Press Release

Institute for Illinois' Fiscal Sustainability
at The Civic Federation

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CIVIC FEDERATION COMMENDS QUINN FOR COURAGEOUS STEP TOWARD PENSION REFORM

Urges General Assembly to Reject Proposed Illinois Budget

CHICAGO (May 11, 2009) –The Civic Federation **rejects** Governor Pat Quinn's proposed $52.9 billion FY2010 operating budget because it raises taxes without fixing the state's core problems. The Federation's new Institute for Illinois' Fiscal Sustainability released today a 90-page analysis of the budget, offering alternative proposals that would more effectively stabilize the state's finances while making the full certified pension contribution of $4.5 billion. Copies of the report are available for download free of charge at www.civicfed.org.

The Civic Federation **commends** Governor Quinn for proposing bold changes to the state's nearly insolvent pensions. The Federation strongly endorses the governor's proposed move to a two-tiered pension system, a reform this organization has advocated for many years. The Federation **urges** the governor to reconsider his decision to eliminate increased pension contributions for current and future state workers from his budget. The sheer scale of the state's financial debacle will require shared sacrifice by all Illinoisans; that sacrifice must include all current and future state employees.

Illinois faces the formidable task of bridging a two-year budget deficit of $11.6 billion, but the governor's proposed budget does not focus sufficiently on overcoming the fiscal crisis, diverting money into policy objectives instead. The budget proposes only $1.3 billion in spending cuts, a level the Civic Federation finds inadequate. Moreover, the proposed income tax increase of $3.15 billion will not be reserved to reduce the state's staggering existing liabilities. This was one of the main recommendations the Federation made in the state budget roadmap it released in March. Instead, the budget increases spending by 12.3% over estimated FY2009 expenditures and funds an under-planned and unprecedented capital program of $26 billion.

To make matters worse, the state proposes to reduce contributions to its woefully underfunded pension systems by $3.0 billion over two years, an irresponsible action that endangers the state's fiscal solvency. Under current pension laws the state's FY2011 required pension contribution is estimated at $5.4 billion, so if it fails to make the $4.0 billion certified contribution this year, it will be enormously difficult for the state to find the political will to make the full payment in FY2011 and beyond. "The state's unfunded pension obligations are major contributors to Illinois' growing budget deficit," said Laurence Msall, president of The Civic Federation. "Shorting the state's pension contribution while raising taxes to address the state's structural budget deficit crisis is illogical and counterproductive."

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The Federation's alternative proposal to balance the budget outlines options that would allow the state to make the full certified pension contribution and target all new revenues to pay down existing obligations. The plan calls for a scaled back income tax increase and deeper budget cuts. "The state has reached a tipping point where it can no longer budget according to what is politically expedient," said Msall. "Whether or not state officials wish to recognize it, the only justifiable purpose for a tax increase is to pay down the state's massive existing obligations, including Medicaid providers and the staggering $79 billion shortfall in state pension funds."

Provided that pension and employee healthcare reforms and deeper spending cuts are implemented, the Civic Federation could support a reasonable increase to the state income tax of one percentage point for the personal income tax and 1.6 percentage points for the corporate income tax, which would raise approximately $3.6 billion. The Federation supports some of the governor's budget-balancing mechanisms such as using $4.8 billion in federal stimulus funds, fund sweeps, and certain tax changes. The governor and General Assembly will need to make difficult choices to balance the remaining deficit of nearly $4.25 billion. The Civic Federation suggests that if the governor and General Assembly are not able to find the will to make additional cuts in state spending, they should consider broadening the base of the state's two largest tax sources by eliminating the exemption on retirement income to be in accord with federal and most state tax codes and/or re-impose the state sales tax on food and drugs as is currently done by many municipalities in Illinois.

"These are not easy choices and the Federation does not lightly propose any tax increase in the middle of a recession," said Msall, "but it is important to note that the Civic Federation's alternatives add up to a budget of $48.55 billion that would still increase state expenditures by 3.3% over last year's estimated spending." The reasoning behind the Federation proposal is to use revenue enhancements to set Illinois on the path to fiscal sustainability, not push its obligations onto future generations.

The Federation **opposes** the governor's $26 billion *Illinois Jobs Now!* capital plan as it is not tied to a comprehensive planning process and is unaffordable now and in the future. The Civic Federation believes that capital investment is desperately needed in Illinois to address deteriorating infrastructure and create jobs. Unfortunately, the state has failed to prepare and make publicly available a comprehensive capital improvement plan (CIP) that assesses needs and prioritizes projects according to those needs. From a fiscal perspective, the Federation is very concerned that the governor's proposal fails to provide an adequate revenue stream to pay the debt service on the capital programs after the third year and extends all the state's current capital debt, which would have expired within the next 15 years, to 2045.

The Civic Federation insists the state must create a CIP so it can spend taxpayer-supported funds efficiently and effectively. "Citizens deserve concrete plans before being asked to support an unprecedented $26 billion capital program," said Msall. The Federation is also concerned that the large amount of debt proposed in the capital budget would jeopardize future state borrowing for decades to come.

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The Institute for Illinois' Fiscal Sustainability at the Civic Federation is made possible by a generous grant from the John D. and Catherine T. MacArthur Foundation. The Institute's mission is to improve the State's decision-making process by providing timely fiscal policy analysis and recommendations to State officials, the media, and the public through education and digital outreach.

STATE OF ILLINOIS FY2010
RECOMMENDED OPERATING & CAPITAL BUDGETS

Analysis and Recommendations

Prepared by:
The Institute for Illinois' Fiscal Sustainability
at
The Civic Federation

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EXECUTIVE SUMMARY

Although the Civic Federation is pleased that Illinois Governor Pat Quinn has proposed essential changes in the state's nearly insolvent pension systems, we are not able to support his FY2010 State of Illinois **operating budget** of $52.9 billion. The budget does not effectively stabilize state finances, nor does it effectively address the unprecedented fiscal crisis that has led to a two-year, $11.6 billion deficit. Illinois' fiscal crisis was caused in part by years of ignoring the state's mounting pension and other debt.

New revenues from any new tax, including the Governor's proposed $3.15 billion income tax increase, must be exclusively used to pay for the state's staggering amount of unpaid bills, as well as to reduce the state's enormous pension fund liability. Unfortunately Governor Quinn's proposal for new tax revenue would be used for a variety of purposes, including funding for an unaffordable, unsustainable $26.0 billion capital plan. To make matters worse, the state proposes to take partial pension holidays for FY2009 and FY2010, reducing the required payments to its woefully underfunded pension systems by $3.0 billion. This is a fiscally irresponsible action that pushes responsibility for today's pension bills onto future generations and endangers the state's fiscal solvency. Under current pension laws the state's FY2011 required pension contribution is estimated at $5.4 billion, so if it fails to make the $4.0 billion certified contribution for FY2010 it will be enormously difficult for the state to find the political will to make the full payment in FY2011 and beyond.

We reject the Governor's $26.0 billion *Illinois Jobs Now!* **capital plan** because it is not tied to a comprehensive capital improvement planning process and because it is unaffordable over time.

Capital investment is needed in Illinois to address the state's deteriorating infrastructure and help create jobs during the current global economic downturn. However, the State has failed to prepare and make publicly available a sufficiently detailed multi-year capital improvement plan that includes criteria used to assess capital needs, a multi-year capital improvement needs inventory, and a multi-year plan that shows when projects will be undertaken and how each will be funded. Citizens deserve concrete multi-year plans *before* being asked to support an unprecedented $26.0 billion capital program. If approved as currently proposed Illinois citizens will have no assurances that the $26.0 billion will effectively address the state's most critical needs. This plan may also jeopardize future state borrowing for the next 25 years.

While the Federation has serious concerns with most of the state's proposal to close the two-year budget deficit and its capital plan, Governor Quinn should be commended for taking a courageous step towards meaningful pension and employee healthcare benefit reform. The Governor proposes reasonable reductions in retirement benefits for new employees that will substantially reduce the state's benefit liabilities and costs over time. He also proposes to reduce mounting employee healthcare expenses by requiring greater cost sharing between the state and its workers.

The Civic Federation offers the following **key findings** on the State of Illinois' FY2010 budget:

- The FY2010 **operating budget totals $52.9 billion**, a $3.2 billion or 6.4% increase over the proposed FY2009 budget of $49.7 billion;
- Two hundred and forty-three **new employees** will be added to the state payroll;

- The state is facing a **two-year budget gap totaling $11.6 billion**, of which approximately $4.3 billion is due to a shortfall in the current FY2009 budget and $7.3 billion is due to a gap in next year's FY2010 budget;
- The Governor is proposing approximately **$1.3 billion in spending cuts** to reduce the two-year deficit; these cuts include targeted reductions and implementation of efficiencies in state agencies for a savings of $390 million;
- The state is adding an additional **243 new positions** at a cost of $84.8 million;
- The governor is proposing to **reduce the state's required pension contribution** for this year (FY2009) by $550 million and for FY2010 by $2.5 billion;
- The federal **American Recovery and Reinvestment Act will provide the State nearly $9.4 billion** in operating and capital funds as denoted in the state's FY2010 budget;
- The Governor is proposing to **restructure all of the state's current general obligation debt**, including existing pension obligation bonds and new proposed capital debt, to reap an estimated savings of $621 million in debt service payments due in FY2010;
- Governor Quinn is proposing $3.8 billion in annual **revenue enhancements** in FY2010, including increases to both the personal and corporate income tax rates;
- The FY2010 budget also proposes **new program initiatives**, including increasing the funding for elementary and secondary education by $174.0 million and establishing a ten day sales tax holiday on qualifying school supplies, clothing and footwear which is estimated to cost $57.0 million; and
- Governor Quinn released a **$26.0 billion *Illinois Jobs Now!* capital budget proposal** simultaneously with the $52.9 billion operating budget proposal. The capital budget includes $20.5 billion in appropriations for FY2010, which is a 51.9% increase over the $13.5 billion capital budget proposed in FY2009.

The Civic Federation **opposes** the following issues in the FY2010 operating budget:

- The Governor's proposed **personal and corporate income tax increase plan**, as well as the associated increase on the standard personal exemption, as the 50% income tax increase is too steep of an increase and the proceeds are not being targeted to address the state's enormous pension deficit;
- The proposed **partial pension holidays** for both the current fiscal year (FY2009) and FY2010, totaling a reduction in required state contributions of nearly $3.0 billion over the next 18 months;
- The **$26.0 billion *Illinois Job Now!* capital budget** due to the lack of a comprehensive Capital Improvement Plan (CIP) and the lack of adequate revenue to cover the annual cost of the proposed increase of $10.6 billion in the state's General Obligation debt;
- The proposed grant of a **ten-day sales tax holiday** on certain clothing, footwear items, and all school supplies, costing the state $57.0 million, as the money generated by the accompanying plan to reduce the retailers' discount is more appropriately spent on reducing the state's enormous deficit;
- **Certain business tax changes**, including decoupling state business income tax treatments from Federal requirements and collecting sales taxes on prewritten licensed software, which would yield an additional $284.9 million if implemented; and
- **Restructuring the state's existing capital debt service** to close the structural budget deficit and push out existing obligations.

The Civic Federation offers its **support** for some components of Governor Quinn's FY2010 budget:

- The Governor's proposal to implement **$1.3 billion in budget reductions** over two years, including targeted reductions and implementation of efficiencies in state agencies, across-the-board reductions for grant programs, increasing employee health care contributions and requiring four furlough days for employees, is an appropriate action but falls short of the necessary level of cuts;
- The historic **pension plan reforms** put forth in this year's budget, including the creation of a second-tier of pension benefits for new state hires and increasing the pension contribution for current employees while decreasing the pension contribution rate for new hires;
- **Selected general tax increases**, including taxing sweetened tea, coffee drinks and grooming and hygiene products at the same sales tax rate at the full state sales tax rate of 6.25%, which will yield $181.0 million in additional revenue for the state if implemented;
- **Additional proposals**, including refinancing current debt if real savings are available and increasing user fees to pay for financing and pay-as-you-go capital projects if the new revenue is tied to a transparent capital planning process;
- Elimination of the **Illinois Health Facilities Planning Board** as it undermines consumer choice, stifles innovation and creates barriers for companies to enter the market or expand; and
- Continued **expansion of state's shared services** division.

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

- Even if tax increases are implemented, **additional expenditure cuts must be made** to set the state on the path to financial stability;
- Impose a **reasonable income tax increase** and use the revenues generated from the increase to make the state's full required pension payment and reduce the state's structural deficit;
- Consider alternative revenue proposals, such as the **taxation of retirement income** and the **reinstatement the state sales tax on food, drugs and medical appliances**;
- Authorize **additional long-term reforms to its pension systems**, including funding state contributions at the certified amount for FY2009 and FY2010, impose a moratorium on new benefits, require balance on pension boards between employees, management and taxpayers, require pension benefit reforms to be fully implemented before even considering issuing any new pension obligation bonds and study the costs and benefits of conversion to a defined contribution plan;
- Implement **additional retiree health insurance reforms**, including elimination of the state's very expensive indemnity plan and studying the possibility of establishing an independent healthcare trust fund;
- Implement planning reforms, including the establishment of a **long-term financial planning process** and **performance measurement system** in order to prioritize state spending; and
- **Improve the budget document format** by including comprehensive data with respect to the state's personnel expenses.

CIVIC FEDERATION POSITION

The Civic Federation **<u>opposes</u>** the FY2010 State of Illinois **operating budget** of $52.9 billion because it does not effectively stabilize state finances, nor does it effectively address the unprecedented fiscal crisis that has led to a two-year, $11.6 billion deficit. New revenues from any new tax, including the Governor's proposed $3.15 billion income tax increase, must be exclusively used to pay for the state's staggering amount of unpaid bills, as well as to reduce the state's enormous pension fund liability. Unfortunately Governor Quinn's proposal for new tax revenue would be used for a variety of purposes, including funding for an unaffordable, unsustainable $26.0 billion capital plan. To make matters worse, the state proposes to take partial pension holidays for FY2009 and FY2010, reducing the required payments to its woefully underfunded pension systems by $3.0 billion. This is a fiscally irresponsible action that pushes responsibility for today's pension bills onto future generations and endangers the state's fiscal solvency. Under current pension laws the state's FY2011 required pension contribution is estimated at $5.4 billion, so if it fails to make the $4.0 billion certified contribution for FY2010 it will be enormously difficult for the state to find the political will to make the full payment in FY2011 and beyond.[1]

We also **<u>oppose</u>** the Governor's $26.0 billion *Illinois Jobs Now!* **capital plan**, as it is not tied to a comprehensive capital improvement planning process and because it is unaffordable over time.

Capital investment is needed in Illinois to address the state's deteriorating infrastructure and help create jobs during the current global economic downturn. However, the state has failed to prepare and make publicly available a sufficiently detailed multi-year capital improvement plan that includes criteria used to assess capital needs, a multi-year capital improvement needs inventory, and a multi-year plan that shows when projects will be undertaken and how each will be funded. Citizens deserve concrete multi-year plans *before* being asked to support an unprecedented $26.0 billion capital program. If approved as currently proposed Illinois citizens will have no assurances that the $26.0 billion will effectively address the state's most critical needs. This plan may also jeopardize future state borrowing for next 25 years.

The proposed $26.0 billion capital plan is unaffordable over time. The $26.0 billion capital plan includes a proposal to issue $10.6 billion in general obligation debt. However, the budget does not identify a sufficient existing source of revenue to cover the increase in debt service necessary to pay for borrowing $10.6 billion for capital purposes. Even by dedicating 10% of revenues from the proposed income tax increase and an estimated $110 million per year from increasing license and vehicles fees as proposed, the new annual debt service will exceed these revenues by $30.7 million in year three of the plan. The debt service will dramatically outpace revenues in later years, peaking in FY2017 when new debt payments will exceed new revenues by $596.0 million. Unless other new taxes or additional sources of revenues are passed to close this gap, the required new debt service could lead to significant state budget gaps until FY2032.

While the Federation has serious concerns with most of the state's proposal to close the two-year budget deficit and its capital plan, Governor Quinn should be commended for taking a courageous step towards meaningful pension and employee healthcare benefit reform. The

[1] Commission on Government Forecasting and Accountability, "Pension Briefing" April 2009, p. 11.

Governor proposes reasonable reductions in retirement benefits for new employees that will substantially reduce the state's benefit liabilities and costs over time. He also proposes to reduce mounting employee healthcare expenses by requiring greater cost sharing between the state and its workers.

The Proposed Budget Cuts Too Little and Taxes Too Much

The state has an enormous task of bridging a two-year, $11.6 billion operating budget deficit. Just as in any budget year, the state must strike an appropriate balance between reducing expenditures while raising additional revenues to resolve its budget deficit. The Civic Federation believes the Governor's plan has struck an inappropriate balance between these two options, resulting in a budget that cuts too little and taxes too much.

The state is proposing $1.3 billion in spending cuts over FY2009 and FY2010; in light of these extraordinary times the Civic Federation believes this level of cuts is inadequate. With respect to the taxes proposed, the budget fails to use new revenues for their only justifiable purpose: paying down existing obligations. Rather, some of the new revenues are being used for a variety of purposes, including funding an unaffordable, unsustainable $26.0 billion capital plan. To matters worse, the state proposes to reduce its contribution to the woefully underfunded pension systems by $3.0 billion.

In February of 2009 the Civic Federation's Institute for Illinois' Fiscal Sustainability released a report entitled "*A Fiscal Roadmap for Creating A Sustainable State Budget*". The report presented key elements that should be included in the state's new budget in order to effectively manage the current budget crisis and longstanding structural deficit.

In this report we noted that the State of Illinois should not substantially increase spending this year; rather, it should cap or reduce spending. Yet this budget is a $3.2 billion, or 6.4% increase, over the proposed FY2009 budget of $49.7 billion. It is a $5.8 billion, or 12.3% increase, from estimated expenditures in FY2009 of $47.0 billion.

We also argued that the state income tax should not be raised unless the increase was reserved to make significant reductions in existing liabilities, rather than to fund new programs. However, the budget proposes to use 10% of new revenues to fund an enormous $26.0 billion capital program that is not based on a publicly available, transparent capital improvement plan (CIP). Not only should the CIP be in place before assigning a revenue source for capital projects, but the total revenues produced by the income tax increase should be used to put the state's fiscal house in order, not to support a new capital program.

Third, we argued that a top priority of the FY2010 budget must be full payment of the state's pension obligations under the terms of the 1995 pension funding reform law. Deviating from the path laid out by the law renders it meaningless and reducing the statutorily required payment will only further exacerbate the pension funds' enormous fiscal challenges. Over the last 15 years we have seen no evidence that the state will ever find it any easier to fully fund its pension obligations.

Despite these facts, the FY2010 budget proposes to reduce the FY2009 and FY2010 state pension contribution by approximately $3.0 billion. The state's rationale behind these actions is that due to the $162 billion reduction in liabilities over 35 years resulting from the proposed pension benefit reforms, the state may apply some of those savings to these payments. We strongly object to this approach because pension reform "savings" must be actually realized before they are taken. Failure to fund the state's pension obligations at the full amount required by the 1995 law each year simply defers expenses to future years. The state's past performance in meeting the terms of the 1995 pension funding reform law has been abysmal, including a $2.3 billion partial pension holiday in FY2006 and FY2007. The proposed pension benefit reforms are worthwhile, but they need to produce realized savings before the state may reduce its current payment plan.

While the Federation has serious concerns with the state budget proposal, we commend Governor Quinn for taking historic steps towards meaningful pension and employee healthcare benefit reform. In his FY2010 budget the Governor proposes reasonable reductions in retirement benefits for new employees that will substantially reduce the state's benefit liabilities and costs over time. The budget also proposes to reduce mounting employee healthcare expenses by requiring greater cost sharing between the state and its workers. Governor Quinn has recently made statements indicating he is no longer considering increasing employee pension contributions. The Federation strongly disagrees with that sentiment. We believe the burden of funding the state's pension systems should be shared by both the employees receiving the benefits and the state's taxpayers.[2]

We salute Governor Quinn for his courageous stand on these issues and urge the General Assembly to adopt these long overdue reforms. The current employee benefit structure is unsustainable and must be reformed; the unfunded liability for the five state retirement funds totaled $73 billion as of December 31, 2008, a figure that is significantly larger than the proposed budget.[3] *Approving the employee pension and health care reforms is essential.* They will help put Illinois on a path to fiscal sustainability. Failure to approve the reforms will ensure that the state continues to lurch from fiscal crisis to fiscal crisis.

Alternative Proposal for Balancing the Operating Budget

The Civic Federation believes that the state should look to implement a much smaller spending plan in FY2010 than Governor Quinn's current $52.9 billion proposal. Our suggested plan requires the state to make the full certified pension contribution for both FY2009 and FY2010 and target all new revenues to paying down existing obligations. This plan should also include a scaled back income tax increase and deeper budget cuts.

The Governor proposes to balance the budget in part using the following actions which total $6.9 billion:

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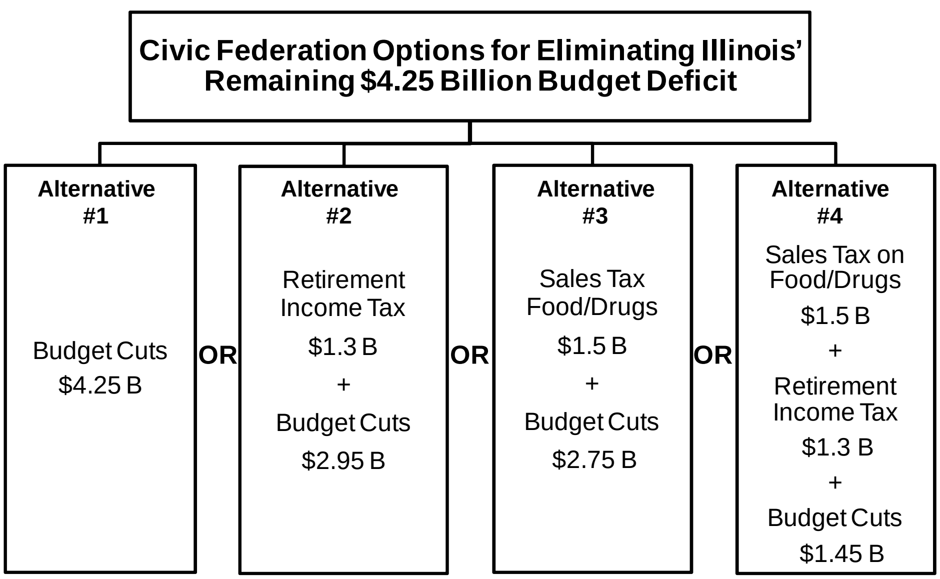
[2] Doug Finke. "Quinn abandons proposed pension cost hike." The State Journal-Register (May 7, 2009).
[3] Commission on Government Forecasting and Accountability, "Financial Condition of the State of Illinois Retirement Systems as of June 30, 2008" (February 2009); Presentation to the Civic Federation by Illinois Governor Chief of Staff Jerome Stermer, March 18, 2009.

- $4.8 billion in federal stimulus funds to pay for Medicaid, education and other programs;
- $1.1 billion in spending cuts;
- $465.9 million in business tax changes;
- $200.0 million in increased employee healthcare contributions;
- $200.0 million in FY2009 funds sweeps; and
- $199.0 million in general tax changes.

We support the use of all of these budget balancing mechanisms, with the exception of $284.9 million in certain business tax changes. The remaining amount totals $6.7 billion.

Eliminating the state's $11.6 billion FY2009-FY2010 deficit and making the state's full certified FY2009 and FY2010 pension contributions will require additional funds and revenues totaling $14.6 billion. Subtracting out the aforementioned $6.7 billion in budget balancing mechanisms leaves a need for additional $7.9 billion in spending reductions and revenue enhancements to close the FY2009 and FY2010 budget gaps.

The Civic Federation proposes that this gap be filled through an income tax increase that is smaller than the Governor's proposal, totaling $3.6 billion, coupled with deeper spending cuts of nearly $4.25 billion. As an alternative or complement to deep budget cuts, the state could consider moving to tax retirement income at a 4% rate and/or re-impose the 5% state sales tax on food and drugs. If fully implemented, these two measures could generate as much as $2.8 billion in combined annual revenue, which would reduce the amount of required budget cuts to $1.45 billion.



At this time, the Civic Federation supports a reasonable income tax increase in FY2010 from 3% to 4% for the personal income tax and from 4.8% to 6.4% for the corporate income tax as a means to reduce the state's enormous $11.6 billion deficit and stabilize its future financial situation. However, it is important to note that our support for an income tax increase is contingent upon the dedication of new revenues to pay down existing liabilities and the implementation of substantive employee benefit reforms that will reduce future costs and liabilities. These reforms include the adoption of the reduced pension benefit structure for new employees proposed by Governor Quinn.

Due to the state's dire fiscal situation we believe all new revenues derived from the proposed income tax increase must be used to pay for state operating obligations. Therefore, we **<u>oppose</u>** diverting any of the increase to fund capital projects or to local government. We also oppose increasing the standard personal exemption; the state needs every additional revenue dollar obtained from this tax increase to fund its $4.5 billion pension payment for FY2010, reduce its backlog of outstanding bills for transfer payments and to stabilize the financing options for existing programs.

The Federation's proposed scaled-back income tax increase would generate a total of approximately $3.6 billion. Of that amount, the personal income tax increase would yield roughly $3.1 billion and the corporate income tax increase will yield approximately $500 million.[4]

A budget that incorporates $3.6 billion in revenues from an income tax increase, $4.25 billion in cuts and $6.9 billion of the Governor's proposed spending reductions and revenue enhancements would eliminate the state's enormous deficit, fully fund its retirement systems at the certified amount and total approximately $48.55 billion. This amount would be $4.25 billion less than the Governor's proposed $52.8 billion budget. It would be, however:

- A 1.5% or $750 million decrease from the enacted FY2009 appropriation of $49.3 billion; and
- A 3.3% or $1.55 billion increase from estimated FY2009 expenditures of $47.0 billion.

We believe that a smaller budget of approximately $48.55 billion, balanced through more judicious spending cuts, supported by a more modest income tax increase that directs new revenues to paying the state's existing obligations is a budget that more appropriately balances the needs for both spending reductions and revenue enhancements as we enter these uncertain financial times.

Issues the Civic Federation Opposes

The Civic Federation **<u>opposes</u>** the following issues in the FY2010 State of Illinois operating and capital budgets.

Governor Quinn's Income Tax Increase Proposal

Governor Quinn proposes to substantially increase the state personal income tax from 3% to 4.5% and the corporate income tax from 4.8% to 7.2%. This represents a 50% increase over the current personal and corporate income tax rates. The standard personal exemption from the income tax will be tripled, rising from $2,000 to $6,000. This action will introduce an element

[4] This calculation is based upon data in the FY2007 Tax Expenditure Report released by the Illinois Comptroller's Office at http://www.apps.ioc.state.il.us/ioc-pdf/TaxExpRptFY2007Web.pdf (last visited on April 24, 2009).

of progressivity into the current flat income tax rate. The two income tax increases are expected to generate $3.15 billion in FY2010.[5]

Local governments, which currently receive 10% of state income tax proceeds, will continue to receive this portion of the tax but will not receive any additional funds from the proposed tax increase.[6] Instead, 10% of the new proceeds will be reserved to pay for the state's proposed $26.0 billion capital program. Some commentators have raised the issue that local governments may lose millions of dollars if the exemption increase is adopted and local governments are not held harmless as total tax revenues will be lower than they would have been otherwise.[7]

The Civic Federation recognizes that the State of Illinois is in an unprecedented fiscal crisis, facing a gargantuan two-year $11.6 billion deficit and a nationwide economic recession that is likely to extend into the next fiscal year. The Civic Federation also recognizes that the solution for resolving this grim fiscal picture must involve both revenue enhancements, including the option of tax increases, as well as service cuts. The Governor's proposal, however, is not an answer that we can support as it does not strike an appropriate balance between these two options. The Civic Federation believes that it would be far better to balance the FY2010 Illinois state budget with a more modest income tax increase that is coupled with much deeper budget cuts.

Any new monies from an income tax increase must be used to only pay for existing obligations and to meet federal mandates, not to provide additional funds for local governments, to fund new operating or capital programs or to meet worthy but unrelated social policy goals. The priority must be paying for the state's mountain of unpaid bills in areas such as Medicaid and reducing the state's enormous liabilities in areas such as the state's pension funds.

In our view, Governor Quinn's income tax increase proposal tries to satisfy far too many policy goals. It provides resources for a massive $26.0 billion capital program that does not appear to be sustainable over time. It also attempts to introduce some progressivity to the income tax code through an indirect strategy of increasing the standard exemption. Both the capital program and the increased personal exemption proposal significantly reduce the amount of money available for solving the fiscal crisis and addressing the state's structural deficit. The state has, over a number of years, already created pension and Medicaid program it clearly cannot afford. Until these issues are resolved, the state cannot afford to expand spending elsewhere.

Raising broad based taxes in a recession is not an optimum action and may result in serious negative economic impacts. This action should only be undertaken as a last resort. Therefore, care should be taken to increase rates only to generate the income needed to stabilize the financial situation. We believe that the Governor's proposal generates more tax revenue than is necessary to resolve the budget crisis. We are concerned that in future years, when the recession ends, the state would enjoy a bonanza of resources. If history is any guide, these revenues will be used to pay for further expansions of operating programs that may or may not

[5] Illinois State Budget FY2010, pp. 5-16.
[6] Dan Mihalapolous. "Mayor Daley rips Gov. Quinn's budget for failing to help city enough," Chicago Tribune, March 31, 2009.
[7] Rich Miller. "Held Harmless?" Capitol Fax. April 21, 2009.

be necessary. New programs, particularly those with rapidly increasing costs such as health care programs, must be discussed and debated thoroughly. That discussion must include a close look at whether such programs are sustainable in the long term. It is absolutely an inappropriate approach to increase the revenue base today so that future unspecified programs may be funded tomorrow.

Partial Pension Payments in FY2009 and FY2010

The Civic Federation opposes the state's proposed partial pension payment holiday for both FY2009 and FY2010. The state's five retirement systems are significantly underfunded as it currently stands. Further delay in paying down the already accrued debt only continues to push responsibility for today's bills onto future generations.

In light of the projected $162 billion in reduced liabilities over 35 years from the proposed pension benefit reforms for new hires, Governor Quinn is proposing to fund only the normal cost of the state's five pension funds for FY2010. The total pension contribution proposed by the state is nearly $2.1 billion, including debt service on the 2003 pension obligation bonds. This is $2.5 billion less than the pension contribution required under the 1995 pension funding law, which is $4.5 billion, including debt service.

Additionally, Governor Quinn has proposed to reduce the state's FY2009 pension payment by $550 million. When combined with the FY2010 reduction, the state is proposing to reduce its pension contributions by $3.0 billion over this two-year period. Under current pension laws the state's FY2011 required pension contribution is estimated at $5.4 billion, so if it fails to make the $4.0 billion certified contribution for FY2010 it will be enormously difficult for the state to find the political will to make the full payment in FY2011 and beyond.[8]

The positive gains accrued from the state's proposal to create a second tier of pension benefits does not give the state license to shirk its current pension funding responsibilities on already accrued liabilities. Reforming the pension benefit structure for new hires is necessary if the state is to have any hope of fixing its currently unaffordable pension system.

Proposed $26 Billion FY2010 Capital Plan

The Civic Federation strongly opposes the $26.0 billion *Illinois Job Now!* capital budget due to the lack of a comprehensive Capital Improvement Plan (CIP). The Civic Federation recognizes the need for capital investment in Illinois to address the state's deteriorating infrastructure and help create jobs during the current global economic downturn. However, the state has failed to prepare and make publicly available a sufficiently detailed multi-year capital improvement plan that includes criteria used to assess capital needs, a multi-year capital improvement needs inventory, and a multi-year plan that shows when projects will be undertaken and how each will be funded. Citizens deserve concrete multi-year plans *before* being asked to support the extremely high level of indebtedness, which will limit an additional borrowing without new revenues for decades to come, as proposed in the FY2010 capital budget.

[8] Commission on Government Forecasting and Accountability, "Pension Briefing" April 2009, p. 11.

Sales Tax Holiday

Governor Quinn proposes a 10-day sales tax holiday in August 2009 on clothing and footwear with a selling price of $100 or less and school supplies. The purpose of the program is to provide targeted relief to families with schoolchildren. The tax holiday will be funded with revenues received from capping the cost of collection discount provided to retailers at 0.75%. This is a reduction from the current discount of 1.75% of the tax receipts collected if retailers file returns and pay sales taxes owed on time.

The Civic Federation this year reiterates its support for capping the collection discount as a reasonable policy. The state faces enormous fiscal challenges that must take priority. Therefore, we believe the $57.0 million generated by reducing the collection discount is more appropriately spent in reducing the state's enormous deficit.

Certain Business Tax Changes

Governor Quinn proposes $465.9 million worth of business tax changes in his FY2010 budget. Of the eleven proposed changes, the Civic Federation opposes five, which are projected to generate $284.9 million.

<u>Proposals to Decouple State Business Income Tax Treatments from Federal Requirements</u>

The FY2010 State budget includes three proposals to decouple Illinois' treatment of certain corporate income tax regulations from the federal tax code. These three proposals are expected to generate $209.9 million. The Federation believes on principle that Illinois' definition of income should conform to the federal tax code. These specific proposals include:

- Decoupling from the federal Qualified Production Activities Income deduction;
- Decoupling from the new federal tax provision of the American Recovery and Reinvestment Act of 2009 allowing a five-year carry back of net operating losses by small businesses; and
- Decoupling from certain new federal tax provisions under the American Recovery and Reinvestment Act of 2009 that will allow firms to delay recognition of gains from reacquisition of business debt security by a borrower at less than face value in 2009 and 2010.

<u>Collecting Sales Taxes on Prewritten Licensed Software</u>

The Civic Federation opposes this proposal at this time. Further discussions with affected parties and practitioners are needed to resolve the administrative and implementation issues posed by this proposal. We commend the Department of Revenue for reaching out to the Civic Federation and other groups to try to determine feasible implementation methods. However, because of the complexity of the issues involved, it is not reasonable to assume that a resolution can be found before the legislature's scheduled adjournment date of May 31.

Limiting the Amount of Credits a Corporation can Claim to 50% of Tax Liability

This proposal would limit income tax credits that could be claimed by corporations to no more than 50% of the income tax liability for these projects. The Civic Federation is concerned that this proposal does not include an exemption for credits that are a part of current business contracts. We have concerns that this may be a violation of the U.S. Constitution's protection against impairment of contracts.

Restructuring Capital Debt Service to Close the Budget Deficit

The Civic Federation **opposes** the proposed plan to restructure the state's outstanding and new capital debt to reduce the deficit in FY2010. Although the Governor's plan to refinance $11.8 billion in existing and $10.6 billion in new capital debt could lower the debt service payment by $621 million in FY2010, and an additional $140 million in FY2011, the increased debt service is likely to add to the state's structural budget deficit in the outlying years. After the initial savings in the first two years of the plan, total debt service will increase to $2.7 billion annually by FY2015, or 42.1% more than FY2009 levels. Debt service will not return to current levels until FY2028 and not decrease significantly until FY2035 assuming no new debt is issued.

Although the state proposes dedicating 10% of the proposed income tax increase to pay for the new debt service and an estimated $110 million per year in new vehicles fees from the Road Fund, the combined estimated revenue is well below the increase in total annual debt service. By year three of the proposed debt service schedule the new revenues will fall behind new debt service by more than $30.7 million, adjusting for an annual increase in the new income tax of 1.9 %[9] and assuming like other vehicle fees that the new licensing revenue will be inelastic. By FY2014 the new revenue source will have fallen behind new debt service by $382 million and the disparity will continue to climb, peaking in FY2017 at $596.0 million. This new debt service schedule will continue to add hundreds of millions to the State of Illinois' structural budget deficit until FY2032 unless the state approves other new revenues not included in the proposed budget.

The legislature should not approve new debt restructuring for capital without fully accounting for how it will pay its annual debt service. By moving forward with this plan it risks adding yet another category to its massive backlog of financial responsibilities pushed off to future generations, as has become the tradition with both pension and health care costs in Springfield.

Additional Borrowing to Support the Illinois Jobs Now! Capital Program.

The Civic Federation opposes increasing borrowing by $10.6 billion as the primary funding for the FY2010 capital program. Even taking into account the proposed FY2010 income tax increase, borrowing by the State of Illinois has far outpaced revenue growth. Since FY2002 state source revenue has increased only 41% compared to state principal debt which will have increased 320% over the same years. When compared to revenue, debt now totals 97% of state

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[9] Illinois state Budgets FY1999-FY2010. Despite volatility from year to year, Illinois income tax revenue increased by an average of 1.9 % annually between FY1999 and FY2010. The Department of Revenue does not provide projections for income tax beyond FY2010.

source revenue compared only 24% in FY2002, which was prior to the FY2003 issuance of pension obligations bonds and the new capital borrowing proposed in FY2010.

The Civic Federation recognizes that the state is long overdue for a new properly funded capital plan to repair and replace neglected state-owned infrastructure. However, if approved, the new $10.6 billion in GO debt will increase state principal debt to $32.1 billion, or 49.3% more than current levels. Furthermore this massive increase in debt is not based on a comprehensive Capital Improvement Plan (CIP). Without the proper planning and transparency provided by a CIP the residents of Illinois cannot be assured that the *Illinois Jobs Now!* Program will properly address the capital needs of the state. At the same time the new proposed debt levels will put a strangle hold on any further capital borrowing for nearly two decades.

Issues the Civic Federation Supports

The Civic Federation **supports** several components of Governor Quinn's FY2010 budget.

Spending Reductions

The Governor proposes $830 million in the FY2009 budget reductions and $500 million in cuts from the FY2010 budget. This $1.1 billion in reductions includes:

- Targeted reductions and implementation of efficiencies in state agencies including consolidation of the Historic Preservation Agency into the Department of Natural Resources, the consolidation of two labor board and the freezing of service levels for seniors and persons with disabilities at FY2008 levels;
- Reductions across-the-board for grant programs, including those in healthcare and education; and
- Requiring certain state employees to take four furlough days.

At a time when the state faces a severe and immediate fiscal crisis, only key priority areas should be fully funded and spending cuts are absolutely essential. We applaud Governor Quinn for moving quickly to cut FY2009 spending and proposing additional targeted cuts for the new fiscal year. Taking these steps is judicious and reasonable.

Funds Sweeps

Approximately $200.0 million in fund balances from the State's 600+ special purpose funds will be transferred to the General Funds to help address the current $4.3 billion FY2009 budget deficit.

The Civic Federation reiterates its support of the concept of transferring surplus revenues from special purpose funds to General Funds. It is a common budgetary practice to "sweep" funds and transfer surpluses in segregated funds to help close budget gaps. We see no compelling reason why Illinois should not also use surplus funds to provide revenues for essential programs.

In most cases, segregating revenues into special purpose funds is a practice that should only be adopted for certain high priority or mandated programs. Unless there is a compelling reason, the

State should be afforded maximum flexibility in allocating resources as needed to meet policy priorities. The General Assembly and the Illinois voters are free to reject the administration's policy choices through the legislative and electoral processes.

The Civic Federation also supports efforts to consolidate special purpose funds into the General Fund when appropriate. Such a move would simplify cash management, expedite bill paying, and simplify the State audit process.

Increased Employee Healthcare Contributions

The Civic Federation supports increasing employee contributions for healthcare expenditures for the upcoming fiscal year. The Governor's FY2010 budget proposal includes a $200 million increase in employee and retiree contributions to their health insurance premiums. This increase is expected to require negotiated changes to collective bargaining agreements with employees, as well as a change to the State Employee Group Insurance Act (5 ILCS 375/10).[10]

Refinancing Current Debt if Real Savings are Available

The Civic Federation supports restructuring current general obligation debt to reduce debt service cost by taking advantage of lower interest rates, if significant savings over the full term of the debt are available. Restructuring should not be used to merely push current debt payments off into future budget years.

Funding Capital Projects with User Fees if Revenues are Linked to a Formal Capital Planning Process

The Civic Federation supports increasing user fees - such as expanding and increasing toll roads, motor fuel tax and other service fees - to pay for financing and pay-as-you go capital projects but only if the new revenue is tied to a transparent capital planning process. A proper CIP includes objective, needs-based criteria to prioritize capital spending tied to strategic and measurable long-term goals. The state's capital planning should also provide for public input and should be publicized on the state's official website. The state should complete and publicize a statewide CIP before raising new revenue or issuing more debt to pay for capital investments.

Elimination of the Illinois Health Facilities Planning Board

The Civic Federation supports the pending repeal of Illinois Health Facilities Planning Act (IHFPA) as of July 1, 2009[11] and opposes the reinstatement of the Certificate of Need (CON) authority along with the establishment of the larger and salaried Health Facilities and Service Review Board as introduced in Illinois Senate Bill 1905. The state's Certificate of Need (CON) statute has served to erect barriers to competition in the health care market and drive up costs for the state and consumers. Although in the past the planning board funded its entire $2 million annual budget through application fees, the enforcement of CON standards for the expansion or new construction of health care facilities has hurt efforts to contain health-care costs. SB 1905

[10] Commission on Government Forecasting and Accountability, "Liabilities of the State Employees' Group Health Insurance Program: Fiscal Year 2010," March 2009, p. 5.
[11] 20 ILCS 3960, Illinois Health Care Facilities Planning Act.

also does not account for the new expense of installing a paid nine-person board and establishing the new Center for Comprehensive Health Planning or its director who is to be paid $150,000 annually.

According to a joint statement issued by the Federal Trade Commission and the U.S. Department of Justice[12], Illinois' Health Facilities Planning Act undermines consumer choice, stifles innovation and creates barriers for companies to enter the market or expand. The federal agencies also contend that the administration of CON laws in Illinois and other states allow "existing competitors to exploit" the process and delay fresh competition.

Rising health care costs are some of the largest contributors the State of Illinois' structural budget deficit. The Civic Federation supports efforts to increase available health care services while lowering costs for medical treatment in Illinois and believes repealing the IHFPA will help to achieve this end.

Certain Tax Changes in the FY2010 Budget

<u>Select General Tax Increases</u>

The Civic Federation supports several general tax increases proposed in the FY2010 budget that total $199.0 million in anticipated revenues.

- The state proposes taxing sweetened tea and coffee drinks at same sales tax rate as soft drinks at the full state sales tax rate of 6.25% and taxing all grooming and hygiene products at the full state full state sales tax rate of 6.25%. Both of these proposals are reasonable attempts to standardize the state's sales tax system and we see no rational reason to tax these items at a lower rate than other similar products.

- The state proposes an increase in the state tax on cigarettes from 98 cents per pack to $1.48 per pack in FY2010 and to $1.98 per pack in FY2011. These monies are intended to be used to pay for Medicaid costs. We have no objection to this proposal and believe that there is a good fit between the tax and its intended purpose.

- Finally, the state proposes to require banks to match account holders with tax delinquents who have been identified by the Department of Revenue so that the Department could more readily pursue tax collection efforts from delinquent taxpayers. This proposal does not change or expand the statutory authority for collection or the banks' legal duty to identify delinquent taxpayers' accounts when asked. Rather, it streamlines the process and makes it easier to find the accounts. This method is similar to the one used in 6 other states for income taxes and in many states for child support collection. Instead of sending out multiple letters to many banks for each taxpayer levy, the revenue departments send out to the banks a list of all the taxpayers they are levying against. The banks are then required to identify the accounts, just as when a single letter is sent for each taxpayer. This method enables the

[12] Joint statement of the Federal Trade Commission & U.S. Department of Justice, "Agencies Say CON Laws Undercut Consumer Choice, Stifle Innovation and Weaken Market's Ability to Contain Health Care Costs," September, 12, 2008. http://www.ftc.gov/opa/2008/09/illcon.shtm.

Department of Revenue to know exactly which bank to send the levy letter to. The Civic Federation finds that this proposal is a reasonable method of identifying tax scofflaws and collecting delinquent taxes.

Select Business Tax Changes

The Civic Federation endorses state efforts to end outdated and economically inefficient corporate tax deductions or credits. We believe as a matter of principle that tax exemptions and benefits should be sunsetted and their renewals debated and discussed, not continued indefinitely. There should be evidence that tax credits or reductions granted actually produce the benefits promised; that analysis should be conducted and published in a report by the Department of Revenue for existing as well as new tax incentives and credits. In our past analyses of the state operating budget, we have supported many of these efforts. We reiterate our past support for state efforts to:

- Include Puerto Rico and the Outer Continental Shelf in the definition of the U.S.;
- Eliminate the manufacturer's purchase credit;
- Restrict the cost of collection discounts;
- Repeal the research and development credit;
- Require entities purchasing insurance from out of state underwriters to pay the state insurance tax.

This year we also support the new proposal to limit the state graphic arts sales tax exemption to businesses primarily engaged in graphic arts production. Currently, the exemption is permitted for other industries using graphic arts machinery and equipment.

Overall, these business tax changes are estimated to yield $181.0 million:

Pension Reform

Creation of a Second Tier of Pension Benefits for New Hires

The Civic Federation supports the proposed changes to the current pension benefit structure for new hires. By creating a second tier of pension benefits for new employees the state is taking an important step towards resolving its mounting pension benefit funding problem.

The FY2010 budget proposed by Governor Quinn creates a separate retirement benefit plan for new hires. Some of the proposed pension benefit reforms for new hires include raising the retirement age for receiving both unreduced and reduced benefits, reforming the benefit formulas and revising the Cost of Living Adjustment to the lesser of 3% or 50% of the Consumer Price Index. Over the next 35 years the proposed reforms are projected to reduce the state's pension liabilities by $162 billion.

For many years the Federation has recommended that the state create a separate tier of benefits for new employees as a means of controlling its out-of-control retiree benefit costs. The Federation commends Governor Quinn for taking this historic step towards resolving the state's unfunded pension crisis and urges the General Assembly to pass these long overdue reforms. The state is facing future financial pension obligations of staggering proportions. Modifying the benefit structure for new employees is a vital part of any plan that will successfully reverse this disastrous course.

Increasing Current Employee Pension Contributions

The Civic Federation endorses the state's proposal to increase pension contributions for current state employees. Recognizing that current employees will receive generous pension benefits upon retirement, the state is taking action to ensure the burden of paying for these benefits is equitably distributed amongst the beneficiaries and taxpayers. Governor Quinn has recently made statements indicating he is no longer considering increasing employee pension contributions. The Federation strongly disagrees with that sentiment. We believe the burden of funding the state's pension systems should be shared by both the employees receiving the benefits and the state's taxpayers.[13]

Employees covered by the State retirement systems contribute a percentage of their compensation for their own pensions and to fund survivors' benefits. Governor Quinn is proposing to increase current employee's pension contribution by two percentage points, while decreasing the employee contribution rate for new hires by one percentage point. We believe a better alternative would be to keep employee contributions the same for both new and existing employees. The rationale put forth by the Governor's office is that the current employees who will be receiving more extensive, and therefore expensive, pension benefits should bear more of the burden associated with funding the plan.

In past analyses the Civic Federation has recommended increasing the amount current employees contribute towards their retiree benefits as a means of offsetting the escalating cost of providing these benefits. The Federation is pleased that this year Governor Quinn has heeded our calls and hopes he continues down the path toward shared responsibility for funding the state's pension systems, injecting much needed funds into the five pension funds while equitably distributing the burden of funding the promises made to state employees.

Continued Expansion of Shared Services

In FY2007, the Governor's Office of Management and Budget (GOMB) set forth a Shared Services Vision that called for six Shared Service Centers to assume responsibility for State agencies' Administrative Services (e.g.: Human Resources, Payroll and Fiscal), Grants Management (e.g.: Grant Application, Monitoring and Reporting), Customer Service (e.g.: State-wide Call Center and Consolidated Front-Office Service Locations), and Business Portal (e.g.: Business Application and Authorization) functions. The Shared Services Vision also identifies Information Technology Infrastructure, Fleet, and Facilities Management as areas that have been addressed by previous initiatives, but might be made more efficient and cost-effective under the Shared Services organizational structure.[14] The purpose of this initiative is to:

[13] Doug Finke. "Quinn abandons proposed pension cost hike." The State Journal-Register (May 7, 2009).
[14] Illinois State Budget FY2007, pp. 3-5.

- Allow agencies to concentrate on their core missions;
- Provide State employees with a more efficient, accessible, and user-friendly Human Resources system;
- Produce substantial savings in line with those realized by businesses and governments that have made similar commitments to administrative reorganization; and
- Increase the transparency of State budgeting processes and State spending.

The Shared Services plan is intended to make budget planning and State spending more transparent for both public officials and citizens by integrating the reporting systems of Accounts Payable, General Accounting, Travel Vouchers, Purchasing, Accounts Receivable, Fixed Assets, Grants, Inventory Accounting, and GAAP reporting. In addition to improving the State's ability to control costs and plan budgets, the integration of these reporting systems will allow for year-round auditing, enabling both officials and citizens to better track the use of public funds.[15] The integration of reporting systems should also enable the State to institute useful and non-burdensome performance measures.

In FY2008 the Shared Services plan evaluated all State administrative processes, implemented a new web-based hiring system, and continued the reorganization of the fiscal and human resources administration. In FY2009 the program transitioned the majority of state fiscal operations to the Public Safety Center and the Administrative and Regulatory Center from their respective agencies. Steps were made to procure software for the state's Illinois Statewide Information System (ISIS), a uniform accounting and human resources system that supports streamlined business processes and provides users with real-time access to data. In FY2010, ISIS software will be selected, an RFP will be issued for ISIS integration services, and interim service improvements will be identified and implemented at the Administrative and Regulatory and Public Safety Centers.[16]

The Civic Federation is a strong proponent of bringing business process reforms to bear on government operations. Such reforms can significantly reduce administrative costs and improve efficiency. We have been encouraged by the administration's willingness to employ business process reforms in past years. We supported the Shared Services program in FY2007[17]and we reaffirm our strong endorsement for its expansion in FY2010.

Civic Federation Financial Management Recommendations

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

Revise the Income Tax Increase Proposal

The Civic Federation supports a reasonable income tax increase in FY2010 from 3% to 4% for the personal income tax and from 4.8% to 6.4% for the corporate income tax to help reduce the

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[15] Illinois State Budget FY2007, pp. 3-7.
[16] Illinois State Budget FY2010, pp. 3-3.
[17] The Civic Federation State of Illinois FY2007 Recommended Operating Budget: Analysis and Recommendations, March 17, 2006, p. 12.

state's enormous $11.6 billion deficit and stabilize its financial situation. **However, revenues from the increase must be 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.** We strongly oppose the use of new revenues for other purposes, including the Governor's expansive new capital program.

An income tax increase from 3% to 4% for the personal income tax and from 4.8% to 6.4% for the corporate income tax will generate a total of approximately $3.6 billion. Of that amount, the personal income tax increase will yield $3.1 billion and the corporate income tax increase $500 million.[18]

Because of the state's dire fiscal situation, we believe that all new monies from income tax increase must be used to pay for state operating obligations. Therefore, we **oppose** diverting any of the increase to fund capital projects or to provide local government additional revenues. We also oppose increasing the personal standard exemption to provide tax relief and introduce progressivity into the income tax system. The state will need every penny it gets from an increase to make its $4.5 billion pension payment, reduce its backlog of billions of dollars in outstanding bills for transfer payments and to stabilize existing programs.

In time, a better way to provide for a progressive income tax system in Illinois would be for the legislature and citizens of Illinois to debate the merits of a graduated personal income tax and for the state to adopt 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.

The Civic Federation endorsed an income tax increase in its review of the state's FY2008 budget. At that time, we linked support for the tax increase to the reduction of the state's billions of dollars in unpaid liabilities and to the adoption of structural reforms that would reduce employee benefit costs and inject more accountability into the management of state funds, including those provided for education. Last year we withdrew our support because of the failure of our political leaders to address the enormous fiscal issues faced by the State of Illinois. We felt that that until the State could clearly demonstrate its dedication to putting its fiscal house in order, neither the Civic Federation nor the public would not be convinced that any new tax dollars would be well spent. This year, the situation has changed. The state finds itself in perhaps its most severe financial crisis since the Great Depression. Raising taxes and generating additional revenues are one of the steps that are needed to address this crisis.

Raising broad based taxes in a recession can have negative economic impacts. Climbing out of an economic downturn requires consumers and businesses to stimulate the economy through increased spending on goods and services. But reducing the amount of money available to taxpayers means that they may spend much less than they would have otherwise, thereby prolonging the impact of the recession. This fiscal crisis, however, requires revenue increases because the situation is so severe that it would be extraordinarily difficult to eliminate the budget

[18] This calculation is based upon data in the FY2007 Tax Expenditure Report released by the Illinois Comptroller's Office at http://www.apps.ioc.state.il.us/ioc-pdf/TaxExpRptFY2007Web.pdf (last visited on April 24, 2009).

deficit through spending cuts alone. Cuts would have to be so deep that they would jeopardize the state's ability to provide key health and income maintenance programs for low- and moderate- income Illinois residents. With that said, deeper cuts than the ones already made are absolutely necessary and proper and we are deeply disappointed that the Governor's budget does not go much further in prioritizing spending and making painful, but essential, reductions. We do not believe it would be realistic or even desirable to balance the state budget solely through cuts.

Mandate Additional Spending Cuts

The Governor's budget strikes an inappropriate balance in reducing its deficit by taxing too much and cutting too little. We are not convinced that the state can only find $500 million to cut from its FY2010 operating budget. If taxpayers are going to be asked to open their wallets to fund state government, the state must demonstrate it is doing everything it can to trim expenditures.

Deep budget cuts will require reductions in existing programs, perhaps even deeper cuts than the cuts that have already been proposed. It may require employee layoffs and reductions in state grants to other governments, entities, and individuals. In our view, cutting spending and limiting future liabilities is an essential, fiscally responsible option to shore up the state's precarious fiscal situation.

Any move to cut state spending must consider federal mandates and the impact reductions could have on the receipt of federal matching funds. It could require the redrafting of rules and regulations in certain areas and reducing eligibility for certain social programs, including areas such as healthcare which have been expanded without regard to cost in recent years.

Some immediate examples for spending reductions the General Assembly may consider that would demonstrate both shared sacrifice and belt tightening include:

- Eliminating the State subsidy for Coal Development and Marketing could yield $23.8 million annually;
- Eliminating compensation for appointed members of state boards and commissions could save up to approximately $6.6 million per year;
- Eliminating General Fund subsidies of the salaries of local assessors, supervisors of assessment and coroners could save up to $4.5 million per year;
- Eliminating State college tuition waivers granted by members of the General Assembly scholarships would generate up to $3.8 million in revenues;
- Eliminating agricultural research grants to public universities could save up to $2.2 million annually; and/or
- Ending the State subsidy for the DuQuoin State Fair, the State's second state fair, could save $407,000 per year.

Eliminate salaries and stipends for members of appointed boards and commissions for savings

The Civic Federation believes that the state should eliminate compensation for service on state boards in order to save approximately $6.6 million in salaries. These savings do not include those realized by the elimination of per diems paid to members of 10 boards and commissions. In FY2009, the state spent at least $6.6 million on annual salaries and stipends for 103 members of appointed boards and commissions and the state paid 86 members of various boards or commissions a per diem for their service. Some members of other boards and commissions received stipends or a per diem from another entity affiliated with the state board or commission. However, members of 241 of the state's 273 boards and commissions received no compensation for their service. Additionally, members of park districts, school boards, and library boards across the state receive no compensation for their service.

Consider Additional Pension Benefit Reforms

The Civic Federation applauds the Governor for proposing a new two-tiered system for pension benefits. However, we believe additional reforms are necessary to make the system's liabilities more manageable in the long-term.

Fund State Pension Systems at Certified Contribution Amount for FY2009 and FY2010

The state of Illinois must make the full mandated FY2009 and FY2010 pension contribution payments under the 1995 pension funding reform law. By not adhering to this funding schedule the state is essentially borrowing money from future generations to pay for current operating expenses. Any amount of savings recognized from restricting benefits for new hires should be used to offset the state's existing enormous pension liability. Deferring current pension payments will only exacerbate the state's pension funding problem and diminish the positive effects of a restructured benefit system for new hires. Under current pension laws the state's FY2011 required pension contribution is estimated at $5.4 billion, so if it fails to make the $4.0 billion certified contribution for FY2010 it will be enormously difficult for the state to find the political will to make the full payment in FY2011 and beyond.[19]

Impose a Moratorium on New Pension Benefits

The General Assembly approved the Pay-As-You-Go Act, which requires that any state pension enhancements also provide for their own funding, after it was proposed by Governor Blagojevich as part of his FY2006 budget. While this plan is a more fiscally responsible approach to pensions than the State has had in the past, the General Assembly can still add to the state's already unaffordable pension plans if it identifies new revenues, thus potentially leaving taxpayers on the hook for continuously expanding benefits and costs. The state should impose a moratorium on **any** new employee benefits until the pension system has achieved a 90.0% funded ratio. We call on the legislature to reject, and the Governor to veto, any new pension enhancements regardless of whether they are tied to additional funding sources.

Require Balance on Pension Boards Between Employees, Management and Taxpayer Interests

The state should require a balance of employee, management, and taxpayer interests in the governance of its retirement system Boards. 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.

[19] Commission on Government Forecasting and Accountability, "Pension Briefing" April 2009, p. 11.

Require Pension Benefit Reforms Before Authorizing Pension Obligation Bonds

The State of Illinois should not issue more pension obligation bonds unless it follows the precedent of the Chicago Transit Authority and negotiates reforms to employee pension benefits with unions that will curb future pension liabilities first.

Study the Costs and Benefits of Conversion to a Defined Contribution Plan

The State should undertake a study to determine both the costs and benefits of moving to a defined contribution pension plan. Such a move would require a very large infusion of assets into the system, such as from a multi-billion dollar asset sale or pension obligation bond issue. This would be necessary because the State would still be required to provide benefits to employees in the existing defined benefit plans for decades. This obligation would persist even as the funding stream for those plans diminishes with the shift of new employees into the new defined contribution plan. There would also be a need for start up funds for the new defined contribution plan.

Conduct a Comprehensive Review of the State's Medicaid Program

The Civic Federation recommends that the state conduct a comprehensive review of the state's entire Medicaid program. The Medicaid program is one of the most complicated and expensive portions of the State budget. It is imperative that the factors driving program growth and quality be well understood in order for the state to provide effective oversight. The Civic Federation's initial review of the program has unearthed a myriad of issues that need to be addressed to determine the effectiveness of the program's current operation and the highest priorities for improving the program. Some of the most important issues are[20]:

- **Institutional care:** Illinois has historically lagged behind other states in developing alternatives to costly institutional care. Although the State has recently added several significant programs to move patients to community settings, it seems highly likely that additional opportunities exist. In addition, the State spends possibly as much as $700 million on institutional care for the mentally ill for which it does not receive federal matching funds because the provision of these services does not comply with federal standards requiring treatment in less restrictive settings.

- **Access to specialty physicians:** Illinois Medicaid reimbursement to physicians appears low compared to other states and to private insurers. Although recent increases in primary care rates have made access to primary care physicians much easier, Medicaid patients are having trouble finding specialty physicians who will see them.

- **Managed care:** Illinois enrolls a smaller percentage of Medicaid recipients in managed care than other states. It is not clear that enrolling more patients in managed care would result in lower expenditures, but the option is worth considering. Currently, as an alternative, the State has focused on its Primary Care Case Management program, which connects each beneficiary with a primary care "medical home." This is a theoretically appealing option and

[20] These are discussed in more detail in the Civic Federation's issue brief on the Illinois Medicaid Program (forthcoming).

could be the cornerstone for broad-scale changes in the Medicaid program, but a rigorous evaluation is necessary.

In light of the dollar impact and the complexity of the above issues, the Civic Federation urges the Governor and General Assembly to establish a blue ribbon commission to conduct a comprehensive review of the Illinois Medicaid program, looking not only at individual provider programs, but also at how the program as a whole is structured and administered. The Governor's Taxpayer Action Board is raising many of the same issues, but it faces a short time frame to develop alternatives and is charged with evaluating a wide range of topics. A longer, in-depth review is necessary to address these issues and many others.

Such a review could guide the FY2011 budget process, help define issues for the 2010 gubernatorial campaign and establish an agenda for whoever wins that election. The oversight of the Medicaid program through the annual appropriation process does not lead to sufficiently comprehensive direction and tends to give too much power to provider groups, who understand the issues much better than the General Assembly.

Implement More Transparent Medicaid Program Reporting

The Civic Federation recommends implementing greater transparency mechanisms for the Medicaid program reporting. The budget is difficult to understand as it pertains to Medicaid since it confounds changes in payment cycles, changes in eligibility, policy changes and changes caused by inflation-related adjustments built into existing programs. Focusing on liabilities rather than appropriations would be an improvement. The level of liabilities is a measure of the bills HFS has in hand, or expects, without regard to when they will be paid. Appropriations, on the other hand, also take into account the degree of acceleration or deceleration of the payment cycle. If the payment cycle were relatively constant, this distinction would not be so important. However, since the Medicaid payment cycle has historically been at the mercy of the State's overall fiscal condition, the payment cycle has varied significantly from year to year. Stabilizing the payment cycle would be the optimal solution, but until that is achieved, HFS should issue regular reports that can be readily understood by the public.[21]

Without greater transparency in the budget information, it is hard for legislators, taxpayers and other interested parties to understand the critical issues, let alone how they have been resolved. Opaque budget documents work entirely to the benefit of insiders. Given the complexity of the program, the budget itself might not be the best medium for providing all the necessary data. However, this data must be made available within the same time frame as the budget process if there are to be informed decisions.

We note that HFS is also required to produce an annual report for the General Assembly. That report typically contains much useful information but leaves many of the critical questions unanswered. One alternative is to require HFS to make this annual report more consistent and more rigorous than the current document and to file the report no later than March 1 of each

[21] Although the additional federal match received as part of the ARRA requires that the State achieve certain payment cycle standards, it has yet to determined whether these will be maintained after the ARRA money is no longer available.

year. It should include program expenditures, liabilities and enrollment and comparisons to other states in similar formats for each program. It should also provide a consistent listing of policy changes, an explanation of expenditure changes and an explanation of how various funding sources interact to yield net state expenditures. The opportunity for a neutral group of experts to review and respond to the report annually would also be beneficial.

Institute Additional Retiree Health Insurance Reforms

In addition to pension benefits, the state also provides Other Post-Employment Benefits (OPEB) to its retirees. The following are recommendations made by the Civic Federation on how the state can reduce the costs associated with escalating OPEB expenses.

<u>Eliminate the Indemnity Plan for Retirees For Both In-Network and Out-of-Network Visits</u>

Eliminating the costly indemnity plan for retirees and placing enrollees in HMO or OAP plans that cost significantly less could save the State between $176.6 and $253.4 million per year (estimated savings in 2007).

<u>Study the Possibility of Establishing an Independent Healthcare Trust Fund</u>

The Civic Federation recommends that the state study the feasibility of establishing an independent healthcare trust fund for its retirees. In a report released in February of 2009, the Civic Committee of the Commercial Club recommended creating an independent healthcare trust fund as a means of funding the health care needs of the state's retired employees. The Civic Committee noted that in 2007 the Illinois General Assembly approved legislation that created a health care trust fund for the retirees of the Chicago Transit Authority.

An initial lump sum payment was necessary to create the CTA's trust fund, and the same would be true for the state if they attempt to create a similar funding structure for their retiree healthcare costs. The Civic Committee estimated that the state could save $1.1 billion if it implemented a retiree healthcare trust fund, along with increased retiree premium contributions and plan modifications.[22]

Consider Taxation of Retirement Income

The Civic Federation recommends that the state study the possibility of taxing retirement income. Currently, Illinois imposes no income tax on public or most private retirement income. This is in contrast to a majority of states, 39, that impose some type of personal income tax on either public or private retirement income.[23] It is important to note that seven states do not impose a personal income tax.[24]

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[22] See "Facing Facts 2009: An Updated Report on the State of Illinois' Fiscal Crisis" Civic Committee of the Commercial Club of Chicago (February 2009).
[23] Ronald Snell and Bert Waisanen, "State Personal Income Taxes on Pensions and Retirement Income: Tax Year 2007." National Conference of State Legislatures (July 2007).
[24] *Ibid.*

The FY2007 Tax Expenditure Report issued by the Illinois Comptroller in 2008 compared other states' tax treatment of retiree income, concluding that "Illinois provides one of the most favorable treatments of retirement income for its retirees."[25] For example, Illinois is one a five states that provides some variation of a full exemption of private retirement income derived from certain private plans.[26] Additionally, Illinois is one of only ten states that excludes all federal, state and local pension income from taxation.[27] 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."[28]

The state could receive approximately $1.3 billion in additional revenue each year if it imposed a 4% personal income tax on retiree income.[29] This number is based on the most recent data available, FY2007, for all federally taxed retirement and social security income earned by Illinois residents.

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 will require the approval of a state constitutional amendment to authorize a progressive personal income tax.

Reinstate the State Sales Tax on Food and Drugs

The Civic Federation recommends repealing the sales tax exemption on food, drugs and medical appliances, combined with the creation of a rebate program to provide tax relief to those who can least afford the increase. According to FY2008 Illinois Department of Revenue data, the state remitted $281.7 million back to local governments that it collected via the 1% sales tax on food, drugs and medical appliances.[30] Based on the FY2008 data, if the state were to eliminate this exemption and tax food, drugs and medical appliances at the full sales rate it would have received $1.4 billion in additional revenue.

While there are administrative costs associated with repealing the sales tax exemption for food, drugs and medical appliances but providing rebates to certain taxpayers, other states have proven that there are efficient ways to administer this policy change. Currently six states impose a sales

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[25] 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 April 24, 2009).

[26] Illinois and Mississippi do not tax retirement income from "qualified" private retirement plans; Hawaii does not tax retirement income from "contributory" private plans; Alabama does not tax retirement income from "defined benefit" private plans; Pennsylvania does not take retirement income from any private plan. Ibid p. 5.

[27] Ronald Snell and Bert Waisanen, "State Personal Income Taxes on Pensions and Retirement Income: Tax Year 2007." National Conference of State Legislatures (July 2007).

[28] *Ibid.*

[29] This calculation is based upon the FY2007 Tax Expenditure Report released by the Illinois Comptroller's Office at http://www.apps.ioc.state.il.us/ioc-pdf/TaxExpRptFY2007Web.pdf (last visited on April 24, 2009).

[30] Communication between the Civic Federation and the Illinois Department of Revenue, April 17, 2009.

tax on food but provide a rebate or income tax credit to poor households as compensation.[31] Kansas is one of the states that imposes a sales tax on food, but its Department of Revenue administers a program that offers a refund on sales tax paid for food to those who file an income tax return with the state, make less than $30,300 annually and are either over the age of 55, disabled or claim a dependent.[32]

The current sales tax exemption, intended to give lower-income households tax relief on necessary purchases, is too broad; federal law already exempts food purchased with food stamps from sales taxes. It would be a far better fiscal policy to apply sales tax on food and drug purchases and provide relief through tax refunds, credits or rebates to lower-income consumers; targeting relief for food and drug purchases to those who need it as opposed to providing the benefit to everyone. As the system currently stands, those who can afford to pay the tax are enjoying the same exemption as those who cannot afford to pay. In addition, the state could choose to reinstate the sales tax on food and drugs at an amount less than the full 5% state rate, thereby reducing the overall impact on consumers.

It is important to note that given the varying sales tax rates across Illinois eliminating the food and drug exemption for the state sales tax rate would mean that the composite tax rate for food and drugs would differ between municipalities and counties.

Implement a Formal Long-Term Financial Planning Process

The National Advisory Council on State and Local Budgeting (NACSLB) and the Government Finance Officers Association (GFOA) both recommend that all governments formally adopt a long-term financial plan as a key component of a sound budget process.[33] Internally, the State of Illinois currently 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. The Civic Federation recommends that the State develop and implement a formal long-term financial planning process.

Improve the State's Existing Performance Measurement System

The FY2010 Illinois State Budget includes five years of performance metrics for each agency. Some agencies provide outcome measures, such as cost per unit. However, most of these metrics are indicators of output, such as workload measures. These are counts of the number or percentage of activities undertaken or services delivered. In addition, goals are not provided for the statistics that are being measured. A lack of articulated goals makes it impossible to

[31] Federation of Tax Administrators, "State Sales Tax Rates" at http://www.taxadmin.org/fta/rate/sales.html (last visited on April 21, 2009).
[32] See Kansas Department of Revenue website at http://www.ksrevenue.org/perstaxtypesfs.htm (last visited on April 21, 2009); The federal poverty guidelines state that a family of four making less than $22,050 annually qualifies meets the financial criteria for certain federal financial assistance programs. *See* U.S. Department of Health and Human Services 2009 Federal Poverty Guidelines at http://aspe.hhs.gov/poverty/09poverty.shtml (last visited on April 21, 2009).
[33] See National Advisory Council on State and Local Budgeting and Government Finance Officers Association.

determine if agencies are meeting, exceeding, or falling short of program and policy targets or if they even have such targets.

A sound financial planning process involves tracking and improving productivity within state agencies. Given the administration's continued focus on improving management efficiency, the Civic Federation urges the State to enhance the quality and effectiveness of the performance data collected, presented, and utilized. Optimally, this would include stated goals as well as more outcome measures of efficiency, effectiveness, and service quality.

Revise the Budget Document Format

The Civic Federation recommends that the state expand the content contained in its annual budget document, especially with regard to information about its annual personnel costs. The State of Illinois budget document format provides both a user guide for the reader, as well as a budget summary that outlines the policy goals and objectives for the fiscal plan. Both of these sections are well done and provide the public and policy makers with useful knowledge regarding the state's finances.

However, the state's information regarding their personnel expenses is severely lacking. A small chart depicting employee headcount and an accompanying descriptive paragraph is the only aggregate information for state personnel data in this year's budget document. Nowhere in the budget is an aggregate total for personnel salary costs; we based our personnel cost calculations in this document on data provided to us by the state.[34] Given the fact that total personnel costs are approximately 10.8% of this year's total state budget, greater transparency for this budget line item must be provided in future years.

Personnel data should be aggregated in one section of the budget and include positions across all funds and for all departments. The data in the personnel section should be broken down by payroll, healthcare and pension expenses. A two- and five-year comparison should be provided for the reader, along with a five-year cost projection that takes into account annual cost of living increases. This expenditure data should be cross-referenced with actual personnel counts for each department that are summarized in one convenient chart.

BUDGET HIGHLIGHTS

Governor Quinn proposes a FY2010 operating budget of $52.9 billion. This is an increase of $3.2 billion, or 6.4%, over the proposed FY2009 budget of $49.7 billion. In FY2010 Governor Quinn proposes a $26.0 billion *Illinois Jobs Now!* capital budget, and a $3 billion mini capital bill was approved by the legislature and signed into law by Governor Quinn on April 3, 2009.

Budget Deficit in FY2009 and FY2010

The State of Illinois faces an enormous budget deficit in FY2010. The FY2010 budget gap is $11.6 billion, of which approximately $4.3 billion is due to a shortfall in the FY2009 budget and

[34] Communication between the Civic Federation and the Governor's Office of Management and Budget, April 27, 2009.

$7.3 billion is due to a gap in the FY2010 budget.[35] The Commission on Governmental Forecasting and Accountability (COGFA) estimates the state's deficit at a higher amount, $12.4 billion. Of that reported amount $5.1 billion is a carryover from FY2009 and $7.3 billion is for the FY2010 budget year.[36]

The multi-billion dollar deficit is the result of significant fiscal pressures that have been exacerbated by the current economic recession. These pressures include a $2.8 billion shortfall in actual versus projected FY2009 General Fund revenues, a backlog of payments to providers and contractors that could reach as much as $4.5 billion at the close of FY2009 and scheduled spending increases for programs such as Medicaid.[37] Approximately $4.3 billion of the two-year deficit can be attributed to spending increases, including legislatively mandated transfers and required pension payments. Approximately $7.3 billion of the two-year deficit is due to shortfalls in revenues required to pay for scheduled spending increases.

State of Illinois Two-Year Budget Deficit FY2009 & FY2010	
Expenditure Increases	$ 4,290,000,000
Revenue Decreases	$ 7,289,000,000
Total	**$ 11,579,000,000**

Source: State of Illinois Budget FY2010, p. 2-12.

A closer look at the deficit in FY2009 versus FY2010 is provided in the following sections.

FY2009 Deficit: $4.3 Billion

A deficit represents a snapshot in time of what the fiscal situation would be if current revenue and spending trends continued without any changes. Assuming no revenue or spending changes were made in FY2009, the gap between total revenues of $27.1 billion and total expenditures of $31.4 billion will be approximately $4.3 billion. The deficit is due to two key factors:

- General Funds revenues in FY2009 will be $2.8 billion less than originally projected ($27.2 billion versus $30.0 billion); and
- Expenditures in FY2009 will increase by $3.6 billion to $31.5 billion from the enacted appropriations of $27.8 billion. This increase is due a number of factors, including a supplemental Medicaid appropriation, legislatively required transfers to other funds, continuing appropriations for the pension funds and the cost of pension obligation bond debt service.

[35] Illinois State Budget FY2010, p. 2-12.
[36] Commission on Governmental Forecasting and Accountability. "Presentation to the Senate Deficit Reduction Committee: Economic and Revenue Update," March 24, 2009, p. 30.
[37] See Illinois Office of the Comptroller. "Transitional Fiscal Report/FY2010 Budgetary Outlook." See www.comptroller.state.il.us/.

State of Illinois General Fund Base Budget Deficit FY2009	
Revenues	**Amount**
State Sources	$ 20,886,000,000
Federal Sources	$ 4,699,000,000
Statutory Transfers-In	$ 1,585,000,000
Total Revenues	**$ 27,170,000,000**
Current Year Expenditures	
Appropriations	$ 28,306,000,000
Unspent Appropriations	$ (500,000,000)
Subtotal Current Year Expenditures	**$ 27,806,000,000**
Statutory Transfers Out	
Legislatively Required Transfers to Other Funds	$ 2,804,000,000
Continuing Appropriation for Pensions	$ 381,000,000
Pension Obligation Bond Debt Service	$ 467,000,000
Subtotal Statutory Transfers Out	**$ 3,652,000,000**
Total Expenditures & Transfers Out	**$ 31,458,000,000**
Budget Deficit	**$ (4,288,000,000)**

Source: State of Illinois Budget FY2009, p. 2-12.

FY2010 Deficit: $7.3 Billion

If no revenue or spending changes are made in FY2010 the gap between revenues and estimated expenditures will be approximately $7.3 billion. Expenditures for Medicaid, social service spending, employee benefits and other costs will increase by $2.8 billion, from $31.5 billion to $34.2 billion. General Funds revenues in FY2010 will remain flat at approximately $27.0 billion.

State of Illinois General Fund Base Budget Deficit FY2010	
Revenues	**Amount**
State Sources	$ 19,699,000,000
Federal Sources	$ 5,594,000,000
Statutory Transfers-In	$ 1,679,000,000
Total Revenues	**$ 26,972,000,000**
Current Year Expenditures	
Appropriations	$ 31,506,000,000
Unspent Appropriations	$ (500,000,000)
Subtotal Current Year Expenditures	**$ 31,006,000,000**
Statutory Transfers Out	
Legislatively Required Transfers to Other Funds	$ 2,786,000,000
Continuing Appropriation for Pensions	$ -
Pension Obligation Bond Debt Service	$ 467,000,000
Subtotal Statutory Transfers Out	**$ 3,253,000,000**
Total Expenditures & Transfers Out	**$ 34,259,000,000**
Budget Deficit	**$ (7,287,000,000)**

Source: State of Illinois Budget FY2010, p. 2-12.

Eliminating the Two-Year Deficit

The two-year budget deficit will be eliminated and new spending paid for through a combination of $1.3 billion in spending cuts, a nearly $3.0 billion reduction in pension payments, $6.7 billion in federal stimulus funds, $621 million in savings from debt refinancing and over $3.8 billion in revenue increases, including $3.15 billion in income tax increases.

Spending Cuts

The Governor proposes approximately $1.3 billion in spending cuts to reduce the two-year deficit. Five hundred million dollars of that amount will be cut from the FY2010 budget and the remaining $830 million in the FY2009 budget.[38] These reductions include the following items, which are listed below with their associated cost-savings.

- Targeted reductions and implementation of efficiencies in state agencies: $390 million
- Decreasing the state's healthcare costs by increasing healthcare contributions for state employees and retirees: $200 million.
- Reductions across-the-board for grant programs, including those in healthcare and education: $80 million.
- Requiring state employees to take four furlough days: $36 million.

[38] "Tough Choices. Reform. Responsibility. Recovery. Fiscal Year 2010 Budget of Governor Pat Quinn." A PowerPoint presentation, See http://budget.illinois.gov/cuttingcosts.htm.

Pension Contribution Reductions in FY2009 and FY2010

The state has proposed a number of employee pension reforms that would reduce the liabilities of the retirement systems by $162 billion over the next 35 years.[39] If these reforms are enacted, the State proposes:

1) To reduce the certified amount it is required to pay under the State's 1995 pension funding reform law from $4.5 billion to $2.1 billion in FY2010; a reduction of $2.4 billion.[40] The $2.1 billion amount includes the required debt service payment on pension obligation bonds of $543.6 million plus the pension systems' $1.5 billion normal cost for the year. The normal cost is the present value of benefits earned by members during the fiscal year.

2) To reduce its FY2009 pension payment by $550 million.

The total amount the state proposes to reduce its contribute to the pension funds in FY2009 and FY2010, therefore, is approximately $3.0 billion.

Federal Stimulus Funds

The federal American Recovery and Reinvestment Act (ARRA) will provide the State of Illinois will billions of dollars in operating funds for FY2009, FY2010 and FY2011.[41] Overall, the state will receive nearly $6.7 billion in stimulus funds.

The state expects to receive approximately $4.8 billion in funds for Medicaid and education. A total of $2.9 billion in federal Medicaid funds will be provided to Illinois over a 27-month period; these funds will be available in FY2009 and FY2010.[42] To qualify for these funds the state is required to maintain a 30-day payment cycle to providers through the end of December 2010. Illinois is also eligible for $2.9 billion in stimulus funds to support elementary, secondary and higher education and avoid layoffs and budget cuts in these areas.[43]

The state also expects to receive $1.8 billion in additional stimulus funds for a variety of programs. Some of these proposed appropriations are guaranteed funding through existing federal formulas. However, much of the stimulus funds will come in the form of grant funding in areas that have yet to be awarded but are still included throughout the operating budget, as well as the separate capital budget.

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[39] Illinois State Budget FY2010, p. 4-3.
[40] *See* Illinois State Budget FY2010, p. 4-3 and Commission on Governmental Forecasting and Accountability. *A Report from the Commission on Governmental Forecasting and Accountability on the Financial Condition of the State of Illinois Retirement Systems as of June 30, 2008*, p. 69.
[41] These funds are in addition to stimulus funds provided for capital projects.
[42] Illinois State Budget FY2010, p. 2-7.
[43] "Tough Choices. Reform. Responsibility. Recovery. Fiscal Year 2010 Budget of Governor Pat Quinn." A PowerPoint presentation, See http://budget.illinois.gov/payingproviderstime.htm.

State of Illinois Federal Recovery Funds for FY2010 (in $ millions)	
Department	**Total**
State Board of Education	$ 2,800.0
Children & Family Services	$ 1,916.6
Commerce & Economic Opportunity	$ 1,185.0
Revenue	$ 346.0
Human Services	$ 147.6
State Board of Higher Education	$ 119.0
Justice Information Authority	$ 54.9
EPA	$ 38.2
Employment Security	$ 30.5
Corrections	$ 20.0
State Police	$ 20.0
Other	$ 14.4
Aging	$ 6.0
Juvenile Justice	$ 4.0
Natural Resources	$ 4.0
Illinois Arts Council	$ 0.4
Total	**$ 6,706.6**

Source: Illinois State Budget FY2010.

Debt Refinancing Savings

The Governor proposes restructuring all of the state's current general obligation debt, including pension obligation bonds new proposed capital debt, to reap an estimated savings of $621 million in debt service payments due in FY2010.[44]

Revenue Enhancements

Governor Quinn proposes a variety of revenue enhancements totaling $3.8 billion in the FY2010 budget.[45] The proposals include:

- An increase from 3% to 4.5% in the personal income tax which will generate $2.8 billion in new revenues. The personal exemption will be increased from $2,000 to $6,000;
- An increase from 4.8% to 7.2% for the corporate income tax, generating $350.0 million annually;
- A state cigarette tax increase from 98 cents per pack to $1.48 per pack in FY2010 and to $1.98 per pack in FY2011, yielding $175.0 million in FY2010;
- Twelve sales, income and other tax changes on business activities that could generate up to $478.0 million annually;
- Taxing sweetened tea and coffee drinks at the state sales tax rate of 6.25%, a measure that would yield $12.0 million per year; and
- Taxing all grooming and hygiene products at state sales tax rate of 6.25% for a revenue yield of $2.0 million per year.

[44] Illinois State Budget FY2010, p. 12-13.
[45] Illinois State Budget FY2010, pp. 5-16 and 5-17.

New Program Initiatives in the FY2010 Operating Budget

The FY2010 budget proposes the following new program initiatives:

- Increasing funding for elementary and secondary education by $174.0 million. This amount includes $114.0 million to raise the foundation level by $130, or from $5,959 to $6,089 per pupil;
- Increasing funding for higher education by $40.0 million;
- Expanding at the LaSalle Veteran's Home by adding 80 beds;
- Funding a new Chicago veteran's home;
- Restoring cuts in parks funding;
- Providing $1.0 million to food banks throughout Illinois; and
- Establishing a 10-day sales tax holiday in August 2009 on clothing and footwear with a selling price of $100 or less, and on school supplies.

The Recession and State Budgets

All state governments have had to respond to the recession's downward effect on state revenues and ensuing budget gaps. In order to balance their budgets, state governments have proposed a variety of strategies, including revenue increases, spending reductions and bonding.[46] Proposed revenue increases include increased federal funding through the American Recovery and Reinvestment Act, fee increases, tax increases on specific goods, such as cigarettes and alcohol, and state income or sales tax increases.[47] A recent report by Standard & Poor's found that many of the recent proposed state tax or fee increases are planned as temporary changes.

Temporary and permanent spending reductions have also been incorporated into many state budgets through reductions in departmental budgets, reduced pension contributions, payment delays, and measures to reduce personnel costs including furloughs, lay-offs, and in pay cuts. Standard & Poor's reported that state governments have proposed reductions in all types of programming, except K-12 education. Finally, some states have proposed borrowing to cover FY2010 costs for operations and pensions, to restructure outstanding debt and to replace pay-as-you-go financing.[48]

Going into FY2010, the nation's most populous states face unprecedented and substantial budget deficits. The State of Illinois' proposed budget attempts to close an $11.6 billion deficit through a combination of spending reductions totaling $1.3 billion, increased federal funding from the federal stimulus package totaling $6.7 billion and other measures expected to generate revenues of $3.8 billion, including personal and corporate income tax increases.[49] Notably, $3.0 billion of the state's proposed spending reductions consist of reduced pension contributions.[50]

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[46] Standard & Poor's, "Recession's effect on Revenues Dominates U.S. States' Budget Deliberations," 23 March 2009, 2-3
[47] *Ibid.*, 3
[48] *Ibid.*
[49] *Ibid.*, 11
[50] *Ibid.*

California, the nation's most populous state, will balance its budget through a combination of spending reductions, tax increases, increased federal stimulus funding, and borrowing. Like Illinois, New Jersey will balance its budget with spending cuts that include reductions in pension payments. New Jersey will reduce its outstanding debt payments for the fiscal year through debt restructuring, and close the rest of its budget gap with increased federal funding from the stimulus package, increased taxes on cigarettes and alcohol, and other temporary tax increases.

Florida will balance its budget with bonding and additional funding from the federal stimulus package. Massachusetts will close its budget gap by increasing spending 0.5% over FY2009 estimated expenditures, use of its budget reserves, eliminating certain sales tax exemptions, and additional funding from the stimulus package. Pennsylvania will balance its budget by reducing spending in all general fund areas except education, public welfare, corrections, and probation and parole by 8.8%, in addition to using a portion of its unreserved fund balance, and enacting a variety of revenue enhancements. These enhancements include new taxes and tax increases on cigarettes and other tobacco products and a new tax on natural gas severance.

Michigan will close nearly half its deficit with spending cuts, that will include reduced personnel costs through employee layoffs and cuts to funding for higher education. The state will also use federal funding from the stimulus package and revenue enhancements to close the rest of the gap. The state's budget document does not include details about the revenue enhancements.[51]

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ECONOMIC OVERVIEW & REVENUES

The following sections provide an overview of the current economic situation both nationwide and with respect to Illinois specifically. It also details the two- and five-year revenue trends for the State of Illinois budget and provides descriptions of the tax law changes proposed for FY2010.

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[51] *State of Michigan FY2010 Executive Budget Overview*, A-5

Economic Overview – United States and Illinois

The Congressional Budget Office (CBO) estimates that the national deficit will total nearly $1.7 trillion this year.[52] The CBO also predicts that the economy will continue to decline through the summer of 2009, and for the next two years economic output will average 7% below its potential.[53] The national unemployment rate in March of 2009 stood at 8.5%, increasing from 8.1% in February of 2009. [54]

However, the CBO does predict that the American Recovery and Reinvestment Act, along with aggressive actions by the Federal Reserve Bank and the U.S. Department of the Treasury, will help end the recession by the fall of 2009.[55]

Nationwide, individual states are experiencing similar economic declines. According to a recently released report by Standard & Poor's, states collectively faced a $100.0 billion initial budget deficit for FY2010.[56] Some of the national budget trends indentified in this report include:

- Weakened revenue sources for all states;
- Spending reductions pursued in both recurring and non-recurring expenses, including pension payment holidays;
- Revenue increase proposals, such as broadened sales tax bases, closing loopholes, and imposing temporary taxes;
- Using reserves or fund sweeps to generate non-recurring revenue; and
- Issuing bonds for operating and/or long-term costs.

Locally, the economic outlook is similar to the national trend. The statewide unemployment rate as of March 2009 rose to 9.1%, increasing by 0.5% over February 2009.[57] The unemployment rate in Illinois is now at its highest level since 1985.[58]

Ratings agencies have taken notice of the state's increasingly fragile economic state by lowering Illinois' bond ratings. In March of 2009 Standard & Poor's lowered the state's General Obligation Rating from 'AA' to 'AA-', citing the state's "limited action in addressing it's

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[52] Congressional Budget Office, "Preliminary Analysis of the President's Budget and an Update of CBO's Budget and Economic Outlook" p. 11 (March 2009).
[53] Congressional Budget Office, "Preliminary Analysis of the President's Budget and an Update of CBO's Budget and Economic Outlook" p. 12 (March 2009).
[54] U.S. Bureau of Labor Statistics, "Employment Situation Summary: March 2009" at http://www.bls.gov/news.release/empsit.nr0.htm (last visited April 13, 2009).
[55] Congressional Budget Office, "Preliminary Analysis of the President's Budget and an Update of CBO's Budget and Economic Outlook" p. 12 (March 2009).
[56] Standard & Poor's, "Recession's Effect on Revenues Dominates U.S. State's Budget Deliberations." March 31, 2009.
[57] U.S. Bureau of Labor Statistics, "Regional and State Employment and Unemployment Summary: February 2009" at http://www.bls.gov/news.release/laus.nr0.htm (last visited April 13, 2009); Crain's Chicago Business, "*State jobless rate at 9.1%, highest since '85.*" April 16, 2009.
[58] Crain's Chicago Business, "*State jobless rate at 9.1%, highest since '85.*" April 16, 2009.

budgetary problems."[59] In April Moody's Investors Service followed suit, lowering the state's general obligation bonds rating to A1 from Aa3.[60]

Revenues

The FY2010 State of Illinois proposed operating budget revenues of $58.9 billion is a 15.2% or $7.7 billion increase in total receipts from the **originally proposed** FY2009 budget. In order to provide an accurate year-to-year comparison, the Civic Federation uses the originally proposed budget figures when conducting its analysis.

State tax revenues are expected to **increase** by 2.1%, or approximately $551 million. Other receipts, which include non-state tax revenues such as fees and lottery revenues, are expected to decrease by 7.2%, and federal revenues, which include federal stimulus funds, will increase by 60.6%.

Projections for elastic revenues in Illinois reflect the negative impact of the current recession. The State forecasts these economically sensitive revenues by making its own projections through econometric modeling. It also contracts with two national firms, Economy.com and Global Insight, which provide independently generated economic forecasts. These forecasts are then reviewed by the Council of Economic Advisors, which is comprised of a group of private and public sector finance experts appointed by the Governor, in addition to the Governor's Office of Management and Budget, the Department of Revenue, and the Department of Employment Security.[61]

Net personal income tax revenues are expected to continue to grow in FY2010 by 13.5% over FY2009. However, the increase is largely due to the Governor's proposed increase to the personal income tax rate from 3% to 4.5%. The state's forecast for personal income tax receipts in FY2010 without the proposed increase is $8.9 billion. This is a 14.4% reduction from the FY2009 budgeted amount of $10.4 billion and a 5.2% reduction from FY2009 actual estimated collections of $9.4 billion.[62]

Corporate income tax receipts are expected to decline by 13.5% in FY2010, falling from $1.7 billion in FY2009 to $1.5 billion. This decline comes even with the proposed corporate tax increase from 4.8% to 7.2%. The forecast for FY2010 without a corporate tax increase is $1.04 billion, a 40.4% reduction from FY2009 budgeted amount of $1.7 billion and a 28.1% reduction from FY2009 actual estimated collections of $1.4 billion.[63]

Sales tax revenues are expected to decrease by 4.9% between FY2010 and the original FY2009 budget. There are three components of the sales tax base: 1) retail sales taxes, 2) sales taxes from vehicle purchases, and 3) taxes from the purchase of motor fuel:

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[59] Miller, James P. "S&P downgrades Illinois' GO bond ratings." *Chicago Tribune*, March 10, 2009.
[60] Moody's Investors Service, " Moody's Lowers State of Illinois' General Obligation Rating to A1 from Aa3; Outlook Stable." April 3, 2009.
[61] Illinois State Budget FY2010, p. 5-5.
[62] Illinois State Budget FY2010, p. 5-7.
[63] Illinois State Budget FY2010, p. 5-7.

- Retail sales are the main sales tax driver, accounting for 76.0% of total sales tax revenue in FY2010. Sales are projected to decrease by 1.5% in the retail sector in FY2010, compared to a 2.5% decrease in FY2009. The slowdown in retail sales is attributable to a variety of broader economic factors, including rising unemployment, decreasing job security and stricter credit standards.[64]

- Vehicle sales tax revenues are expected to fall by 10.0% in FY2010, compared to a dramatic 22% decline in FY2009. Overall, sales taxes from motor vehicles will account for 13.0% of all sales tax receipts in FY2010.[65]

- Revenue from motor fuel sales is projected to decline by 21% in FY2010, compared to a 25% decrease in FY2009. It will account for roughly 11.0% of all sales tax receipts in FY2010. The decline will be caused by drops in average fuel prices as well as consumption.[66]

Riverboat gaming taxes and fees are expected to continue to decline in FY2010, falling by 23.3% from FY2009. This is a decrease from the budgeted amount of $717.0 million for FY2009 versus $550.0 million for this fiscal year. It is important to note, however, that the actual FY2009 year-end estimate of riverboat revenues will only be $470 million. The sharp decline in revenues is attributed to the impact of the recession as well as the Smoke Free Illinois Act which bans smoking in casinos.[67]

Revenues from **Federal Sources** will rise by 60.6%, from $13.3 billion in FY2009 to $21.4 billion in FY2010. This $8.1 billion increase can be attributed in large part to stimulus funds provided under the auspices of the American Recovery and Reinvestment Act of 2009.

[64] Illinois State Budget FY2010, p. 5-9.
[65] Illinois State Budget FY2010, p. 5-9.
[66] Illinois State Budget FY2010, pp. 5-8 and 5-9.
[67] Illinois Public Act 95-0017.

State of Illinois Revenues for All Funds: FY2009-FY2010 (in $ millions)				
	Projected FY2009	Projected FY2010	$ change	% change
State Taxes				
Income Taxes (Net)	$ 12,182	$ 13,358	$ 1,176	9.7%
Personal	$ 10,432	$ 11,845	$ 1,413	13.5%
Corporate	$ 1,750	$ 1,513	$ (237)	-13.5%
Sales Taxes	$ 7,803	$ 7,419	$ (384)	-4.9%
Motor Fuel Tax	$ 1,477	$ 1,395	$ (82)	-5.6%
Public Utility Tax	$ 1,857	$ 1,907	$ 50	2.7%
Cigarette Taxes	$ 619	$ 570	$ (49)	-7.9%
Liquor Taxes	$ 161	$ 161	$ -	0.0%
Inheritance Tax	$ 275	$ 275	$ -	0.0%
Insurance Taxes/Fees	$ 423	$ 435	$ 12	2.8%
Corporate Franchise Taxes/Fees	$ 208	$ 203	$ (5)	-2.4%
Riverboat Gaming Taxes/Fees	$ 717	$ 550	$ (167)	-23.3%
Subtotal State Taxes	**$ 25,722**	**$ 26,273**	**$ 551**	**2.1%**
Other Receipts				
Motor Vehicle/Operators License Fees	$ 1,301	$ 1,233	$ (68)	-5.2%
Interest Income	$ 206	$ 80	$ (126)	-61.2%
Revolving Fund Receipts	$ 658	$ 661	$ 3	0.5%
Lottery	$ 976	$ 974	$ (2)	-
Assessment Funds Receipts	$ 1,364	$ 1,616	$ 252	18.5%
Intergovernmental Payments	$ 1,326	$ 1,168	$ (158)	-11.9%
Group Insurance Receipts	$ 1,397	$ 1,353	$ (44)	-3.1%
Tobacco Settlement Receipts	$ 321	$ 318	$ (3)	-0.9%
Other Taxes,Fees,Earnings & Net Transfers	$ 4,523	$ 3,794	$ (729)	-16.1%
Subtotal Other Receipts	**$ 12,072**	**$ 11,197**	**$ (875)**	**-7.2%**
Federal Receipts	$ 13,333	$ 21,417	$ 8,084	60.6%
Total	**$ 51,127**	**$ 58,887**	**$ 7,760**	**15.2%**

Source: FY2009 State Budget, Table II-A: All Appropriated Funds Revenues by Source, p. 2-37.
FY2010 State Budget, Table II-A: All Appropriated Funds Revenues by Source, p. 2-32.

General Funds Receipts

The next exhibit shows projected changes in **General Funds receipts** between the original FY2009 budget proposal and the FY2010 budget proposal. The state expects General Fund revenues to increase by 2.3%, or $754.0 million, from $32.3 billion in FY2009 to $33.1 billion in FY2010. However, state source revenues, which the state controls, are projected to decrease significantly by 14.6%, falling from $24.8 billion in FY2009 to approximately $21.2 billion in FY2010. This is a drop of nearly $3.6 billion. The largest dollar increase will be from net total income tax receipts, which will rise from $12.1 billion in FY2009 to $13.1 billion in FY2010, a $993 million or 8.2% increase.[68]

[68] The $13.1 million figure is derived from the net $9.9 billion figure listed under base revenues – state sources plus the $3.2 billion projected from the income tax increase under recurring revenues in the exhibit.

State of Illinois Revenues for General Funds: FY2009-FY2010 (in $ millions)				
	Projected FY2009	Projected FY2010	$ change	% change
Base Revenues				
State Sources				
Income Taxes (Net)	$ 12,182	$ 9,968	$ (2,214)	-18.2%
Personal	$ 10,432	$ 8,925	$ (1,507)	-14.4%
Corporate	$ 1,750	$ 1,043	$ (707)	-40.4%
Sales Taxes	$ 7,297	$ 6,394	$ (903)	-12.4%
Public Utility Taxes	$ 1,110	$ 1,150	$ 40	3.6%
Cigarette Taxes	$ 350	$ 350	$ -	0.0%
Liquor Taxes	$ 161	$ 161	$ -	0.0%
Inheritance Taxes	$ 275	$ 275	$ -	0.0%
Insurance Taxes & Fees	$ 325	$ 325	$ -	0.0%
Corporate Franchise Fees & Taxes	$ 205	$ 205	$ -	0.0%
Interest on State Funds & Investments	$ 180	$ 80	$ (100)	-55.6%
Cook County Intergov. Transfer	$ 256	$ 240	$ (16)	-6.3%
Other State Sources	$ 535	$ 430	$ (105)	-19.6%
Transfers-In				
Lottery	$ 664	$ 645	$ (19)	-2.9%
Riverboat Gaming Taxes	$ 642	$ 478	$ (164)	-25.5%
Other Transfers	$ 678	$ 480	$ (198)	-29.2%
10th License	$ -	$ 50	$ 50	100.0%
Subtotal State Sources	**$ 24,860**	**$ 21,231**	**$ (3,629)**	**-14.6%**
Federal Sources	$ 5,108	$ 5,555	$ 447	8.8%
Total Base Revenues	**$ 29,968**	**$ 26,786**	**$ (3,182)**	**-10.6%**
Increases to Base Revenues				
One-Time Revenues				
Federal Recovery	$ 2,154	$ 1,882	$ (272)	-12.6%
Transfer In	$ 200	$ 364	$ 164	82.0%
Subtotal One-Time Revenues	**$ 2,354**	**$ 2,246**	**$ (108)**	**-4.6%**
Recurring Revenues				
Income Taxes	$ -	$ 3,207	$ 3,207	100.0%
Cigarette Taxes	$ -	$ 365	$ 365	100.0%
Equity Charges	$ -	$ 287	$ 287	100.0%
Titles and Fees	$ -	$ 185	$ 185	100.0%
Subtotal Recurring Revenues	**$ -**	**$ 4,044**	**$ 4,044**	**100.0%**
Total Adjusting Sources	**$ 2,354**	**$ 6,290**	**$ 3,936**	**167.2%**
Total General Fund Revenues	**$ 32,322**	**$ 33,076**	**$ 754**	**2.3%**

Source: FY2009 State Budget, Table II-B General Funds Revenues by Source, p. 2-38. (Note: One-Time Revenues for FY2009 reported in FY2010 Budget).
FY2010 State Budget, Table II-B General Funds Revenues by Source, p. 2-33.

Projected v. Estimated FY2009 General Funds Revenues

The state originally projected that General Funds revenues in FY2009 would be approximately $30.0 billion. The estimate of General Funds FY2009 revenues has been revised to total $27.2 billion. This represents a nearly $2.8 billion or 9.3% decrease in revenues.

State of Illinois Base Revenues for General Funds: Proj FY2009 & Est FY2009 (in $ millions)				
	Projected FY2009	Estimated FY2009	$ change	% change
Base Revenues - State Sources				
Income Taxes (Net)	$ 12,182	$ 10,867	$ (1,315)	-10.8%
Personal	$ 10,432	$ 9,417	$ (1,015)	-9.7%
Corporate	$ 1,750	$ 1,450	$ (300)	-17.1%
Sales Taxes	$ 7,297	$ 6,674	$ (623)	-8.5%
Public Utility Taxes	$ 1,110	$ 1,159	$ 49	4.4%
Cigarette Taxes	$ 350	$ 350	$ -	0.0%
Liquor Taxes	$ 161	$ 161	$ -	0.0%
Inheritance Taxes	$ 275	$ 275	$ -	0.0%
Insurance Taxes & Fees	$ 325	$ 325	$ -	0.0%
Corporate Franchise Fees & Taxes	$ 205	$ 205	$ -	0.0%
Interest on State Funds & Investments	$ 180	$ 80	$ (100)	-55.6%
Cook County Intergov. Transfer	$ 256	$ 253	$ (3)	-1.2%
Other State Sources	$ 535	$ 452	$ (83)	-15.5%
Transfers-In				
Lottery	$ 664	$ 625	$ (39)	-5.9%
Riverboat Gaming Taxes	$ 642	$ 470	$ (172)	-26.8%
Other Transfers	$ 678	$ 575	$ (103)	-15.2%
Subtotal State Sources	**$ 24,860**	**$ 22,471**	**$ (2,389)**	**-9.6%**
Base Revenues - Federal Sources	$ 5,108	$ 4,700	$ (408)	-8.0%
Total Base Revenues	**$ 29,968**	**$ 27,171**	**$ (2,797)**	**-9.3%**

Sources: FY2009 State Budget, Table II-B General Funds Revenues by Source, p. 2-38.
FY2010 State Budget, Table II-B General Funds Revenues by Source, p. 2-33.

Five-Year Revenue Trends

The next two exhibits show five-year revenue trends for all funds and for just the General Funds. In order to provide an accurate comparison, the figures presented are the **originally proposed** revenues for each fiscal year. From FY2006 to FY2010, total receipts for all funds are expected to increase by 29.0% while the State's own source tax revenues will rise by 21.1%.

State of Illinois Revenues for All Funds: FY2006-FY2010 (in $ millions)				
	Projected FY2006	Projected FY2010	$ change	% change
State Taxes				
Income Taxes (Net)	$ 9,283	$ 13,358	$ 4,075	43.9%
Personal	$ 8,120	$ 11,845	$ 3,725	45.9%
Corporate	$ 1,161	$ 1,513	$ 352	30.3%
Sales Taxes	$ 7,362	$ 7,419	$ 57	0.8%
Motor Fuel Tax	$ 1,450	$ 1,395	$ (55)	-3.8%
Public Utility Tax	$ 1,218	$ 1,907	$ 689	56.6%
Cigarette Taxes	$ 620	$ 570	$ (50)	-8.1%
Liquor Taxes	$ 146	$ 161	$ 15	10.3%
Inheritance Tax	$ 255	$ 275	$ 20	7.8%
Insurance Taxes/Fees	$ 453	$ 435	$ (18)	-4.0%
Corporate Franchise Taxes/Fees	$ 194	$ 203	$ 9	4.6%
Riverboat Gaming Taxes/Fees	$ 710	$ 550	$ (160)	-22.5%
Subtotal State Taxes	**$ 21,689**	**$ 26,273**	**$ 4,584**	**21.1%**
Other Receipts				
Motor Vehicle/Operators License Fees	$ 1,171	$ 1,233	$ 62	5.3%
Interest Income	$ 70	$ 80	$ 10	14.3%
Revolving Fund Receipts	$ 514	$ 661	$ 147	28.6%
Lottery	$ 924	$ 974	$ 50	5.4%
Assessment Funds Receipts	$ 635	$ 1,616	$ 981	154.5%
Intergovernmental Payments	$ 1,409	$ 1,168	$ (241)	-17.1%
Group Insurance Receipts	$ 1,756	$ 1,353	$ (403)	-22.9%
Tobacco Settlement Receipts	$ 283	$ 318	$ 35	12.4%
Other Taxes,Fees,Earnings & Net Transfers	$ 4,151	$ 3,794	$ (357)	-8.6%
Subtotal Other Receipts	**$ 10,913**	**$ 11,197**	**$ 284**	**2.6%**
Federal Receipts	$ 13,040	$ 21,417	$ 8,377	64.2%
Total	**$ 45,642**	**$ 58,887**	**$ 13,245**	**29.0%**

Source: FY2010 State Budget, Table II-A: All Appropriated Funds Revenues by Source, p. 2-32.
FY2006 State Budget, Table II-A: All Appropriated Funds Revenues by Source, p. 1-27.

General Fund base revenues, including state own source tax and fee revenues and federal intergovernmental aid, are projected to increase by only 1.4% between FY2006 and FY2010, from $26.4 billion to $26.8 billion. Total General Fund receipts from all sources, including tax and fee increases and ARRA funds, will increase by 15.0% or $4.3 billion, from $28.8 billion in FY2006 to $33.1 billion in FY2010.

State of Ilinois Revenues for General Funds: FY2006-FY2010 (in $ millions)				
	Projected FY2006	Projected FY2010	$ change	% change
Base Revenues				
State Sources				
Income Taxes (Net)	$ 9,281	$ 9,968	$ 687	7.4%
Personal	$ 8,120	$ 8,925	$ 805	9.9%
Corporate	$ 1,161	$ 1,043	$ (118)	-10.2%
Sales Taxes	$ 6,778	$ 6,394	$ (384)	-5.7%
Public Utility Taxes	$ 1,096	$ 1,150	$ 54	4.9%
Cigarette Taxes	$ 400	$ 350	$ (50)	-12.5%
Liquor Taxes	$ 146	$ 161	$ 15	10.3%
Inheritance Taxes	$ 255	$ 275	$ 20	7.8%
Insurance Taxes & Fees	$ 366	$ 325	$ (41)	-11.2%
Corporate Franchise Fees & Taxes	$ 194	$ 205	$ 11	5.7%
Interest on State Funds & Investments	$ 45	$ 80	$ 35	77.8%
Cook County Intergov. Transfer	$ 340	$ 240	$ (100)	-29.4%
Other State Sources	$ 436	$ 430	$ (6)	-1.4%
Transfers-In				
Lottery	$ 628	$ 645	$ 17	2.7%
Riverboat Gaming Taxes	$ 696	$ 478	$ (218)	-31.3%
Other Transfers	$ 916	$ 480	$ (436)	-47.6%
10th Riverboat License	$ -	$ 50	$ 50	100.0%
Subtotal State Sources	**$ 21,577**	**$ 21,231**	**$ (346)**	**-1.6%**
Federal Sources	$ 4,834	$ 5,555	$ 721	14.9%
Total Base Revenues	**$ 26,411**	**$ 26,786**	**$ 375**	**1.4%**
Increases to Base Revenues				
One-Time Revenues				
Federal Recovery	$ 2,154	$ 1,882	$ (272)	-12.6%
Transfer In	$ 200	$ 364	$ 164	82.0%
Subtotal One-Time Revenues	**$ 2,354**	**$ 2,246**	**$ (108)**	**-4.6%**
Recurring Revenues				
Income Taxes	$ -	$ 3,207	$ 3,207	100.0%
Cigarette Taxes	$ -	$ 365	$ 365	100.0%
Equity Charges	$ -	$ 287	$ 287	100.0%
Titles and Fees	$ -	$ 185	$ 185	100.0%
Subtotal Recurring Revenues	**$ -**	**$ 4,044**	**$ 4,044**	**100.0%**
Total Adjusting Sources	**$ 28,765**	**$ 33,076**	**$ 4,311**	**15.0%**

Source: FY2010 State Budget, Table II-B General Funds Revenues by Source, p. 2-33.
FY2006 State Budget, Table II-B General Funds Revenues by Source, p. 1-28.

Proposed State of Illinois Tax Changes

The FY2010 state budget proposes several revenue enhancements totaling over $3.8 billion, which are listed in the exhibit below. Of that amount, over $3.3 billion are general tax changes and $465.9 million are business tax changes. Several of the business tax changes were previously proposed by former Illinois Governor Blagojevich and rejected by the Illinois General Assembly.

State of Illinois Revenue Changes: FY2010 (in $ millions)	
General Tax Changes	**$ Amount**
Personal Income Tax Increase	$ 2,800.0
Corporate Income Tax Increase	$ 350.0
Cigarette and Tobacco Products Tax Increase	$ 175.0
Tax sweetened tea and coffee drinks at same sales tax rate as soft drinks	$ 12.0
Tax all grooming and hygiene products at same sales tax rate	$ 2.0
Bank Matching Acct Holders w/ Lists of Tax Delinquents To Assist the IDoR w/ Tax Collection	$ 10.0
Total General Tax Changes	**$ 3,349.0**
Business Sales Tax Changes	
Restricting Cost of Collection Discounts	$ 57.0
Collect Sales Tax on Canned Software	$ 50.0
Eliminate the Manufacturer's Purchase Credit	$ 20.0
Limiting Graphic Arts Exemption	$ 10.0
Subtotal Business Sales Tax Changes	**$ 137.0**
Business Income Tax Changes	
Decouple from New Fed Tax Law Allowing Delay Recognition of Gains from Reacquisition of Business Debt Security by a Borrower at less than face value in 2009 and 2010	$ 143.5
Decouple from Federal Qualified Production Activities	$ 64.0
Include Puerto Rico and Outer Continental Shelf in definition of U.S.	$ 57.0
Repeal Research and Development Credit	$ 27.0
Limiting the Amount of Credits a Corporation can Claim to 50% of Tax Liability	$ 25.0
Decouple from New Fed Tax Law Allowing 5 Year Carryback of Net-Op Loss by Small Business	$ 2.4
Subtotal Business Income Tax Changes	**$ 318.9**
Other Business Tax Changes	
Require entities purchasing insurance from out-of-state sellers to pay the state insurance tax	$ 10.0
Subtotal Other Business Tax Changes	**$ 10.0**
Total Business Tax Changes	**$ 465.9**
Total General & Business Tax Changes	**$ 3,814.9**

Source: Communication between the Civic Federation and the Illinois Department of Revenue, April 2009.

General Tax Changes

Governor Quinn proposes four general tax changes in the FY2010 budget that are projected to yield approximately $3.5 billion per year.

1) <u>Personal and Corporate Income Tax Increases: $3.15 billion</u>

The biggest revenue change in the FY2010 state budget will be a 50% increase in the personal and corporate income tax rates. These two tax increases are expected to generate $3.15 billion in gross receipts. Ten percent of that amount will be reserved for the state capital program and the remaining $2.8 billion will be set aside for operational spending in FY2010.[69]

[69] Illinois State Budget FY2010, pp. 5-16.

The personal income tax rate is proposed to increase from 3.0% to 4.5%. The personal exemption will be increased from $2,000 to $6,000, making the flat rate tax more progressive in nature. The state estimates that a family of four making a median income of $72,000 would pay only $240 more in income taxes.[70]

Illinois is one of seven states that have a flat individual income tax rate. The Illinois tax rate of 3.0% is the lowest rate imposed in these states. Thirty-five states impose graduated rates. The graduated tax rates vary widely, from a low of 0.36% for certain taxpayers in Iowa to a high of 9.5% in Vermont.[71] Nine states do not impose an individual income tax.

State and District of Columbia Income Tax Structures: Tax Year 2008			
Graduated Tax Rates		**Flat Tax Rates**	**No Income Tax**
Alabama	Montana	Illinois - 3.0%	Alaska
Arizona	Nebraska	Pennslyvania - 3.07%	Florida
Arkansas	New Jersey	Indiana - 3.4%	Nevada
California	New Mexico	Michigan - 4.35%	New Hampshire*
Connecticut	New York	Colorado - 4.63%	South Dakota
Delaware	North Carolina	Utah - 5.0%	Tennessee*
Georgia	North Dakota	Massachusetts - 5.3%	Texas
Hawaii	Ohio		Washington
Idaho	Oklahoma		Wyoming
Iowa	Oregon		
Kansas	Rhode Island		
Kentucky	South Carolina		
Louisiana	Vermont		
Maine	Virginia		
Maryland	West Virginia		
Minnesota	Wisconsin		
Mississippi	District of Columbia		
Missouri			

*Income Tax on Dividends and Interest Income Only

Source: Federation of Tax Administrators, "State Individual Income Taxes," at http://www.taxadmin.org/fta/rate/ind_inc.html, (last visited on April 13, 2009).

Corporate income taxes will increase from a rate of 4.8% to 7.2%. This increase is expected to generate $350 million in general fund receipts. It is important to note that corporations also pay the personal property replacement tax, which is a second income tax at a 2.5% rate. Therefore, the corporate tax increase will essentially increase the corporate tax rate to 9.7%.

The next exhibit shows corporate income tax rates in the 50 states and the District of Columbia. In contrast to personal income tax structures, more states impose flat rate corporate income taxes rather than graduated rates. In all, thirty states and the District of Columbia have authorized a flat rate corporate income tax. These flat rates range from 4.63% in Colorado to 9.99% in Pennsylvania. The Illinois corporate income tax rate is 4.8%. However, many corporations pay the composite business tax rate is 7.3%.

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[70] Illinois State Budget FY2010, pp. 5-16.
[71] Federation of Tax Administrators at www.taxadmin.org/fta/rate/ind_inc.html (last visited on April 13, 2009)

Fourteen states currently impose graduated corporate income taxes, ranging from a low of 1.0% for certain businesses in Alaska and Arkansas to a high of 12.0% for selected businesses in Iowa. Six states have no corporate income tax.[72]

State and District of Columbia Corporate Income Tax Structures				
Flat Tax Rate		Graduated Tax Rates		No Corporate Income Tax
State	Rate	State	Rate	
Pennsylvania	9.99%	Alaska	1.0% - 9.4%	Ohio**
District of Columbia	9.98%	Arkansas	1.0% - 6.5%	Nevada
Minnesota	9.80%	Hawaii	4.4% - 6.4%	South Dakota
Massachusetts	9.50%	Iowa	6.0% - 12.0%	Texas
Rhode Island	9%	Kansas	4.0% - 7.1%	Washington
California	8.84%	Kentucky	5.0% - 6.0%	Wyoming
Delaware	8.70%	Louisiana	4.0% - 8.0%	
Indiana	8.50%	Maine	3.5% - 8.93%	
New Hampshire	8.50%	Mississippi	3.0% - 5.0%	
West Virginia	8.50%	Nebraska	5.58% - 7.81%	
Wisconsin	7.90%	New Jersey	6.5% - 9.0%	
Idaho	7.60%	New Mexico	4.8% - 7.65	
Connecticut	7.50%	North Dakota	2.6% - 6.5%	
ILLINOIS*	**7.30%**	Vermont	6.0% - 8.5%	
New York	7.10%			
Maryland	7%			
Arizona	6.97%			
North Carolina	6.90%			
Montana -	6.75%			
Oregon	6.60%			
Alabama	6.50%			
Tennessee	6.50%			
Missouri	6.25%			
Georgia	6%			
Oklahoma	6%			
Virginia	6%			
Florida	5.50%			
South Carolina	5%			
Utah	5%			
Michigan	4.95%			
Colorado	4.63%			

*Includes a 2.5 % personal property replacement tax, S-Corps pay only 1.5% replacement tax

** Ohio is currently transitioning from a corporate income tax to a gross-receipts tax.

Source: State tax rates compiled by The Tax Federation: http://www.taxfoundation.org/taxdata/show/230.html

2) Cigarette and Tobacco Products Tax Increase: $175 million

The State proposes to increase the state tax on cigarettes from 98 cents per pack to $1.48 per pack in FY2010 and to $1.98 per pack in FY2011. This is expected to generate an additional

[72] Federation of Tax Administrators at www.taxadmin.org/fta/rate/corp_inc.html.

$175 million in FY2010, which will be used to pay down outstanding Medicaid obligations.[73] Regarding elasticity of demand, the state estimates that for every one percentage point increase in the retail price of cigarettes, the consumption of taxable cigarettes will decline by 0.85% and that for every one percentage point change in retail price, there will be a corresponding 0.92% decline in consumer demand.

The federal government raised its cigarette tax by 62 cents per pack on April 1, 2009 to pay for an expansion of the State Children's Health Insurance Program.[74] Therefore, by 2011, the cigarette tax in Cook County could be $5.67 per pack.

3) Tax sweetened tea and coffee drinks at same sales tax rate as soft drinks: $12 million

This proposal would require that sweetened tea and coffee drinks would be subject to the state sales tax rate of 6.25%, the same rate imposed on soft drinks. It would generate an additional $12 million per year.[75]

4) Tax all grooming and hygiene products at same sales tax rate: $2.0 million

All grooming and hygiene products would be subject to the full state sales tax rate of 6.25% under this proposal, generating $2.0 million per year.[76] Currently, certain shampoos and soaps and other hygiene products with medicinal properties are exempt from the state sales tax. A 1.0% sales tax is currently imposed on these products; proceeds are collected by the state and then distributed to municipalities.

5) Require Banks to Match Account Holders with Lists of Tax Delinquents to Assist the Department of Revenue with Tax Collection Efforts: $10 million

The State proposes to require banks to match accounts with tax delinquents who have been identified by the Illinois Department of Revenue. This would enable the Department to more readily pursue tax collection efforts from delinquent taxpayers. The state expects to generate an additional $10.0 million in revenue each year from this proposal.

Business Tax Changes

The FY2010 budget proposes eleven sales, income and other tax changes on business activities that could generate up to $478.0 million annually.

Business Sales Tax Changes

1) Restrict Cost of Collection Discounts: $57.0 million

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[73] See Illinois Department of Revenue Fiscal Note on SB0044, Mach 20, 2009. *See also* Joel Hood and Ashley Ruff. "As Cigarette Prices Rise, State Mulls Higher Tax," *Chicago Tribune*, April 1, 2009.
[74] Dean Olsen. *SJ-R.com*, "Higher Costs have Smokers Kicking Habit," April 2, 2009.
[75] Illinois State Budget FY2010, pp. 5-17.
[76] Illinois State Budget FY2010, pp. 5-17.

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.[77] 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.[78]

In the FY2010 budget the State of Illinois proposes to cap the cost of collection discount at 0.75%. The revenues received from this action are to be used to pay for a 10-day sales tax holiday in August 2009 on clothing and footwear with a selling price of $100 or less and school supplies.

2) <u>Collect Sales Tax on Prewritten Licensed Software: $50.0 million</u>

This proposal makes all prewritten licensed software purchased or used in Illinois subject to the state sales tax, including electronically downloaded and licensed software. Put another way, this proposal aims to eliminate the current exemption for prewritten licensed software. Custom software remains exempted from the tax, along with software used to run exempt machinery. The portion of prewritten software that requires customization is exempt if it is separately invoiced. Customized or modified licensed software will be taxed only on the prewritten portion of the transaction. Regarding prewritten software delivered electronically to a company's out of state offices, only the portion used in Illinois will be taxed.

The proposal would impose a sales tax on the transfer of prewritten computer software as well. "Transfer" is defined as the transfer of the right to use or possess prewritten computer software regardless of whether that right is combined with the title to or ownership of the software. It includes, but is not limited to, a transfer by sale, lease, license, or rental. In addition, tax payment would be required on the prewritten base on which modified software is built.

The proposal, which was previously rejected several times by the General Assembly, would yield an estimated $50.0 million annually.

3) <u>Eliminate Manufacturer's Purchase Credit: $20.0 million</u>

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.[79] The Governor's proposal would eliminate this credit and would generate an estimated $20.0 million per year. This proposal was rejected by the General Assembly last year.

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[77] Illinois Department of Revenue. *Publication 133: Retailer's Overview of Sales and Use Tax*, April 2005, p. 8
[78] Federation of Tax Administrators, "State Sales Tax Rates and Vendor Discounts – January 1, 2008," at www.taxadmin.org/fta/rate/sale_vdr.html.
[79] Illinois Department of Revenue at www.revenue.state.il.us/Businesses/TaxInformation/Sales/mpc.htm.

4) Limiting the Graphic Arts Sales Tax Exemption: $10.0 million

The current state graphic arts sales tax exemption will be limited to businesses primarily engaged in graphic arts production. Currently, the exemption is permitted for other industries using graphic arts machinery and equipment.

Business Income Tax Changes

5) Decouple from Certain 2009 and 2010 New Federal Tax Provisions: $143.5 million

This proposal would decouple from new federal tax provisions that will allow firms to delay recognition of gains from reacquisition of business debt security by a borrower at less than face value in 2009 and 2010.

The American Recovery and Reinvestment Act of 2009 allows businesses to defer cancellation of debt income when they cancel or repurchase debt for a sum less than the adjusted issue price after Dec. 31, 2008, and before Jan. 1, 2011, until calendar year 2014 and then report the income ratably over the 2014 through 2018 tax years. This proposal would require Illinois businesses to report this income in 2009 and 2010, effectively decoupling from the federal law.[80]

6) Decouple from Federal Qualified Production Activities Income Deduction: $64.0 million

The federal Qualified Production Activities Income (QPAI) deduction allows corporations to claim an income tax deduction based on profits accruing from "qualified production activities." Essentially, the QPAI deduction allows corporations to deduct an escalating percentage of the gross income they receive from the production of goods in the United States.[81] This production encompasses a wide range of activities, including manufacturing, "food processing, software development, filmmaking, electricity/natural gas production and construction."[82] Eighteen states and the District of Columbia have chosen to decouple from the federal deduction. If Illinois joined these jurisdictions, it is projected that the State would gain $64.0 million annually in recurring revenues.

7) Include Puerto Rico, Outer Continental Shelf in State's Definition of the U.S.: $57.0 million

The State proposes 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. An example of such situations cited in the State of Illinois FY2007 Budget (p. 5-17) is oil production from the Outer Continental Shelf being placed in a separate subsidiary, thereby

[80] See Illinois State Chamber of Commerce " Business Tax Increase Proposals" at http://www.ilchamber.org?Business_issue_councils/Tax_institute/2009TaxIncreaseProposals (last visited on April 29, 2009).

[81] Information provided to the Civic Federation by the Governor's Office of Management and Budget.

[82] Elizabeth McNichol and Nicholas Johnson. Center on Budget and Policy Priorities. *States are Decoupling from the Federal "Qualified Production Activities Income" Deduction*. September 14, 2005. See www.cbpp.org/9-14-05sfp.htm.

reducing Illinois tax liability. A similar proposal was also introduced in FY2005, FY2007 and FY2009.

8) 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.[83] 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.[84] Repealing the credit is expected to generate approximately $27.0 million.

9) Limiting the Amount of Credits a Corporation can Claim to 50% of Tax Liability: $25.0 million

The state of Illinois provides certain income tax credits to encourage investments in research and development and/or business expansion in underdeveloped areas. This proposal would limit income tax credits that could be claimed by corporations to no more than 50% of the income tax liability for these projects.[85]

10) Decouple from the new federal tax provision allowing a 5 year carry-back of net operating losses by small businesses: $2.4 million

The American Recovery and Reinvestment Act of 2009 extends the maximum net operating loss carry-back to five years for small businesses that have gross receipts of $15 million or less for 2008 only. The State proposes to decouple from this federal income tax provision.[86]

Other Business Tax Changes

11) Requiring entities purchasing insurance from out of state underwriters to pay the state insurance tax: $10.0 million

Currently, large entities can purchase insurance directly from an underwriter who is 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.

APPROPRIATIONS

The Governor's FY2010 operating budget recommends a total appropriation of $52.9 billion, an increase of $3.2 billion, or 6.4%, over the FY2009 originally proposed appropriation of $49.7

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[83] 35 ILCS 5/201 (k) - Illinois Income Tax Act.
[84] Information provided to the Civic Federation by the Governor's Office of Management and Budget.
[85] See Illinois State Chamber of Commerce, " Business Tax Increase Proposals," at http://www.ilchamber.org?Business_issue_councils/Tax_institute/2009TaxIncreaseProposals.
[86] See Illinois State Chamber of Commerce, " Business Tax Increase Proposals," at http://www.ilchamber.org?Business_issue_councils/Tax_institute/2009TaxIncreaseProposals.

billion. This total includes $28.4 billion in the General Funds, $15.6 billion in Other State Funds and $8.8 billion in Federal Funds.

Two-Year Appropriation Trend – All Funds

In FY2010 proposed General Funds appropriations will decrease by 1.8%, or approximately $518.7 million, from the previous year. Other State Funds appropriations will rise by 4.9%, or approximately $737.5 million.[87] Federal funds will increase by 49.8% or $2.9 billion.

The largest fund group in the budget is the General Funds, which represent 53.7% of total recommended appropriations. "Other State Funds" includes a wide range of funds, such as highway funds and other special purpose state funds.[88] The primary purpose of these funds is to receive either tax revenue distributions or specific revenues such as permit and license fees which are reserved for specific projects. These funds represent approximately 29.6% of the total State operating budget proposal for FY2010.

State of Illinois Appropriations by Fund: FY2009-FY2010
(in $ thousands)

	FY2009	FY2010	$ Change	% Change
General Funds	$ 28,909,285	$ 28,390,541	$ (518,744)	-1.8%
Other Funds	$ 14,908,166	$ 15,645,633	$ 737,467	4.9%
Federal Funds	$ 5,897,232	$ 8,836,464	$ 2,939,232	49.8%
Total	**$ 49,714,683**	**$ 52,872,638**	**$ 3,157,955**	**6.4%**

Source: Illinois State Budget FY2009, 2-27 to 2-36; Illinois State Budget FY2010, 2-30.

FY2010 Appropriations by Purpose – All Funds

The following exhibit shows how FY2010 appropriations are allocated across all funds. Healthcare, Human, and Family Service programs will require 46.7% of the $52.9 billion FY2010 operating budget. Spending for elementary, secondary and higher education is the second largest category, consuming 27.4% of all appropriations.

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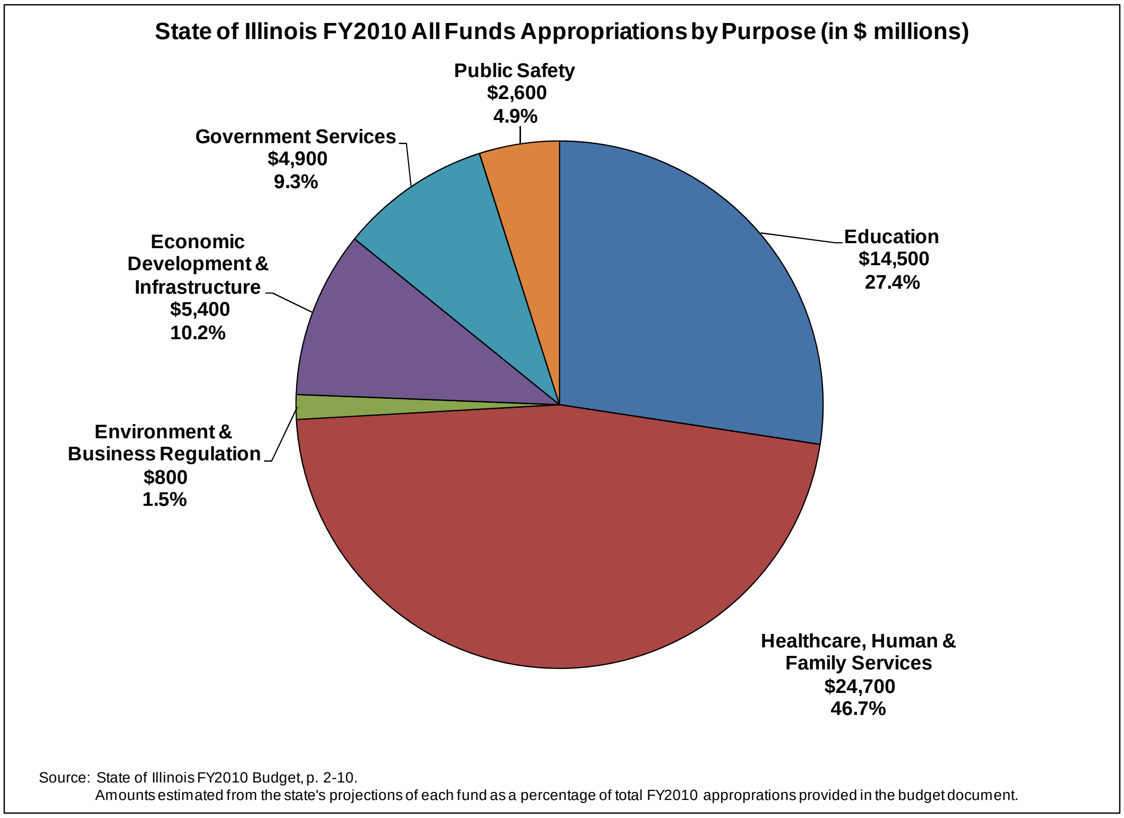
[87] Please note that the figures used in this analysis compare the proposed budgets put forth by the State of Illinois for FY2009 and FY2010.

[88] Other state funds include: special purpose or special revenue funds like the Motor Fuel Tax Fund, Illinois Wildlife Preservation Fund, Illinois Habit Fund or the Road Fund.



Appropriations for education, Healthcare, Human and Family Services, economic development and infrastructure, government services and public safety will increase for FY2009. Appropriations for economic development and infrastructure will nearly double in FY2010, rising from $3.7 billion to $5.4 billion. Environment and business regulation will remain flat at $800.0 million.

State of Illinois FY2010 Appropriations by Purpose - All Funds (in $ millions) FY2009-FY2010				
Purpose	**FY2009**	**FY2010**	**$ Change**	**% Change**
Education	$ 14,100	$ 14,500	$ 400	2.8%
Healthcare, Human & Family Services	$ 23,900	$ 24,700	$ 800	3.3%
Environment & Business Regulation	$ 800	$ 800	$ -	0.0%
Economic Development & Infrastructure	$ 3,700	$ 5,400	$ 1,700	45.9%
Government Services	$ 4,700	$ 4,900	$ 200	4.3%
Public Safety	$ 2,400	$ 2,600	$ 200	8.3%
Total	**$ 49,600**	**$ 52,900**	**$ 3,300**	**6.7%**

Source: State of Illinois FY2009 Budget, 2-30; FY2010 Budget, 2-10.

Amounts estimated from the state's projections of each fund as a percentage of total FY2009 and FY2010 appropriations provided in the FY2009 and FY2010 budget documents.

Two- and Five-Year Appropriations by Agency – All Funds

The next exhibit shows changes in proposed appropriations between FY2009 and FY2010 for major program areas in the state budget. Spending for agencies under the Governor,[89] the largest

[89] The Governor's agencies include over 55 departments that oversee agriculture, justice, utilities, health, economic development and finance issues across the state.

appropriation category, will increase by 9.8%, or $3.4 billion. Appropriations for elementary and secondary education, the next largest category, will increase by 3.9% or $427.2 million.

State of Illinois Recommended Appropriations: FY2009-FY2010 (in $ thousands)				
Type	**FY2009**	**FY2010**	**$ Change**	**% Change**
Legislative Agencies				
Legislative Agencies Total	**$ 109,110**	**$ 100,968**	**$ (8,142)**	**-7.5%**
General Funds	$ 89,497	$ 79,305	$ (10,192)	-11.4%
Other State Funds	$ 19,614	$ 21,663	$ 2,049	10.4%
Judicial Agencies				
Judicial Agencies Total	**$ 444,657**	**$ 449,095**	**$ 4,438**	**1.0%**
General Funds	$ 416,853	$ 409,210	$ (7,643)	-1.8%
Other State Funds	$ 25,504	$ 37,557	$ 12,053	47.3%
Federal Funds	$ 2,300	$ 2,329	$ 29	1.3%
Elected Officials And Elections				
Elected Officials And Elections Total	**$ 2,480,819**	**$ 2,425,195**	**$ (55,624)**	**-2.2%**
General Funds	$ 338,944	$ 319,321	$ (19,623)	-5.8%
Other State Funds	$ 2,131,375	$ 2,095,013	$ (36,362)	-1.7%
Federal Funds	$ 10,500	$ 10,861	$ 361	3.4%
Agencies Under the Governor				
Governor's Agencies Total	**$ 35,082,954**	**$ 38,515,659**	**$ 3,432,705**	**9.8%**
General Funds	$ 17,051,450	$ 16,836,041	$ (215,409)	-1.3%
Other State Funds	$ 14,790,149	$ 16,162,802	$ 1,372,653	9.3%
Federal Funds	$ 3,241,355	$ 5,516,815	$ 2,275,460	70.2%
Elementary and Secondary Education				
Elementary and Secondary Education	**$ 11,072,146**	**$ 11,499,332**	**$ 427,186**	**3.9%**
General Funds	$ 8,738,421	$ 8,530,113	$ (208,308)	-2.4%
Other State Funds	$ 44,732	$ 43,668	$ (1,064)	-2.4%
Federal Funds	$ 2,288,994	$ 2,925,551	$ 636,557	27.8%
Higher Education				
Higher Education Total	**$ 3,010,852**	**$ 3,001,717**	**$ (9,135)**	**-0.3%**
General Funds	$ 2,389,726	$ 2,372,551	$ (17,175)	-0.7%
Other State Funds	$ 266,022	$ 248,258	$ (17,764)	-6.7%
Federal Funds	$ 355,104	$ 380,908	$ 25,804	7.3%
Revolving Funds	**$ (2,780,128)**	**$ (2,963,328)**	**$ (183,200)**	**6.6%**
Governor's Operating Initiatives	**$ (54,195)**	**$ (76,000)**	**$ (21,805)**	**-**
Governor's *Illinois Covered* Initiative	**$ 417,506**	**$ -**	**$ (417,506)**	**-100.0%**
Agency Across The Board Cuts	**$ (69,038)**	**$ (80,000)**	**$ (10,962)**	**-**
Sub-Totals				
General Funds	**$ 28,909,285**	**$ 28,390,541**	**$ (518,744)**	**-1.8%**
Other State Funds	**$ 14,908,166**	**$ 15,645,633**	**$ 737,467**	**4.9%**
Federal Funds	**$ 5,897,232**	**$ 8,836,464**	**$ 2,939,232**	**49.8%**
Total	**$ 49,714,683**	**$ 52,872,638**	**$ 3,157,955**	**6.4%**

Source: Illinois State Budget FY2009, 2-27 to 2-36; Illinois State Budget FY2010, 2-21 to 2-30.

The next section presents an analysis of five-year appropriation trends between FY2006 and FY2010. In order to provide an accurate comparison, the figures presented are for the appropriations originally proposed in the budget per fiscal year.

Proposed operating budget appropriations are expected to increase by 21.4% between FY2006 and FY2010. This represents a $9.3 billion increase from $43.6 billion to $52.9 billion. General

Fund appropriations will rise by over $3.9 billion, or 15.8%, while Other Funds will increase by $2.3 billion, or 16.9%. Agencies under the control of the Governor, which will account for 72.8% of all operations spending in FY2010, will rise by 21.1%, from $31.8 billion to $38.5 billion. Appropriations for Elementary and Secondary Education are expected to increase by 29.8%, or $2.6 billion.

State of Illinois Recommended Appropriations: FY2006-FY2010 (in $ thousands)				
Type	**FY2006**	**FY2010**	**$ Change**	**% Change**
Legislative Agencies				
Legislative Agencies Total	**$ 87,971**	**$ 100,968**	**$ 12,997**	**14.8%**
General Funds	$ 72,136	$ 79,305	$ 7,169	9.9%
Other State Funds	$ 15,835	$ 21,663	$ 5,828	36.8%
Judicial Agencies				
Judicial Agencies Total	**$ 417,057**	**$ 449,095**	**$ 32,038**	**7.7%**
General Funds	$ 390,405	$ 409,210	$ 18,805	4.8%
Other State Funds	$ 23,202	$ 37,557	$ 14,355	61.9%
Federal Funds	$ 3,450	$ 2,329	$ (1,121)	-32.5%
Elected Officials And Elections				
Elected Officials And Elections Total	**$ 2,358,987**	**$ 2,425,195**	**$ 66,208**	**2.8%**
General Funds	$ 268,030	$ 319,321	$ 51,291	19.1%
Other State Funds	$ 2,079,064	$ 2,095,013	$ 15,949	0.8%
Federal Funds	$ 11,893	$ 10,861	$ (1,032)	-8.7%
Agencies Under The Governor				
Governor's Agencies Total	**$ 31,812,177**	**$ 38,515,659**	**$ 6,703,482**	**21.1%**
General Funds	$ 14,956,143	$ 16,836,041	$ 1,879,898	12.6%
Other State Funds	$ 13,640,864	$ 16,162,802	$ 2,521,938	18.5%
Federal Funds	$ 3,215,170	$ 5,516,815	$ 2,301,645	71.6%
Elementary and Secondary Education				
Elementary and Secondary Education	**$ 8,860,821**	**$ 11,499,332**	**$ 2,638,511**	**29.8%**
General Funds	$ 6,680,324	$ 8,530,113	$ 1,849,789	27.7%
Other State Funds	$ 26,373	$ 43,668	$ 17,295	65.6%
Federal Funds	$ 2,154,125	$ 2,925,551	$ 771,426	35.8%
Higher Education				
Higher Education Total	**$ 2,626,746**	**$ 3,001,717**	**$ 374,971**	**14.3%**
General Funds	$ 2,204,022	$ 2,372,551	$ 168,529	7.6%
Other State Funds	$ 154,865	$ 248,258	$ 93,393	60.3%
Federal Funds	$ 267,859	$ 380,908	$ 113,049	42.2%
Revolving Funds	**$ (2,494,323)**	**$ (2,963,328)**	**$ (469,005)**	**-**
Governor's Operating Initiatives	**$ (108,458)**	**$ (76,000)**	**$ 32,458**	**-29.9%**
Governor's *Illinois Covered* Initiative	**$ -**	**$ -**	**$ -**	**-**
Agency Across The Board Cuts	**$ -**	**$ (80,000)**	**$ (80,000)**	**-**
Sub-Totals				
General Funds	**$ 24,526,491**	**$ 28,390,541**	**$ 3,864,050**	**15.8%**
Other State Funds	**$ 13,381,989**	**$ 15,645,633**	**$ 2,263,644**	**16.9%**
Federal Funds	**$ 5,652,497**	**$ 8,836,464**	**$ 3,183,967**	**56.3%**
Total	**$ 43,560,977**	**$ 52,872,638**	**$ 9,311,661**	**21.4%**

Sources: Illinois State Budget FY2006, pp. 1-15 to 1-26; Illinois State Budget FY2010, pp. 2-21 to 2-30.

Appropriations for Top Ten Largest Agencies – All Funds

In FY2010, the agencies with top ten the largest budgets will consume 85.7% of the state's $52.9 billion budget. The Department of Healthcare and Family Services will receive $14.6 billion, or 27.6% of the budget, and will increase by $664.4 million, or 4.8% over FY2009's recommended appropriation. The State Board of Education will receive the second largest appropriation for a single agency, $10.6 billion, or 20.0% of the budget, and will increase by $864.1 million, or 8.9% over FY2009. The Department of Human Services, the state's third largest agency, will receive $6.1 billion, or 11.5% of the budget, and will increase by $207.7 million, or 3.5% over FY2009's appropriation.

State of Illinois Top Ten Largest Agencies FY2009 - FY2010 (in $ thousands)				
Agency	**FY2009**	**FY2010**	**$ Change**	**% Change**
Office of the State Treasurer	**$ 1,845,594**	**$ 1,792,347**	**$ (53,247)**	**-2.9%**
General Funds	$ 23,673	$ 19,208	$ (4,465)	-18.9%
Other State Funds	$ 1,821,922	$ 1,773,139	$ (48,783)	-2.7%
Federal Funds	$ -	$ -	$ -	0.0%
Department of Children and Familiy Services	**$ 1,342,097**	**$ 1,337,751**	**$ (4,346)**	**-0.3%**
General Funds	$ 901,934	$ 899,308	$ (2,626)	-0.3%
Other State Funds	$ 432,096	$ 430,376	$ (1,720)	-0.4%
Federal Funds	$ 8,068	$ 8,068	$ -	0.0%
Department of Commerce and Economic Opportunity	**$ 695,881**	**$ 2,456,990**	**$ 1,761,109**	**253.1%**
General Funds	$ 55,256	$ 55,217	$ (39)	-0.1%
Other State Funds	$ 177,920	$ 253,851	$ 75,931	42.7%
Federal Funds	$ 462,705	$ 2,147,922	$ 1,685,217	364.2%
Department of Corrections	**$ 1,414,523**	**$ 1,370,647**	**$ (43,876)**	**-3.1%**
General Funds	$ 1,309,624	$ 1,244,185	$ (65,439)	-5.0%
Other State Funds	$ 107,899	$ 126,462	$ 18,563	17.2%
Federal Funds	$ -	$ -	$ -	0.0%
Department of Human Services	**$ 5,874,551**	**$ 6,082,226**	**$ 207,675**	**3.5%**
General Funds	$ 4,362,421	$ 4,163,532	$ (198,889)	-4.6%
Other State Funds	$ 403,406	$ 557,923	$ 154,517	38.3%
Federal Funds	$ 1,108,724	$ 1,360,771	$ 252,047	22.7%
Department of Healthcare and Family Services	**$ 13,935,363**	**$ 14,599,802**	**$ 664,439**	**4.8%**
General Funds	$ 7,653,398	$ 7,734,168	$ 80,770	1.1%
Other State Funds	$ 5,755,002	$ 66,665,634	$ 60,910,632	1058.4%
Federal Funds	$ 526,963	$ 200,000	$ (326,963)	-62.0%
Department of Healthcare & Family Svs Group Ins	**$ 3,088,638**	**$ 3,254,320**	**$ 165,682**	**5.4%**
General Funds	$ 1,068,100	$ 1,059,918	$ (8,182)	-0.8%
Other State Funds	$ 2,020,538	$ 2,194,403	$ 173,865	8.6%
Federal Funds	$ -	$ -	$ -	0.0%
Department of Revenue	**$ 1,213,883**	**$ 1,524,356**	**$ 310,473**	**25.6%**
General Funds	$ 159,748	$ 153,766	$ (5,982)	-3.7%
Other State Funds	$ 1,054,036	$ 1,024,540	$ (29,496)	-2.8%
Federal Funds	$ 100	$ 346,050	$ 345,950	345950.0%
Department of Transporation	**$ 2,333,041**	**$ 2,317,627**	**$ (15,414)**	**-0.7%**
General Funds	$ 69,817	$ 31,460	$ (38,357)	-54.9%
Other State Funds	$ 2,259,552	$ 2,282,156	$ 22,604	1.0%
Federal Funds	$ 3,672	$ 4,010	$ 338	9.2%
State Board of Education	**$ 9,731,599**	**$ 10,595,745**	**$ 864,146**	**8.9%**
General Funds	$ 7,397,874	$ 7,626,527	$ 228,653	3.1%
Other State Funds	$ 44,732	$ 43,668	$ (1,064)	-2.4%
Federal Funds	$ 2,288,994	$ 2,925,551	$ 636,557	27.8%
Total	**$ 41,475,170**	**$ 45,331,811**	**$ 3,856,641**	**9.3%**

Source: Illinois State Budget FY2010, 2-21 to 2-30; Illinois State Budget FY2009, 2-27 to 2-36.

Appropriations for Selected Agencies under the Governor – All Funds

In the aggregate, the Governor's agencies will receive the largest increase in appropriations, 9.8%, or $3.4 billion over FY2009's recommended appropriations. The following exhibit summarizes appropriation two-year trends for selected agencies under the Governor. Of the selected agencies, the Department of Commerce and Economic Opportunity will increase the most over FY2009 recommended appropriations with an increase of $1.8 billion, or 253.1%.

The Department of Revenue will increase by $310.4 million, or 25.6%. Both increases can be attributed to substantial expected increases in federal funding for both agencies. The Department of Corrections will decrease the most with a 3.1%, or $43.9 million, decrease from its FY2009 recommended appropriation.

Selected State of Illinois Agencies Under the Governor FY2009 -FY2010 (in $ thousands)				
	FY2009	FY2010	$ Change	% Change
Department on Aging	**$ 675,153**	**$ 709,939**	**$ 34,786**	**5.2%**
General Funds	$ 574,486	$ 620,282	$ 45,796	8.0%
Other State Funds	$ 8,136	$ 9,436	$ 1,300	16.0%
Federal Funds	$ 74,532	$ 80,221	$ 5,689	0.0%
Department of Agriculture	**$ 109,832**	**$ 109,210**	**$ (622)**	**-0.6%**
General Funds	$ 39,955	$ 39,124	$ (831)	-2.1%
Other State Funds	$ 53,332	$ 55,588	$ 2,256	4.2%
Federal Funds	$ 16,546	$ 14,498	$ (2,048)	-12.4%
Department of Children and Familiy Services	**$ 1,342,097**	**$ 1,337,751**	**$ (4,346)**	**-0.3%**
General Funds	$ 901,934	$ 399,308	$ (502,626)	-55.7%
Other State Funds	$ 432,096	$ 430,376	$ (1,720)	-0.4%
Federal Funds	$ 8,068	$ 8,068	$ -	0.0%
Department of Central Management Services	**$ 943,896**	**$ 952,907**	**$ 9,011**	**1.0%**
General Funds	$ 84,038	$ 75,040	$ (8,998)	-10.7%
Other State Funds	$ 859,858	$ 877,867	$ 18,009	2.1%
Federal Funds	$ -	$ -	$ -	0.0%
Department of Commerce & Economic Opportunity	**$ 695,881**	**$ 2,456,990**	**$ 1,761,109**	**253.1%**
General Funds	$ 55,256	$ 55,217	$ (39)	-0.1%
Other State Funds	$ 177,920	$ 253,851	$ 75,931	42.7%
Federal Funds	$ 462,705	$ 2,147,922	$ 1,685,217	364.2%
Department of Natural Resources	**$ 223,315**	**$ 274,626**	**$ 51,311**	**23.0%**
General Funds	$ 40,179	$ 68,514	$ 28,335	70.5%
Other State Funds	$ 169,179	$ 188,666	$ 19,487	11.5%
Federal Funds	$ 13,958	$ 17,447	$ 3,489	25.0%
Department of Corrections	**$ 1,414,523**	**$ 1,370,647**	**$ (43,876)**	**-3.1%**
General Funds	$ 1,306,624	$ 1,244,185	$ (62,439)	-4.8%
Other State Funds	$ 107,899	$ 126,462	$ 18,563	17.2%
Federal Funds	$ -	$ -	$ -	0.0%
Department of Employment Security	**$ 281,202**	**$ 310,456**	**$ 29,254**	**10.4%**
General Funds	$ 14,243	$ 13,815	$ (428)	-3.0%
Other State Funds	$ 1,917	$ 1,917	$ -	0.0%
Federal Funds	$ 265,042	$ 294,724	$ 29,682	11.2%
Department of Human Services	**$ 5,874,551**	**$ 6,082,226**	**$ 207,675**	**3.5%**
General Funds	$ 4,362,421	$ 4,163,532	$ (198,889)	-4.6%
Other State Funds	$ 403,406	$ 557,923	$ 154,517	38.3%
Federal Funds	$ 1,108,724	$ 1,360,771	$ 252,047	22.7%
Departmentn of Healthcare and Family Services	**$ 13,935,363**	**$ 14,599,802**	**$ 664,439**	**4.8%**
General Funds	$ 7,653,398	$ 7,734,168	$ 80,770	1.1%
Other State Funds	$ 5,755,002	$ 6,665,634	$ 910,632	15.8%
Federal Funds	$ 526,963	$ 200,000	$ (326,963)	-62.0%
Department of Healthcare & Family Srvs Group Ins	**$ 3,088,638**	**$ 3,254,320**	**$ 165,682**	**5.4%**
General Funds	$ 1,068,100	$ 1,059,918	$ (8,182)	-0.8%
Other State Funds	$ 2,020,538	$ 2,194,403	$ 173,865	8.6%
Federal Funds	$ -	$ -	$ -	0.0%
Department of Public Health	**$ 446,939**	**$ 464,895**	**$ 17,956**	**4.0%**
General Funds	$ 161,355	$ 150,296	$ (11,059)	-6.9%
Other State Funds	$ 97,156	$ 102,816	$ 5,660	5.8%
Federal Funds	$ 188,428	$ 211,784	$ 23,356	12.4%
Department of Revenue	**$ 1,213,883**	**$ 1,524,356**	**$ 310,473**	**25.6%**
General Funds	$ 159,748	$ 153,766	$ (5,982)	-3.7%
Other State Funds	$ 1,054,036	$ 1,024,540	$ (29,496)	-2.8%
Federal Funds	$ 100	$ 346,050	$ 345,950	345950.0%
Department of State Police	**$ 435,759**	**$ 449,314**	**$ 13,555**	**3.1%**
General Funds	$ 221,583	$ 214,511	$ (7,072)	-3.2%
Other State Funds	$ 194,176	$ 194,803	$ 627	0.3%
Federal Funds	$ 20,000	$ 40,000	$ 20,000	100.0%
Department of Transporation	**$ 2,333,041**	**$ 2,317,627**	**$ (15,414)**	**-0.7%**
General Funds	$ 69,817	$ 31,460	$ (38,357)	-54.9%
Other State Funds	$ 2,259,552	$ 2,282,156	$ 22,604	1.0%
Federal Funds	$ 3,672	$ 4,010	$ 338	9.2%
Governor's Office of Mangement and Budget	**$ 322,878**	**$ 322,541**	**$ (337)**	**-0.1%**
General Funds	$ 2,955	$ 2,660	$ (295)	-10.0%
Other State Funds	$ 319,923	$ 319,881	$ (42)	0.0%
Federal Funds	$ -	$ -	$ -	0.0%
Illinois Environmental Protection Agency	**$ 285,097**	**$ 309,588**	**$ 24,491**	**8.6%**
General Funds	$ 1,445	$ -	$ (1,445)	-100.0%
Other State Funds	$ 220,393	$ 230,393	$ 10,000	4.5%
Federal Funds	$ 63,260	$ 79,195	$ 15,935	25.2%
Illinois Emergency Management Agency	**$ 417,797**	**$ 588,174**	**$ 170,377**	**40.8%**
General Funds	$ 5,320	$ 5,076	$ (244)	-4.6%
Other State Funds	$ 29,171	$ 28,457	$ (714)	-2.4%
Federal Funds	$ 383,306	$ 554,641	$ 171,335	44.7%
Total	**$ 34,039,845**	**$ 37,435,369**	**$ 3,395,524**	**10.0%**

Source: Illinois State Budget FY2009, 2-27 to 2-36; Illinois State Budget FY2010, 2-21 to 2-30.

Medicaid Appropriations

Medicaid is a program that purchases healthcare for beneficiaries who meet certain categorical descriptions (e.g. elderly, disabled or a child) and have relatively low incomes. It is jointly financed by the state and federal governments. About one-third of those covered by Medicaid are currently, or will soon be, covered by Medicare, including the recipients consuming the greatest share of the expenses. More than 1 in 6 Illinois citizens rely on Medicaid to cover all or a substantial part of their health care. Conventionally, Medicaid in the Illinois budget context is considered equivalent to the Medical Assistance Program in the Department of Healthcare and Family Services (HFS). As a technical matter, however, almost one fifth of Medicaid expenditures are in the budgets of other departments, primarily the Department of Human Services, and about 10% of the HFS Medical Assistance Program expenses are outside of the Medicaid program.

The Federal Medicaid match typically covers half of Medicaid expenses, so the net cost to Illinois of each $1 of appropriations is only 50 cents.[90] The American Recovery and Reinvestment Act of 2009 (ARRA) has temporarily raised the match to 60.48% from October 1, 2008, through December 31, 2010. To receive this additional $2.9 billion in federal funds, the ARRA requires the state to pay bills from health care providers within 30 days. Illinois law allows the state to defer payments for Medicaid claims to the next fiscal year, and the state has repeatedly carried over substantial Medicaid liabilities, making year-to-year analysis difficult.

Total Medicaid expenditures in Illinois ranked 7th among states in 2007, slightly below its population ranking of 5th. However, in recent years the growth in Medicaid spending in Illinois has outpaced that in other states. The State's Medicaid program appears, in aggregate, to be a little broader in the number of services and the percentage of citizens who receive some coverage, while being a little more restrictive on reimbursement to providers. Illinois ranked 5th among states in overall Medicaid enrollment in 2006 but 42nd in Medicaid payments per enrollee.[91]

Without careful analysis, it is easy to make superficial observations but hard to actually understand what is happening with Illinois' Medicaid budget. In Illinois, as elsewhere, many of the problems of Medicaid costs are simply reflections of problems in the overall American health care system. Nevertheless, there are clear areas of concern and the program is such a significant portion of the state's budget that it deserves considerably more oversight than it has received.

The FY2010 proposed appropriation for the Medical Assistance Program in the Department of Healthcare and Family Services (HFS) is $14.2 billion. This appropriation is 26.8% of the entire proposed operating budget for the state. Most of the appropriation comes from the General Fund, but there are also significant contributions from the Cook County Private Trust Fund, the Hospital Provider Fund, the Long Term Care Provider Fund, the Drug Rebate Fund and the

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[90] In fact, net State expenditures are lower than 50% in certain categories because of the use of "provider assessments" by which service providers such as hospitals and nursing homes contribute the State's share of expenditures for some portion of the expenses. Provider assessments reduce State expenditures by several billion dollars over what would otherwise be required to generate the current level of federal matching funds.

[91] The Kaiser Family Foundation, statehealthfacts.org. Data for federal fiscal years ending September 30. Please note that the latest expenditure data is for 2007, while the latest enrollment data is for 2006.

Tobacco Settlement Recovery Fund. Although the proposed FY2010 appropriation is 8.5% above the proposed FY2009 appropriation, it includes no major new initiatives. The increase primarily reflects the fact that the original FY2009 budget deliberately underestimated expenses and planned to cover the shortfall by lengthening payment cycles. However, with the opportunity created from additional ARRA funds and the ARRA requirement of reasonable payment cycles, supplemental appropriations were made to reduce the payment cycle. When these subsequent supplemental appropriations to the FY2009 budget are considered, the proposed FY2010 appropriation is virtually flat, which is what would be expected given that there were no major program changes or major changes in eligibility.

The impact of payment timing changes can be seen in the proposed appropriation for long term care, which shows an increase of 32.7% from the appropriation proposed last year. However, there have been supplemental appropriations since that time and the proposed FY2010 appropriation is now slightly below the full FY2009 appropriation. Thus, the 32.7% increase is a function of changes in the timing of payments to health care providers.

Illinois Department of Healthcare and Family Services Medical Programs Recommended Appropriations: FY2009-FY2010 (in $ thousands)				
Type of appropriation	**FY2009**	**FY2010**	**$ change**	**% change**
Hospitals*	$ 6,640,060	$ 7,090,488	$ 450,428	6.8%
Long Term Care	$ 1,677,497	$ 2,225,967	$ 548,470	32.7%
Physicians	$ 971,957	$ 953,483	$ (18,474)	-1.9%
Prescriptions	$ 1,928,438	$ 1,884,487	$ (43,951)	-2.3%
Other	$ 1,946,095	$ 2,125,299	$ 179,204	9.2%
Total	**$ 13,164,047**	**$ 14,279,724**	**$ 1,115,677**	**8.5%**

Sources: Illinois State Budget FY2009, pp. 7-19 to 7-22; Illinois State Budget FY2010, pp. 7-17 to 7-20.
*Hospital line includes substantial appropriations for Cook County and U of I Intergovernmental Transfers

It is equally difficult to reconcile the budget from FY2006 to FY2010. While the annual increase over the period is about 5%, understanding this amount is complicated by changes in eligibility, variations in the payment cycle and other programmatic changes.

Illinois Department of Healthcare and Family Services Medical Programs Recommended Appropriations: FY2006-FY2010 (in $ thousands)				
Type of Appropriation	**FY2006**	**FY2010**	**$ change**	**% change**
Hospitals*	$ 5,625,343	$ 7,090,488	$ 1,465,145	26.0%
Long Term Care	$ 1,785,593	$ 2,225,967	$ 440,374	24.7%
Physicians	$ 635,478	$ 865,814	$ 230,336	36.2%
Prescriptions	$ 2,328,764	$ 1,884,487	$ (444,277)	-19.1%
Other	$ 1,345,291	$ 2,125,299	$ 780,008	58.0%
Total	**$ 11,720,469**	**$ 14,192,055**	**$ 2,471,586**	**21.1%**

Sources: Illinois State Budget FY2006, pp. 5-17 to 5-20; Illinois State Budget FY2010, pp. 7-17 to 7-20.
*Hospital line includes substantial appropriations for Cook County and U of I Intergovernmental Transfers

PERSONNEL

This section provides detail on the number of state employees and their associated salary and benefit costs.

Number of Positions

The Governor's FY2010 budget recommends filling 55,701 full-time equivalent (FTE) positions. This is a 0.4% or 243 position increase from the number of positions originally authorized in FY2009. The majority of the new positions in FY2010 are designated for public safety needs, which will gain 154 new positions over last year's authorized amount. Economic Development and Infrastructure will also see an increase in personnel numbers, increasing by 136 positions. Government Services positions will decrease by 118 positions, while Healthcare and Family Services will decrease by 12 positions.

Since FY2006, the number of FTE positions will have decreased by 1.7% or 947 positions, from the 56,648 FTE actual positions in FY2006 to 55,701 authorized FTEs in FY2010.

State of Illinois Employee Count
FY2006 - FY2010

Purpose	FY2006 Actual	FY2007 Actual	FY2008 Actual	FY2009 Authorized	FY2010 Authorized	FY06-FY10 # Change	FY06-FY10 % Change
Human Services	19,940	20,951	20,952	20,654	20,732	792	4.0%
Public Safety	17,702	16,022	17,851	15,604	15,758	-1,944	-11.0%
Econ Dev/Infrastructure	8,461	8,166	8,589	8,133	8,269	-192	-2.3%
Government Services	4,078	4,036	4,417	4,318	4,200	122	3.0%
Environ/Business Reg	4,154	4,142	4,398	4,192	4,197	43	1.0%
Healthcare/Family Services	2,313	2,422	2,627	2,557	2,545	232	10.0%
Total	**56,648**	**55,739**	**58,834**	**55,458**	**55,701**	**-947**	**-1.7%**

Source:Illinois State Budget FY2010, 2-13, Illinois State Budget FY2009, 2-15 and Illinois State Budget FY2008, 2-16.

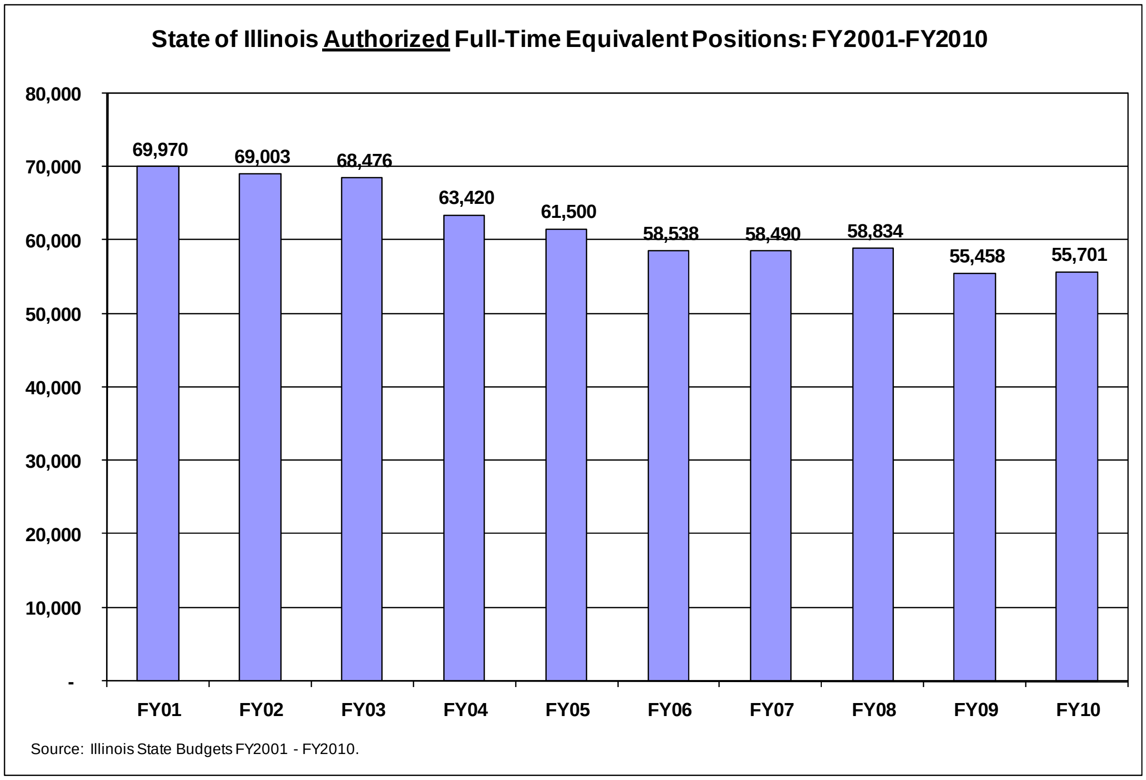
The state does not necessarily fill all of the positions that are authorized in a budget. In FY2009, the state estimated that only 54,810 of the 55,458 positions authorized were actually filled. Comparing the FY2009 estimate with the FY2010 personnel authorization shows that, if all the positions authorized for FY2010 were filled, the number of FTEs would increase by 1.6% or 891 positions.

State of Illinois Employee Count:
FY2009 Estimated and FY2010 Authorized

Purpose	FY2009 Estimated	FY2010 Authorized	# change	% change
Human Services	20,343	20,732	389	1.9%
Public Safety	15,500	15,758	258	1.7%
Econ Dev/Infrastructure	8,176	8,269	93	1.1%
Government Services	4,156	4,200	44	1.1%
Environ/Business Reg	4,114	4,197	83	2.0%
Healthcare/Family Services	2,521	2,545	24	1.0%
Total	**54,810**	**55,701**	**891**	**1.6%**

Source: Illinois State Budget FY2010, 2-13.

The next exhibit shows changes in the number of authorized full-time equivalent positions in the ten-year period between FY2001 and FY2010. During that period, the number of authorized FTEs has fallen by 20.4% or 14,269 FTE positions.



Salary and Benefit Expenses

In FY2010 the state estimates the cost of payroll, healthcare expenses and pensions will total nearly $5.7 billion. The state estimates that payroll will slightly increase by 2.2%, rising from $3.8 billion in FY2009 to $3.9 billion in FY2010. Healthcare costs for state employees and their dependents will total $1.1 billion in FY2010, rising slightly over FY2009 costs by 0.1%.[92] The state will make $670.8 million in pension expenditures for state employees, declining by 21.9% over FY2009 state pension contribution of $858.9 million.[93] These personnel costs represent 10.8% of the overall state budget.

State of Illinois General Fund Personnel Costs: Salary and Benefits FY2009 & FY2010 (in $ millions)

Expense	FY2009	FY2010	$ Change	% Change
Payroll Expenditures	$ 3,822.1	$ 3,906.9	$ 84.8	2.2%
Health Care Expenditures	$ 1,120.5	$ 1,121.9	$ 1.4	0.1%
Pension Expenditures	$ 858.9	$ 670.8	$ (188.1)	-21.9%
Total	**$ 5,801.5**	**$ 5,699.6**	**$ (101.9)**	**-1.8%**

Source: Communication between the Civic Federation and the Governor's Office of Management and Budget, April 27, 2009.

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[92] Communication between the Civic Federation and John Frigo, Associate Director of the Governor's Office of Management and Budget, March 24, 2009; Communication between Colm Brewer, Budget Chief for the Office of Healthcare Purchasing in the Department of Healthcare and Family Services, March 27, 2009.

[93] Communication between the Civic Federation and the Governor's Office of Management and Budget, April 29, 2009.

Increased Employee and Retiree Contributions for Health Insurance

The Governor's FY2010 budget proposal includes a $200 million increase in employee and retiree contributions to their health insurance premiums. This increase is expected to require negotiated changes to collective bargaining agreements with employees, as well as a change to the State Employee Group Insurance Act (5 ILCS 375/10).[94]

The State of Illinois Group Insurance Program serves employees, retirees, and dependents of the State government, State universities, the General Assembly, and the judiciary. Participants can choose from three major health care plan types: an indemnity plan (Quality Care Health Plan), a modified preferred provider plan (Open Access Plan), and a health maintenance organization (various HMOs). The Quality Care Health Plan (QCHP) is a self-insured indemnity plan, also commonly called a "traditional plan" or a "fee-for-service plan." Indemnity plans were the standard health insurance program before the rise of managed care plans (e.g., HMOs and PPOs) in the 1980s. A major service feature distinguishing indemnity plans from managed care plans (e.g., HMOs and PPOs) is the degree of freedom that enrollees have in choosing medical service providers. Participants are permitted to choose any physician or hospital, although QCHP provides discounted rates for use of physicians that are members of a network, a feature modeled on PPO plans. Indemnity plans also typically have higher participant out-of-pocket costs than managed care plans.

The Open Access Plan (OAP) is a modified Preferred Provider Organization (PPO), which is a plan that uses significant monetary incentives to encourage the use of network providers. The OAP has different tiers offering different levels of freedom of choice and participant cost-sharing.

Health Maintenance Organizations (HMO) are typically the most restrictive, but the lowest cost health insurance programs. HMO plan coverage is restricted to network providers only and referrals for specialized services or hospitalization must be directed by the patient's primary care physician. Participant plan costs are low, with no deductibles and limited co-payments.

The State Employees' Group Health Insurance Program had an estimated 346,451 participants in FY2009, of which 35.7% were in the QCHP indemnity plan and 64.3% were in managed care plans (OAP or HMO).[95] In FY2009 the average cost per participant was $6,108 for the QCHP plan, compared to $4,517 for the HMO plans and $4,415 for the OAP plans.[96]

The Governor's proposal would increase premiums for employees who choose to participate in the QCHP indemnity plan. According to the Commission on Government Forecasting and Accountability, QCHP participants paid an average monthly premium of $79.15, or 12.0% of the total premium in FY2009. This would rise 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

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[94] Commission on Government Forecasting and Accountability, "Liabilities of the State Employees' Group Health Insurance Program: Fiscal Year 2010," March 2009, p. 5.

[95] Commission on Government Forecasting and Accountability, "Liabilities of the State Employees' Group Health Insurance Program: Fiscal Year 2010," March 2009, p. 5.

[96] Commission on Government Forecasting and Accountability, "Liabilities of the State Employees' Group Health Insurance Program: Fiscal Year 2010," March 2009, p. 11.

retirees in QCHP would rise from $12.98 currently to $582.71, which would be 62.7% of the total premium in FY2010.[97]

Salaries and Stipends Paid to Members of State Boards and Commissions

The Governor and some local government officials appoint members to 273 commissions to oversee and advise state elected officials, agencies, and organizations.[98] Thirty-two of these boards and commissions pay their members a salary, stipend, or per diem for their service and twenty-four of those salaries are paid for by the state.[99] In FY2009, the state spent at least $6.6 million on annual salaries and stipends for 103 members of appointed boards and commissions and the state paid 86 members of various boards or commissions a per diem for their service.[100] For more information about individual boards and commissioners please visit www.appointments.illinois.gov.

The following chart summarizes compensation data for members of state boards and commissions who receive an annual salary or stipend paid for by the state.

Compensation for Appointed Members of State Boards and Commissions FY2009 (for members that receive an annual salary or stipend from the state)

Board or Commission	FY2009 Annual Salary for Each Member	Total Salaried or Stipended Members	Total Annual Salaries Payable*
Civil Service Commission	$30,404 for chairman, $25,320 for members	5	$ 131,684
Illinois Commerce Commission	$134,022 per year for chairman, $117,043 for commissioners	5	$ 602,194
Illinois Courts Commission	$62,535 for Chief Justice, $57,724 for judges	7	$ 408,879
Educational Labor Relations Board	$100,538 for chairman, $90,487 for members	5	$ 462,486
State Board of Elections	$56,302 for chair, $46,247 for vice chair, $36,196 for members, plus expenses	8	$ 319,725
Employment Security Board of Review	$15,000	5	$ 75,000
Executive Ethics Commission	$36,196	9	$ 325,764
Human Rights Commission	$50,269 for chairman, $45,241 for members	13	$ 593,161
Illinois Liquor Control Commission	$37,492 for chairman, $32,806 for members	7	$ 234,328
Miners' Examining Board	$12,434 plus expenses	4	$ 49,736
Pollution Control Board	$121,040 for chairman, $117,043 for members	5	$ 589,212
Prisoner Review Board	$95,872 for chairman, $85,886 for members	15	$ 1,298,276
Property Tax Appeals Board	$62,334 for chairman, $50,269 for members	5	$ 263,410
Workers' Compensation Commission	$125,232 plus expenses for chairman, $119,840 plus expenses for members	10	$ 1,203,792
Total		**103**	**$ 6,557,647**

Source: State of Illinois Appointments Website at www.appointments.illinois.gov (last visited on April 17, 2009)

*These figures do not include reimbusements for expenses.

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[97] Commission on Government Forecasting and Accountability, "Liabilities of the State Employees' Group Health Insurance Program: Fiscal Year 2010," March 2009, p. 14.
[98] State of Illinois Appointments Website, www.appointments.illinois.gov, (last viewed April 20, 2009).
[99] *Ibid.*
[100] *Ibid.*

The next exhibit summarizes the total members of state boards and commissions compensated at a per diem rate paid for by the state.

Compensation for Appointed Members of State Boards and Commissions (for members that receive an annual salary or stipend)		
Board or Commission	**Per Diem Rates for Service**	**# of Members Compensated at Per Diem Rates**
Carnival Amusement Safety Board	$36 per diem plus expenses	7
Deaf And Hard of Hearing Commission	$50 per diem for lost wages, travel expenses	11
State Board of Education,	$50 per diem for lost wages, expenses	9
Illinois Gaming Board	$300 per diem, plus expenses	5
State Board of Health	$150 per diem, plus expenses	17
Judicial Inquiry Board	$200 per diem, plus expenses (Judges only receive expenses)	7
Lottery Control Board	$100 per diem to maximum of $1,200 per year, plus expenses	5
Low-Level Radioactive Waste Task Group	$300 per diem plus expenses	9
Illinois Racing Board	$300 per diem with maximum of $10,640, plus expenses	11
Illinois State Police Merit Board	$228 per diem, plus expenses (maximum of 100 days pay)	5
Total Members Compensated at a Per Diem Rate		**86**

Source: State of Illinois Appointments Website at www.appointments.illinois.gov (last visited on April 17, 2009).

STATE OF ILLINOIS RETIREMENT SYSTEMS

This section of the analysis describes the funding and reform proposals for the state's five retirement systems. The first section provides membership and funding information for the plans in FY2010, along with a discussion regarding the Governor's proposed pension benefit reforms. The next section depicts the pension reform and funding proposals since 2003.

The Governor's FY2010 Pension Funding Proposal

The State of Illinois funds five retirement systems: the General Assembly Retirement System (GARS), the Judges' Retirement System (JRS), the State Employees Retirement System (SERS), the State Universities Retirement System (SURS), and the Teachers' Retirement Employment Retirement System (TRS). Currently there a total of 708,990 individuals are currently enrolled in these five systems.

Members of Illinois Retirement Systems: Current Enrollment			
Pension Fund	**Members as of 06.30.08**	**Annuitants**	**Total**
Teachers	265,735	91,497	357,232
University	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.

In FY2010 the state will fund the normal cost of their five pension plans for a total pension payment of $1,517.0 million.[101] Normal cost represents the amount needed to cover the present value of the benefits earned by system members in each fiscal year. The state will also pay $543.6 million in required debt service payments on pension obligation bonds issued in 2003.[102] As a result, **the total FY2010 payment for pensions will be $2,060.6 million**.

In order to fulfill the statutory requirement that the state's pension systems attain a 90.0% funded ratio by June 30, 2045, **the required contribution to the systems for FY2010 should be $4,046.7 million.**[103] Including the $543.6 million in debt service, the pension payments that the state should make in FY2010 total **$4,514.5 million, or roughly 8.5% of the state's proposed operating budget.**[104]

The Governor is also proposing to reduce the state's FY2009 pension payment by $550 million. Combined with the $2,453.9 million reduction in the state's FY2010 proposed pension payment, the state will be decreasing its required contribution to the five pension funds by over **$3.0 billion** over the two-year period. Under current pension laws the state's FY2011 required pension contribution is estimated at $5.4 billion, and rises to $5.6 billion in FY2012 in order to reach a target of 90% funded in the year 2045.[105]

As of March 18, 2009 the five state pension funds had accrued an actuarial loss of approximately $20.0 billion for the first part of FY2009.[106] This is combined with an actuarial loss of $9.0 billion in FY2008.[107]

According to the most recent audited financial statements, the five state pension funds had a combined funded ratio of 54.3% and unfunded liabilities of $54.4 billion on June 30, 2008.[108]

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[101] Illinois State Budget FY2010, p. 4-3.
[102] Commission on Government Forecasting and Accountability, "Pensions – A Report on the Financial Condition of the State of Illinois Retirement Systems as of June 30, 2008", (February 2009), p. 82.
[103] Commission on Government Forecasting and Accountability, "Pensions – A Report on the Financial Condition of the State of Illinois Retirement Systems as of June 30, 2008", (February 2009), p. 69.
[104] The $4,514.5 million total is reached by adding the debt service and required pension contributions to the systems, minus $75.8 million in debt service for SERS that is already included in the required contribution figure. Information provided by the Commission on Government Forecasting and Accountability, April 28, 2009.
[105] Commission on Government Forecasting and Accountability, "Pension Briefing" April 2009, p. 11.
[106] Illinois State Budget FY2010, p. 2-2.
[107] Illinois State Budget FY2010, p. 2-2.

An unaudited estimate of the funds' financial condition **as of December 31, 2008 shows a combined funded ratio of 40.0% and unfunded liabilities of $73.4 billion**.[109]

The Governor's FY2010 Pension Reform Proposal

The FY2010 budget proposes several changes to the current pension structure for *new* state hires, maintaining the current pension structure for existing state employees. These changes include adjustments to the retirement age, benefit formula, cost of living payment increases and employee contributions. The following chart depicts current plan benefits as compared to the Governor's proposed changes for new hires.

State of Illinois FY2010 Budget: Comparison of Current Pension Benefits and Proposed Pension Benefit Reforms

	Current Plan for Current Employees and New Hires	Proposed Changes for New Hires
Basic Benefit Formula	2.2% if not covered by Social Security 1.67% if covered by Social Security Alternate formula for special risk employees	2.0% if not covered by Social Security 1.5% if covered by Social Security No alternate formula
Final Average Salary	Total salary & averaged over 4 highest consecutive years during final 10 years	Base salary & averaged over 8 highest consecutive years during final 10 years Social Security Covered Wage Base indexed going forward
Credited Service	No service limit and may purchase/convert credited service	Service limited to 35 years and may not purchase credited service or convert sick/vacation time
Maximum Benefit	75% for SERS and TRS 80% for SURS	70% if not covered by Social Security 52.5% if covered by Social Security
Retirement Age - Unreduced Benefits	SERS: age 60 & 8 years; 35 years; Rule of 85 SURS: age 60 &8; age 62 &5; 30 years TRS: age 60 &10; age 62 & 5; 35 years	Later of 1) Social Security Retirement age, and 2) 10 years
Retirement Age - Reduced Benefits	SERS: age 55 & 25 years SURS: age 55 & 8 years TRS: age 55 & 20 years Reduction = 6% per early year	62 years & 10 years Reduction = 6% per early year
Form of Benefit	50% joint and survivor + optional forms w/ reduction	Life annuity + optional forms w/ reduction
COLA	3% & Compound Interest	Lesser of 3% or 50% of CPI & Simple Interest
Employee Contributions - Current Employees	SERS covered by SS: 4% SERS not covered by SS and SURS: 8% TRS: 9%	SERS covered by SS: 6% SERS not covered by SS and SURS: 10% TRS: 11%
Employee Contributions - New Hires	SERS covered by SS: 4% SERS not covered by SS and SURS: 8% TRS: 9%	SERS covered by SS: 3% SERS not covered by SS and SURS: 7% TRS: 8%
Death Benefits	SERS & TRS: 30% to 80% of average pay SURS: 50% of accrued benefit	Survivor portion of 50% joint and survivor benefit payable to spouse
Disability Benefits	SERS: 50% of FAP non-occupational; 75% occupational SURS: 50% of FAP TRS: 35% of FAP non-occupational; 60% occupational	Unreduced accrued benefit to begin following receipt of all sick leave, STD and LTD benefits

Source: Governor's Office of Management and Budget, State of Illinois.

[108] Commission on Government Forecasting and Accountability, "Financial Condition of the State of Illinois Retirement Systems as of June 30, 2008" (February 2009), p. 83.
[109] Commission on Government Forecasting and Accountability, "Monthly Briefing" (February 2009), p. 8.

The Governor is proposing to increase the age at which new hires would be eligible for retirement benefits to mirror the age requirement for receiving federal Social Security benefits, 67 years of age for those born after 1960. Furthermore, new hires would not be eligible for early reduced benefits prior to obtaining 62 years of age.

Changes are also being proposed to the formulas used to calculate retirement benefits. For example, retirees covered by Social Security would earn 1.5% of final pay per service year, whereas retirees not covered by Social Security would earn 2.0%. The definition of "final pay" for new hires will be calculated by using the average base pay over the final eight years of service, and going forward will base salary calculations on indexed Social Security Covered Wage Base. Additionally, years eligible for credited service will be limited to 35.

The cost of living adjustment calculation would also be modified for new hires under Governor Quinn's plan. The new COLA calculation would be based on either 50% of the change in the consumer price index (CPI) or 3%, whichever is lower, and would accrue as simple rather than compounded interest.

The aforementioned changes are all designed to bring uniformity to pension plans for new hires. Existing pension plans would not experience these changes. In light of this fact, Governor Quinn is proposing to increase the employee contributions for *current* employees by 2 percentage points, while reducing the employee contribution rate for new hires by 1 percentage point. The intent behind this change is to place more of the burden for funding the current, and more generous, pension plans on the employees who will be receiving the benefits. However, it should be noted that Governor Quinn has recently made statements indicating he is no longer considering increasing employee pension contributions.[110]

Overall, it is estimated that the changes in the new hires' plans would reduce pension liabilities by $162 billion over the next 35 years.[111] The state will release its revised pension funding schedule via upcoming draft legislation.[112]

Changes in State Pension Funding: 2003 to 2008

Since 2003, several changes have been made regarding how the State's retirement systems are funded.

Issuance of $10.0 Billion in Pension Obligation Bonds in 2003

In his first year in office, Governor Blagojevich championed Public Act 93-0002, which authorized the issuance of $10.0 billion in pension obligation bonds. The proceeds of these bonds were to be used to boost the pension funds' assets and reduce unfunded liabilities.

Initially, the funds' managers and the Governor's financial team estimated that the pension funds would earn investment income at the traditional long-term actuarial rate of 8.5% and that the

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[110] Doug Finke. "Quinn abandons proposed pension cost hike." The State Journal-Register (May 7, 2009).
[111] Illinois State Budget FY2010, p. 4-3.
[112] Communication between the Civic Federation and the Governor's Office of Management and Budget, April 27, 2009.

pension bond proceeds would earn at least that rate over the 30-year life of the bonds. The financial team forecasted that economic savings would result from issuing the $10.0 billion in bonds at the then-current market interest rate of approximately 5.8%, as long as the funds earned a long-term actuarial rate of 8.0%.

In fact, the bonds were ultimately issued at an interest rate of 5.05% while the pension funds' actuaries ultimately projected an 8.5% expected rate of return for the entire asset portfolio. The State estimated that it would realize $860.0 million in additional "savings" from these favorable rates. In its FY2005 budget, the State proposed to capture $215.0 million, or 25.0% of the increase, reserving the remainder for capture in future years. The $215.0 million "savings" was used as the basis for reducing the State's pension contribution by a similar amount in FY2005.

Governor's FY2006 Pension Funding Reform Proposals and Partial Pension Holiday

Governor Blagojevich proposed a number of pension funding reform proposals in the FY2006 State of Illinois Budget. These proposals were all originally recommended by the Governor's Blue Ribbon Pension Commission, which was composed of representatives from the General Assembly, business, labor, and civic groups. The Governor accepted all but two of the Commission's recommendations:

- Requiring employees to increase the percentage of salary they pay into the retirement systems by 1 percentage point; and
- Considering shifting to a defined contribution (DC) plan at some point in the future.

The General Assembly approved a few of the Governor's proposed reforms with some modifications. The most significant proposals enacted into law were capping end-of-career salary increases, eliminating the State Universities Retirement Systems money purchase option for new hires, limiting eligibility for alternative formulas, and requiring funding for enhanced benefits. The legislators rejected proposals to:

- Change the eligibility for full benefits to age 65, with between 8 and 30 years of service; age 62 with 30 to 35 years of service; or age 60 with 35 years or more of service; and
- Limit automatic benefit increases for new hires to the lesser of the change in the rate of inflation or 3% and apply increases only to the first $12,000 in annual pension for retirees covered by Social Security and $24,000 for retirees not covered by Social Security.

New proposals approved by the legislature and signed into law by the Governor enacted a two-year deferral of $2.3 billion in pension contributions, created a second Blue Ribbon Task Force to further study pension reform, created a cost neutral early retirement program, and eliminated lump sum awards for earned and untaken sick pay.

The exhibit below presents a comparison of the Governor's FY2006 original pension funding proposals, as well as new proposals that were advanced during the legislative session and the final action taken by the General Assembly.

Pension Funding Reforms Original v. New Proposals for FY2006	
Governor's Original Proposals	**Final Budget Approved by GA**
Cap end-of-career salary increases to 3%	6% annual cap adopted
Eliminate SURS money purchase option for new hires	Approved
Recalculate money purchase interest rate to reflect long-term rate of return, not 9%	Authorized comptroller to set rate
No new benefits without funding	Approved
Limit automatic increases to CPI	Approved
Change retirement age for new hires	Not approved
New Proposals	**Final Budget Approved by GA**
Defer pension contributions by $2.3 billion over two years	Approved
Create task force to study pension reform	Approved
Create cost neutral early retirement program paid for by local employers/beneficiaries	Approved
Eliminate lump sum awards for unearned sick pay to boost pensions	Approved

In addition to the pension funding reforms, the General Assembly approved legislation (P.A. 94-0004) in FY2006 which authorized reductions in State contributions to its five retirement systems from the originally certified amounts in both FY2006 and FY2007 (for a total reduction of $2.3 billion). In accordance with P.A. 94-0004, the State contributed nearly $1.4 billion to its retirement funds in FY2007—that figure was $1.1 billion less than the certified contribution amount. The exhibit below shows the difference between the certified amount for each State pension fund and the amount that was appropriated in FY2006 and FY2007.

FY2006 & FY2007 Certified Contributions v. Final General Assembly Appropriations (in $ millions)

	FY2006			FY2007				
System	Certified Contributions	P.A. 94-0004	Difference	Certified Contributions	P.A. 94-0004	Difference	Total 2-Year Contributions	Total Reduction
TRS	$ 1,058.5	$ 531.8	$ 526.7	$ 1,233.1	$ 735.5	$ 497.6	$ 2,291.6	$ 1,024.3
SERS	$ 690.3	$ 203.8	$ 486.5	$ 832.0	$ 344.2	$ 487.8	$ 1,522.3	$ 974.3
SURS	$ 324.9	$ 166.6	$ 158.3	$ 391.9	$ 252.1	$ 139.8	$ 716.8	$ 298.1
JRS	$ 38.0	$ 29.2	$ 8.8	$ 44.5	$ 35.2	$ 9.3	$ 82.5	$ 18.1
GARS	$ 5.5	$ 4.2	$ 1.3	$ 6.3	$ 5.2	$ 1.1	$ 11.8	$ 2.4
Total	**$ 2,117.2**	**$ 935.6**	**$ 1,181.6**	**$ 2,507.8**	**$ 1,372.2**	**$ 1,135.6**	**$ 4,625.0**	**$ 2,317.2**

Source: Commission on Government Forecasting and Accountability. Report on the 90% Funding Target of Public Act 88-0593.

The Commission on Governmental Forecasting and Accountability estimated that the final pension program approved for FY2006 would cost the State an additional $4.7 billion and reduce actuarial liabilities by $38.6 billion over 40 years. The retirement systems' actuaries estimated that $6.8 billion more would be incurred in costs and the liabilities would be reduced by $44.6 billion.

Estimated Impact of P.A. 94-0004
Total Projected State Contributions for FY2006-FY2045
Prepared by CFGA (in $ millions)

State Contributions	TRS	SERS	SURS	JRS	GARS	TOTAL
Pre P.A. 94-0004	$ 160,302	$ 68,065	$ 61,184	$ 6,538	$ 862	$ 296,951
P.A. 94-0004	$ 155,507	$ 78,068	$ 60,531	$ 6,654	$ 877	$ 301,637
Difference	$ (4,795)	$ 10,003	$ (653)	$ 116	$ 15	$ 4,686
FY2045 Liability Reduction	**$ 26,265**	**$ 667**	**$ 11,690**	**$ -**	**$ -**	**$ 38,622**

Source: Commission on Government Forecasting and Accountability, August 2005.

Estimated Impact of P.A. 94-0004 Total Projected State Contributions for FY2006-FY2045 Prepared by Retirement Systems (in $ millions)						
State Contributions	TRS	SERS	SURS	JRS	GARS	TOTAL
Pre P.A. 94-0004	$ 156,715	$ 65,340	$ 60,688	$ 6,538	$ 862	$ 290,143
P.A. 94-0004	$ 152,550	$ 75,928	$ 60,914	$ 6,654	$ 877	$ 296,923
Difference	$ (4,165)	$ 10,588	$ 226	$ 116	$ 15	$ 6,780
FY2045 Liability Reduction	**$ 34,322**	**$ 675**	**$ 9,655**	**$ -**	**$ -**	**$ 44,652**

Source: Commission on Government Forecasting and Accountability, August 2005.

Governor Blagojevich's FY2008 Pension Funding Proposal

The Governor's FY2008 budget proposed providing the State's five pension plans with $25.9 billion in new assets. This infusion would have provided for an 83.0% funded ratio in FY2008, 34 years ahead of the current 50-year funding schedule, had this proposal been adopted.[113] Under the Governor's proposal, the increase in the funded ratio would have been achieved through two financing mechanisms:

1. *The long-term lease of the Illinois Lottery:* The State proposed entering into a long-term concession of the Illinois Lottery. The State expected that the lease of the Illinois Lottery would generate $10.0 billion in cash; and

2. *The issuance of $15.9 billion in pension obligation bonds:* All proceeds from the bond issue would be paid into the State retirement systems. The structure of the pension obligation bond issue would have resembled the previous POB transaction in 2003. Debt service payments would have been supported by deductions from the unfunded liability payments that would have been necessary if the bonds were not issued.

The General Assembly rejected the Governor's FY2008 pension funding proposal.

Governor Blagojevich's FY2009 Pension Funding Proposal

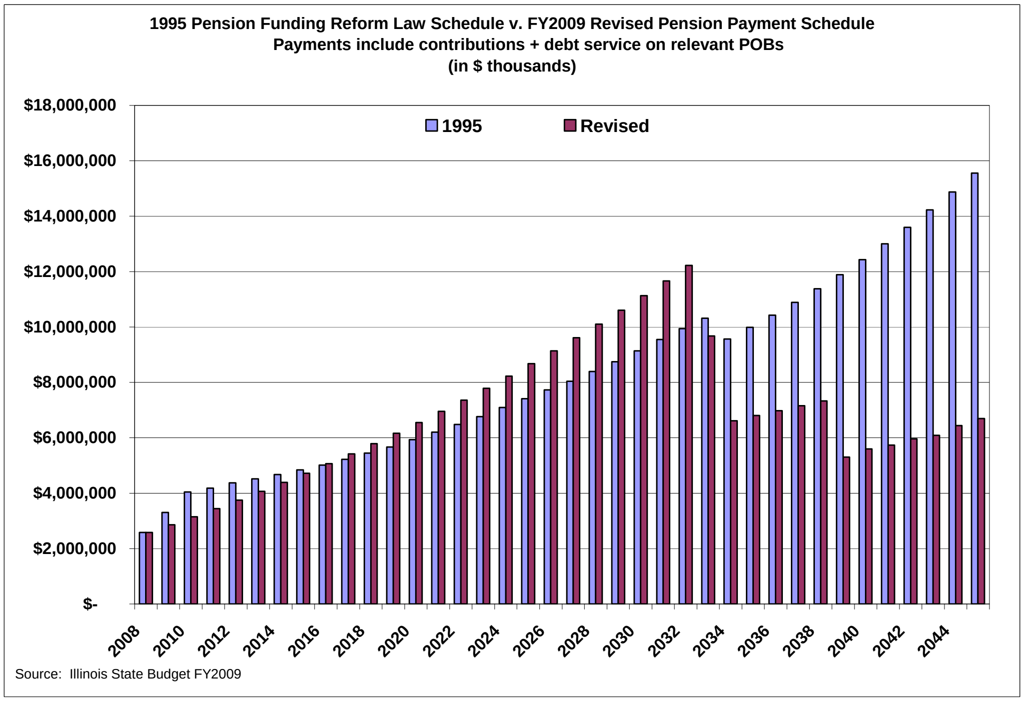
The FY2009 budget proposed issuing between $12.0 and $20.0 billion in pension obligation bonds to increase the assets of the state's pension funds. The bonds would have been paid for through General Fund revenues.

If the state had issued $16.0 billion in pension obligation bonds, it could have immediately placed $15.9 billion of that amount into the pension funds, thereby increasing the funded ratio from 62.6% to approximately 75.2%. One hundred million dollars would have been used for administrative costs associated with bond issuance. Also, pension payments would have been rescheduled and the FY2009 payment would have been $280.0 million greater than the payment made in the previous year. In succeeding years, payments would have been equal to $280.0 million plus a 3% annual increase until the funds achieved a 90.0% funded ratio in 2033, twelve years ahead of the current schedule. The current system required $19.9 billion in debt service

[113] Presentation by John Filan, Chief Operating Officer, State of Illinois, to the Civic Federation, March 14, 2007, p. 25.

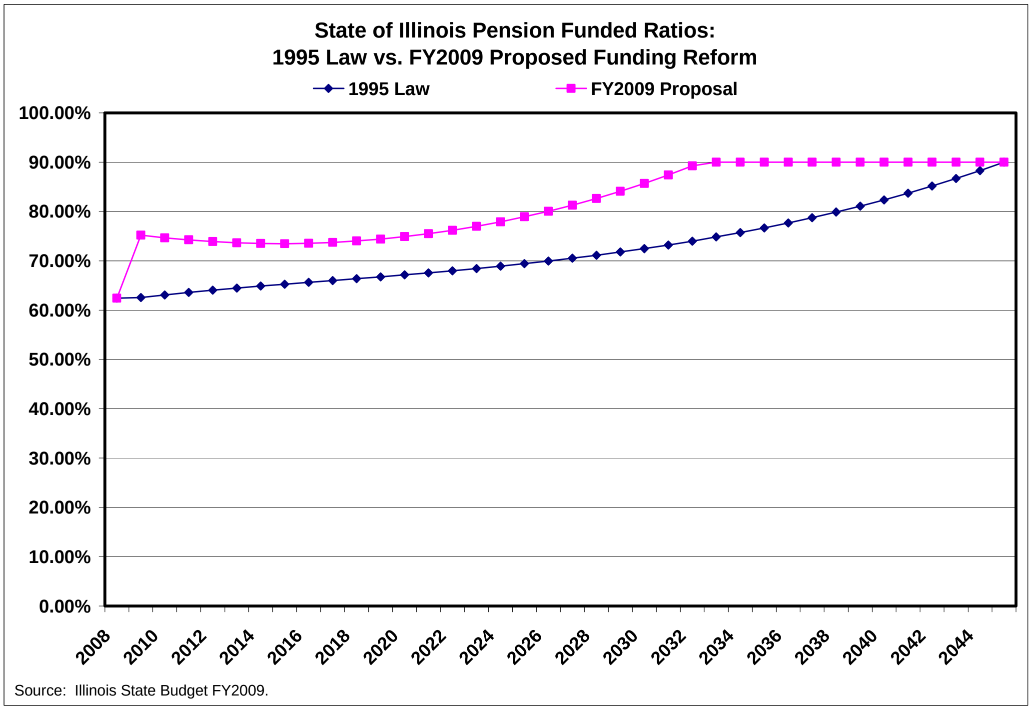
through FY2033 to pay for the $10.0 billion 2003 pension obligation issue. This contrasted with the $57.6 billion in debt service costs for two pension obligation bond issues (2003 and 2008) under the FY2009 reform proposal.

Overall, it was estimated that the plan would have saved the state $55.0 billion in future contributions.[114] The savings would have accrued because the interest rate on the pension obligation bonds would have been approximately 5.5% while the borrowed funds would have earned 8.5% through investment returns. The "savings" represented the spread between interest paid on the bonds and interest earned on the invested funds. The state proposed to use the savings to reduce its pension obligation payments to the amount required under the 1995 pension funding reform law. The following exhibit illustrates the differences in required payments for contributions plus debt service under the current 1995 pension funding law versus under the FY2009 budget proposal.



The differences between the funded ratios of the five State of Illinois pension systems under the 1995 pension funding reform law versus under the Governor's FY2009 proposal is illustrated below. Putting $15.9 billion into the pension funds would have immediately increased the funded ratio from 62.5% to 75.2% in FY2009. In FY2033, the funded ratio would have reached 90%, as compared to 74.8% under the current system.

[114] Illinois State Budget FY2009, pp. 4-1 and 4-2.



The General Assembly rejected the Governor's FY2009 pension funding proposal.

OTHER POST-EMPLOYMENT BENEFITS

Retired State of Illinois employees and their dependents are entitled to other post-employment benefits (OPEB), including health care, dental, vision and life insurance.[115] The State of Illinois pays for the retirement systems' portion of the employer cost for these benefits for all five retirement systems.[116]

It is projected that there will be 78,000 retirees and survivors enrolled in the state's OPEB program in FY2010, along with an additional 157,000 dependents.[117] As of April 21, 2008 the actuarial liability for the state's other post-employment obligations totaled $24.2 billion.[118] OPEB costs are paid for by the state using a pay-as-you-go method, which means monies have not been set aside in a separate fund or trust to pay down this existing liability.[119] In FY2007, the last year for which audited financial data is available, the state's OPEB expenses for retirees and their dependents totaled $599.3 million.[120]

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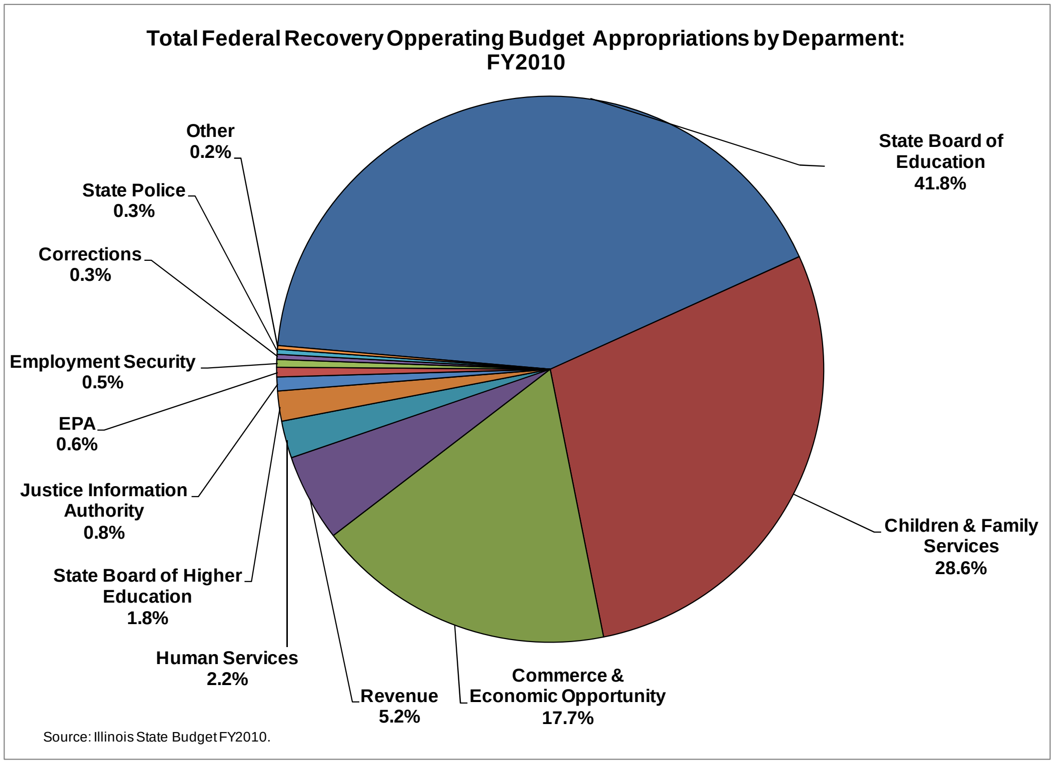
[115] According to the State's audited financial statements: "Substantially all State employees become eligible for postemployment benefits if they eventually become annuitants under one of the State sponsored pension plans." State of Illinois Comprehensive Annual Financial Report for FY2007, p. 117.
[116] State of Illinois Comprehensive Annual Financial Report for FY2007, p. 117; State Employees' Retirement System of Illinois Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2008, p. 27.
[117] Communication between the Civic Federation and the Governor's Office of Management and Budget, April 30, 2009.
[118] Communication between the Civic Federation and the Governor's Office of Management and Budget, April 30, 2009.
[119] State of Illinois Comprehensive Annual Financial Report for FY2007, p. 117.
[120] State of Illinois Comprehensive Annual Financial Report for FY2007, p. 117.

FEDERAL RECOVERY

The federal American Recovery and Reinvestment Act (ARRA) is a $787 billion plan to provide funding to counteract the cyclical recessionary economic trends currently hampering the global economy. Stimulus payments will be provided to states in the form of increased federal formula dollars and merit based grants. The priorities for the federal funding are increasing money for social welfare, creating jobs through infrastructure projects and bolstering failing state revenues. There are also a myriad of grants for technology innovation and efficiency programs.

The State of Illinois has included an estimated $9.4 billion in total stimulus funding within the capital and operating budgets. Programs in Illinois that will receive funding through ARRA are denoted in the FY2010 Budget Book as "Federal Recovery." The State has included $6.7 billion in Illinois operating budget appropriations and $2.8 billion in capital budget appropriations. Although some of these proposed appropriations are guaranteed funding through existing federal formulas, grant funding in many areas has yet to be awarded but are still included throughout the both the capital and operating budget. The largest portions of the federal recovery funding in the FY2010 budget are dedicated to increasing federal funding for education totaling $2.9 billion and increasing the federal matching funds for Medicaid assistance, totaling $1.9 billion through the end of FY2010 and $2.9 billion over the entire 27-month federal program.

This one-time increase in federal funding makes up 5.5% of the total $33.1 general fund revenues for FY2010 in Illinois.[121] The following exhibit shows proportions of appropriations from ARRA by department.



[121] Illinois State Budget FY2010, p. 2-10

The following chart provides a list of all itemized federal stimulus appropriations included in the state's operating budget for FY2010.

Federal Recovery Funds Included In FY2010 Budget (in $ millions)		
Department	**Funds**	**Notes**
State Board of Education	$ 2,800.0	To support K-12 education including new funding for disadvantaged schools, special education and education technology. (30 months)
State Board of Higher Education	$ 119.0	To restore funding for universities and community colleges to FY2009 level and increase funding in FY2010
Aging	$ 6.0	Increased nutrition program funding and employment services for seniors
Children & Family Services	$ 1,900.0	Estimated total increase in Medicaid matching funds from 50.32% to 60.48% (27 months)
Children & Family Services	$ 16.6	Increased federal reimbursement for Title IV-E foster care programs by 6.2% (27 months)
Human Services	$ 147.6	Increase in federal funding for Women, Infants & Children (WIC) (27 months)
Juvenile Justice	$ 4.0	To fund Aftercare system, a new program to reduce recidivism
Corrections	$ 20.0	Payments for expenses related to Law Enforcement and other Programs
Justice Information Authority	$ 4.5	Justice Assistance Grants(JAG), VAWA, and Victims of Crime Act. Funding for enforcement personnel, violence prevention and education programs, drug treatment programs
Justice Information Authority	$ 23.0	JAG/Byrne grants to local governments and nonprofits
Justice Information Authority	$ 23.0	JAG/Byrne grants to state agencies
Justice Information Authority	$ 1.3	Grants to victim assistance programs for state agencies
Justice Information Authority	$ 0.1	Grants to victim assistance programs for local government and nonprofits
Justice Information Authority	$ 3.0	For Violence Against Women program
Illinois State Police	$ 20.0	Federally funded program assistance
Environmental Protection Agency	$ 10.0	Brownfield and LUST Remediation
Environmental Protection Agency	$ 3.2	Drinking Water Loan Program
Environmental Protection Agency	$ 7.2	Water Pollution Control Loan Program
Environmental Protection Agency	$ 6.0	Diesel Retrofit
Environmental Protection Agency	$ 10.0	SuperFund Site Cleanup
Environmental Protection Agency	$ 1.8	Water Quality Planning

(continued next page)

Federal Recovery Funds Included In FY2010 Budget (in $ millions, continued)		
Department	**Funds**	**Notes**
Natural Resources	$ 2.5	Infrastructure for recreation, and economic development to enhance state park facilities, and improve park roadways and trails.
Natural Resources	$ 1.5	Grants for restoration of natural areas at beaches
Employment Security	$ 17.5	Improve opperations of Unemployment Insurance Administration
Employment Security	$ 13.0	Expand Employment Service Program
Illinois Arts Council	$ 0.4	National Endowment for the Arts
Revenue	$ 96.0	HOME investment partnership program
Revenue	$ 250.0	Low Income Housing Tax Credit Exchange Program
Commerce and Economic Opportunity	$ 34.0	Community Development Block Grant
Commerce and Economic Opportunity	$ 48.0	Community Services Block Grant Act
Commerce and Economic Opportunity	$ 250.0	Grants and Technical Assistance for nonprofit community organizations
Commerce and Economic Opportunity	$ 20.0	Rural Utilities Service, telemedicine, distance learning and broadband
Commerce and Economic Opportunity	$ 300.0	The Innovative Technology Loan Guarantee Program
Commerce and Economic Opportunity	$ 308.0	The State Energy Program
Commerce and Economic Opportunity	$ 2.5	The Workforce Investment Act , high growth and emerging industry sectors
Commerce and Economic Opportunity	$ 26.8	The Workforce Investment Act, adult programs
Commerce and Economic Opportunity	$ 68.5	The Workforce Investment Act, dislocated worker program
Commerce and Economic Opportunity	$ 62.2	The Workforce Investment Act, youth programs
Commerce and Economic Opportunity	$ 65.0	Wireless and broadband
Total	**$ 6,692.2**	

Source: Illinois State Budget FY2010

The state's appropriations of $2.9 billion for education from the federal recovery funds are based on an estimate provided by the U.S. Department of Education[122]. These preliminary estimates for funding for K-12 education and the State Board of Higher Education are from the US Department of Education (ED) and US Department of Agriculture (USDA).

The estimated $2.9 billion in increased Medicaid funding is based on a 10.1% increase in federal matching funds for state health care for nine federal fiscal quarters dating back to Oct. 1, 2008. The state is already drawing on $471 million in prorated federal recovery funds for the final six months of FY2009.[123]

[122] See Department of Education website at http://www.ed.gov/about/overview/budget/statetables/index.html (last visited on April 29, 2009).
[123] Illinois Department of Health and Family Services, http://www.hfs.illinois.gov/recovery/ (last visited May 5, 2010)

DEBT TRENDS

This section of the analysis examines trends in long-term and short-term debt issued by the State of Illinois, as well as bond ratings, new proposed borrowing for capital purposes and an overview of the debt service schedule. Also included in this section is a review of the Governor's proposal to restructure all current and new general obligation debt for capital purposes, which will extend the life of state's current capital debt burden to 2045 to obtain some FY2010 savings.

State of Illinois General Obligation Debt

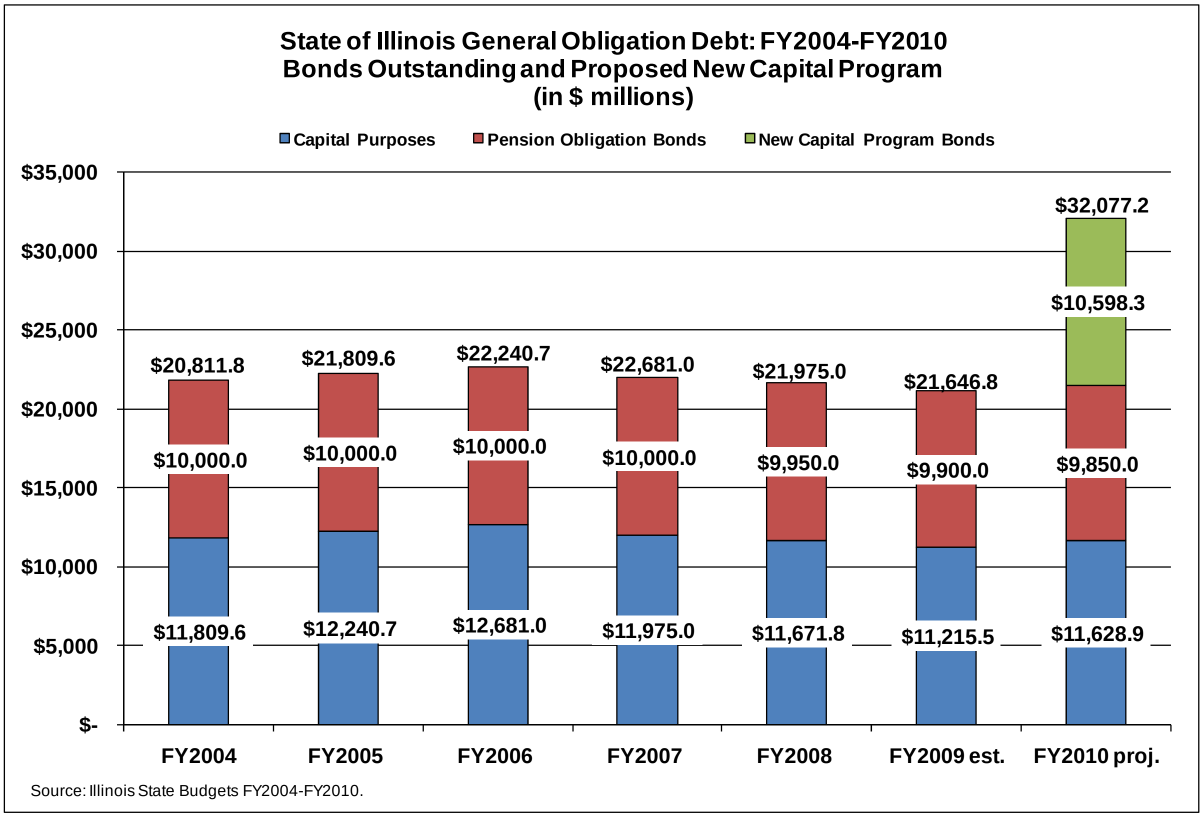
The State of Illinois estimates its outstanding general obligation bonds (GO bonds) total $21.5 billion in FY2010. This figure excludes the proposed $10.6 billion of new and reauthorized capital bonds included in the *Illinois Jobs Now!* Capital program. The existing debt includes $9.9 billion from the 2003 pension obligation bond issue. The remaining $11.6 billion comes from three different types of capital purpose general obligation debt: GO capital debt, Build Illinois debt, and Civic Center debt. 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. There were $100.0 million in Civic Center bonds outstanding in FY2009 and the last of the bonds are scheduled to expire in 2022. Although originally financed in part by horse racing taxes, these bonds are now fully repaid out of the general fund.[124]

Build Illinois Bonds were first issued in 1985 and are backed by the state's of sales tax receipts. The total bond authorization has been increased by the legislature on several occasions since Governor Thompson's inaugural program in the late 1980s. At the end of fiscal year 2009 there was nearly $2.1 billion worth of Build Illinois bonds, down from $2.2 billion outstanding at the end of FY2002.[125] The state now proposes selling $557.7 million of Build Illinois Bonds over the next seven years as part of the funding for the FY2010 capital budget.

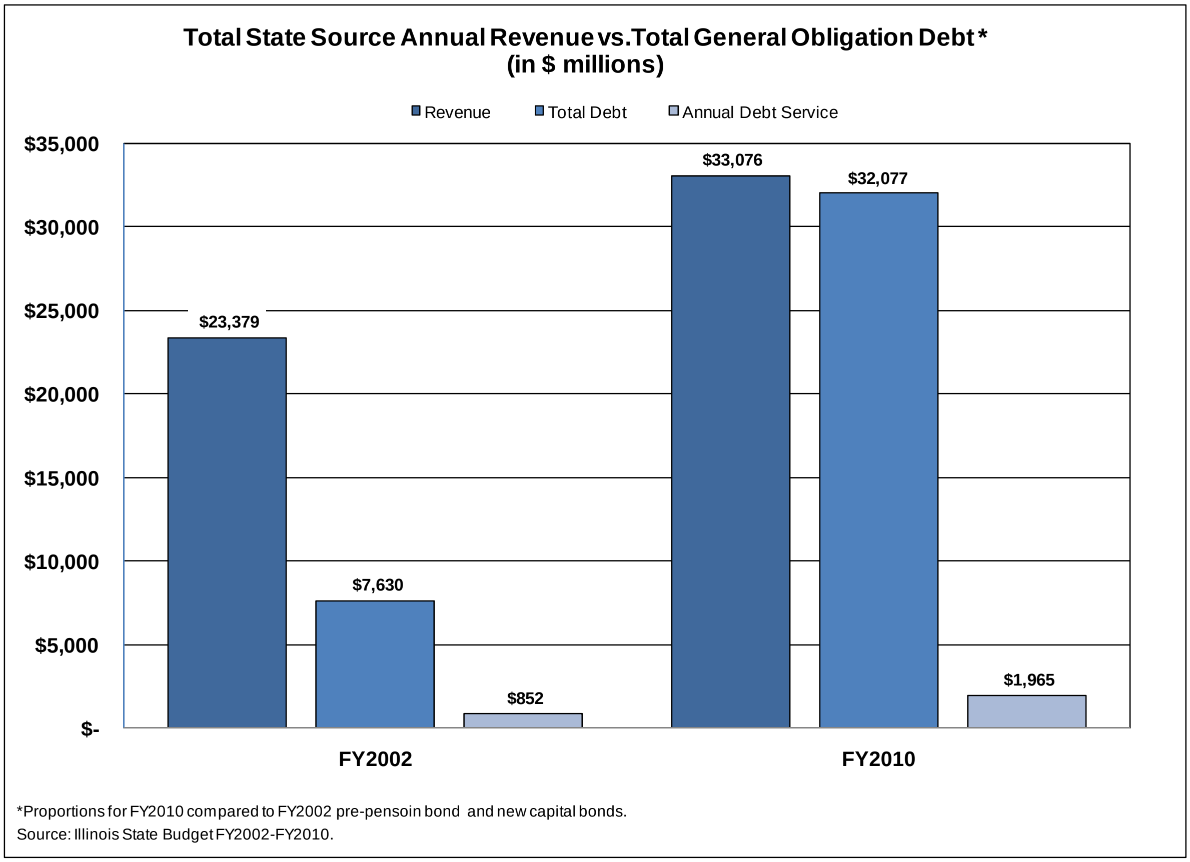
General Obligation bonds are the state's largest area of borrowing and are used for investments in roads, all state owned facilities, environmental projects, mass transit, aviation projects, school construction grants and any other departments requesting capital funding. At the end of FY2009, Illinois' existing GO bonds totaled $9.1 billion, down from a recent high of $10.2 billion in FY2006.

Including the new proposed capital bonds the total amount of GO debt outstanding will rise by 54.1%, or $11.3 billion, between FY2004 and FY2010, for a total of $32.1 billion of outstanding GO debt. The following graph shows total GO debt including pension and all capital bonds dating back to 2004.

[124] 30 ILCS 355, Metropolitan Civic Center Support Act, 1987.
[125] State of Illinois Budget FY2010, p. 61.



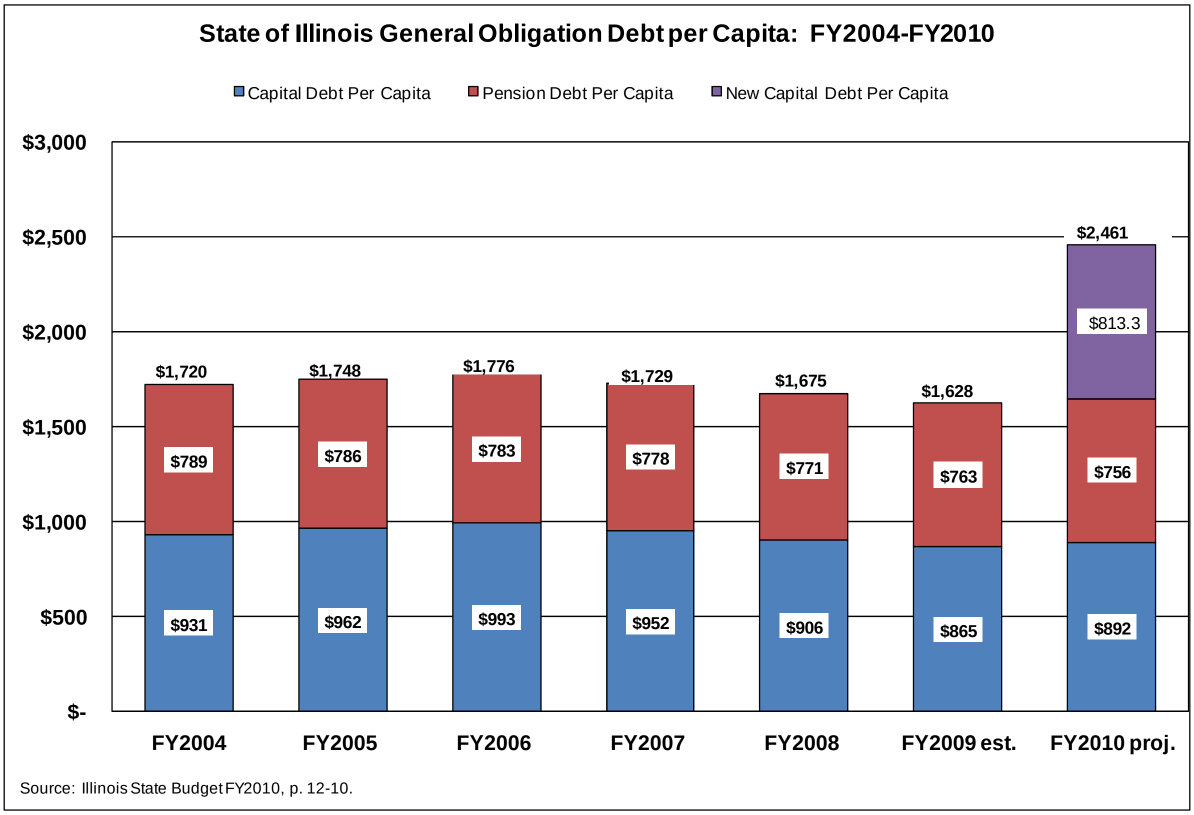
Since FY2006 the state has retired more capital purpose debt than it has issued, reducing the total outstanding capital debt by $1.1 billion over the past five years. However, Illinois' total GO debt has increased dramatically over the same years due to the issuance of $10 billion in Pension Obligation bonds in 2003. The chart below shows that in the proposed FY2010 budget, annual state source general revenue, which is the primary source of debt repayment, has increased by 41.5% since FY2002 but that over the same time period outstanding debt will have increased 320.4%, or $24.4 billion. In FY2002 outstanding GO debt equaled only 32.4% of total state source annual revenue whereas under the proposed FY2010 budget it would total 97.0% of the total state source annual receipts. Annual debt service paid by the state to maintain this level of bonded indebtedness in FY 2010 is more than double what it was in FY2002. The sale of $10 billion of Pension Obligation bonds in FY2003 and the proposed new capital improvement bonds for the Illinois Jobs Now! program are the largest contributors to this change in the state's revenue to debt proportions.



Although the State proposes raising personal income tax by 1.5 percentage points to create new revenues and dedicating 10% of the proceeds to cover debt service on new capital borrowing, revenue still is not likely to keep pace with the rate of borrowing for the State of Illinois.

Debt Per Capita

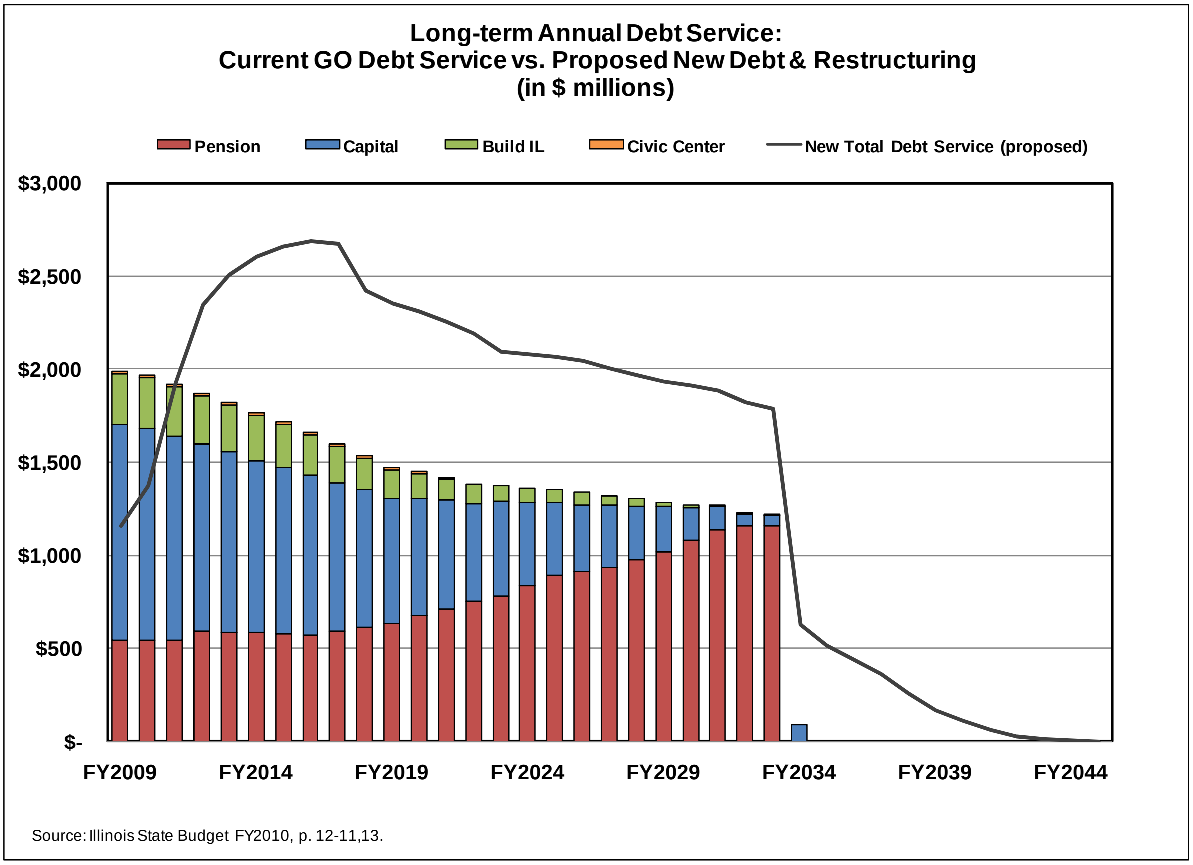
One of the most common measures used analyze a state's debt burden is total outstanding debt to the state's estimated population. Between FY2004 and FY2010, existing GO debt per capita fell by 4.5%, from $1,720 in FY2004 to $1,643 in FY2010. However, new borrowing for the proposed capital plan will increase the debt burden per capita in FY2010 by 49.9%, or $813 more per Illinois resident than in FY2009. The following exhibit shows Illinois' General Obligation Debt Per Capita by purpose of borrowing. Also debt as a percentage of total personal income in Illinois will increase from 4.2% in FY2009 to 6.4 % in FY2010 under the proposed budget.



Debt Service and Restructuring

The State's debt service schedule sets forth the principal and interest amounts due for outstanding bonds on an annual basis. The FY2010 Governor's Budget proposes restructuring all outstanding capital debt and new capital borrowing for the *Illinois Jobs Now!* capital program to take advantage of lower interest rates and reduce its debt service payment by $621 million in FY2010 and $140 million in FY2011. However, the restructuring will also extend the life of $11.8 billion worth of existing GO Bonds for capital purposes and Build Illinois Bonds scheduled to expire between FY2010 and FY2035 for an additional 10 years, until FY2045. Net savings over the new debt service schedule will total an estimated $170 million, not adjusting for present value. On the new schedule after the savings in the first two years annual debt service payments will increase steadily from $1.9 billion in FY2012 to a peak of $2.7 billion in FY2015 and not return to current levels until after FY2028. The state projects that debt service will not decrease significantly until after FY2035 assuming no new debt is issued.

The following chart compares the proposed total General Obligation bond debt service for the refinanced capital bonds, existing Pension Obligation bonds and proposed new capital bonds to the current debt service schedule for existing debt by purpose of borrowing.

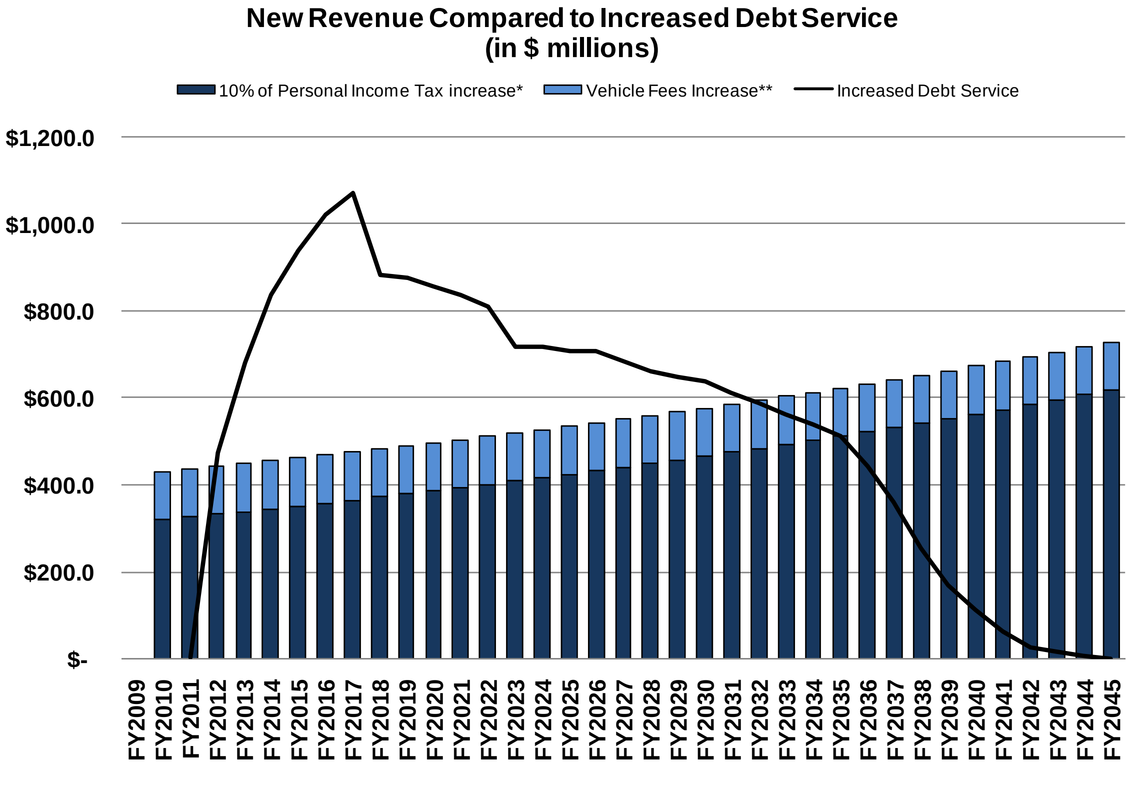


Under the current debt service schedule, total debt service payments for principal and interest were projected to decline from FY2009 through FY2033, from $1.9 billion to $1.2 billion, falling to $89 million in 2034 and retiring all debt by FY2035. The state has paid off more capital purpose debt than it has issued from FY2006 through FY2009 decreasing the outstanding GO Bonds for capital by 11.6%, or $1.5 billion.[126] However, outstanding Pension Obligation Bond debt service payments are backloaded and although the total pension bonds will decrease by $50 million annually until the principal is retired in FY2033, annual debt service payments will increase from $546 million in FY2007 to $1.1 billion in FY2033. The proposed restructuring plan does not include pension debt. Between FY2009 and FY2033, the State of Illinois will pay a total of $19.9 billion in debt service for the pension obligation bonds.

On the current schedule it will also pay $18.5 billion in total debt service for $11.9 billion in previously issued bonds for capital purposes.[127] If the new debt restructuring plan and new capital borrowing are approved, Pension Bond totals will remain unchanged, and the state will pay $36.8 billion in debt service for $22.4 billion of total capital improvement bonds, nearly $11.0 billion of which are new certificates.[128] Under the proposed FY2010 borrowing and restructuring plan the state's total debt service will increase by 48.2% to $56.2 billion, to secure a total of $32.9 billion in principal borrowing, an increase of 50.9% over current state indebtedness.

[126] Stat of Illinois Budget FY2010, p 12-10.
[127] State of Illinois Budget FY2010, p. 12-11.
[128] State of Illinois Budget FY2010, p. 12-13

The state proposes dedicating 10% of a 1.5 percentage point personal income tax increase to pay for the new debt service and an estimated $110 million per year from increasing license and vehicles fees. But the combined estimated revenue falls short of the new total annual debt service for many years. By year three of the proposed debt service schedule the new revenues will fall behind new debt service by more than $30.7 million, adjusting for an annual increase in the new income tax of 1.9 %[129] and assuming that the new licensing revenue and vehicle fees will be inelastic. By FY2014 the new revenue source will have fallen $382 million behind new debt service and the disparity will continue to climb peaking in FY2017 at $596.0 million. This new borrowing will continue to add hundreds of millions to the State of Illinois' structural budget deficit until FY2032 unless the state authorizes other new revenues not included in the proposed FY2010 budget. The following graph shows the disparity between new revenue proposed to pay for new borrowing and the annual debt service payments proposed in the FY2010 budget.



Source: Illinois State Budget FY2010
*Projecting a 1.9% average annual increase for Personal Income Tax
** Projecting no growth in vehicle fees

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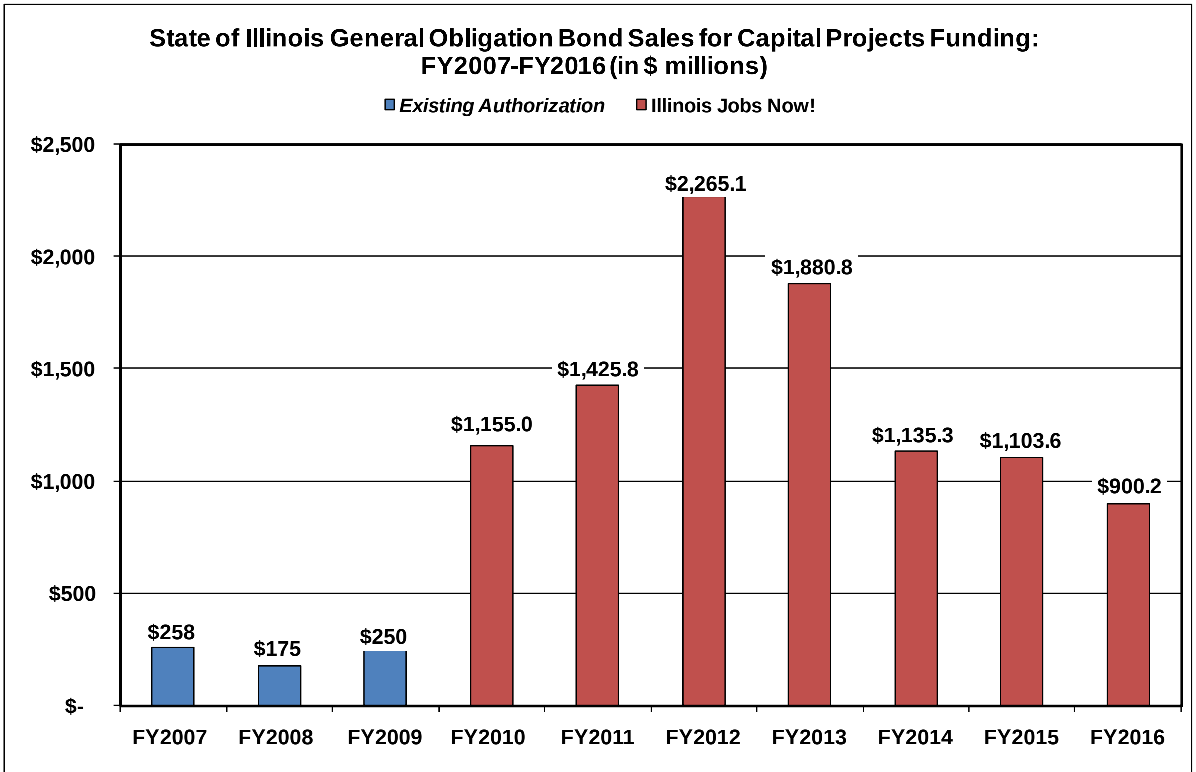
129 Illinois State Budgets FY1999-FY2010. Despite volatility from year to year, Illinois income tax revenue increased by an average of 1.9 % annually between FY1999 and FY2010. The Department of Revenue does not provide projects for income tax beyond FY2010.

Bond Sales

The following chart shows the projected bond sales per year over the first seven years of the new capital program. However, the new capital bonds are included in the proposed restructuring and the state will be negotiating 100% of the entire $10.6 billion in new certificates starting in FY2010. The bond sales schedule will be subject to the negotiations.



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

Restructuring Bond Act Changes

In order to accomplish the proposed debt restructuring in fiscal year 2010, the Governor proposes removing several statutory obstacles. The state proposes lifting the level principal and Cumulative Test restrictions of the GO and Build Illinois Bond Acts to allow it to restructure its outstanding debt to provide budgetary relief in FY2010 and FY2011, totaling $621 million and $140 million respectively. After the first two years of the plan the annual debt service payments will increase dramatically and the estimated net savings over the full term of the capital debt service is projected to total only $170 million.

There is debate among economic experts as to the advantages of either competitive bond sales or negotiated bonds sales to produce lower cost borrowing to government entities. The General Obligation Bond Act and the Build Illinois Bond Act both currently require that a minimum of 25% of all bond sales are competitive and no more than 75 % are negotiated.

Level principal structure requires that principal portions of any state debt service payments are paid in level amounts annually ensuring that total debt service decreases over the term of the notes issued. The level principal does not prohibit restructuring debt but limits the ability to reap early year savings in any financing plan, which is the goal of the proposed FY2010 plan.

Bond Ratings

The State of Illinois' general obligation bond ratings have been reduced by each of the three major rating agencies since FY2009: [130]

	Moody's Investors Services	Standard & Poor's	Fitch Ratings
FY2009	Aa3	AA	AA
FY2010	A1	AA-	AA-

Source: Illinois State Budgets FY2009, FY2010.

Consequently overall debt service costs for Illinois will increase in the next fiscal year. The state does not provide current interest rate estimates or estimated increases in debt service cost due to this change.

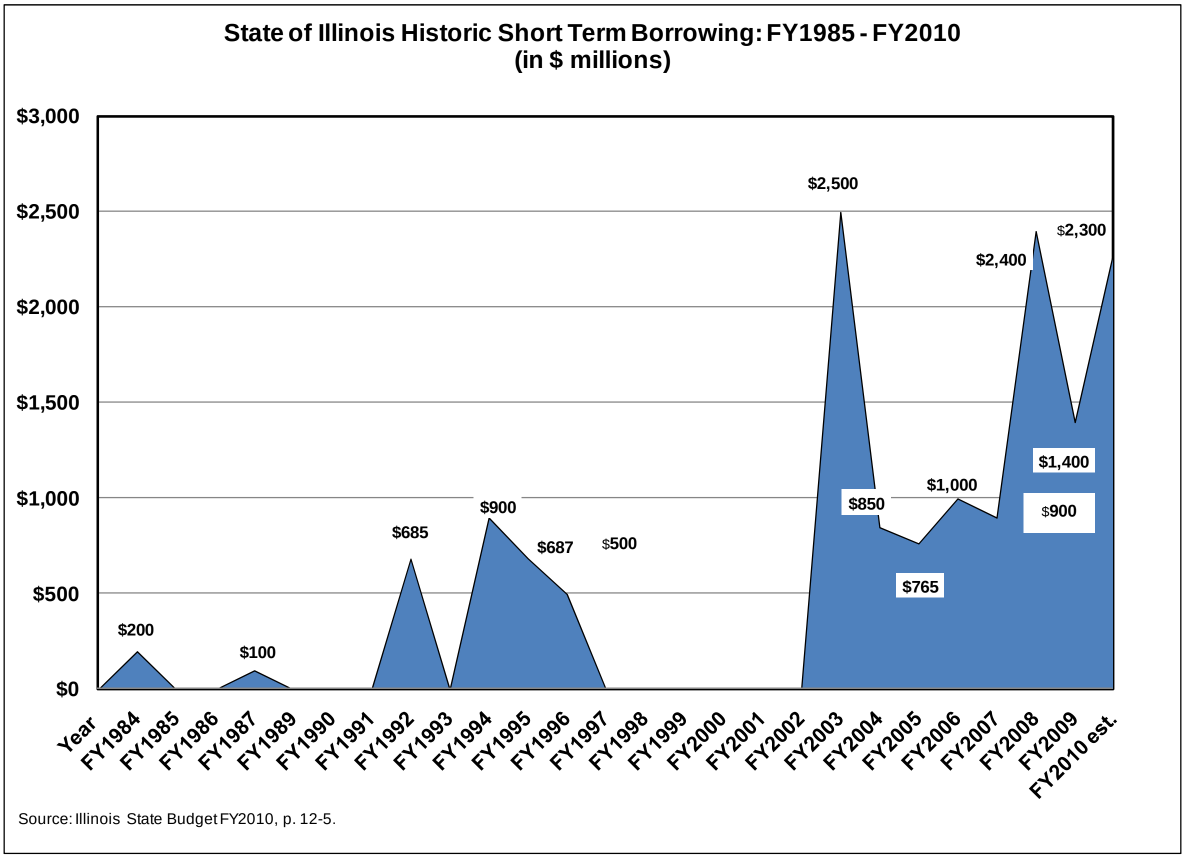
Short-Term Debt

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

Under the Short Term Borrowing Act,[131] 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. The second scenario, which applies to the short-term notes that will be issued at the onset of FY2010, allows the state to borrow up to 15% of the total appropriations for any year if there is a failure in revenue. 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 July 2002 through FY2010.

[130] Fitch Rating and Standard & Poor's ratings from Illinois State Budget FY2010, p. 12-2, Moody's reduced the Debt Rating on Illinois General Obligation bonds on April 4, 2009 after the FY2010 budget was released.
[131] 30 ILCS 340



In the last eight years the state has expanded 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. 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. Most recently $1.4 billion was borrowed in December 2008 to pay for some of the state's outstanding liabilities through the end of FY2009. This issuance expires in June, 30 2009. However the state has notified the market that it intends to sell an additional $2.3 billion in short term certificates in FY2010 to cover a declared failure in revenue in FY2009.[132] The FY2010 short-term notes may be issued for up to a 12-month term.

[132] Communications between Civic Federation and Governor's Chief of Staff, Jerome Stermer, March 18, 2008.

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.

CAPITAL BUDGET

In FY2009, the State Legislature rejected the capital budget proposed by then Governor Rod Blagojevich, which included $13.5 billion in FY2009 capital appropriations part of a $25 billion *Illinois Works* multi-year capital program. The FY2009 program was mostly pay-as-you-go funded through new revenue proposals including a partial lease of the state lottery and $3.8 billion in new capital bonds.

In FY2010 Governor Quinn proposes a $26 billion *Illinois Jobs Now!* capital budget, released simultaneously with the state's $52.8 billion operating budget on March 18, 2009. Since then, a $3 billion mini capital bill was approved by the legislature and signed into law by Governor Quinn on April 3, 2009.[133] The capital budget includes $20.5 billion in total appropriations for FY2010 a 51.9 % increase over the rejected capital budget appropriations for FY2009.

The following exhibit shows the sources and uses of the proposed capital spending in the *Illinois Jobs Now!* program.

Sources and Uses of FY2010 Capital Appropriations (in $ millions)

	Multiyear Road Program (FY2010-FY2015	Other Road & Bridge Programs	Education	Environment & Energy	Transportation	State Facilities	Economic Development	Total Sources	As a % of Total Sources
Federal Funds	$ 7,499	$ -	$ -	$ 1,023	$ 3,020	$ 15		$ 11,557	45.2%
State	$ 1,898	$ 3,000	$ 2,546	$ 506	$ 1,520	$ 251	$ 875	$ 10,596	41.5%
Local	$ 725	$ -	$ 1,600	$ 50	$ -	$ -		$ 2,375	9.3%
Stimulus	$ -	$ 936	$ 25	$ 375	$ 564	$ -	$ 96	$ 1,996	7.8%
Total	**$ 10,122**	**$ 3,936**	**$ 4,171**	**$ 1,954**	**$ 5,104**	**$ 266**	**$ 971**	**$ 25,553**	**100.0%**

Source: State of Illinois Capital Budget FY2010, p. 9.

133 Increased General Obligation Bond authorization proposed as HB289 enacted in IL Public Act 096-0005, appropriations proposed in HB 210 enacted in IL Public Act 096-0004.

Planning

Although the Governor's office provided a list of projects to be funded in FY2010, no planning documents were provided to explain the prioritization or estimated total capital needs among departments. Very little has been publicized about the selection of projects to be funded in FY2010. The capital budget book describes a process coordinated by the Capital Development Board and the Governor's Office of Management and Budget to assemble and prioritize the projects in the capital program but no documentation of the process was included with the budget or made public.[134] The State of Illinois still does not have an established publicly available Capital Improvement Plan (CIP) that explains the prioritization of projects or the overall needs assessment for all state owned assets.

The following exhibit shows a list of the top 20 largest funding areas and individual projects as described in the FY2010 capital budget projects list.

Major Proposed Funding Areas and Specific Projects FY2010 Capital Budget			
Project Description	**Agency**	**New/Existing**	**FY2010 Appropriation**
Statewide - Transportation and Related Construction	Transportation	New	$ 3,000,000,000
Statewide - School Construction Grants	Capital Development Board	New	$ 1,500,000,000
Public Transit - Transportation Grants	Transportation	New	$ 1,275,000,000
Community Revitalization	Commerce And Econ Opp	New	$ 450,000,000
Statewide - Community Reinvestment Fund	Commerce And Econ Opp	New	$ 250,000,000
Downstate - Public Transit - Transportation Grants	Transportation	New	$ 225,000,000
General Local And Statewide Grants As Authorized under Build Illinois Bond Act Sec. 4	Commerce And Econ Opp	Existing	$ 102,880,674
Statewide - Transportation and Related Construction	Transportation	Existing	$ 100,056,987
Statewide Private Colleges & Universities - Construction,Planning, Supplies, Equipment, Materials	Capital Development Board	New	$ 100,000,000
Statewide - For School Maintenance Grants	Capital Development Board	New	$ 100,000,000
Healthcare Facilities	Commerce And Econ Opp	New	$ 100,000,000
Statewide Water resource management	Natural Resources	New	$ 82,515,000
SIU - Edwardsville - Madison County - Construct Science Lab (via CDB)	University, Southern Illinois	New	$ 78,867,300
Maximum Security Facilities Statewide - Expenses for Planning, Design, Construction, Equipment and all Other Necessary Costs	Corrections	Existing	$ 77,469,014
Energy Development	Commerce And Econ Opp	New	$ 75,000,000
Northeastern Illinois University - Cook County - Construct Education Building (via CDB)	University, Northeastern Illinois	New	$ 72,977,200
Western Illinois University - Mc Donough County - Construct Performing Arts Center (via CDB)	University, Western Illinois	New	$ 67,835,768
Designated purpose balance as authorized by subsection (b) of section 3 of the GO Bond Act for correctional purposes at State prison and correctional centers or for grants to State agencies for such purposes (via CDB)	Corrections	Existing	$ 63,075,849
Illinois State University - Mc Clean County - Renovation of the Visual Arts Center (via CDB)	Capital Development Board	New	$ 54,250,100
Specific Project Total			**$ 273,930,368**
Funding Area Total			**$ 7,500,997,524**
Total			**$ 7,774,927,892**

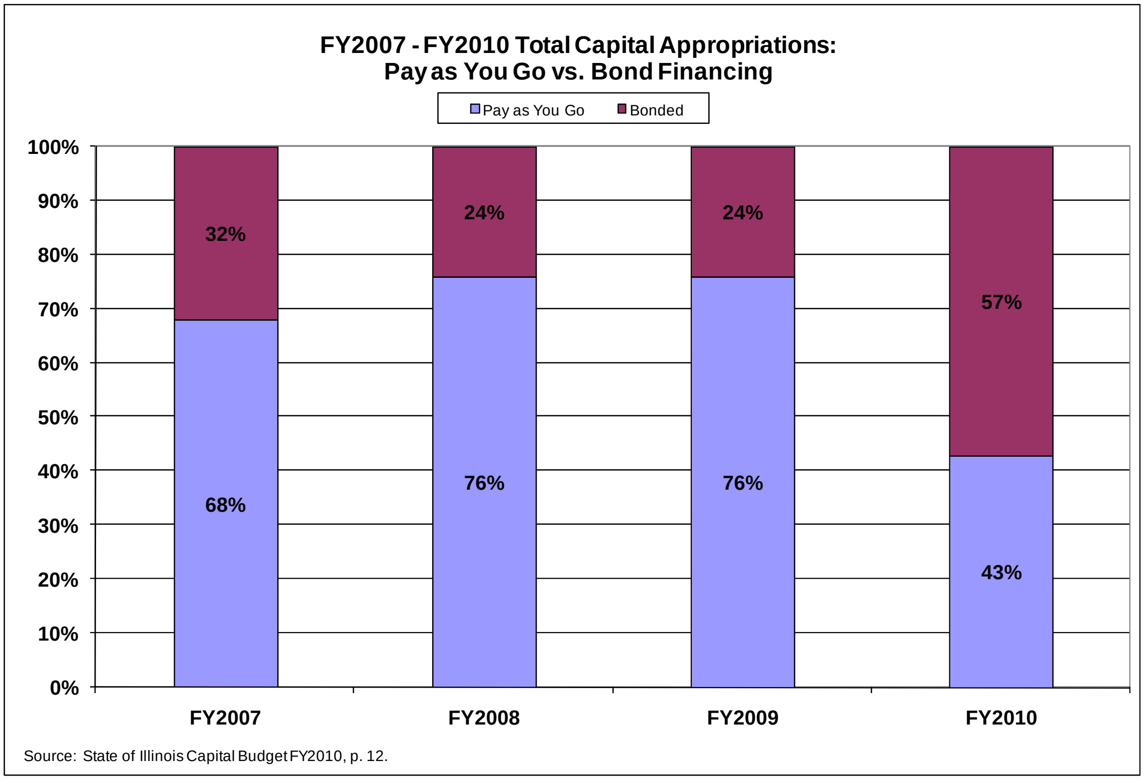
*Source: Illinois State Capital Budget Project List

Funding

Of the total $26 billion proposed capital budget, 57% will be funded by General Obligation (GO) debt or sales tax supported Build Illinois Bonds. New borrowing will total $10.6 billion. The $3 billion mini capital bill is entirely debt funded and passed with no new revenue to support the borrowing. The following chart shows the increasing trend in debt funded capital spending

[134] State of Illinois Capital Budget FY2010, pg. 3.

versus pay-as-you-go funding.



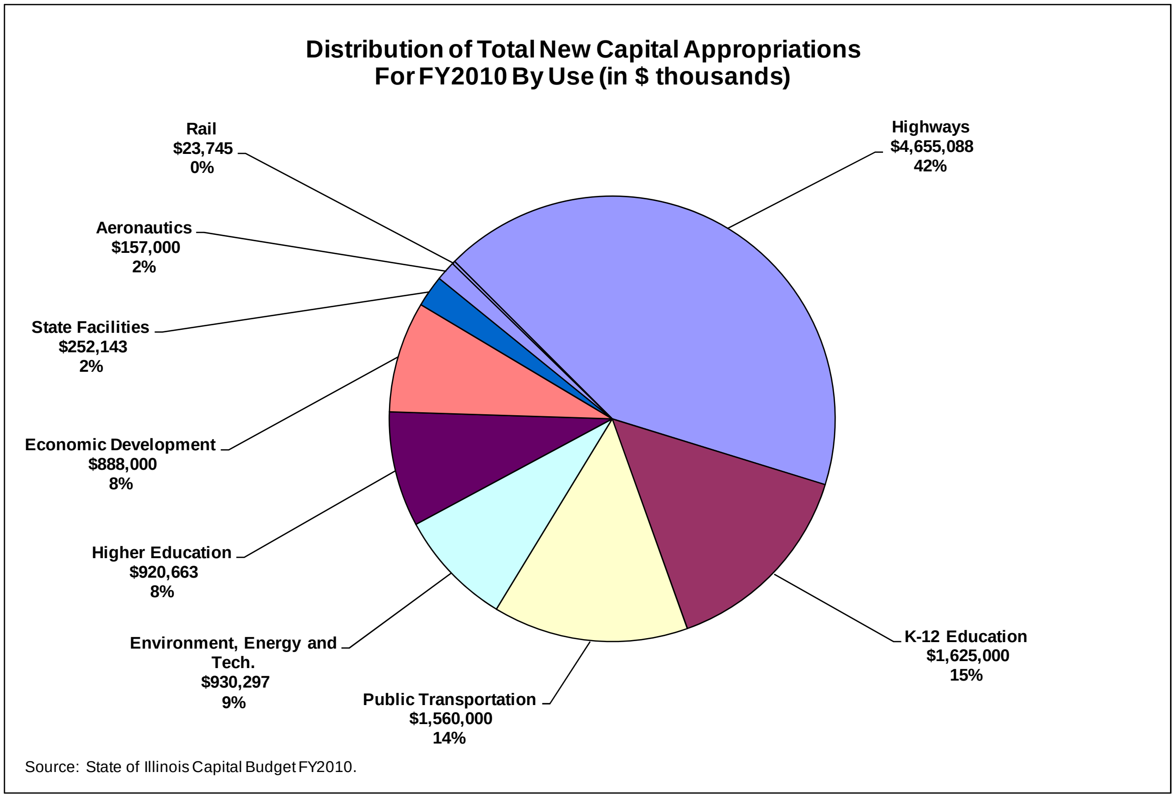
Of the $20.5 billion in appropriations proposed in the FY2010 capital budget only $11 billion are new appropriations. The following exhibit shows the difference between the reappropriations and the proposed new funding by project area.

Distribution of Total Recommended Appropriations by Uses FY2010 (in $ thousands)			
Use	**New**	**Reappropriations**	**Total**
Highways	$ 4,655,088	$ 4,513,544	$ 9,168,632
Rail	$ 23,745	$ 1,194,768	$ 1,218,513
Public Transportation	$ 1,560,000	$ 177,818	$ 1,737,818
Aeronautics	$ 157,000	$ 571,492	$ 728,492
K-12 Education	$ 1,625,000	$ 32,673	$ 1,657,673
Higher Education	$ 920,663	$ 452,733	$ 1,373,396
Environment, Energy and Tech.	$ 930,297	$ 1,605,076	$ 2,535,373
Economic Development	$ 888,000	$ 340,027	$ 1,228,027
State Facilities	$ 252,143	$ 598,390	$ 850,533
Total	**$ 11,011,936**	**$ 9,486,521**	**$ 20,498,457**

Source: State of Illinois Capital Budget FY2010, pg. 70.

Of the $11.0 billion in new appropriations 79%, or $8.7 billion, will be debt funded. The state will rely exclusively on federal funding including recovery dollars from the American Recovery and Reinvestment Act (ARRA) – some allocated by formula and some anticipated through grants

– to support pay-as-you-go projects. The following exhibit shows total new appropriations by purpose.



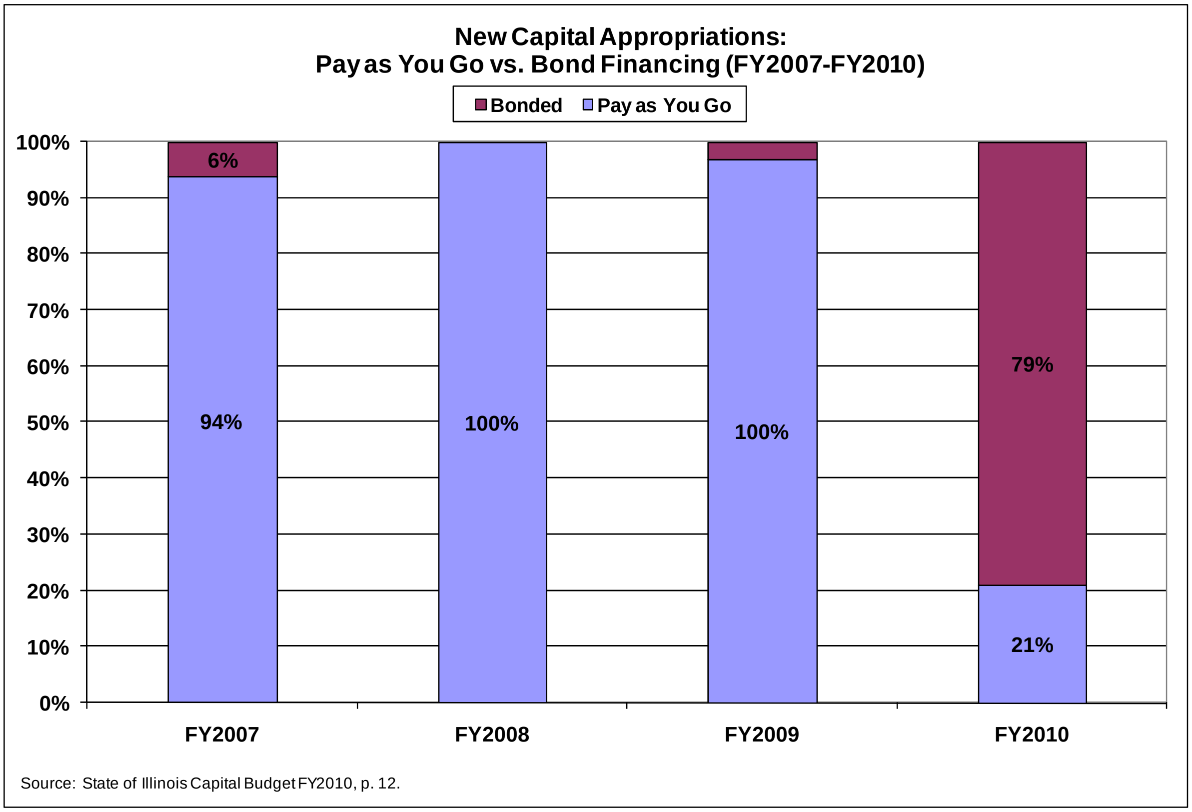
Transportation and education remain the state's top priorities for capital funding as proposed in the FY2010 capital budget. The following chart shows the percentage of new projects by area of state investments.

Proposed New Capital Appropriations by Use FY2010

Use	Total		%
Highways	$	4,655,088	42.3%
K-12 Education	$	1,625,000	14.8%
Public Transportation	$	1,560,000	14.2%
Environment, Energy and Tech.	$	930,297	8.4%
Higher Education	$	920,663	8.4%
Economic Development	$	888,000	8.1%
State Facilities	$	252,143	2.3%
Aeronautics	$	157,000	1.4%
Rail	$	23,745	0.2%
Total	**$**	**11,011,936**	**100.0%**

Source: Illinois State Capital Budget FY2010, pg. 70.

The majority the new appropriations in the capital budget for FY2010 will be debt funded. The following chart shows the trend in increased borrowing for new capital purposes.



Mini-Capital Bill

On April 3, 2009 the Governor signed a preliminary capital bill funded by $3 billion in new general obligation debt and made up of new projects proposed in the FY2010 Capital Budget. This mini-capital plan is made up entirely of new transportation appropriations, and includes $2 billion for roads and bridges as well as $1 billion for mass transit. Illinois House Bill 289[135] increased the GO Bond authorization from $27.6 billion to $30.6 billion for capital purposes. Illinois House Bill 210[136] authorized the appropriations in these areas and also included the proposed stimulus projects that have already received funding from the American Recovery and Reinvestment Act of 2009 (ARRA).

Federal Recovery

The Governor included $1.9 billion in stimulus funding from the ARRA legislation in the $26 billion capital plan. However, the accompanying project list included $2.8 billion in new projects funded by the federal recovery bill. The variation in these totals comes from the difference between formula-funded and grant-funded infrastructure projects. Under ARRA there are more than $31.6 billion in competitive grants available to states. These grants are managed by individual federal departments and although some have begun distributing awards, most will not release criteria and qualified projects for grant funding until mid-May.

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[135] IL Public Act 096-0005
[136] IL Public Act 096-0004

The state has already received $1.4 billion in ARRA funding for transportation: $936 million dedicated to roads and bridges and $467 million for mass transit.

Illinois expects to receive a $1 billion grant from the Department of Energy to revive the FutureGen Coal operation. The grant was tailored to the project as the only “near zero-emissions power plant(s)” that is shovel ready in the country. However, this award has not yet been formally issued.

The Federal Aviation Administration has announced a $12 million grant from ARRA for runway expansion at O’Hare International Airport, but this funding will go directly to the City of Chicago. Illinois also received $80 million in Amtrak funding as announced on March 25, 2009. Governor Quinn included several grant funded areas that have yet to be awarded in the state capital budget for FY2010, including $150 million for airports and $500 million for high speed rail.

The following project areas were included in the FY2010 capital budget project list:

Federal Recovery Appropriations for FY2010 Included in Project List		
Department	**Project Desciption**	**FY2010**
Environmental Protection	Federal Recovery - Wastewater Infrastructure Program	$ 180,000,000
Environmental Protection	Federal Recovery - Drinking Water Program	$ 80,200,000
Natural Resources	Federal Recovery - For the Purpose of Advancing Forestry Resources in Illinois	$ 15,000,000
Natural Resources	Federal Recovery - For the Purpose of Advancing Forestry Resources in Illinois	$ 5,000,000
Transportation	Federal Recovery - Local Earmarks- Local Pass through	$ 50,000,000
Transportation	Federal Recovery - Northeastern Illinois - Federal Pass Through Funding for C.R.E.A.T.E Program	$ 300,000,000
Transportation	Federal Recovery - State Wide Road Improvements- Local Share of Road fund/Road Program	$ 325,000,000
Transportation	Federal Recovery - Statewide - Financial Assistance to Airports (Federal and Local share)	$ 150,000,000
Transportation	Federal Recovery - Statewide - Grant for the Federal Share of Capital, Operating, Consultant Services, and Technical Assistance	$ 40,000,000
Transportation	Federal Recovery - Statewide - High Speed Rail - Federal Share	$ 500,000,000
Transportation	Federal Recovery - Statewide - Rail Freight Improvements	$ 6,000,000
Transportation	Federal Recovery - Statewide - Rail Passenger Improvements	$ 285,000,000
Transportation	Federal Recovery - Statewide - Transportation and Related Construction	$ 900,000,000
Total		**$ 2,836,200,000**

Source: State of Illinois FY2010 Capital Projects List

New Capital Bonds

The Governor's office estimates the *Illinois Jobs Now!* Program will support 340,000 jobs in Illinois but will increase the total general obligation debt (including pension bonds and reissued Build Illinois Bonds) from $21.9 billion to $32.5 billion. The Governor's plan also includes a proposal to restructure all outstanding and new capital debt through a negotiated sale that will extend the life of the debt from FY2035 to FY2045 and increase the total estimated debt service on all general obligation debt (including pension bonds and new capital bonds) from $38 billion to $56.4 billion (see page 76 for detailed analysis).

CONCLUSION

Although the Civic Federation is pleased that Illinois Governor Pat Quinn has proposed essential changes in the state's nearly insolvent pension systems, we are not able to support his FY2010 State of Illinois **operating budget** of $52.9 billion. This budget fails to strike an appropriate balance between raising revenues and cutting expenditures. Additionally, new revenues from any new tax, including the Governor's proposed $3.15 billion income tax increase, must be exclusively used to pay for the state's staggering amount of unpaid bills, as well as to reduce the state's enormous pension fund liability.

We reject the Governor's $26.0 billion *Illinois Jobs Now!* **capital plan** because it is not tied to a comprehensive capital improvement planning process and because it is unaffordable over time. Capital investment is needed in Illinois to address the state's deteriorating infrastructure and help create jobs during the current global economic downturn. However, the State has failed to prepare and make publicly available a sufficiently detailed multi-year capital improvement plan.

While the Federation has serious concerns with most of the state's proposal to close the two-year budget deficit and its capital plan, Governor Quinn should be commended for taking a courageous step towards meaningful pension and employee healthcare benefit reform.

Unfortunately, Governor Quinn is also proposing to fund only the normal cost of the state's five pension funds for FY2010 and reduce FY2009's pension contribution by $550 million. The positive gains accrued from the state's proposal to create a second tier of pension benefits does not give the state license to shirk its current pension funding responsibilities on already accrued liabilities.