book. FY2009 expenditures used in this report were from an email communication between the Civic Federation and the Governor's Office of Management and Budget. FY2010 revenues are projections, including August 2009 projections listed in the Commission on Government Forecasting and Accountability's FY2010 Budget Summary, December 2009 projections from State of Illinois Official Statement and March 2009 estimates from the State of Illinois FY2010 Budget Book. In addition, the Civic Federation estimated FY2001 and FY2002 appropriations and expenditure data from State of Illinois Budget Books. In order to compare these years to FY2003-FY2010, capital appropriations and expenditures were extracted from the data.

Payroll expenditure data came from the Illinois State Comptroller. The Civic Federation used the Illinois State Comptroller's Expenditures Control Panel by Detailed Object website to estimate FY2008 and FY2009 data. Data on state employee group insurance was obtained from the Commission on Government Forecasting and Accountability's reports on Liabilities of the State Employees' Group Health Insurance Program FY2010 and Budget Summary FY2010. Retirement system information was compiled from State of Illinois Budget Books as well as reports from the Commission on Government Forecasting and Accountability.

Revenues and expenditures were adjusted for inflation using the U.S. Consumer Price Index for All Urban Consumers from the U.S. Bureau of Labor Statistics. Data were adjusted to current-year dollars using the average monthly CPI during each fiscal year.

Revenue estimates in the Civic Federation plan were developed using data from the State of Illinois FY2010 budget book, the Illinois State Comptroller's Tax Expenditure Report and communication with the Illinois Department of Revenue and Governor's Office of Management and Budget.

APPENDIX 2: REVENUES

Table A: Revenues for All Funds

State of Illinois Revenues for All Funds: FY2001-FY2010 (in $ millions)												
	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	Estimated FY2009*	Estimated FY2010*	$ change	% change
State Taxes												
Income Taxes (Net)	$ 9,032	$ 8,274	$ 8,079	$ 8,209	$ 9,151	$ 10,062	$ 11,158	$ 12,180	$ 10,933	$ 9,570	$ 538	6.0%
Individual	$ 7,996	$ 7,471	$ 7,341	$ 7,272	$ 7,979	$ 8,635	$ 9,408	$ 10,320	$ 9,223	$ 8,438	$ 442	5.5%
Corporate	$ 1,036	$ 803	$ 738	$ 936	$ 1,172	$ 1,427	$ 1,750	$ 1,860	$ 1,710	$ 1,132	$ 96	9.3%
Sales Taxes	$ 6,563	$ 6,646	$ 6,593	$ 6,739	$ 7,030	$ 7,493	$ 7,631	$ 7,816	$ 7,632	$ 7,266	$ 703	10.7%
Motor Fuel Tax (Gross)	$ 1,367	$ 1,374	$ 1,432	$ 1,424	$ 1,435	$ 1,446	$ 1,454	$ 1,335	$ 1,488	$ 1,395	$ 28	2.0%
Public Utility Taxes	$ 1,271	$ 1,225	$ 1,138	$ 1,204	$ 1,299	$ 1,328	$ 1,884	$ 1,925	$ 1,926	$ 1,907	$ 636	50.0%
Cigarette Taxes and Tobacco Products Taxes	$ 473	$ 469	$ 637	$ 760	$ 692	$ 152	$ 639	$ 614	$ 581	$ 570	$ 97	20.5%
Liquor Gallonage Taxes	$ 124	$ 122	$ 123	$ 127	$ 147	$ 273	$ 156	$ 158	$ 158	$ 161	$ 37	29.8%
Inheritance Tax	$ 361	$ 329	$ 237	$ 222	$ 310	$ 407	$ 264	$ 373	$ 288	$ 275	$ (86)	-23.8%
Insurances Tax and Fees	$ 284	$ 314	$ 370	$ 466	$ 470	$ 198	$ 412	$ 396	$ 425	$ 435	$ 151	53.2%
Corporate Franchise Taxes and Fees	$ 529	$ 580	$ 142	$ 163	$ 184	$ 769	$ 201	$ 238	$ 208	$ 203	$ (326)	-61.6%
Riverboat Gaming Taxes and Fees	$ 146	$ 159	$ 670	$ 775	$ 816	$ 816	$ 772	$ 688	$ 549	$ 500	$ 354	242.5%
Subtotal State Taxes	**$ 20,150**	**$ 19,492**	**$ 19,421**	**$ 20,088**	**$ 21,534**	**$ 22,944**	**$ 24,571**	**$ 25,723**	**$ 24,188**	**$ 22,282**	**$ 2,132**	**10.6%**
Other Receipts												
Motor Vehicle and Operations License Fees	$ 1,272	$ 1,320	$ 1,107	$ 1,162	$ 1,169	$ 1,226	$ 1,288	$ 1,302	$ 1,108	$ 1,233	$ (39)	-3.1%
Interest Income	$ 355	$ 190	$ 93	$ 82	$ 128	$ 152	$ 202	$ 210	$ 80	$ 80	$ (275)	-77.5%
Revolving Fund Receipts	$ 290	$ 290	$ 251	$ 353	$ 387	$ 624	$ 623	$ 683	$ 677	$ 661	$ 371	127.9%
Lottery	$ 765	$ 827	$ 817	$ 880	$ 903	$ 981	$ 957	$ 992	$ 988	$ 974	$ 209	27.3%
Assessment Funds Receipts	$ 73	$ 63	$ 81	$ 74	$ 706	$ 74	$ 1,529	$ 2,189	$ 1,654	$ 1,616	$ 1,543	2113.7%
Intergovernmental Receipts	$ 920	$ 932	$ 1,191	$ 1,332	$ 1,363	$ 1,331	$ 1,319	$ 1,268	$ 1,236	$ 1,168	$ 248	27.0%
Group Insurance Receipts	$ 1,150	$ 1,220	$ 1,353	$ 1,460	$ 1,629	$ 1,276	$ 1,310	$ 1,268	$ 1,480	$ 1,353	$ 203	17.7%
Tobacco Settlement Receipts	$ 277	$ 314	$ 319	$ 296	$ 290	$ 273	$ 285	$ 310	$ 317	$ 318	$ 41	14.8%
Other Taxes, Fees, Earnings and Net Transfers	$ 1,274	$ 1,374	$ 3,812	$ 4,008	$ 4,091	$ 3,637	$ 3,748	$ 4,698	$ 3,830	$ 3,794	$ 2,520	197.8%
Subtotal Other Receipts	**$ 6,376**	**$ 6,530**	**$ 9,024**	**$ 9,647**	**$ 10,666**	**$ 9,574**	**$ 11,261**	**$ 12,920**	**$ 11,370**	**$ 11,197**	**$ 4,821**	**75.6%**
Federal Receipts	$ 9,771	$ 10,224	$ 10,471	$ 12,198	$ 12,206	$ 12,391	$ 12,999	$ 13,565	$ 17,499	$ 21,237	$ 11,466	117.3%
Total	**$ 36,297**	**$ 36,246**	**$ 38,916**	**$ 41,933**	**$ 44,406**	**$ 44,909**	**$ 48,831**	**$ 52,208**	**$ 53,057**	**$ 54,716**	**$ 18,419**	**50.7%**

*Personal and corporate income taxes, liquor gallonage tax and inheritance tax are actual revenues for FY2009 and estimates as of December 15, 2009 for FY2010. Total sales tax revenue for FY2010 is a Civic Federation estimates based on the amount of sales tax revenue that is estimated to be deposited in General Funds. All other FY2009 and FY2010 revenues are estimates from the State of Illinois FY2010 Budget Book, March 2009, 2-32.

Sources: State of Illinois FY2004 Budget in Brief, 23 and 24; State of Illinois FY2006 Budget Book, 1-27 and 1-28; State of Illinois FY2008 Budget Book, 2-36 and 2-37; State of Illinois FY2010 Budget Book 2-32 and 2-33; State of Illinois, $3.466 Billion General Obligation Bonds Taxable Series of January 2010, *Official Statement* , January 7, 2010; Commission on Government Forecasting and Accountability, *State of Illinois Budget Summary FY2010* , 28.

Table B: Consumer Price Index

Data were adjusted for inflation using the average monthly Consumer Price Index for All Urban Consumers during each fiscal year.

Consumer Price Index: All Urban Consumers (indexed to 1982-1984=100)										
Fiscal Year	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010*
Consumer Price Index	175.1	178.2	182.1	186.1	191.7	199.0	204.2	211.7	214.7	215.9

*FY2010 CPI includes July-December 2009 data

Source: Adapted from the U.S. Bureau of Labor Statistics, http://www.bls.gov (last visited on January 15, 2010).

Table C: Revenues for General Funds

State of Illinois Revenues for General Funds: FY2001-FY2010
(in $ millions)

	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	Projected FY2010	$ change	% change
Base Revenues												
State Sources												
Income Taxes (Net)	$ 9,032	$ 8,274	$ 8,079	$ 8,208	$ 9,151	$ 10,063	$ 11,159	$ 12,180	$ 10,933	$ 9,570	$ 538	6.0%
Personal	$ 7,996	$ 7,471	$ 7,341	$ 7,272	$ 7,979	$ 8,635	$ 9,409	$ 10,320	$ 9,223	$ 8,438	$ 442	5.5%
Corporate	$ 1,036	$ 803	$ 738	$ 936	$ 1,172	$ 1,428	$ 1,750	$ 1,860	$ 1,710	$ 1,132	$ 96	9.3%
Sales Taxes	$ 5,958	$ 6,052	$ 6,059	$ 6,331	$ 6,595	$ 7,092	$ 7,136	$ 7,215	$ 6,773	$ 6,394	$ 436	7.3%
Public Utility Taxes	$ 1,146	$ 1,104	$ 1,006	$ 1,079	$ 1,056	$ 1,074	$ 1,130	$ 1,157	$ 1,168	$ 1,150	$ 4	0.3%
Cigarette Taxes	$ 400	$ 400	$ 400	$ 400	$ 450	$ 400	$ 349	$ 350	$ 350	$ 350	$ (50)	-12.5%
Liquor Taxes	$ 124	$ 122	$ 123	$ 127	$ 147	$ 152	$ 156	$ 158	$ 158	$ 161	$ 37	29.8%
Inheritance Taxes	$ 361	$ 329	$ 237	$ 222	$ 310	$ 272	$ 264	$ 373	$ 288	$ 275	$ (86)	-23.8%
Insurance Taxes & Fees	$ 246	$ 272	$ 313	$ 362	$ 342	$ 317	$ 310	$ 299	$ 334	$ 325	$ 79	32.1%
Corporate Franchise Fees & Taxes	$ 146	$ 159	$ 142	$ 163	$ 181	$ 181	$ 193	$ 225	$ 201	$ 205	$ 59	40.4%
Interest on State Funds and Investments	$ 274	$ 135	$ 66	$ 55	$ 73	$ 153	$ 204	$ 212	$ 81	$ 80	$ (194)	-70.8%
Cook County Intergov. Transfer	$ 245	$ 245	$ 355	$ 428	$ 433	$ 350	$ 307	$ 302	$ 253	$ 240	$ (5)	-2.0%
Other State Sources	$ 441	$ 550	$ 383	$ 516	$ 500	$ 475	$ 482	$ 475	$ 445	$ 330	$ (111)	-25.2%
Transfers-In												
Lottery	$ 501	$ 555	$ 540	$ 570	$ 614	$ 670	$ 623	$ 656	$ 625	$ 645	$ 144	28.7%
Riverboat Gaming Taxes	$ 460	$ 470	$ 554	$ 661	$ 699	$ 689	$ 685	$ 564	$ 430	$ 420	$ (40)	-8.7%
Other Transfers	$ 452	$ 454	$ 1,033	$ 2,511	$ 918	$ 746	$ 935	$ 679	$ 538	$ 1,056	$ 604	133.6%
10th Riverboat License	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 50	$ 50	N/A
Subtotal State Sources	**$ 19,786**	**$ 19,121**	**$ 19,290**	**$ 21,633**	**$ 21,469**	**$ 22,634**	**$ 23,933**	**$ 24,845**	**$ 22,577**	**$ 21,251**	**$ 1,465**	**7.4%**
Federal Sources	$ 4,320	$ 4,258	$ 3,940	$ 5,189	$ 4,691	$ 4,725	$ 4,702	$ 4,815	$ 5,001	$ 4,985	$ 665	15.4%
Subtotal Base Revenues	**$ 24,106**	**$ 23,379**	**$ 23,230**	**$ 26,822**	**$ 26,160**	**$ 27,359**	**$ 28,635**	**$ 29,660**	**$ 27,578**	**$ 26,236**	**$ 2,130**	**8.8%**
Federal Recovery	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 1,566	$ 1,966	$ 400	25.5%
Total Revenues for General Funds	**$ 24,106**	**$ 23,379**	**$ 23,230**	**$ 26,822**	**$ 26,160**	**$ 27,359**	**$ 28,635**	**$ 29,660**	**$ 29,144**	**$ 28,202**	**$ 4,096**	**17.0%**

Note: Transfers-In, Other Transfers includes Pension Obligation Bond Reimbursement Transfers of $300 million in FY2003 and $1.5 billion in FY2004

Sources: State of Illinois FY2004 Budget in Brief, 23 and 24; State of Illinois FY2005 Budget in Brief, 41; State of Illinois FY2006 Budget Book, 1-27 and 1-28; State of Illinois FY2008 Budget Book, 2-36 and 2-37; State of Illinois FY2010 Budget Book 2-32 and 2-33; State of Illinois, $3.466 Billion General Obligation Bonds Taxable Series of January 2010, *Official Statement* , January 7, 2010; Commission on Government Forecasting and Accountability, *State of Illinois Budget Summary FY2010* , 28; State of Illinois Report of the Pension Modernization Task Force, November 2009, 47.

APPENDIX 3: APPROPRIATIONS AND EXPENDITURES

Table A: Appropriations

State of Illinois Enacted Appropriations: FY2001-FY2010 (in $ billions)										
	FY2001*	FY2002*	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010
General Funds	$ 22.7	$ 23.4	$ 22.3	$ 23.3	$ 23.7	$ 24.5	$ 25.8	$ 27.5	$ 30.3	$ 26.3
Other State Funds	$ 12.5	$ 13.4	$ 11.8	$ 12.3	$ 13.3	$ 14.1	$ 15.4	$ 15.8	$ 17.8	$ 18.8
Federal Funds	$ 5.0	$ 5.3	$ 5.3	$ 5.6	$ 5.9	$ 5.7	$ 5.8	$ 5.8	$ 7.2	$ 9.5
Total	**$ 40.2**	**$ 42.1**	**$ 39.4**	**$ 41.2**	**$ 42.9**	**$ 44.3**	**$ 47.0**	**$ 49.1**	**$ 55.3**	**$ 54.6**

*Other State Funds for FY2001 and FY2002 are Civic Federation estimates calculated from the State of Illinois FY2003 Budget Book and the State of Illinois FY2004 Budget Book.

Source: State of Illinois FY2003 Budget Book; State of Illinois FY2004 Budget Book; State of Illinois FY2005 Budget Book, 1-34; State of Illinois FY2006 Budget Book, 1-25; State of Illinois FY2007 Budget Book, 2-32; State of Illinois FY2008 Budget Book, 2-35; State of Illinois FY2009 Budget Book, 2-36; State of Illinois FY2010 Budget Book, 2-30; State of Illinois, $3.466 Billion General Obligation Bonds Taxable Series of January 2010, *Official Statement* , January 7, 2010; Commission on Government Forecasting and Accountability, *State of Illinois Budget Summary FY2010* , p. 191.

Table B: Appropriated Expenditures

State of Illinois Appropriated Expenditures: FY2001-FY2009 (in $ billions)									
	FY2001*	FY2002*	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009
General Funds	$ 22.4	$ 22.7	$ 21.9	$ 22.7	$ 22.5	$ 24.1	$ 25.5	$ 27.2	$ 29.8
Other State Funds	$ 9.9	$ 10.4	$ 9.5	$ 10.7	$ 11.5	$ 11.4	$ 12.2	$ 13.5	$ 13.3
Federal Funds	$ 3.2	$ 3.2	$ 3.5	$ 3.6	$ 3.9	$ 4.0	$ 4.0	$ 4.0	$ 4.5
Total	**$ 35.5**	**$ 36.3**	**$ 34.9**	**$ 37.0**	**$ 37.9**	**$ 39.5**	**$ 41.7**	**$ 44.7**	**$ 47.5**

*Other State Funds and Federal Funds for FY2001 and FY2002 are Civic Federation estimates calculated from the State of Illinois FY2003 Budget Book and FY2004 Budget Book.

Source: State of Illinois Office of the Comptroller, *Traditional Budgetary Financial Report Fiscal Year 2004,* January 18, 2005, 9; State of Illinois FY2003 Budget Book; State of Illinois FY2004 Budget Book; State of Illinois FY2005 Budget Book, 1-34; State of Illinois FY2006 Budget Book, 1-25; State of Illinois FY2007 Budget Book, 2-32; State of Illinois FY2008 Budget Book, 2-35; State of Illinois FY2009 Budget Book, 2-36; State of Illinois FY2010 Budget Book, 2-30; State of Illinois, $3.466 Billion General Obligation Bonds Taxable Series of January 2010, *Official Statement,* January 7, 2010; Email communication between the Civic Federation and the Governor's Office of Management and Budget, January 27, 2010.

Table C: Elementary and Secondary Education Expenditures

State of Illinois Elementary and Secondary Education Expenditures: FY2001-FY2010 (in $ millions)									
	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009
General Funds	$ 5,865.9	$ 6,106.9	$ 5,898.9	$ 6,459.2	$ 6,758.4	$ 6,729.7	$ 7,360.4	$ 8,179.8	$ 8,959.3
Other State Funds	$ 218.9	$ 99.8	$ 96.4	$ 69.2	$ 18.1	$ 38.3	$ 29.7	$ 27.8	$ 26.1
Federal Funds	$ 1,164.7	$ 1,300.3	$ 1,534.9	$ 1,636.3	$ 1,806.2	$ 1,792.8	$ 1,770.3	$ 1,856.6	$ 1,991.1
Total	**$ 7,249.5**	**$ 7,506.9**	**$ 7,530.2**	**$ 8,164.7**	**$ 8,582.7**	**$ 8,560.8**	**$ 9,160.4**	**$ 10,064.2**	**$ 10,976.5**

Source: State of Illinois FY2003 Budget Book, 3-5; State of Illinois FY2004 Budget Book, 2-11; State of Illinois FY2005 Budget Book, 1-32; State of Illinois FY2006 Budget Book, 1-23; State of Illinois FY2007 Budget Book, 2-31; State of Illinois FY2008 Budget Book, 2-33; State of Illinois FY2009 Budget Book, 2-34; State of Illinois FY2010 Budget Book, 2-28; Email communication between the Civic Federation and the Governor's Office of Management and Budget, January 27, 2010.

Table D: General State Aid Expenditures

State of Illinois Total Appropriations for General State Aid and GSA Hold Harmless: FY2001-FY2010 (in $ millions)										
	FY2001 Actual	FY2002 Actual	FY2003 Actual	FY2004 Actual	FY2005 Actual	FY2006 Actual	FY2007 Actual	FY2008 Actual	FY2009 Actual	FY2010 Enacted
General State Aid	$ 3,060.6	$ 3,266.4	$ 3,142.1	$ 3,445.6	$ 3,682.2	$ 3,895.7	$ 4,127.1	$ 4,424.3	$ 4,581.6	$ 4,600.3
General State Aid - Hold Harmless*	$ -	$ -	$ 64.2	$ 37.0	$ 27.1	$ 21.6	$ 19.6	$ 20.7	$ 26.1	$ 15.7
Total	**$ 3,060.6**	**$ 3,266.4**	**$ 3,206.3**	**$ 3,482.6**	**$ 3,709.3**	**$ 3,917.3**	**$ 4,146.7**	**$ 4,445.0**	**$ 4,607.7**	**$ 4,616.0**

*Prior to FY2003 Appropriations for GSA Hold Harmless were aggregated with GSA appropriations.
Sources: State of Illinois FY2003 Budget Book, 3-3; State of Illinois FY2004 Budget Book, 2-7; State of Illinois FY2005 Budget Book, 2-5; State of Illinois FY2006 Budget Book, 4-4; State of Illinois FY2007 Budget Book, 6-3; State of Illinois FY2008 Budget Book, 6-4; State of Illinois FY2009 Budget Book, 6-3; State of Illinois FY2010 Budget Book, 6-4; Illinois State Board of Education, FY2010 Enacted and Management Plan, http://www2.illinois.gov/budget/Documents/586-ISBE.pdf (last visited on February 8, 2010).

Table E: Higher Education Expenditures

State of Illinois Higher Education Expenditures: FY2001-FY2010 (in $ millions)									
	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009
General Funds	$ 2,500.6	$ 2,613.6	$ 2,420.4	$ 2,295.9	$ 2,213.2	$ 2,193.2	$ 2,285.4	$ 2,211.4	$ 2,466.0
Other State Funds	$ 20.4	$ 56.6	$ 59.6	$ 62.9	$ 205.6	$ 132.3	$ 186.1	$ 394.3	$ 279.0
Federal Funds	$ 221.0	$ 186.4	$ 219.8	$ 170.2	$ 180.2	$ 208.4	$ 286.1	$ 194.4	$ 266.6
Total	**$ 2,742.1**	**$ 2,856.5**	**$ 2,699.8**	**$ 2,529.0**	**$ 2,599.0**	**$ 2,533.9**	**$ 2,757.6**	**$ 2,800.1**	**$ 3,011.6**

Source: State of Illinois FY2003 Budget Book, 3-26; State of Illinois FY2004 Budget Book, 2-31, 2-50; State of Illinois FY2005 Budget Book, 1-33; State of Illinois FY2006 Budget Book, 1-24; State of Illinois FY2007 Budget Book, 2-32; State of Illinois FY2008 Budget Book, 2-34; State of Illinois FY2009 Budget Book, 2-35; State of Illinois FY2010 Budget Book, 2-29; Email communication between the Civic Federation and the Governor's Office of Management and Budget, January 27, 2010.

APPENDIX 4: RETIREMENT SYSTEMS

Table A: Projected Retirement System Unfunded Liabilities

Projected Retirement System Unfunded Liabilities: FY2010-FY2045 (in $ millions)		
Fiscal Year	Unfunded Liabilities	Funded Ratio
FY2010	$ 66,517.8	49.8%
FY2011	$ 70,720.5	49.2%
FY2012	$ 74,915.0	48.7%
FY2013	$ 79,055.7	48.3%
FY2014	$ 81,677.1	48.9%
FY2015	$ 84,228.2	49.6%
FY2016	$ 86,785.3	50.2%
FY2017	$ 89,343.6	50.9%
FY2018	$ 91,885.8	51.5%
FY2019	$ 94,399.9	52.2%
FY2020	$ 96,889.3	52.8%
FY2021	$ 99,340.7	53.5%
FY2022	$ 101,735.6	54.2%
FY2023	$ 104,051.2	54.9%
FY2024	$ 106,270.2	55.7%
FY2025	$ 108,354.6	56.6%
FY2026	$ 110,289.2	57.4%
FY2027	$ 112,036.3	58.4%
FY2028	$ 113,586.6	59.4%
FY2029	$ 114,930.3	60.4%
FY2030	$ 116,000.3	61.5%
FY2031	$ 116,786.2	62.6%
FY2032	$ 117,215.1	63.9%
FY2033	$ 117,221.7	65.2%
FY2034	$ 116,454.2	66.7%
FY2035	$ 115,148.6	68.3%
FY2036	$ 113,237.6	69.9%
FY2037	$ 110,658.0	71.7%
FY2038	$ 107,281.6	73.6%
FY2039	$ 103,012.3	75.6%
FY2040	$ 97,802.1	77.7%
FY2041	$ 91,555.3	79.9%
FY2042	$ 84,201.8	82.2%
FY2043	$ 75,425.5	84.7%
FY2044	$ 65,167.9	87.3%
FY2045	$ 53,269.6	90.0%

Source: Commission on Government Forecasing and Accountability, *Monthly Briefing* , January 2010, p. 13.

Table B: Projected State Contribution to Employee Retirement Systems

Projected State Contribution to Employee Retirement Systems: FY2010-FY2045 (in $ millions)	
Fiscal Year	**State Contribution**
FY2010	$ 4,046.6
FY2011	$ 4,576.3
FY2012	$ 4,832.1
FY2013	$ 5,156.3
FY2014	$ 5,477.4
FY2015	$ 5,806.7
FY2016	$ 6,056.3
FY2017	$ 6,310.5
FY2018	$ 6,579.1
FY2019	$ 6,862.2
FY2020	$ 7,154.1
FY2021	$ 7,461.9
FY2022	$ 7,786.6
FY2023	$ 8,128.1
FY2024	$ 8,478.8
FY2025	$ 8,842.7
FY2026	$ 9,230.4
FY2027	$ 9,635.2
FY2028	$ 10,050.4
FY2029	$ 10,487.8
FY2030	$ 10,941.6
FY2031	$ 11,406.2
FY2032	$ 11,910.3
FY2033	$ 12,444.8
FY2034	$ 13,126.9
FY2035	$ 13,705.2
FY2036	$ 14,312.5
FY2037	$ 14,951.7
FY2038	$ 15,621.7
FY2039	$ 16,323.1
FY2040	$ 17,060.2
FY2041	$ 17,838.2
FY2042	$ 18,661.6
FY2043	$ 19,525.6
FY2044	$ 20,428.0
FY2045	$ 21,368.7

Source: Commission on Government Forecasting and Accountability, *Monthly Briefing* , January 2010, p.13.

APPENDIX 5: GENERAL FUNDS EXPENDITURES AND TRANSFERS OUT

State of Illinois General Funds Expenditures and Transfers Out: FY2001-FY2010 (in $ millions)

	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010*
Expenditures	**$ 22,366**	**$ 22,739**	**$ 21,893**	**$ 22,630**	**$ 22,563**	**$ 24,103**	**$ 25,499**	**$ 27,153**	**$ 29,961**	**$ 25,910**
Legislatively Required Transfers	$ 2,217	$ 2,159	$ 2,031	$ 2,519	$ 3,163	$ 2,632	$ 2,544	$ 2,735	$ 2,532	$ 2,724
Pension Obligation Bond Debt Service Transfer	$ -	$ -	$ -	$ -	$ 495	$ 427	$ 429	$ 467	$ 467	$ 520
Transfer to Budget Stabilization Fund	$ -	$ -	$ -	$ 50	$ -	$ -	$ -	$ -	$ -	$ -
Total Transfers Out	**$ 2,217**	**$ 2,159**	**$ 2,031**	**$ 2,569**	**$ 3,658**	**$ 3,059**	**$ 2,973**	**$ 3,202**	**$ 2,999**	**$ 3,244**
Total Expenditures and Transfers Out	**$ 24,583**	**$ 24,898**	**$ 23,924**	**$ 25,199**	**$ 26,221**	**$ 27,162**	**$ 28,472**	**$ 30,355**	**$ 32,960**	**$ 29,154**

*FY2010 are estimates as of December 15, 2009.

Sources: Illinois Office of the Comptroller, *Traditional Budgetary Financial Report Fiscal Year 2005*, page 5 and 9; State of Illinois $963 million General Obligation Bonds Series A and B of October 2003, *Official Statement*, October 29, 2003, page 42; State of Illinois $274,950,000 General Obligation Refunding Bonds Series of June 2006, *Official Statement*, June 21, 2006, page 21; State of Illinois $1.4 billion General Obligation Certificates of December 2008, *Official Statement Addendum*, December 16, 2008, page 18; State of Illinois, $3.466 Billion General Obligation Bonds Taxable Series of January 2010, *Official Statement*, January 7, 2010, page 22.

APPENDIX 6: DEBT PER CAPITA

Per Capita Debt Data (in millions)			
	Population	Total Debt	Debt Per Capita
FY2001	12.5	$8,444.2	$ 676.5
FY2002	12.3	$9,542.6	$ 777.1
FY2003	12.6	$20,811.8	$ 1,651.6
FY2004	12.7	$21,809.6	$ 1,645.1
FY2005	12.7	$22,240.7	$ 1,748.5
FY2006	12.8	$22,693.9	$ 1,776.2
FY2007	12.9	$22,230.3	$ 1,729.6
FY2008	12.9	$21,621.8	$ 1,675.8
FY2009	12.9	$21,115.5	$ 1,628.5
FY2010*	12.9	$21,872.0	$ 1,682.1
FY2011*	12.9	$25,411.4	$ 1,954.3

Source populations:

FY2001-FY2005: State of Illinois, $300,000,000 General Obligation Bonds, Series November 2004, Official Statement p. 33.

FY2006-FY2011: Official Statement, State of Illinois General Obligation Bonds, Taxable Build America Bonds, Series 2010-1, January 28, 2010, p. 34.

Source Debt (includes G.O. Bonds, POBs, Build Illinois and Civic Center Bonds):

State of Illinois Budgets FY2005-FY2010.

State of Illinois General Obligation Bonds, Taxable Build America Bonds, Series 2010-1, Official Statement, January 28, 2010, p. 36,40.

Note: Duplicate population data used for FY2010 and FY2011 projections.

APPENDIX 7: GENERAL FUNDS DEFICIT

Table A: General Funds Surplus (Deficit) History

Illinois General Funds Surplus (Deficit) History: FY2001-FY2010 (in $ millions)										
	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010*
Fiscal Year's Surplus (Deficit)	$ (477)	$ (1,520)	$ 271	$ 684	$ (64)	$ 183	$ 156	$ (699)	$ (2,839)	$ (1,996)
Prior Year Carryover	$ 632	$ 155	$ (1,365)	$ (1,094)	$ (410)	$ (473)	$ (291)	$ (135)	$ (834)	$ (3,673)
Total Surplus (Deficit)	**$ 155**	**$ (1,365)**	**$ (1,094)**	**$ (410)**	**$ (474)**	**$ (290)**	**$ (135)**	**$ (834)**	**$ (3,673)**	**$ (5,669)**

*Estimated

Sources: Illinois Office of the Comptroller, *Traditional Budgetary Financial Report Fiscal Year 2005* , page 5 and 9; State of Illinois $963 million General Obligation Bonds Series A and B of October 2003, *Official Statement* , October 29, 2003, page 42; State of Illinois $274,950,000 General Obligation Refunding Bonds Series of June 2006, *Official Statement* , June 21, 2006, page 21; State of Illinois $1.4 billion General Obligation Certificates of December 2008, *Official Statement Addendum* , December 16, 2008, page 18; State of Illinois, $3.466 Billion General Obligation Bonds Taxable Series of January 2010, *Official Statement* , January 7, 2010, page 22.

Table B: Total Two Year Budget Deficit FY2010-FY2011

Total Two-Year Budget Deficit FY2010-FY2011 (in $ millions)	
Carry-forward of FY2010 Deficit	$ 5,669
Borrowing for Pension System Contribution	$ 3,466
Increase in Statutory Pension Contribution	$ 659
Pension Note Repayment	$ 803
Statutory Transfer of Pension Bond Debt Service	$ 345
Reduction in Federal Recovery	$ 1,537
Fund Sweeps Included in Revenue	$ 352
FY2011 Total Budget Gap	**$ 12,831**

Sources: Carry-forward of FY2010 deficit: State of Illinois, $3.466 Billion General Obligation Bonds Taxable Series of January 2010, *Official Statement,* January 7, 2010. FY2011 pension system contribution is a Civic Federation estimate based on: State of Illinois Report of the Pension Modernization Task Force, November 2009, 51-56; Commission on Government Forecasting and Accountability, *Monthly Briefing* , January 2010, 13. Statutory transfer of pension bond debt service: 30 ILCS 330/15 (2009); phone communication between the Civic Federation and Illinois State Comptroller's Office, February 8, 2010. Federal recovery: State of Illinois Report of the Pension Modernization Task Force, November 2009, 47; E-mail communication between the Civic Federation and the Governor's Office of Management and Budget, January 27, 2010. Fund Sweeps: 30 ILCS 105/8.49 (2009).

APPENDIX 8: CITATIONS FOR STATE COMPARISONS CHART

Sources for all states:

National Governors Association and National Association of State Budget Officers, "Fiscal Survey of the States: December 2009," p. 43, http://www.nasbo.org/Publications/FiscalSurvey/tabid/65/Default.aspx, Last Viewed February 4, 2010.

Sources for Illinois:

Civic Federation, State of Illinois Enacted FY2010 Budget: A Review of the Operating and Capital Budgets Enacted for the Current Fiscal Year, pp. 8 and 25, http://civicfed.org/iifs/publications/state-illinois-enacted-fy2010-budget-review-operating-and-capital-budgets-enacted- ;

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California State Budget 2009-2010, p.1, http://2009-10.archives.ebudget.ca.gov/pdf/Enacted/BudgetSummary/FullBudgetSummary.pdf, Last Viewed February 4, 2010;

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Telephone Communication between the Civic Federation and Spokesperson for Governor Mitch Daniels Jane Jankowski, February 4, 2010.

Sources for Wisconsin:

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Wisconsin Office of the Governor Press Release, "Governor Doyle Signs State Budget Invests in Stronger Wisconsin, First On-Time Budget since 1977," June 29, 2009, http://www.wisgov.state.wi.us/journal_media_detail.asp?locid=19&prid=4373;

Wisconsin Governor Jim Doyle Veto Message for FY2010-FY2011 Enacted Budget, June 29, 2009 pp. i, xviii, xix and 30, http://www.doa.state.wi.us/debf/pdf_files/2009-11VetoMessage.pdf;

Pew Center on the States, "Beyond California States in Fiscal Peril," November 2009, p. 51, http://archive.stateline.org/images/2009_Nov_11-BeyondCalifornia/BeyondCalifornia.pdf.

Sources for Virginia:

Telephone communication between the Civic Federation and Deputy Staff Director of the Senate Finance Committee of the Virginia General Assembly Richard Hickman, January 19, 2010 and January 25, 2010.

APPENDIX 9: CITATIONS FOR RECENT STATE BUDGET PROPOSALS CHART

Civic Committee of The Commercial Club of Chicago, *Facing Facts 2009: An Updated Report on the State of Illinois' Fiscal Crisis*, February 2009, http://www.civiccommittee.org/initiatives/StateFinance/FacingFacts2009.pdf, (last visited on February 11, 2010).

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