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ANALYSIS OF PROPOSED ILLINOIS FY2013 GENERAL FUND BUDGETS

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1. INTRODUCTION

Many of the fiscal problems that have plagued Illinois over the last decade remain apparent in the FY2013 General Fund Budget proposals that the Governor and Illinois House of Representatives have put on the table. These problems include a significant accumulated deficit that, at a minimum, will be just over $7.7 billion, a failure to invest adequately in basic core services like educating our children or caring for vulnerable members of society, and an ongoing structural imbalance between General Fund revenue growth on the one hand and service cost growth on the other, that will only get worse when the temporary tax increases which recently passed begin to phase out in FY2015. Given these ongoing structural fiscal problems, the Governor has requested each agency receiving General Fund appropriations in FY2013 to identify spending cuts varying from five to nine percent from FY2012 levels. The primary ramification of this request by the Governor is clear: the actual line item appropriations set forth in the Governor's proposed FY2013 General Fund Budget are at best maximum potential allocations. Actual spending will almost invariably be somewhat less, as agencies identify the cuts requested by the Governor.

How can this be, when just over one year ago, in January 2011, Illinois passed significant, albeit temporary, tax increases to help the state cope with its fiscal problems? Well, because at that time the accumulated General Fund deficit stood at just under $16 billion.[1] Meanwhile, the temporary tax increase (P.A. 96-1496) generated approximately $7.2 billion in new revenue, primarily by increasing the state's personal income tax rate from three to five percent, and corporate income tax rate from 4.8 to seven percent.[2] Hence, the accumulated FY2012 deficit was reduced to around $8.8 billion, but not eliminated. Even after implementing around $263 million in spending cuts during FY2012, that still left an accumulated deficit to carry forward into FY2013 of $8.5 billion.

Making the January 2011 tax increases temporary—they begin to phase-out in FY2015— would have been an appropriate way to address the state's fiscal woes, if in fact those woes were mostly caused by the Great Recession, which began in December of 2007 and continued through June of 2009. Unfortunately, Illinois' fiscal woes are primarily the result of long-term, structural flaws in the state's tax system which the Great Recession certainly exacerbated, but did not cause. So, while the temporary tax increases of 2011 helped mitigate Illinois' fiscal woes for a few years, the state's structural fiscal problems remain unresolved.

2. NEW DEVELOPMENTS IN STATE BUDGETING

Three significant changes from prior practice in state budgeting must be born in mind when reading this budget analysis for FY2013. First, the Taxpayer Accountability and Budget Stabilization Act (P.A. 96-1496) that passed in January, 2011, (**TABSA**) caps aggregate General Fund spending in FY2013, FY2014 and FY2015. This is the first time in Illinois history that total General Fund spending will be capped. The amount of those annual caps, together with the revenue projected for each fiscal year subject to the caps, are set forth in Figure 1. Note that, in no year over the sequence is it projected that the state will actually have enough General Fund revenue to spend up to the cap.

Figure 1
Annual Amount by Which Revenue Projection Falls Short of Spending Caps, FY2013-FY2015
($ Billions)

	FY2013	FY2014	FY2015
Revenue Projections	$33.719	$34.975	$33.461
Annual Spending Caps under P.A. 96-1496	$37.550	$38.310	$39.070
Revenue Shortfall	**(-$3.831)**	**(-$3.335)**	**(-$5.609)**

Sources: FY2013 revenue estimate is from Amendment No. 1 to HR707 adopted March 1, 2012, and Senate Floor Amendment No. 1 to SR 586 adopted March 12, 2012. FY2014 and FY2015 revenue estimates are from the Governor's three-year budget forecast issued in January, 2012.

The items of General Fund spending which are subject to the aggregate caps established under TABSA (the **Capped Items**) are:

(i) The current "operations budget" for all public services covered by the General Fund—this includes the core services of Education, Healthcare, Human Services and Public Safety, which collectively account for over 90 percent of all General Fund spending;

(ii) "Statutory Transfers Out" of the General Fund for hard costs over which the Legislature and Governor have little to no authority to change—these hard costs primarily include items such as debt service owed to bond holders and financial institutions, payments made to local governments under the Local Government Distributive Fund (**LGDF**) and repayments of amounts borrowed from other state special funds, like the Budget Stabilization Fund, to cover General Fund spending; and

(iii) Payment of all amounts owed to the five public pension systems for which the state has responsibility,[3] including both the normal cost contribution needed to fund the future benefits of current workers (approximately $1.58 billion in FY2013), as well as the portion of the repayment of the $83 billion debt the state owes to its five pension systems that is due in FY2013 (approximately $3.51 billion). The debt the state owes to the pension systems was built up over decades as lawmakers and governors alike chose to divert revenue they should have used to fund pensions to instead cover the cost of then current service delivery. This practice essentially used the state pension systems to subsidize the cost of service delivery to taxpayers. While this practice benefited taxpayers by reducing the cost of public services they consumed in the past, the price of repaying the pension debt incurred to reduce the cost of past services is proving difficult to manage.

Second, the Budgeting for Results Act (**BFR**), which was signed into law on July 1, 2010, became fully effective for the first time in FY2013. BFR changes how General Fund appropriations are made and reported.[4] Among other things, BFR requires the Governor to make three-year projections for both General Fund spending and revenue. It also requires the Governor's Office of Management and Budget (**GOMB**) to report proposed appropriations for services not just by department and agency, but also by category of services being rendered. The initial seven service categories the Governor established under BFR are Education, Healthcare, Human Services, Public Safety, Economic Development, Quality of Life and Government Services. This new BFR methodology for categorizing public services will complicate long-term comparison of service funding trends, because the new service categories do not fully comport with the way services were categorized in the past.

The most significant change implemented under BFR is the new "results-based" budgeting process for state-funded programs. The concept is to use data-driven outcome measures to evaluate the effectiveness of all program initiatives funded under each service category. This is intended to focus budget funding on statewide policy goals rather than department or agency goals. This is a departure from the past, line-item approach to budgeting utilized in Illinois. Under prior practice, the appropriation budgeted to an agency or program in the preceding fiscal year was used as the baseline for incremental funding changes in the current fiscal year. This incremental, line-item approach to budgeting frequently resulted in near automatic continuation of programs from year-to-year. Under BFR, that near automatic funding process ends, and is replaced by setting an aggregate appropriation for the new service categories annually, and then divvying that aggregate appropriation up amongst programs that are best achieving the underlying service objectives, using a data-based analysis,.

While this approach has the potential to improve service delivery, it is essential that all appropriate metrics be utilized in the process. This would include both program-specific metrics, as well as overall capacity evaluation. Obviously, if a program has insufficient financial resources on the input side, it will deliver inadequate results on the output side. In such an instance, inadequate results would not have been driven by programmatic flaws, but rather lack of funding, hence further funding cuts would be an inappropriate and counterproductive solution.

Third, the General Assembly has decided to issue its own projections of revenue for the General Fund in FY2013, rather than relying on the projections issued by the Governor. This is the second, consecutive fiscal year the General Assembly has made its own, independent revenue projections. In addition, the Illinois House of Representatives (**House**) issued a proposed appropriations package for the FY2013 General Fund that appropriates $867 million less on services than does the Governor's proposal. This adds another layer of complexity to the budget process that will make it even more difficult for taxpayers, citizens, providers and advocates alike to understand what is really happening to the state's investment in core services. To the extent practicable, this analysis will attempt to reconcile both the House's and Governor's General Fund Budget proposals for FY2013 with each other, as well as with FY2012 and long-term budget trends.

3. FY2013 BUDGET HIGHLIGHTS

Highlights of the two FY2013 budget proposals include the following:

- The General Assembly estimates that total revenue from all sources for FY2013 will be $33.719 billion, which is $221 million less than the Governor's estimate of $33.94 billion. Similarly, the Governor and House of Representatives have issued different proposals for General Fund spending in FY2013.

- The Governor has issued a full, detailed, line-item General Fund Budget proposal for FY2013 that would, at a maximum, appropriate $24.825 billion for spending on core public services. Unlike the Governor, the House has not detailed by line-item how it would spend the maximum $24.108 billion it proposes to appropriate on services in FY2013. Instead, the House only identifies maximum aggregate appropriations by overall service category (e.g. P-12, Higher Education, Human Services, etc.) under the new *Budgeting for Results* legislation, without specifying how those appropriations would be allocated to different programs within the larger service categories.

- In any event, both the Governor's and House's aggregate General Fund appropriations for services are more than what will ultimately be spent on those services in FY2013 for the following reasons:

  (i) Despite appropriating $24.825 overall to services, the Governor's proposal assumes $500 million of that amount will not be spent. This reduces the overall appropriations under the Governor's FY2013 proposal to $24.325 billion. It is unclear which budget lines will be cut or payments deferred to account for that $500 million in unspent appropriations.

  (ii) Similarly, the House proposal assumes $650 million of its $24.108 in gross appropriations will not be spent in FY2013, reducing overall appropriations under the House proposal to $23.458 billion. It is unclear which budget areas will be cut or payments deferred to account for that $650 million in unspent appropriations.

  (iii) Both the Governor's and House's FY2013 General Fund budget proposals are predicated on the state cutting Medicaid spending by $2.7 billion and Group Health Insurance spending by $260 million from FY2012 levels. To the extent those cuts do not materialize fully in FY2013, either other service areas will be cut or the state's accumulated deficit will increase.

- After accounting for unspent appropriations, the House proposes to spend a maximum of $23.458 billion, or $867 million less than the Governor, on core services covered by the General Fund in FY2013.

- Except for Higher Education, the Governor's FY2013 proposed appropriations for services by major category (P-12 Education, Higher Education, Healthcare, Human Services and Public Safety) are either cut from or remain constant in real terms with FY2012 appropriations. Under the House proposal, every core service (P-12, Higher Education, Healthcare, Human Services and Public Safety) would be cut in both nominal and real terms from FY2012 levels.

- In FY2013, P-12 funding will be cut under the Governor's proposal by just over $150 million in real terms from FY2012 levels. The FY2013 House proposal, on the other hand, would cut P-12 funding in FY2013 by $258 million nominal dollars and $445 million in real terms from the final FY2012 appropriation.

- Actual spending on PreK-12 education in FY2013 will in any event be less than what is in the Governor's budget proposal. This is because the Governor's Office of Management and Budget has already informed the Illinois State Board of Education that the formula portion of general state aid to school districts will be "prorated"—meaning, not funded at 100 percent of its stated level—in FY2013.

- The nonpartisan Education Funding Advisory Board (**EFAB**) is required by law to recommend a "Foundation Level" of per pupil spending that is sufficient to cover the cost of an adequate P-12 education. The Foundation Level is supposed to include most of the basic costs of educating a "non-at-risk" child, that is, a child with a reasonable likelihood of academic success. The Foundation Level does not include the cost of significant items, like transportation, special education, and educating children who are English language learners or live in poverty.

- The funding cuts for P-12 under both the Governor's and House's FY2013 proposals will further diminish the quality of public education in Illinois. In FY2003, the state's actual Foundation Level was $120 less per child than the EFAB recommendation tied to the actual, base cost of educating a non-at-risk child. By FY2013, the state's actual Foundation Level will be at least $2,207 less than the EFAB recommendation.

- The General Fund will end FY2013 with an accumulated deficit ranging from $8.3 to $10.2 billion under the Governor's proposal, and $7.7 to $9.3 billion under the House's proposal.

- Since hard costs like debt payments and statutory transfers out must be paid, the full, accumulated FY2013 General Fund deficit affects solely that portion of the General Fund budget ($24.325 billion in the Governor's proposal and $23.458 in the House's proposal) appropriated for delivery of current services in FY2013, like Education, Healthcare, Human Services and Public Safety.

- Although the state's contribution to its five pension systems of $5.09 billion in FY2013 is scheduled to be 23 percent greater than the $4.135 billion contribution for FY2012, none of this increase is due to benefits payable under the pension plans. Instead, the year-to-year increase is driven entirely by the schedule established for repaying the debt the state owes to its pension systems after decades of borrowing against those systems to subsidize the cost of delivering public services in prior years. While this practice benefited taxpayers by reducing the cost of public services consumed in the past, the schedule for repayment of this debt is straining current fiscal resources.

- The annual cost in lost revenue to the state's General Fund from the tax expenditures of $93 million (for a full fiscal year) granted under PA. 097-0636 to the Chicago Mercantile Exchange, a company that reported over $950 million in annual profits in 2010, is more than what the state will save in General Fund revenue costs from closing eight Department of Corrections facilities and two Department of Juvenile Justice facilities, and making staff reductions at and consolidations of offices within the Department of Children and Family Services, Department of Agriculture, Central Management Services, and the Illinois State Police, combined.

- The state's Medicaid program has not contributed at all to the growth in the General Fund budget deficit. Indeed, use of state own-source tax revenue to fund Illinois' Medicaid program will be $900 million less in FY2013 than in FY2007 under both the House's and Governor's proposals. This means the state's Medicaid program has freed up $900 million in state own-source tax revenue to fund other services.

- After adjusting for inflation, spending on all the core services of P-12 Education, Higher Education, Human Services, Healthcare and Public Safety will be lower in FY2013 under both the Governor's and House's proposals, than in FY2000.

- Based on the Governor's three-year projections issued under the new *Budgeting for Results* legislation, the trend of cutting core services can be expected to continue into the future. Indeed, after accounting for inflation, by FY2015 spending on: (i) P-12 will be -7.5 percent less than FY2012; (ii) Higher Ed -4.9 percent less; (iii) Human Services -7.2 percent less; (iv) Healthcare -14.1 percent less; and (v) Public Safety -16.7 percent less.

- Even assuming Illinois can continue making significant, real, inflation-adjusted cuts in spending to all services covered by the General Fund in FY2014 and FY2015, the structural deficit in the General Fund will worsen into the foreseeable future, unless the state implements comprehensive tax reform that raises adequate revenue to sustain public services, modernizes the tax system and imposes taxes more fairly.

4. **REVENUE ESTIMATES**

As of the date of this report, the General Assembly and Governor have prepared two separate estimates of the total amount of General Fund revenue that will be available in FY2013 to cover the Capped Items. Figure 2 delineates those revenue projections, broken down by state own-source revenue and federal revenue. As Figure 2 shows, total revenue available to cover the Capped Items in FY2013 is anticipated to range from $33.7 billion to $33.9 billion.

FIGURE 2
FY2013 Revenue Estimates
($ Millions)

	GOMB Estimate	General Assembly Resolutions	Difference between General Assembly and GOMB
Personal Income Tax	$15,273	$15,140	(-$133)
Corporate Income Tax	$2,550	$2,504	(-$46)
Sales Tax	$7,335	$7,335	$0
Other Taxes, Fees and Interest Income	$3,047	$3,005	(-$42)
Transfers In (Primarily Lottery and Gaming)	$1,800	$1,800	$0
Total State Sources	$30,005	$29,784	(-$221)
Federal Sources	$3,935	$3,935	$0
Total General Fund Revenue	$33,940	$33,719	(-$221)

Sources: FY2013 GOMB Budget Book, Ch. 2-63; Amendment No. 1 to HR707 adopted March 1, 2012, and Senate Floor Amendment No. 1 to SR586 adopted March 7, 2012.

This is the second consecutive fiscal year in which the General Assembly has decided to issue a projection of General Fund revenue that differs from the Governor's. In FY2012, the General Assembly's revenue projection of $33.182 billion was $757 million less than the revenue projection issued by the Governor. Ultimately, the FY2012 General Fund Budget was built using the lower revenue estimate issued by the General Assembly.

For FY2013, the General Assembly's revenue estimate of $33.719 billion is $221 million less than the GOMB estimate of $33.94 billion. Since the lower revenue estimate issued by the General Assembly was used to form the FY2012 budget, this report will use the lower revenue estimate issued by the General Assembly for FY2013.

Interestingly, despite the accumulated $8.5 billion backlog of unpaid bills from FY2012 that will carry-forward into FY2013, and the state's long-term structural deficit, in December of 2011, Illinois decision makers elected to pass legislation designed to reduce ongoing revenue generation from both the state's corporate and personal income taxes. Under P.A. 097-0636, effective as of December 16, 2011, the state created or expanded a number of tax expenditures purportedly designed either to keep existing jobs in Illinois or to promote long-term economic growth. P.A. 097-0636 also implemented changes to existing law which will reduce the annual General Fund revenue generated by Illinois estate tax. It is unclear what the rationale was for this new estate tax expenditure, given that it is contrary to all the text book principles of sound taxation (i.e. tax policy should be fair, responsive, stable and efficient),[5] and cannot be expected to generate any non-tax policy benefits like, for instance, economic development. Indeed, on average, only the wealthiest two percent pay this tax.[6] In any event, Figure 3 shows the annual, projected revenue loss these tax expenditures will generate in FY2013 and FY2014.

FIGURE 3
Revenue Loss from Tax Expenditures for Business
And the Affluent Under P.A. 097-0636 ($ Millions)

Category	FY2013	FY2014
Reduction in Corporate Income Taxes Payable by CME	(-$ 43)	(-$ 85)
Exchange Market Data Tax Expenditure for CME	(-$ 8)	(-$ 8)
Sears	(-$ 15)	(-$ 15)
R&D Credit	(-$ 40)	(-$ 40)
Net Operating Loss Reinstatement	(-$ 50)	(-$ 50)
Live Theatre Credit	(-$ 1)	(-$ 1)
Total Corporate Tax Expenditures	(-$157)	(-$199)
Estate Tax Cut	(-$ 20)	(-$ 43)
TOTAL REVENUE LOSS	(-$177)	(-$242)

Source: Fiscal Note to P.A. 097-0636.

As Figure 3 shows, under P.A. 097-0636, the state singled out primarily two large corporations, the Chicago Mercantile Exchange (**CME**) and Sears, for annual tax breaks of $93 million and $15 million respectively, once those tax breaks are in effect for a full fiscal year. Overall, the annual cost of P.A. 097-0636 in lost corporate income tax revenue for the state's General Fund will increase to $199million in FY2014 and thereafter, when the legislation will be in effect for the full fiscal year.

This tax expenditure legislation was justified as a way to keep jobs in the state. However, it should be pointed out that in 2010, the CME reported its profitability at $951 million. Providing this tax expenditure to CME will in all likelihood boost that company's annual profits to over $1 billion. It is unclear why such a profitable business requires to be subsidized with public revenue. Meanwhile, Sears has closed five stores in Illinois since receiving its $15 million annual subsidy of public revenue.[7]

Interestingly, the public facilities recently targeted for staff reductions and closure to save General Fund revenue, eight Department of Corrections facilities, two Department of Juvenile Justice facilities, and numerous consolidations of offices in the Department of Human Services, Department of Child and Family Services, Department of Agriculture, Central Management Services and Illinois State Police offices will reduce state expenditures by approximately $80 million annually, or less than the annual cost of the CME tax break alone.[8]

Under P.A. 097-0652, also effective as of December 16, 2011, the state increased the value of its existing Earned Income Tax Credit (**EITC**) from five percent to ten percent of the amount of the federal EITC, and increased the standard exemption available under the individual income tax from $2,000 to $2,050 (with subsequent annual increases tied to the Consumer Price Index)[9] to create more tax fairness in Illinois. Figure 4 shows the projected annual revenue loss for FY2013 and FY2014 associated with this legislation.

FIGURE 4
Revenue Loss from Tax Expenditures
for Individuals Under P.A. 097-0652 ($ Millions)

Category	FY2013	FY2014
EITC Increase	(-$ 56)	(-$ 53)
Personal Exemption Increase	(-$ 30)	(-$ 30)
TOTAL	(-$ 86)	(-$ 83)

Source: Fiscal Note to P.A. 097-0636.

The concept behind P.A. 097-0652 was to create more tax fairness in Illinois. This is a legitimate tax policy goal for the state to pursue, given that it currently has one of the most unfair tax systems of any state in the nation, particularly for low and middle income families.[10] Aggregated together, the ongoing annual cost of the tax relief provided to millions of the state's citizens under P.A. 097-0652 will be slightly less than the tax relief given to CME, one of the nation's most profitable businesses under P.A. 097-0652.

5. PROPOSED FY2013 GENERAL FUND APPROPRIATIONS FOR PUBLIC SERVICES

(a) The Governor's Proposed Spending Plan. The Governor's proposed FY2013 General Fund appropriations are detailed by major service area in Figure 5, in a manner consistent with past reporting practices. Note that these categories include proposed appropriations for all the Capped Items.

FIGURE 5
Governor's FY2013 Proposed
General Fund Appropriations
($ Millions)

Category		Appropriation
(i)	Total General Fund Appropriation for Capped Items	$33,777
(ii)	Total Hard Costs	$9,450
	Debt Service (Pension & Capital Bonds)	$2,071
	Other Statutory Transfers Out	$2,289
	Pension Contributions	$5,090
(iii)	General Fund Service Approps Gross	$24,825
	Pre K-12	$6,783
	Higher Education	$2,161
	Healthcare (Medicaid, DHFS, and DPH)	$6,890
	Group Health Insurance	$1,171
	Human Services	$5,060
	Public Safety	$1,510
	Other	$1,250
(iv)	"Unspent Appropriations"	$500
(v)	Net General Fund Service Appropriations	$24,325

Source: FY2013 GOMB Budget Book, Ch. 2-63.

The appropriations for all public services delineated in Figure 5 exclude any pension contributions to each of the relevant state funded pension systems, i.e. the Teachers' Retirement System (**TRS**), State University Retirement System (**SURS**), State Employees Retirement System (**SERS**), the General Assembly Retirement System (**GARS**) or the Judicial Retirement System (**JRS**), as applicable. This was done to isolate the maximum amount proposed to be spent on current delivery of services. The total of $5.09 billion in pension payments the Governor proposes to make in FY2013 include both the contributions required to fund the benefits promised to current workers (approximately $1.58 billion), as well as an installment payment (approximately $3.51 billion) of the debt owed to the five state pension systems. The state incurred this debt to the pension systems, which now stands at approximately $83 billion, over decades, primarily by borrowing against contributions the state owed to the five pension systems to subsidize the cost of delivering public services in past fiscal years.

The "Human Services" category in Figure 5 includes all appropriations to the three agencies primarily responsible for delivering those services, the Department of Aging (**DOA**), Department of Children and Family Services (**DCFS**) and the Department of Human Services (**DHS**). The "Public Safety" category includes the appropriations proposed for the Department of Justice (**DOJ**), Department of Juvenile Justice (**DJJ**) and the Illinois State Police.

The "Healthcare" category includes the $6.767 billion in appropriations proposed for the Department of Health and Family Services (**DHFS**) and $126 million in appropriations proposed for the Department of Public Health. Note that the vast majority of funding for DHFS is a $6.638 billion appropriation for Medicaid. Group Health Insurance covers the state's health insurance programs provided to its workers.

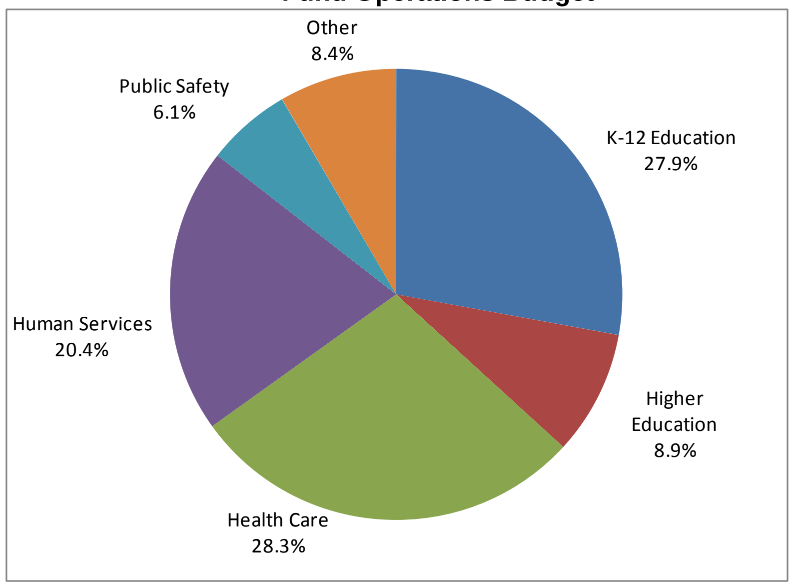
Two poorly understood categories of General Fund spending are the lines reserved for "Statutory Transfers Out" and "Other". As the name implies, "Statutory Transfers Out" covers funds that, pursuant to state legislation, must be paid from the General Fund to other state funds, local governments, and to cover other state obligations created by statute. The most significant items included under the "Statutory Transfers Out" category are payments made to the Local Government Distributive Fund (**LGDF**) ($1.098 billion in FY2013), repayment of loans extended to the General Fund by other, special state funds like the Budget Stabilization Fund, and debt service payments, primarily on various pension obligation bonds and some capital project debt ($2.071 billion in FY2013). Under the LGDF, the state currently shares with local governments across Illinois one-tenth of the income tax revenue it receives from that portion of state income tax receipts generated by 60 percent of net personal income tax revenue and 68.6 percent of net corporate income tax revenue.[11] This is a change from past practice when the state shared 10 percent of all income tax revenue with local governments through the LGDF. This change in policy was made when the state increased its individual and corporate income tax rates in January of 2011,[12] effectively freezing the local government share in state income tax revenue at the same level as pertained prior to those tax increases.

The category "Other" includes: appropriations for legislative agencies such as the General Assembly and the Commission on Government Forecasting and Accountability (**COGFA**); smaller state agencies such as the Department of Central Management Services (**CMS**), Department of Commerce and Economic Opportunity (**DCEO**), and the Department of Revenue (**IDOR**); a portion of Group Health Insurance; and various boards, commissions and authorities such as the Capital Development Board, the Illinois Deaf and Hard of Hearing Commission, and East St. Louis Financial Advisory Authority.

"Statutory Transfers Out" and the "Pension Contributions" are identified as "hard costs" in Figure 5 because those appropriations are required by law and neither the General Assembly nor Governor have discretionary appropriation authority over them. This has consequences, the most significant of which involves the impact of the General Fund deficit. Since the hard costs must be paid, the full, accumulated FY2013 General Fund deficit, which is estimated to range from $7.7 to $10.2 billion (see Section 6 of this Report) affects solely the $23.325 billion the Governor proposes to appropriate for delivery of current services in FY2013, like Education, Healthcare, Human Services and Public Safety.

The Governor's FY2013 budget proposal continues to prioritize funding the same core services of P-12 through Higher Education (36.8% of the General Fund Services budget----net of hard costs), Healthcare (28.3%), Human Services (20.4%) and Public Safety (6.1%), in roughly the same proportions as have historically pertained. These core service areas account for over $9 out of every $10 appropriated in the Governor's proposed FY2013 General Fund budget.

FIGURE 6
Governor's Proposed FY2013 General Fund Operations Budget



Source: GOMB FY2013 Budget Book, Table I-A "Operating Appropriations by Agency

A word of caution about the appropriations for public services identified in subpart (iii) of Figure 5. These are the maximum target appropriations for those service categories in FY2013. In all likelihood, however, the actual spending on those service areas in FY2013 stands to be less than what is appropriated in the Governor's proposed budget for a number of reasons.

First, as referenced in the introduction to this report, the Governor has requested all agencies receiving General Fund revenue to cover current service delivery costs in FY2013, to hold back, and ultimately find ways to cut, spending on their respective service areas by anywhere from five to nine percent from FY2012 levels. Obviously, to the extent such cuts are made, the final spending on those services will be reduced from the appropriation amounts cited in the FY2013 budget proposal.

Second, as highlighted in line (iv) of Figure 5, the Governor's FY2013 spending proposal assumes that at least $500 million of the proposed $24.825 billion General Fund Budget for services will not be spent. How that $500 million in cuts is allocated among the core service areas will of course result in a concomitant reduction in spending from the amount of appropriations identified in the FY2013 budget book.

Third, actual spending on P-12 education in FY2013 will in any event be less than what is in the Governor's budget proposal, as reported in Figure 5. This is because GOMB has already informed the Illinois State Board of Education (**ISBE**) that general state aid to school districts will be "prorated" in FY2013. This simply means that schools will not receive the full appropriation for general state aid identified in the budget book. This will be the second, consecutive fiscal year in which general state aid to school districts has been prorated. While the final cut in general state aid for the 2012-2013 school year has not been identified, estimates are that it could reach $187 million.[13]

Fourth, the appropriations identified in the Governor's FY2013 budget proposal assume that Medicaid expenditures in FY2013 will be cut by $2.7 billion from FY2012 levels and that Group Health Insurance costs will be reduced by $269 million from FY2012 levels. To the extent those reductions are not realized in FY2013, either spending levels for other services will be reduced, or the accumulated deficit remaining in the General Fund at the end of FY2013 will increase.

(b) The General Assembly's Proposed Spending Plan. The House of Representatives, pursuant to HR706 (Enrolled), which passed on March 29, 2012 (the "**House Proposal**"), makes aggregate appropriations to services by major category for the FY2013 General Fund,[14] which do not comport with those of the Governor outlined above. Figure 7 delineates the House Proposal by major service category.

FIGURE 7
Illinois House of Representatives
FY2013 Proposed General Fund Appropriations
($ Millions)

Category		Appropriation Amount
(i)	Total General Fund Appropriations for Capped Items	$33,719
(ii)	Total Hard Costs	$9,460
	Debt Service (Pension & Capital Bonds)	$2,218
	Other Statutory Transfers Out	$2,142
	Pension Contributions	$5,100
(iii)	Repayment of Bills from FY2012	$800
	Medicaid (backlog from FY2012)	$500*
	Backlog of Other Unpaid Bills from 2012	$300
(iv)	General Fund Services Approps Gross	$24,108
	Pre K-12	$6,492
	Higher Education	$1,979
	Medicaid (FY2013 Services)	$6,638
	Human Services	$5,087
	Public Safety	$1,576
	Group Health Insurance	$1,171
	Other	$1,165
(v)	Unspent Appropriations	$650
(vi)	Net General Fund Service Approps for FY2013	$23,458

Source: HR706 Enrolled, adopted March 29, 2012. Totals off by $50 million due to rounding.

*Note that, in HR706, the amount shown for the repayment in FY2013 of Medicaid bills left over from FY2012 is $1 billion, not the $500 million identified in Figure 7. CTBA reports the repayment this way because only $500 million in General Fund revenue will be used to pay that backlog. The remaining $500 million will come from Medicaid matching funds the federal government will transfer to Illinois, bringing the total payment up to the $1 billion indicated in HR706.

As with the Governor's proposal, there is a line item for "Unspent Appropriations" in the FY2013 House Proposal. The House's unspent appropriation amount of $650 million is $150 million more than the Governor's $500 million allocation. Again, this means that the appropriation amounts identified for any specific service category in the House Proposal are maximum target appropriations, which collectively will be reduced by $650 million. Since the "Hard Costs" identified in Figure 7 have to be paid by law, all spending cuts associated with the "Unspent Appropriation" line will have to come from the public service categories listed under item (iv) in Figure 7, which are subject to the discretionary appropriation authority of the General Assembly and Governor.

The House Proposal differs from the Governor's FY2013 proposal in two key ways. First, it does not include any line item appropriations for specific programs and services. Instead, the House Proposal identifies the potential, maximum, aggregate appropriation by major service category, using the BFR process. How those gross appropriations are ultimately allocated to specific services is left undetermined. Second, the House Proposal anticipates appropriating approximately $867 million less for delivery of current public services under the General Fund in FY2013 than does the Governor.

The "Human Services" funding category under BFR as interpreted by the House in HR706 includes the following agencies in addition to DHS, DOA and DCFS:

- Department of Health and Family Services (Administration and Child Support Functions)
- Department of Public Health (**DPH**)
- Human Rights Commission
- Human Rights Department
- Council on Developmental Disabilities
- Veterans Affairs
- Guardianship and Advocacy Commission
- Deaf and Hard of Hearing

Figure 8 reconciles, to the extent possible, the differences between the Governor's and House's FY2013 General Fund Budget proposals.

FIGURE 8
Reconciliation Between Governor's and House's FY2013 General Fund Budget Proposals ($ Millions)

Category		Governor's FY2013 Approps	House FY2013 Approps Under HR706	Difference House/GOMB
(i)	Total General Fund Appropriations	$33,777	$33,719	(-$58)
(ii)	Total Hard Costs	$9,450	$9,460	$10
	Debt Service (Pension & Capital Bonds)	$2,218	$2,218	$0
	Other Statutory Transfers Out	$2,142	$2,142	$0
	Pension Contributions	$5,090	$5,100	$10
(iii)	Repayment of Bills from FY2012	$0	$800	$800
	Medicaid	$0	$500	$500
	Other	$0	$300	$300
(iv)	General Fund Services Approps Gross	$24,825	$24,108	(-$717)
	Pre K-12	$6,783	$6,492	(-$291)
	Higher Education	$2,161	$1,979	(-$182)
	Medicaid (FY2013 Services)	$6,638	$6,638	$0
	Human Services & other, non-Medicaid Healthcare	$5,312	$5,087	(-$225)
	Public Safety	$1,510	$1,576	(-$66)
	Group Health Insurance	$1,171	$1,171	$0
	Other	$1,250	$1,165	(-$85)
(v)	Unspent Appropriations	$500	$650	$150
(vi)	Net FY2013 General Fund Service Approps	$24,325	$23,458	(-$867)

Sources: FY2013 GOMB Budget Book, Ch. 2-63; and HR706 (Enrolled), adopted March 29, 2012.

(c) Nominal Dollar (without adjusting for inflation) Comparison of FY2013 Budget Proposals to FY2012. Figure 9 shows how the Governor's proposed appropriations for public services in FY2013 compare to FY2012 in nominal dollars. Year-to-year, Higher Education fares the best, being recommended for a 7.6 percent nominal dollar increase, while Group Health Insurance (-18.7 percent), Public Safety (-9.6 percent) and "Other" (-9.4 percent) fare the worst.

Except for Higher Education, under the Governor's FY2013 budget proposal spending for services are either cut from or remain constant in nominal dollars with FY2013 appropriations.

FIGURE 9
GOMB FY2013 General Fund Appropriation Proposal
Compared to FY2012 Final – Nominal Dollars ($ Millions)

Category	FY2012 Final — After Vetoes and Supplementals	FY2013 Proposed GOMB	$ Diff	% Change
PreK-12 Education	$6,750	$6,783	$33	0.48%
Higher Education	$2,092	$2,161	$69	3.3%
Medicaid	$6,640	$6,638	(-$2)	—
Group Health	$1,440	$1,171	(-$269)	-18.7%
Other Healthcare	$260	$250	(-$10)	-3.8%
Human Services (net of Healthcare)	$5,020	$5,060	$40	0.8%
Public Safety	$1,670	$1,510	(-$160)	-9.6%
Other	$1,380	$1,250	(-$130)	-9.4%

Sources: FY2012 Final Budget Summary issued by COGFA in August 2011, and FY2013 GOMB Budget Book, Ch. 2-63.

Figure 10 highlights the nominal dollar change in appropriations by major service category between the final FY2012 budget and the FY2013 House Proposal. Under the House Proposal for FY2013, every service category is cut from FY2012 levels in nominal dollars. Note that under its interpretation of BFR, the House lumped the "Other Healthcare" expenditures in with "Human Services" in its FY2013 proposal. Unfortunately, the House Proposal does not delineate how much of its aggregate FY2013 Human Services appropriation is specifically targeted to DPH and DHFS administrative costs and child support services and how much to the actual delivery of Human Services. So, to try to make it an apples-to-apples comparison with FY2012, those "Other Healthcare" expenditures are estimated to be $250 million in FY2013, which is the amount the Governor's FY2013 budget proposal allocates to those items.

FIGURE 10
FY2013 House General Fund Budget Proposal
Compared to FY2012 Final – Nominal Dollars ($ Millions)

Category	FY2012 Final — After Vetoes and Supplementals	FY2013 Proposed House	$ Difference	% Change
PreK-12 Education	$6,750	$6,492	(-$258)	-3.8%
Higher Education	$2,092	$1,979	(-$113)	-5.4%
Medicaid	$6,640	$6,638	(-$2)	—
Group Health	$1,440	$1,171	(-$269)	-18.7%
Human Services (net of Healthcare)	$5,020	$4,837	(-$183)	-3.6%
Public Safety	$1,670	$1,576	(-$94)	-5.6%
Other	$1,380	$1,165	(-$215)	-15.6%

Sources: HR706 Enrolled, adopted March 29, 2012; GOMB FY2013 Budget Book and Illinois House Budget Committees Jurisdiction Lists.

(d) Both the Governor's and House's FY2013 General Fund Budget Proposals Continue the Trend of Cutting Every Major Category of Public Services Going Back to FY2000. Of course, a nominal dollar comparison does not provide an accurate barometer of whether spending on services is actually growing, staying flat or declining. That is because nominal dollar comparisons do not adjust for either inflation or population growth, both of which make it more expensive to provide the same level of services from one fiscal year into the next.

There are two major inflation metrics published by the Federal Bureau of Labor Statistics (**BLS**) that are used to determine how much the cost of products and services increase over time. The first is the Consumer Price Index or "**CPI**". The CPI is a comprehensive inflation measure that broadly covers the change in price for all goods and services in the economy. The CPI includes changes in the cost of everything from pop tarts and hair care products to uranium ore and bowling. It should be noted state government does not purchase the vast majority of items included in the CPI. So while the CPI is an excellent metric for evaluating the economy as a whole, it is not the best choice for evaluating public sector spending.

The second major inflation metric is the Employment Cost Index or "**ECI**". As the name implies, the ECI is more narrow than the CPI, and focuses on changes in the cost of paying compensation to workers over time. Public services are very labor intensive, and the vast majority of public sector expenditures made through the Illinois General Fund, 80 to 90 percent, cover the compensation paid to the healthcare workers, teachers, police officers, social workers and other civil servants who actually provide the public services consumed in communities across the state. Hence, the ECI is the more accurate metric for analyzing the inflationary cost increases that impact public sector expenditures on services.

The way inflation adjustments work over time is easy. Say expenditures on public safety were $100 in year one, and the inflation rate for that year was five percent. In year two, the appropriation for public safety would have to be $105 to purchase the same level of services provided in year one, in what is referred to as "real"—i.e. inflation-adjusted terms. If in year two public safety received an appropriation of $103, then despite the three dollar increase in nominal appropriations, in real, inflation-adjusted terms, spending was actually cut by two dollars.

Figure 11 shows how spending under the General Fund in FY2013 under the Governor's proposal compares to FY2000, in both nominal and real, inflation-adjusted terms.

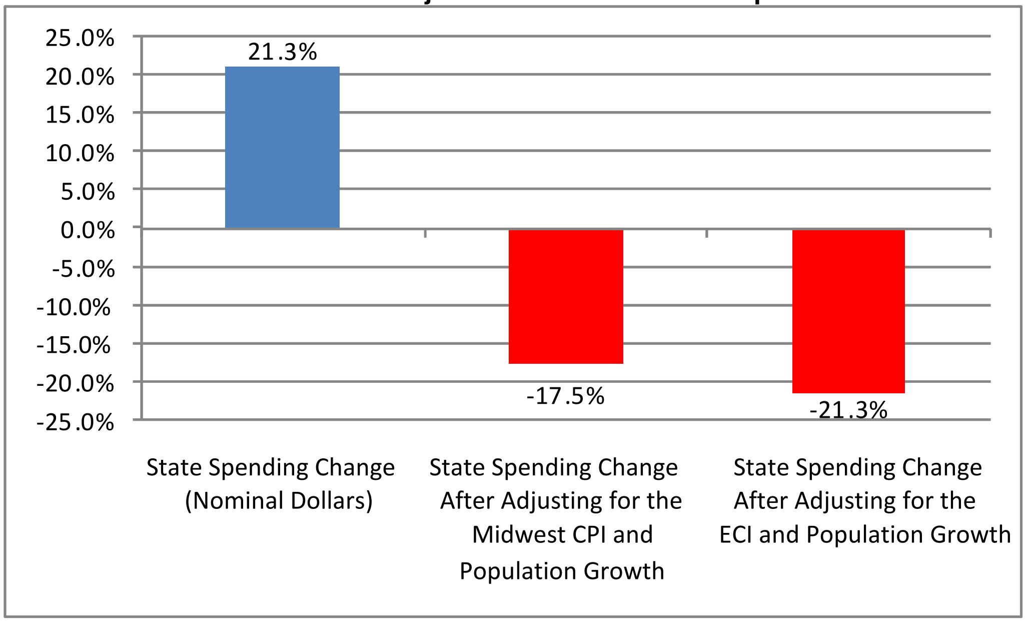
FIGURE 11
Illinois General Fund Spending by Major Public Service Category
FY2013 Governor's Proposal Compared to FY2000 Enacted,
And FY2000 Adjusted for Inflation and Population Growth ($ Millions)

Category	FY2000 Enacted	FY2013 Proposed GOMB	Nominal % Change	FY2000, Enacted Adj for Infl (ECI) and Pop Growth	$ Diff FY2013 –FY2000 Adj (ECI and Pop Growth)	% Change
General Fund excluding Pensions	$20,064	$24,325	21.2%	$30,915	(-$6,590)	-21.3%
P-12	$4,844	$6,783	40.03%	$7,464	(-$681)	-9.1%
Higher Ed	$2,152	$2,161	0.43%	$3,315	(-$1,154)	-34.8%
Healthcare (excluding Group Health)	$5,022	$6,893	37.25%	$8,934	(-$2,041)	-22.8%
Human Services (excluding all Healthcare)	$4,599	$5,060	10%	$7,086	(-$2,026)	-28.6%
Public Safety	$1,350	$1,510	11.9%	$2,081	(-$571)	-27.4%

Sources: Unadjusted appropriations from Governor's final budget summary for FY2000 and from GOMB budget proposal for FY2013. Inflation for all categories except Healthcare computed at cumulative change in ECI from 2000-2012. Inflation for Healthcare calculated using the cumulative change in the Midwest Medical Care CPI (Midwest Medical CPI) from 2000 through 2011.

Figure 12 shows that after adjusting for inflation and population growth using either the CPI or ECI, spending on services under the Governor's proposed FY2013 budget will be lower in real terms than FY2000 levels.

FIGURE 12
Governor's FY2013 Proposed General Fund Services Appropriations (Excluding Pensions) Relative to FY2000, in Nominal Dollars and Adjusted for Inflation and Population Growth



Sources: COGFA FY2002 Budget Summary; GOMB FY2013 Budget Book; Bureau of Labor Statistics: Employment Cost Index, Midwest CPI, Midwest Medical Care CPI; Department of Commerce and Economic Opportunity.

The long-term trend of cutting expenditures on current public services covered by the General Fund would be even worse under the FY2013 House Proposal, as shown in Figure 13.

FIGURE 13
Illinois General Fund Spending by Major Public Service Category, FY2013 House Proposal Compared to FY2000 Enacted, and FY2000 Adjusted for Inflation and Population Growth ($ Millions)

Category	FY2000 Enacted	FY2013 House Proposal	Nominal % Change	FY2000, Enacted Adj for Infl (ECI) & Pop Growth	$ Diff FY2013 – FY2000 Adj (ECI & Pop Growth)	% Change
General Fund excluding Pensions	$20,064	$23,458	16.9%	$30,915	(-$7,457)	-24.1%
P-12	$4,844	$6,492	34%	$7,464	(-$972)	-13%
Higher Ed	$2,152	$1,979	-8%	$3,315	(-$1,336)	-34.8%
Healthcare (excluding Group Health)	$5,022	$6,888 *	37%	$8,934	(-$2,046)	-22.9%
Human Services (excluding all Healthcare)	$4,599	$4,837 **	5.1%	$7,086	(-$2,249)	-31.7%
Public Safety	$1,350	$1,576	16.7%	$2,081	(-$505)	-24.3%

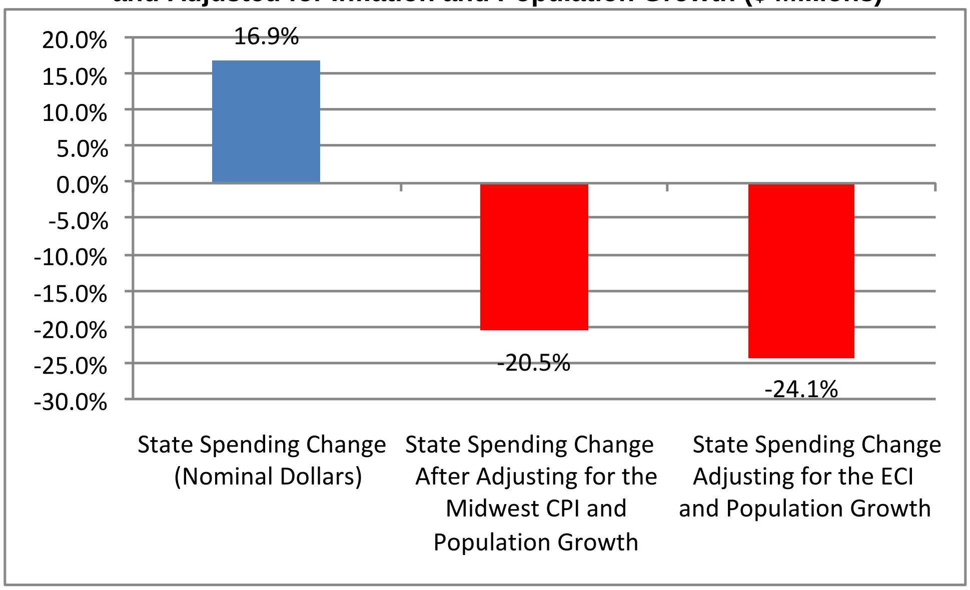
Sources: Unadjusted appropriations from Governor's final budget summary for FY2000, FY2013 appropriations from HR706 Enrolled, adopted March 29, 2012.

Notes * and **: Because the House Proposal does not contain an itemized appropriation for "Other Healthcare" (DPH and DHFS administrative costs and child support services), the $250 million appropriation for those items in the Governor's FY2013 Budget Proposal is added to the House Proposal's Medicaid approp to estimate the House's aggregate "Healthcare" approp in Figure 13—and is likewise subtracted from the House Proposal's Human Services approp to estimate the House's Human Services only approp.

If the House Proposal is used to create the final FY2013 General Fund Budget, long-term spending on every major category of services would be cut more in real terms than under the Governor's proposal, except for Public Safety, which the House would cut by -24.3% since FY2000, versus the Governor's proposed -27.4% cut, in real, inflation-adjusted dollars. The House's proposed cuts to Higher Education are so significant that in FY2013 spending on universities and community colleges would be less in nominal dollars than in FY2000.

Figure 14 shows that under the House Proposal, total General Fund spending on services in FY2013 would be lower in real terms than in FY2000, whether the CPI or ECI is used as the inflation metric.

FIGURE 14
FY2013 House Proposed General Fund Appropriations (Excluding Pensions) Relative to FY2000, in Nominal Dollars and Adjusted for Inflation and Population Growth ($ Millions)



Sources: COGFA FY2002 Budget Summary; GOMB FY2013 Budget Book; Bureau of Labor Statistics: Employment Cost Index, Midwest CPI, Midwest Medical Care CPI; Department of Commerce and Economic Opportunity.

6. ILLINOIS' FY2013 OPERATING AND ONGOING STRUCTURAL DEFICITS

(a) The General Fund will End FY2013 with an Accumulated Deficit Ranging from $7.7 to $10.2 Billion. As shown in Figure 15, even after accounting for the new revenue from the temporary tax increases that passed in January, 2011, and the General Fund spending cuts of approximately $263 million implemented in FY2012,[15] the state will nonetheless have a minimum, accumulated General Fund deficit ranging from $7.7 to $8.3 billion in FY2013, after accounting for the unpaid bills left over from FY2012. Obviously, Illinois continues to struggle with a material unpaid bill backlog (which last year CTBA estimated would be at least $8.0 billion at the end of FY2012), despite significant budget cutting over the last few fiscal years.

FIGURE 15
FY2013 Accumulated Deficit
($ Billions)

Category		GOMB	House
(i)	Projected FY2013 Revenue	$33.94	$33.719
(ii)	FY2013 Hard Costs	$9.450	$9.460
(iii)	Deficit Carry Forward from FY 2012	$8.500	$8.500
(iv)	Net FY2013 General Fund Revenue Available for Services	$15.990	$15.759
(v)	General Fund Service Appropriations in Proposal (Net of "Unspent Appropriations")	$24.328	$23.458
(vi)	Minimum FY2013 General Fund Deficit	(-$8.335)	(-$7.699)
(vii)	Deficit as a Percentage of General Fund Service Approps	**-34.3%**	**-32.7%**

Sources: Appropriations from GOMB FY2013 Budget Book, Chapters 2-18, and HR 706 Enrolled, adopted March 29, 2012; Revenue from Amendment No. 1 to HR 707 adopted March 1, 2012, and Senate Floor Amendment No. 1 to SR 586 adopted March 7, 2012; and unpaid bills from January 2012 Quarterly Report from the Comptroller.

In the likely event that the General Assembly's revenue estimate of $33.719 billion is used for FY2013, the minimum accumulated deficit for FY2013 under the Governor's budget proposal increases from -$8.335 billion to -$8.545 billion.

Figure 15 shows only the minimum, accumulated deficit for FY2013 for two key reasons. First, both the Governor's and House's FY2013 budget proposals assume that Group Health Insurance costs can be reduced by $260 million from FY2012 levels. This may be difficult to attain, given that the average annual increase in healthcare inflation over the last decade was 4.1 percent.[16]

Second, both the Governor's and House's budget proposals for FY2013 assume that Medicaid expenditures will be reduced by $2.7 billion from FY2012 levels. Such a significant cut in Medicaid expenditures will be difficult to realize. Among other things, reducing Medicaid spending by $2.7 billion would require significant changes to existing law. On the one hand, reimbursement rates paid to Medicaid providers would have to be reduced by anywhere from six percent to nine percent from current levels. Implementing such a policy will be difficult to justify, given that Illinois already has some of the lowest Medicaid provider reimbursement rates in the nation, ranking ninth lowest of all 50 states.[17] Moreover, reductions of the magnitude needed would in all likelihood discourage healthcare providers from taking on Medicaid eligible patients.

On the other hand, eligibility for Medicaid also would have to be cut, and/or the services Medicaid eligible populations receive would have to be reduced. Given that 32 percent of the state's population is currently uninsured or on Medicaid,[18] cuts to eligibility or available services in the Medicaid program could have material adverse consequences for many families that are struggling to get by. Complicating the matter further, under current federal law most of the changes to the Medicaid program Illinois desires to implement to save money would have to be approved by the federal government.[19] Attaining that approval is no sure thing, and even if it is obtained, the process is not a quick one.

Assuming Illinois is not able to realize $2.7 billion in cuts to its Medicaid program, the accumulated deficit in FY2013 would increase significantly—but not by the full $2.7 billion. That is because Medicaid is jointly funded by states and the federal government. Under the program, the federal government reimburses states for their qualified Medicaid expenses at pre-determined rates.[20] Generally, the federal government reimburses Illinois for half of its Medicaid expenditures (i.e., for the most part Illinois' matching rate is 50 percent).[21] That means if the state cuts Medicaid expenditures by $2.7 billion, it also loses the $1.35 billion in federal matching funds it would have received as a partial reimbursement for those expenditures. Similarly, if the state spent the additional $2.7 billion on Medicaid in FY2013, half of that cost or $1.35 billion, would be reimbursed to Illinois by the federal government.

Figure 16 shows the growth in the accumulated FY2013 General Fund Budget deficit that would remain if the state does not realize the projected savings from the proposed cuts to the Group Health Insurance and Medicaid currently assumed in both the Governor's and House's FY2013 budget proposals.

FIGURE 16
FY2013 Accumulated Deficit without Medicaid & Group Health Insurance Cuts ($ Billions)

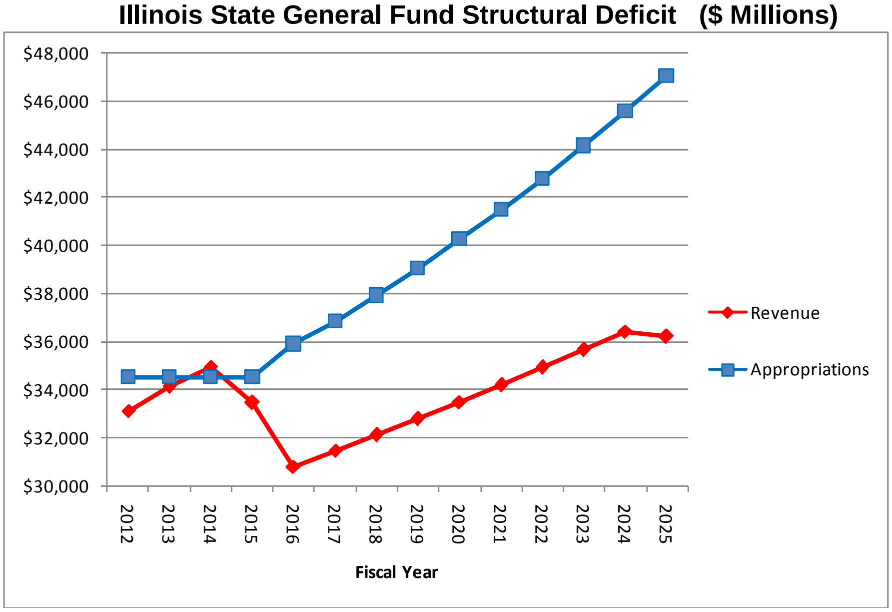
Category		GOMB	House
(i)	Projected FY2013 Revenue	$33.940	$33.719
(ii)	FY2013 Hard Costs	$9.450	$9.460
(iii)	Deficit Carry Forward from FY 2012	$8.500	$8.500
(iv)	Net FY2013 General Fund Revenue Available for Services	$15.990	$15.759
(v)	General Fund Service Appropriations in Proposal (Net of "Unspent Appropriations")	$24.325	$23.458
(vi)	Minimum FY2013 General Fund Deficit	(-$8.335)	(-$7.699)
(vii)	Potential Adjustments to Minimum Deficit		
	Potential Increase to Deficit from Group Health	(-$.260)	(-$.260)
	Potential Increase to Deficit from Medicaid	(-$1.350)	(-$1.350)
	Use of House Rather than GOMB Revenue Estimate	(-$.210)	$0
(viii)	Increased FY2013 Deficit	(-$10.155)	(-$9.309)
(ix)	**Deficit as a percentage of General Fund Services Approps**	**(-41.7%)**	**(-39.7%)**

Sources: FY2013 GOMB Budget Book, Ch. 2-63, HR706 Enrolled, adopted March 29, 2012; Amendment No. 1 to HR707 adopted March 1, 2012 and Senate Floor Amendment No. 1 to SR586 adopted March 7, 2012.

(b) Illinois' Structural Deficit. For over a decade CTBA has pointed out that the Illinois tax system does not generate enough General Fund revenue over time to maintain delivery of the same level of public services from year to year.[22] This remains the case in FY2013, even after the temporary tax increases passed in January 2011.

This ongoing mismatch in the state's General Fund between the lower rate of growth for revenues than the rate of increase in the cost of maintaining service levels from year to year is commonly called a "structural deficit." Figure 17 is a graphic depiction of the structural deficit in the Illinois General Fund.

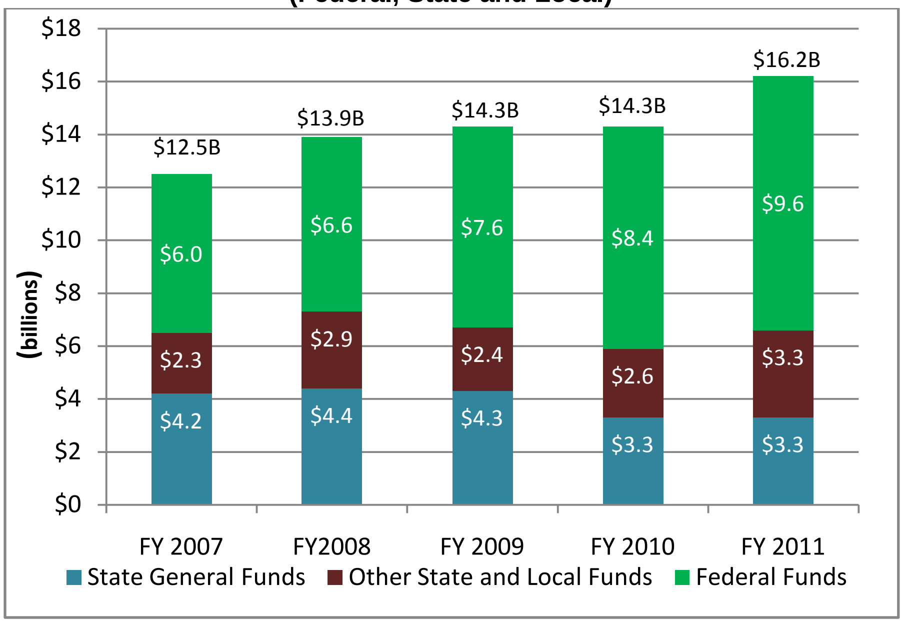
FIGURE 17
Illinois State General Fund Structural Deficit ($ Millions)



The structural deficit depicted in Figure 17 assumes revenues and appropriations for FY2014 and FY2015 that follow the Governor's three-year budget projection.[23] Recall that in the Governor's three-year projection: General Fund spending in nominal dollars on Healthcare and Education remain flat over the next two fiscal years, and spending on Human Services and Public Safety are cut by 5.1 percent and eight percent respectively from FY2012 levels. The takeaway from that is both clear and troubling—even assuming Illinois can continue making significant, real, inflation-adjusted cuts in spending to all services covered by the General Fund in FY2014 and FY2015, the structural deficit in the General Fund will worsen nonetheless.

It must be noted that although Medicaid is targeted for significant spending cuts in both the Governor's and House's FY2013 budget proposals —**NONE OF THE STRUCTURAL DEFICIT GROWTH IN ILLINOIS IS DUE TO INCREASING STATE MEDICAID PAYMENTS**. Indeed, as Figure 18 shows, state own-source tax revenue used to fund Medicaid in 2011 was almost $1 billion less than in FY2007. In other words, since 2007, the state's Medicaid programs freed up almost $1 billion in state tax revenue for funding other core services. Far from "crowding out" other spending priorities, Medicaid has subsidized them.

FIGURE 18
Medicaid Spending by Funding Source
(Federal, State and Local)



Source: National Association of State Budget Officers State Expenditure Report, 2010, released December 13, 2011, Pg. 47, Table 28.

The reason for this is the way the state of Illinois has used innovative initiatives, like the Hospital Provider Assessment[24] and intergovernmental transfers with local governments like Cook County, to increase the portion of the Medicaid program paid for by the federal government. Ignore FY2011, when the federal government increased Illinois' Medicaid matching rate from 50 percent to 61.88 percent under the federal stimulus.[25] In FY2010, of the total $14.3 billion Illinois spent on Medicaid, only $3.3 billion, or 21 percent, was from state, own-source tax revenue, while $8.4 billion or 58.7 percent was covered with federal revenue. This was less than the $4.2 billion or 33.6 percent of Medicaid expenditures covered with state own-source tax revenue in FY2007.

(c) **Looking Forward**. The state's structural deficit, outlined in Figure 17, together with the Governor's three-year spending projection that goes through FY2015, raise a number of concerns about the state's capacity to continue funding all core services into the future. Consider, for instance, the minimum potential impact on human services funding. If average annual inflation (using the ECI) and population continue to grow at the same rates as pertained over the last decade (2002-2012), a decade of incredibly low growth in inflation, then in real terms FY2015 General Fund spending on Human Services will be -7.2 percent lower than it was just three years previously, in FY2012.

In FY2015, Public Safety will fare even worse, facing a -16.7 percent real cut from FY2012 levels, while real spending on P-12 Education would be cut by -7.5 percent from FY2012. Meanwhile, spending on Higher Education stands to be $111 million or -4.9 percent less in FY2015 than in FY2012. Similarly, based on historic (FY2002 to FY2012) annual growth of 4.0 percent in the Midwest Medical CPI and DCEO projected 0.8 percent annual population growth, real Healthcare spending in FY2015 will be cut by -14.1 percent from FY2012 levels.

Figure 19 highlights how much each of the core public service areas stand to be cut from FY2012 levels in real terms by FY2015.

FIGURE 19
Projected Real General Fund Spending Cuts to the Core Service Areas under The Governor's Three-Year Projections for the FY2012 – FY2015 Sequence
($ billions)

Category	FY2012 Enacted	FY2012 Infl & Pop Adj to FY2015	Governor's FY2015 Projected Approp	% Change	$ Diff
PreK-12	$6.75	$7.33	$6.78	-7.5%	-0.55
Higher Education	$2.09	$2.27	$2.16	-4.9%	-0.11
Human Services (Net of all Health Care)	$5.02	$5.45	$5.06	-7.2%	-0.39
Health Care Total	$8.34	$9.38	$8.06	-14.1%	-1.32
Medicaid	$6.64	$7.47	$6.64	-11.1%	-0.83
Group Health	$1.44	$1.62	$1.17	-27.7%	-0.45
Other	$1.38	$1.50	$1.25	-16.6%	-0.25
Public Safety	$1.67	$1.81	$1.51	-16.7%	-0.30

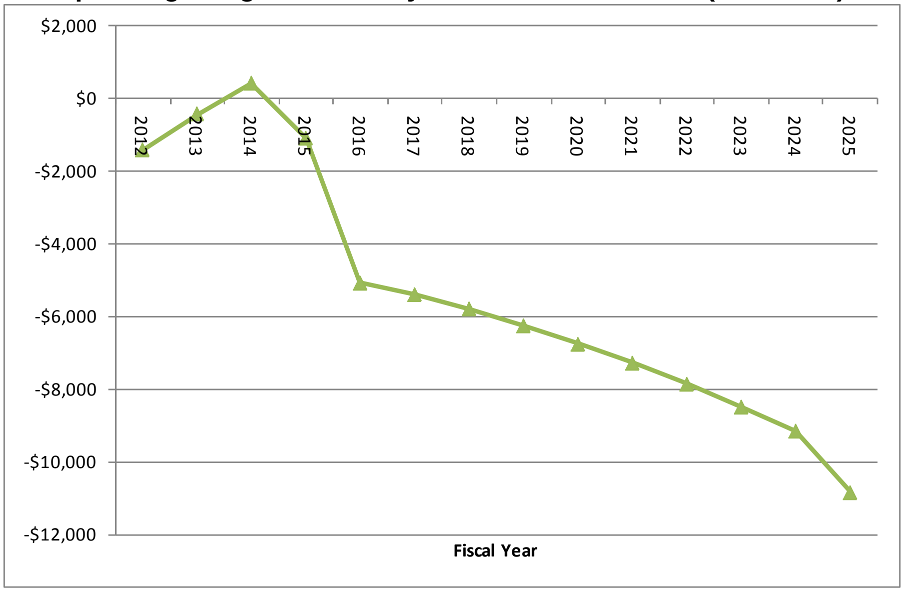
Note: Governor's Projected FY2015 is equal to Governor's Proposed FY2013 based on GOMB flat three-year projected budget.

Figure 20 assumes that the state maintains constant spending on services in real terms through FY2025, meaning that no new programs are added and no existing programs are expanded. Instead, public spending on the core services of: (i) Education (PreK-Higher Ed), Human Services and Public Safety over this period increases solely to account for inflation—computed at the average, annual ECI of 2.9 percent from 2002-2012—and projected average annual population growth of 0.8 percent; and (ii) Healthcare increases solely to account for inflation—computed at the average, annual Midwest Medical CPI that pertained over the last decade of four percent. On the revenue side, Figure 20 assumes: (i) the currently legislated phase-out (in 2015 and 2025) of the increases in the Individual and Corporate Income tax rates that passed in January, 2011; (ii) average, annual state "own-source revenue" growth of 2.4 percent (computed at the historic, FY2002 to FY2009, "trough to trough" rate;"[26] and (iii) average annual increases of 0.9 percent in Federal Funding growth based on the most recent COGFA data.[27]

As shown in Figure 20, despite the very large nominal and real cuts in state spending projected by the Governor through FY2015, and assuming no real increases in spending on any core service, the state will nonetheless have an estimated operating deficit of almost $11 billion in FY2025.

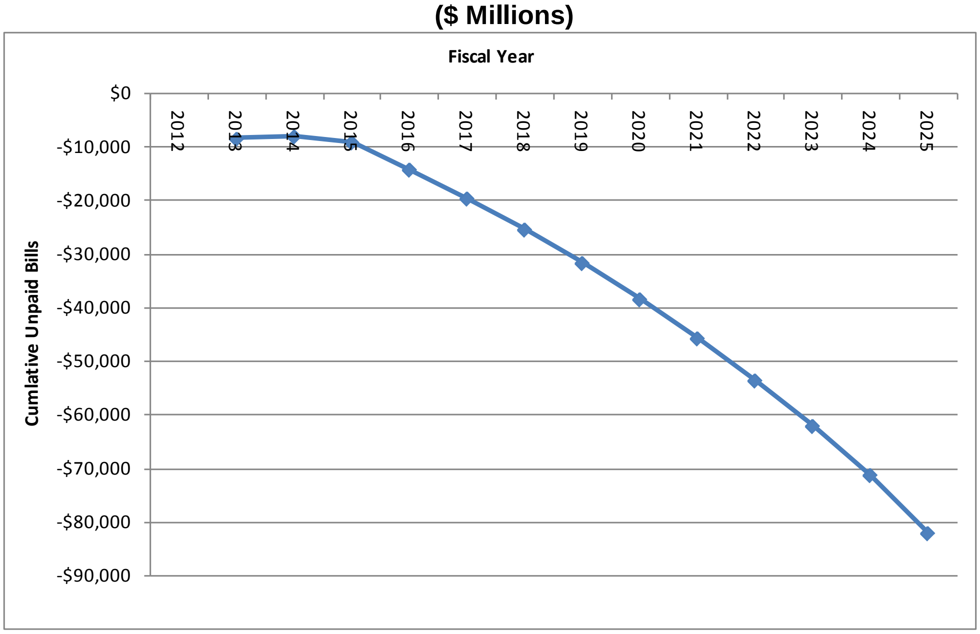
Note, the growth in annual operating deficit depicted in Figure 20 does not take into account the accumulated General fund deficit of $7.7 to $10.2 billion that will exist by the end of FY2013.

FIGURE 20
Projected Growth in Illinois State General Fund Annual Operating Budget Caused by the Structural Deficit ($ Millions)



Longer term, if decision makers opt not to increase state revenue, Figure 21 shows that Illinois could have cumulative unpaid bills of $82.154 billion by FY2025.

FIGURE 21
Illinois State General Fund Cumulative Structural Deficit ($ Millions)



7. FY2013 APPROPRIATION DRILL-DOWN BY MAJOR CATEGORY

(a) Slight Nominal Increase for Human Services Does Not Counter Significant Real Cuts. Human Services (provided primarily through DOA, DHS, and DCFS) are somewhat unique among the four primary budget categories (Education, Healthcare, Human Services, and Public Safety). Unlike the other core public services, each of which has a relatively narrow program focus, human services encompass a broad panoply of programs that cover everything from aiding adults with developmental disabilities, to assisting homebound seniors, abused and neglected children, and individuals with substance abuse and mental health issues. And while most human services are delivered under the auspices of DOA, DHS and DCFS, multiple other agencies also administer human services programs. Because of this, it is difficult to analyze human services funding over time with a true "apples-to-apples" comparison.

That said, Figure 22 shows the nominal dollar difference between the Governor's FY2013 proposed General Fund appropriations for the three primary Human Services agencies and the final appropriations for those agencies in the FY2012 budget. Note, a similar comparison cannot be made of the House Proposal, because the House Proposal only specifies aggregate proposed appropriations for all programs falling under the "Human Services" category, rather than providing specific appropriations by line, agency and program.

FIGURE 22
Nominal Dollar Comparison of Human Services Appropriations, FY2012 Final vs. GOMB FY2013 Proposed ($ Millions)

Category	FY2012 After Veto	FY2013 GOMB Proposed	Diff FY2013 Proposed – FY2012 After Veto	% Change
Department of Aging	$737.4	$814.8	$77	10.5%
Department of Child and Family Services	$808.5	$767.7	-$41	-5.0%
Department of Human Services	$3,209	$3,385	$176	5.5%
TOTAL ACROSS AGENCIES	$4,754	$4,967	$213	4.5%

Sources: FY2013 GOMB Budget Book, Ch. 2-63; and COGFA FY2013 Final General Fund Budget Summary, issued in August, 2011.

The Governor's proposed nominal dollar increases for DHS and DOA in FY2013, if they materialize, will help maintain the same service levels provided by those agencies in real terms at FY2012 levels. Unfortunately, even if those proposed appropriations hold, real funding for Human Services in Illinois will be substantially less (some -$1.637 billion less) in FY2013 than a decade ago in FY2002, as shown in Figure 23.

FIGURE 23
Illinois General Fund and Major Service Area Inflation Adjusted Appropriation Comparison FY2002 Actual vs. Governor's FY2013 Proposed ($ Millions)

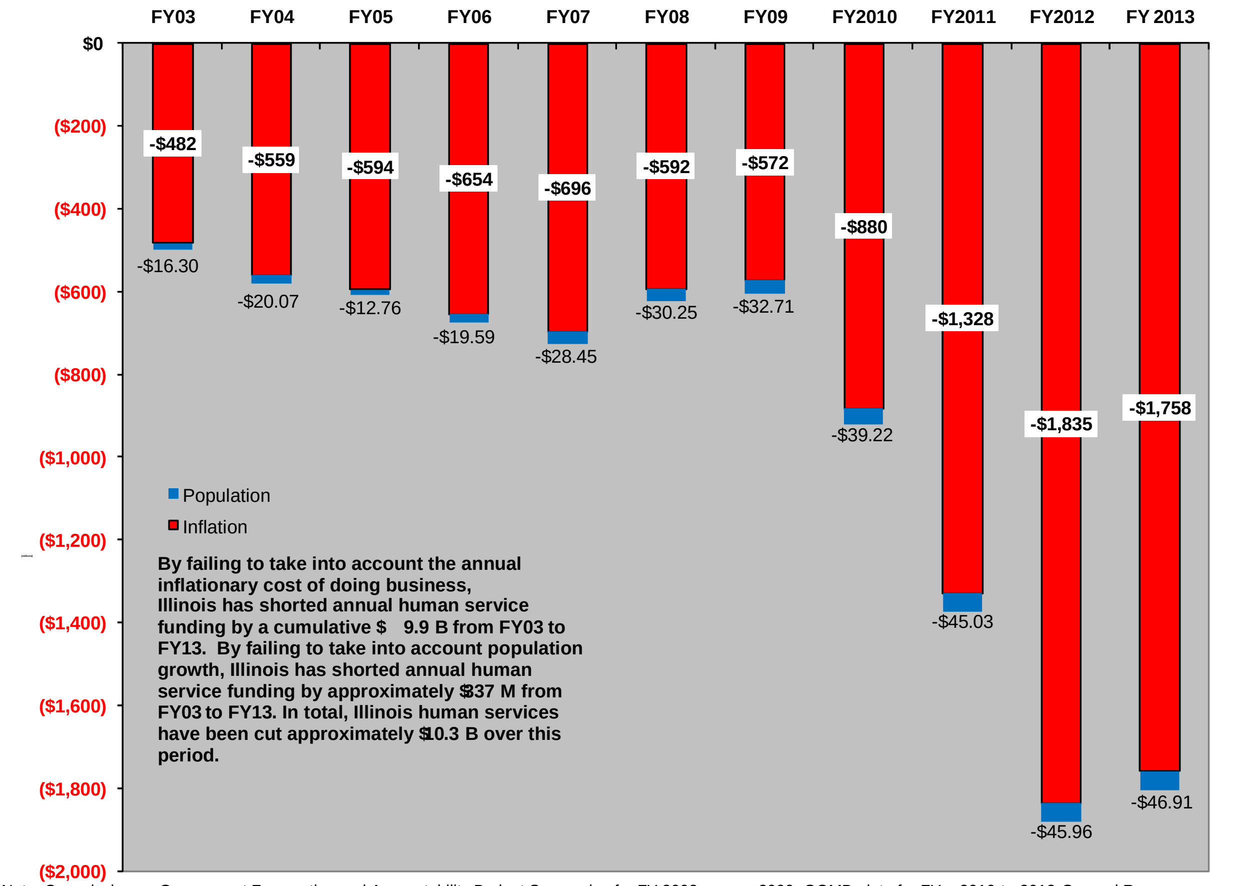
Category	FY2002 Final	FY2002 Adjusted	FY2013 Rec	$ Diff 02 - 13	% Diff 02 - 13
General Fund	$23,409.3	$31,101.0	$24,328.0	-$6,773.0	-21.8%
P-12 + Higher Education	$8,894.3	$11,816.7	$8,943.2	-$2,873.5	-24.3%
Healthcare	$5,397.6	$7,171.1	$6,893.5	-$277.7	-3.9%
Human Services	**$4,971.2**	**$6,604.6**	**$4,967.4**	**-$1,637.2**	**-24.8%**
Public Safety	$1,552.3	$2,062.3	$1,473.2	-$589.1	-28.6%

Sources: COGFA Budget Summary FY2002, GOMB Proposed Budget FY2013. Inflation adjusted using ECI and population.

The long-term funding analysis outlined above has not been fully reconciled with the budget processes created under BFR. As highlighted previously, the new budgeting rules under BFR establish seven priority areas for the General Fund budget, which represent major functions and responsibilities of state government. The goal of the human services budget area is "protection of the most vulnerable of our residents."[28] Grouping specific programs into service 'priority areas' sounds both logical and good. However, because GOMB does not delineate which specific programs fall under each priority area, the BFR process actually makes it *more* difficult to analyze long-term funding for human services in the General Fund in FY2013 and beyond.

Figure 24 highlights the cumulative, real impact of the General Fund cuts to Human Services over the last decade. Note that, despite the Human Services increases the Governor proposes for FY2013, human service providers will have had to make up for, in the aggregate, over $10 billion in lost funding from the General Fund since FY2003. Because over 75 percent of human services are delivered by private sector providers[29], this significant loss in state funding has led to a concomitant loss in private sector jobs.

FIGURE 24
Cumulative Impact of Cuts in Illinois Human Service Spending Since FY2002 Adjusted for Inflation and Population Growth ($ Millions)



Note: Commission on Government Forecasting and Accountability Budget Summaries for FY 2002 to FY 2009, GOMB data for FY 2010 to 2013 General Revenue appropriations for the Illinois Departments of Aging, Children & Family Services, and Human Services. Appropriations shortfalls necessary to maintain real value of FY2002 appropriation based on National Employment Cost Index (ECI). Population growth estimates from Census and Illinois Department of Commerce and Economic Opportunity.

As indicated previously, the BFR process requires GOMB to release a three year General Fund budget projection, listing expenditures by BFR priority area. GOMB's projections show that Human Services will be flat funded for FY2014 and FY2015. Because the cost of delivering care increases with inflation and population growth annually, this flat funding will result in a real, inflation-adjusted spending cut to Human Services programs of at least $390 million, as shown in Figure 19.

(b) Both FY2013 Budget Proposals Short Change Education. The Governor proposes that the FY2013 General Fund appropriation for P-12 education be $6.78 billion dollars, which represents a nominal increase of $32.1 million or 0.5 percent compared to the FY2012 appropriation of $6.75 billion, as illustrated in Figure 25. Unfortunately inflation (using the ECI and population) for FY2012 is estimated at nearly three percent (2.76%), which means in FY2013 P-12 funding will be cut under the Governor's proposal by just over $150 million in real terms from FY2012 levels.

FIGURE 25
Governor's FY2013 Proposed P-12 Education Appropriations Compared to FY2012 in Nominal Dollar and Inflation Adjusted ($Millions)

Category	FY 2012 Enacted	FY 2012 Adjusted	GOMB FY 2013 Rec	Nominal % Change FY02 - FY13	Nominal $ Change FY02 - FY 13	Real % Change FY02 - FY13	Real $ Change FY02 - FY 13
P-12 Education	$6,750.4	$6,937.0	$6,782.5	0.5%	$32.1	-2.2%	-$154.4

Sources: COGFA FY2012 Budget Summary and GOMB Budget Book FY2013, all dollars in millions, data does not include pension contributions

The FY2013 House Proposal, on the other hand, would cut P-12 funding in FY2013 in both nominal and real terms from the final FY2012 appropriation, as shown in Figure 26.

FIGURE 26
House's Proposed FY2013 Appropriations for P-12 Education Compared to FY2012, Nominal Dollars ($Millions)

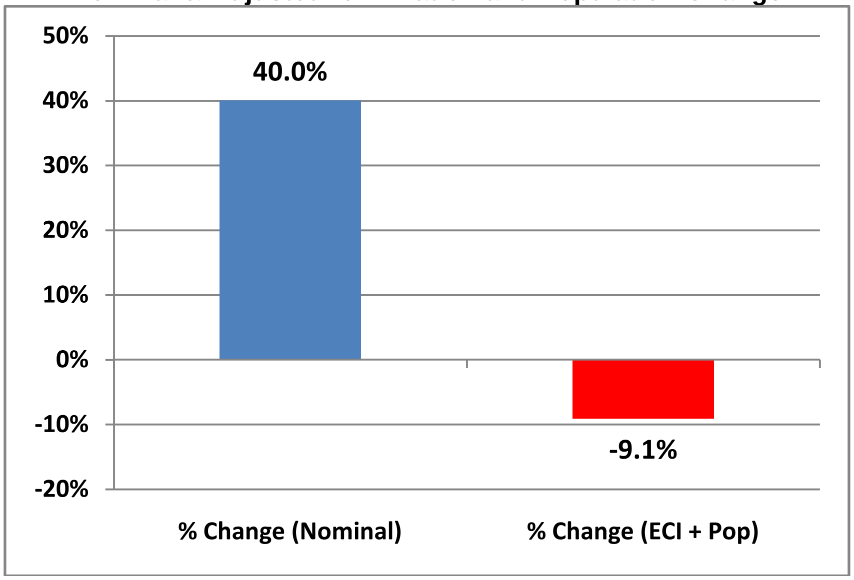
Category	FY 2012 Enacted	FY 2012 Adjusted	HR706 FY 2013 Rec	Nominal % Change FY02 - FY13	Nominal $ Change FY02 - FY 13	Real % Change FY02 - FY13	Real $ Change FY02 - FY 13
P-12 Education	$6,750.4	$6,937.0	$6,492.0	-3.8%	-$258.4	-6.4%	-$445.0

Sources: COGFA FY2012 Budget Summary issued August, 2011; and HR706 Enrolled, adopted March 29, 2012.

As it turns out, the House's proposed FY2013 appropriations for P-12 education may be closer to actual FY2012 spending on P-12 than the Governor's. This is because the General State Aid formula-grant portion of the P-12 appropriations identified in the budget for the 2012-2013 school year, a total of $2.345 billion, will be "prorated" for that year.[30] As indicated previously, that means school districts will not receive the full appropriation for General State Aid identified in the Governor's budget, but rather a smaller portion—or proration—of what was appropriated. The amount of this proration, which is currently estimated at around 92 percent, has not yet been finalized. In any event, the actual investment in P-12 for the FY2012-2013 school year will be less than indicated in the budget—and school districts statewide will have to compensate for this loss of state funding.

Considered over the long-term, both the Governor's and House's appropriations for P-12 continue the disturbing trend of cutting the state's funding of public education in real terms. Indeed, as illustrated in Figure 27, although under the Governor's proposal, the appropriation for P-12 education would be 40 percent more in nominal dollars in FY2013 than it was in FY2000, once inflation and population changes are accounted for, real P-12 education appropriations would be cut by almost 10 percent.

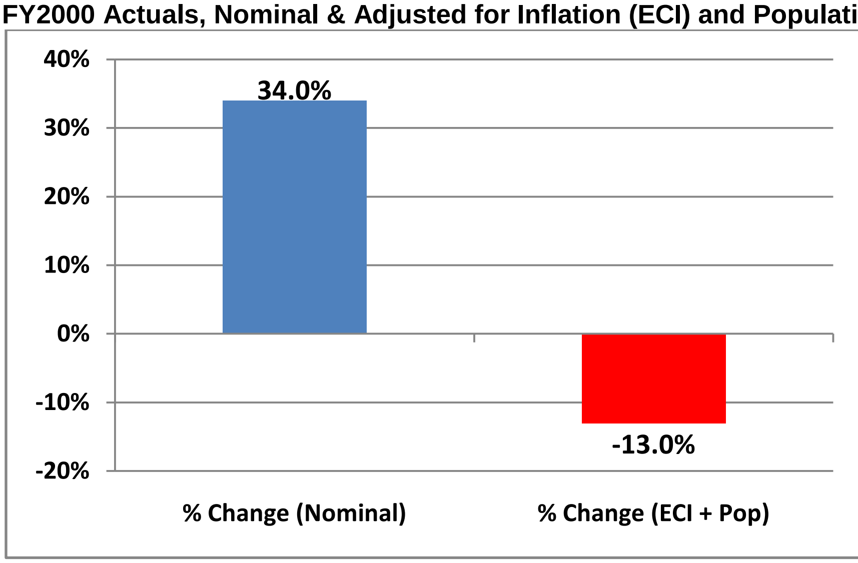
FIGURE 27
Governor's Proposed P-12 Education Appropriations for FY2013 Compared to FY2000, Nominal & Adjusted for Inflation and Population Change



Sources: GOMB FY2013 Budget Proposal, COGFA FY2002 Budget Summary. Inflation adjusted using ECI index and population.

Under the House Proposal, the real cut to P-12 funding in FY2013 compared to FY2000 would be worse than under the Governor's proposal, as shown in Figure 28.

FIGURE 28
House's Proposed P-12 Appropriations for FY2013 Compared to FY2000 Actuals, Nominal & Adjusted for Inflation (ECI) and Population



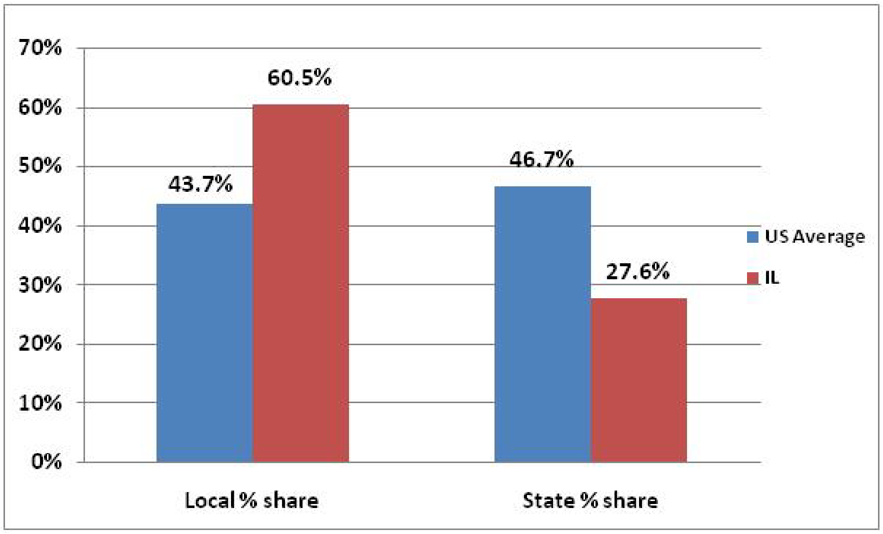
Sources: HR706 Enrolled, adopted March 29, 2012; and COGFA Budget Summary FY2002. Inflation adjusted using ECI index and population.

The trend of real cuts to public education funding in Illinois can be expected to continue. As reported previously, the Governor's three-year budget projection calls for flat funding of education in FY2014 and FY2015. Because the cost of delivering education increases each year due to inflation and population growth, this flat funding—if it is attained—will result in a real cut for P-12 education.

It is hard to justify continued cuts to P-12 funding by the state, given how clearly the data demonstrate that state General Fund spending on education in Illinois is inadequate, whether considered under national or by the state's own standards.

Consider national comparisons first. According to the National Center for Education Statistics (**NCES**), Illinois ranks dead last among the states in the portion of education funding covered by state, rather than local resources. Indeed, as Figure 29 shows, Illinois only covers 27.6 percent of public education costs, while the national average is 46.7 percent. Meanwhile, over 60 percent of P-12 education costs are covered by local resources in Illinois.

FIGURE 29
Local and State Share of Education Funding Spending



Source: National Center on Education Statistics, 2011. "Revenues and Expenditures for Public Elementary and Secondary Education: School Year 2008-2009 (Fiscal Year 2009)."

Figures 30 and 31 show how Illinois stacks up with other large states and the Midwest.

FIGURE 30
State Share of Education Funding

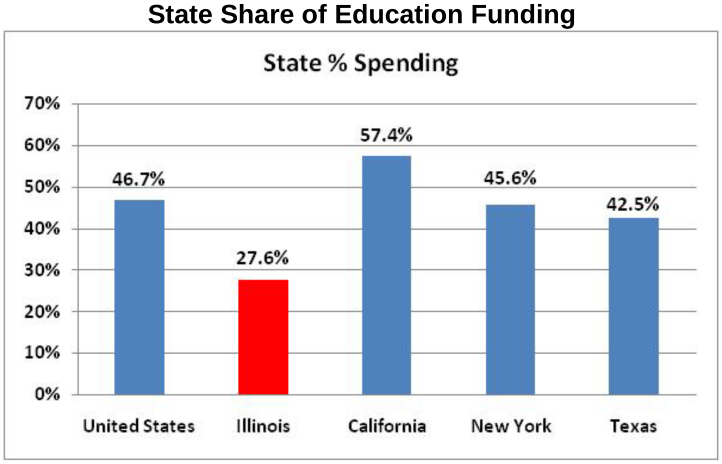
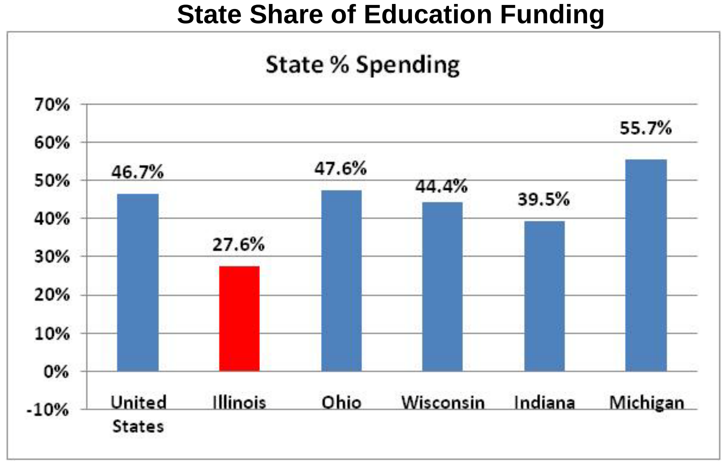


FIGURE 31
State Share of Education Funding



Source: National Center on Education Statistics, 2011. "Revenues and Expenditures for Public Elementary and Secondary Education: School Year 2008-2009 (Fiscal Year 2009)."

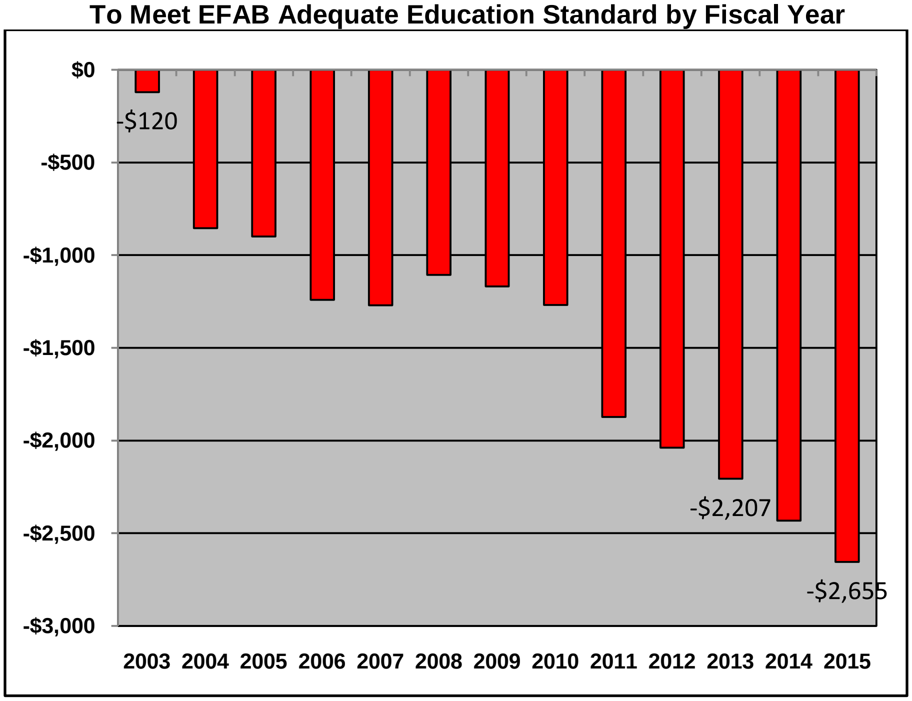
The state's poor record of funding education from state-based resources has forced local property taxes to cover a disproportionately high portion of education funding in Illinois. The data show that Illinois' significant over-reliance on local property taxes is a material cause of both poor and inequitable educational outcomes in the state.[31]

Meanwhile, despite the significant portion of education funding local school districts have assumed, overall education funding levels in Illinois remain low compared to national averages. According to the National Association of Budget Officers (**NASBO**), Illinois ranks 40th in per-capita education spending, in spite of having the 15th highest per-capita income among the states.[32] In order for Illinois to move up to being just "average" in per-capita spending (a ranking of 25) among the states, the state appropriation for K-12 education in FY2008 would have had to have been $2.89 billion greater than it was.[33] Adjusting for inflation (ECI) and population growth, then, the appropriation for K-12 in FY2013 would have to be $10.58 billion, or fully $3.80 billion more than what is in the Governor's proposal, and $4.09 billion more than in the House Proposal for Illinois to be "average" in FY2013. Rather than increasing education funding, since 2008, the state has cut its investment in K-12 by $493 million in real terms.[34]

Now consider the state's own standards. Every year the nonpartisan Education Funding Advisory Board (**EFAB**) is required by law to recommend a "Foundation Level" of per pupil spending that is sufficient to cover the cost of an adequate P-12 education. Made up of a combination of both state and local resources, the Foundation Level is supposed to include most of the basic costs of educating a "non-at-risk" child, that is, a child with a reasonable likelihood of academic success. The Foundation Level does not include the cost of significant items, like transportation, special education, and educating children who are English language learners or live in poverty.

Figure 32 shows the difference between the dollar amount of the Foundation Level as set by the General Assembly and Governor, versus what the Foundation Level should have been to cover the basic cost of educating a non-at-risk child, as recommended by EFAB over the FY2003 through FY2012 sequence, with projections for FY2013 through FY2015 based on the Governor's proposals. According to ISBE, in FY2012 the total amount needed to increase the state's actual Foundation Level to the EFAB recommendation was $3.1 billion. Note that by FY2015, it is projected that Illinois' actual Foundation Level will be $2,655 less per child than the cost of a basic education.

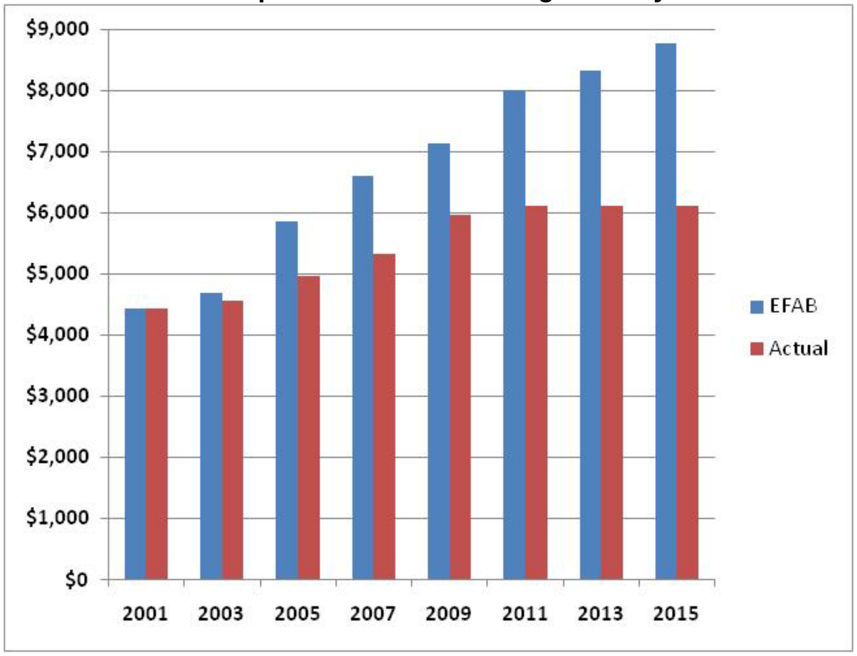
FIGURE 32
Dollar Shortfall in State Per-Pupil K-12 Education Funding
To Meet EFAB Adequate Education Standard by Fiscal Year



Source: CTBA Analysis of January 2011 EFAB data. Inflation projection FY2012-FY2015 based upon ECI inflation.

Figure 33 shows how the difference between the EFAB recommendation and the state's actual Foundation Level can be expected to grow through FY2015, based on the Governor's projections for FY2014 and FY2015 contained in his three-year General Fund Budget projections issued in January of 2012.

FIGURE 33
EFAB Per-Pupil Funding Recommendation Compared to the Actual Per-Pupil Foundation Funding Level by Fiscal Year



Source: CTBA analysis of EFAB data. Inflation projection FY2012-FY2015 based upon ECI inflation.

In any event, the actual shortfall between the Foundation Level set by the state and the EFAB recommendation will be greater than what is shown in either Figure 32 or Figure 33 for FY2012 and FY2013 (and in all likelihood thereafter) due to the decision to "prorate" General State Aid in FY2012 and FY2013.

(c) After a Decade of Cuts, Mixed Proposals for Higher Education in FY2013. The Governor's proposed FY2013 General Fund appropriation for Higher Education is $2.16 billion dollars, which is a nominal increase of $69 million or 3.3 percent compared to the FY2012 appropriation of $2.09 billion. If the Governor's FY2013 proposed appropriation for Higher Education is attained, it will represent a real, inflation-adjusted increase over FY2012 levels of 0.5 percent.

FIGURE 34
Governor's Proposed Higher Education Appropriations for FY2013 Compared to FY2012 ($ Millions)

Category	FY 2012 Enacted	FY 2012 Adjusted	GOMB FY 2013 Rec	Nominal % Change FY12 - FY13	Nominal $ Change FY12 - FY 13	Real % Change FY12 - FY13	Real $ Change FY12 - FY 13
Higher Education	$2,092.0	$2,149.8	$2,161.0	3.3%	$69.0	0.5%	$11.2

Source: COGFA FY2012 Budget Summary and GOMB Budget Book FY2013 (excluding pension contributions).

As it does with P-12 funding, the House Proposal instead would cut FY2013 spending on Higher Education in nominal dollars from FY2012 levels, as shown in Figure 35.

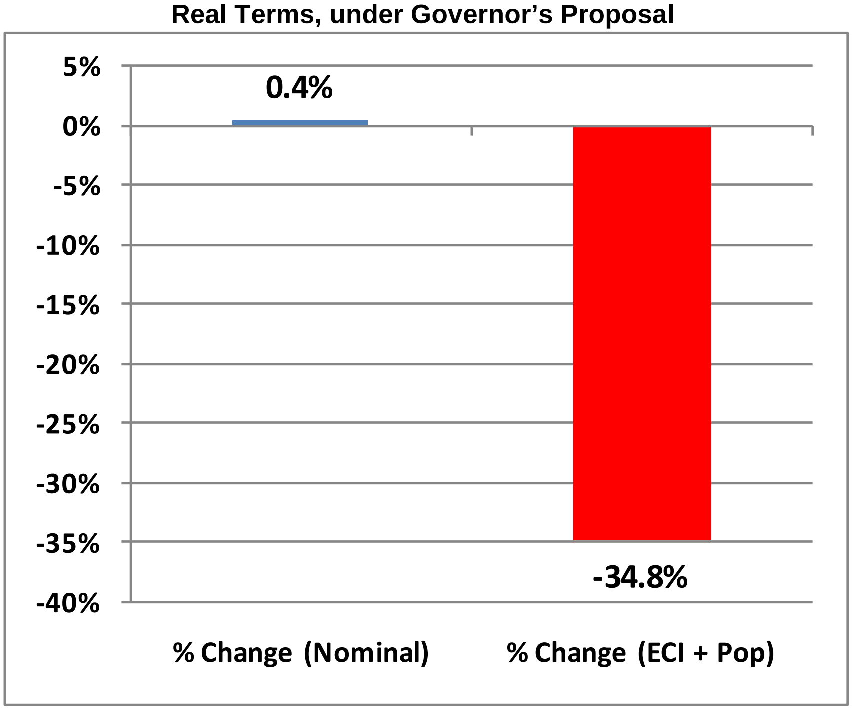
FIGURE 35
House's Proposed Appropriations for Higher Education
In FY2013 Compared to FY2012, Nominal Dollars ($ Millions)

Category	FY2012 Enacted	FY2012 Adjusted	HR706 FY2013 Rec	Nominal	% Change FY12 - FY13	Nominal $ Change FY12 - FY 13	Real % Change FY12 - FY13	Real $ Change FY12 - FY 13
Higher Education	$2,092.0	$2,149.8	$1,979.0		-5.4%	-$113.0	-7.9%	-$170.8

Sources: COGFA FY2012 Budget Summary and HR706 Enrolled, adopted March 29, 2012 (excluding pension contributions).

Irrespective of which FY2013 General Fund appropriation for Higher education is used, the long-term funding trend is not pretty, as highlighted in Figures 36 and 37. Indeed, under both the Governor's and House's FY2013 budget proposals, real funding for Higher Education would be significantly less than in FY2000.

FIGURE 36
Percentage Change in Higher Education Funding Between FY2000 and FY2013, in Nominal and Real Terms, under Governor's Proposal

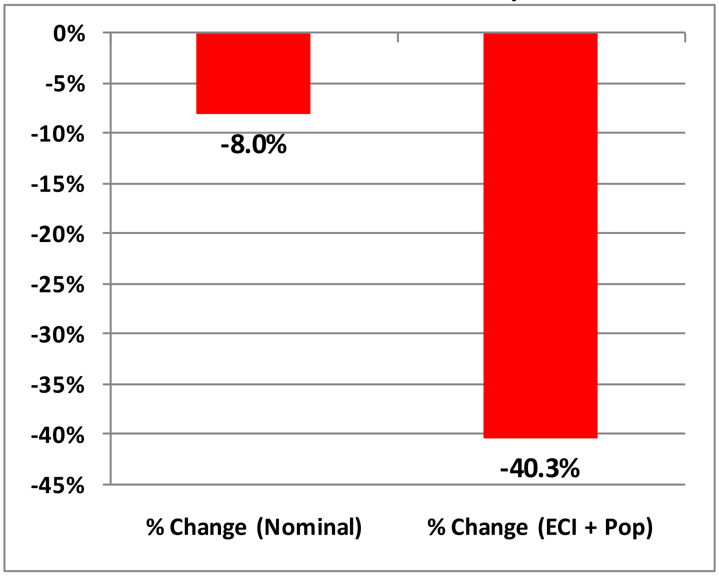


Sources: GOMB Proposed Budget FY2013, COGFA Budget Summary FY2002. Inflation adjusted using ECI index and population.

As illustrated in Figure 36, the Governor's proposed appropriation for Higher Education in FY2013 would represent a nominal dollar increase of just 0.40 percent over FY2000 levels. Once inflation and population changes are accounted for, however, the Governor's proposed Higher Education appropriation for FY2013 would be almost 35 percent less than FY2000.

Things are even worse under the House's Proposed FY2013 budget, as shown in Figure 37.

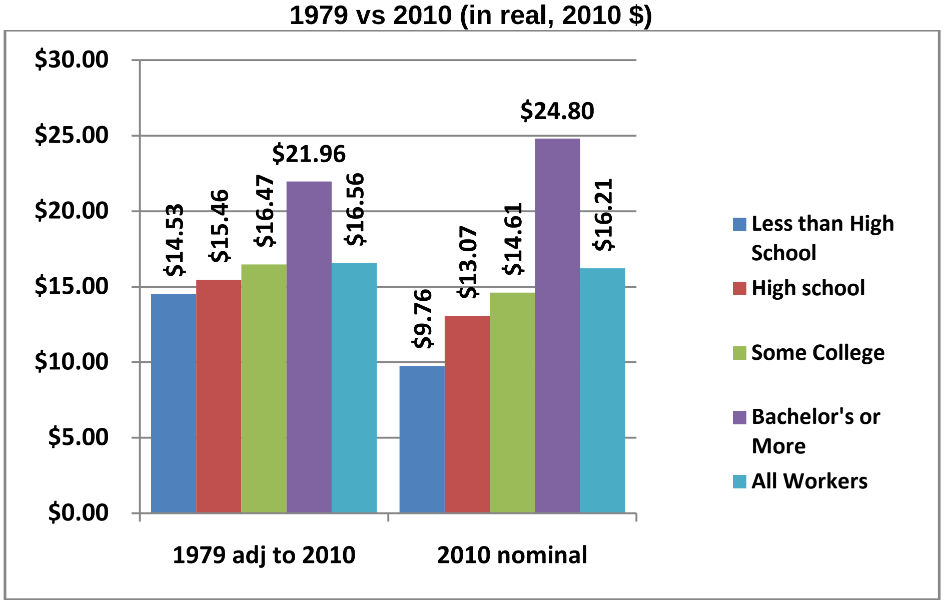
FIGURE 37
Percentage Change in Higher Education Funding Between FY2000 and FY2013, in Nominal and Real Terms, Under House Proposal



Sources: HR706 Enrolled, adopted March 29, 2012; and COGFA FY2012 Final Budget Summary issued in August, 2011.

Cuts to Higher Education will make it harder for many Illinois students to attend college, at a time when a college degree is more important than ever when it comes to success in the labor market. Indeed, as shown in Figure 38, the only cohort of workers in Illinois who realized a real increase in wages from 1979 through 2010 had a college degree. Every other worker saw his or her pay decline in real terms.

FIGURE 38
Hourly Wage Comparison by Education Level, 1979 vs 2010 (in real, 2010 $)



This is a real problem in Illinois. Consider that the state's fiscal woes have so hampered its ability to assist low income students in paying for colleges, that as recently as March 21, 2012, the *Chicago Tribune* reported that funding for the Monetary Award Program (**MAP**) grants, which provide this very crucial support, has been exhausted. The consequences of this are clear: Approximately 140,000 Illinois college students will lose out on up to $4,968 each in state grants to help offset the price of tuition.[35]

(d) Healthcare Overall. There have traditionally been three primary categories of Healthcare spending in the state's General Fund: Medicaid for poor, disabled and low-income populations; Group Health Insurance for state workers; and funding for the Department of Public Health. Also historically included in Healthcare funding were the administrative and related costs of and child support services delivered by the Department of Health and Family Services. Under the new BFR regimen, however, Public Health, Group Health and the administrative costs of and child support services delivered by DHFS have been re-categorized as "Human Services" spending—collectively described in the Governor's FY2013 budget proposal as "Other Healthcare" within the rubric of Human Services.

The House does not make a line item appropriation for either Public Health or the administrative costs of and child support services delivered by DHFS in its FY2013 proposal. Instead, the House just lumps those two "Other Healthcare" items into its overall Human Services appropriation of $5.087 billion. Hence, it is not possible to determine exactly how much will be appropriated to any individual agency like DPH within the House's larger Human Services category. Therefore, CTBA has estimated that appropriation to be the same as the Governor's for FY2013.

Given those changes in how funding for these services is categorized, Figure 39 shows the differences between the FY2012 budget and both the Governor's and House's FY2013 budget proposals, in nominal dollars.

FIGURE 39
Comparison of FY2012 and FY2013
Appropriations for Healthcare ($ Mllions)

Category	FY2012 Enacted	FY2013 Governor's Proposed	FY2013 House Proposed
Medicaid	$6,640	$6,638	$6,638
Group Health	$1,440	$1,170	$1,170
Other Healthcare	$ 260	$ 250	**$250
TOTAL	**$8,340**	**$8,058**	

Sources: FY2013 GOMB Budget Book; and HR706 Enrolled, Enacted March 29, 2012.
**House allocation to this item estimated at same level as Governor's

There has been much concern expressed recently about Healthcare expenditures generally and Medicaid expenditures specifically. Medicaid will be dealt with at some length in the following section of this Report. However, even after Medicaid expenditures are taken into account, overall inflation-adjusted General Fund spending on Health Care Services for the public (excluding Group Health Insurance) in Illinois will be less in FY2013 under the Governor's budget proposal than it was in FY2000, as shown in Figure 40.

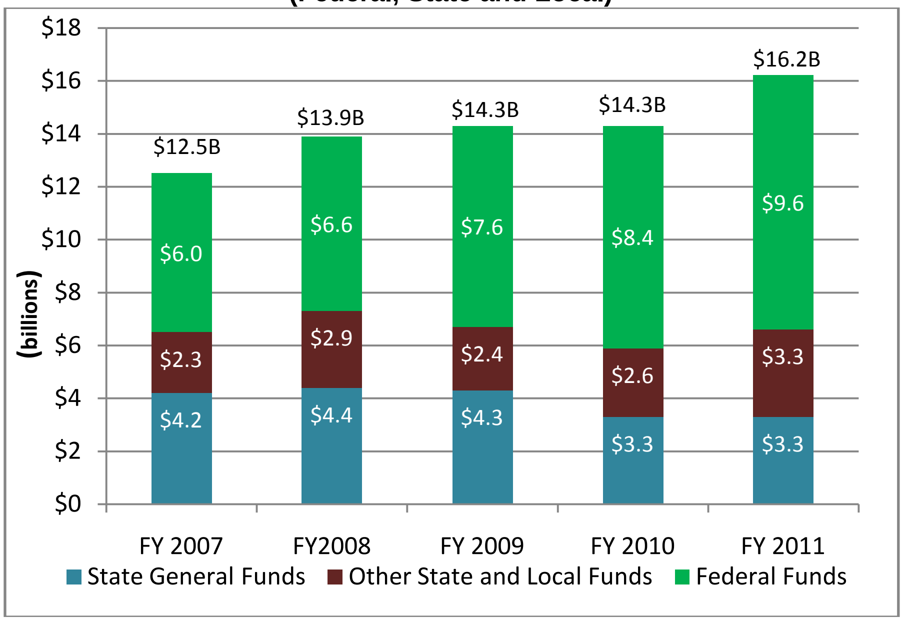
FIGURE 40
Health Care Spending, GOMB FY2013 Proposed vs. FY2000 Actuals,
Adjusted for Inflation and Population ($ Millions)

Category	FY2012 Enacted	FY2000 Infl & Pop Adj to FY2013	FY2013 GOMB Proposed	% Diff FY2013 GOMB & FY2000 Adj
Healthcare (including Medicaid, DHFS and DPH, but excluding Group Health Insurance)	$6,903	$8,934	$6,893	-22.8%

Sources: Unadjusted historic appropriations from Governor's Final Budget Summary for FY2000; GOMB FY2013 Budget Book; Ch. 2-32. Health Care spending inflation adjusted using the Midwest Medical CPI.

(e) Medicaid. In FY2013, Medicaid spending is targeted by both the House and Governor for a significant, $2.7 billion cut from FY2012 levels. Ostensibly, the reason for making this cut to Medicaid is because officials are worried that the growth in overall Medicaid expenditures over time has been absorbing so much state revenue that it is crowding out funding for other core services in the General Fund. However, as indicated previously, nothing could be further from the truth. Despite the fact that overall Medicaid expenditures have been increasing over the last five years, the portion of Medicaid expenditures actually paid by state, own-source tax revenue has been declining, as shown in Figure 41.

FIGURE 41
Medicaid Spending by Funding Source
(Federal, State and Local)



Source: National Association of State Budget Officers State Expenditure Report, 2010, released December 13, 2011, Pg. 47, Table 28.

Note that the FY2011 Medicaid expenditures are estimated, and include a significant increase in the state's federal matching rate under the Federal Stimulus program from 50 percent to 61.88 percent.[36] That said, the state own-source General Fund tax revenue used to cover Medicaid expenses in FY2010 and as projected for FY2011 was $3.3 billion, or fully $900 million less than in FY2007. This means the way the state finances its Medicaid program actually freed up $900 million in state tax revenue that formerly was used for Medicaid, to instead fund other core services. So, rather than crowding out the other core services, the Medicaid program has actually been subsidizing them.

(e) Unrealistic Schedule for Repayment of Debt Owed to the Pension Systems Continues to Strain Fiscal Resources. As indicated previously in this Report, Illinois state government has the responsibility to fund five distinct public employee pension systems: TRS, SURS, SERS, GARS and JRS.[37] Presently, all five state-sponsored retirement systems are significantly underfunded, with a combined unfunded liability of $82.9 billion and a collective funded ratio of just 43.4 percent.[38] This means the retirement systems' assets cover less than 50 percent of their liabilities. Figure 42 shows the current financial condition of each retirement system. Since public employee pension benefits are constitutionally guaranteed in Illinois,[39] the state must pay the full $82.9 billion in unfunded liabilities it owes.

FIGURE 42
Summary of State-Sponsored Retirement Systems' Financial Conditions ($ Thousands)

System	Assets	Liabilities	Unfunded Liability	Funded Ratio	Unfunded Liability to Payroll Ratio
JRS	614,596.2	1,952,539.4	1,337,943.2	31.5%	791.0%
SERS	11,159,836.6	31,395,007.8	20,235,171.2	35.6%	480.5%
TRS	37,769,753.0	81,299,745.0	43,529,992.0	46.5%	472.9%
SURS	13,945,700.0	31,514,300.0	17,568,600.0	44.3%	507.6%
GARS	63,161.0	298,408.4	235,247.3	21.2%	1548.9%

Source: Each systems' FY2011 Comprehensive Annual Financial Report (CAFR)
Note: Assets are calculated using the actuarial value of assets method, which smoothes losses/gains over five years.

According to GOMB, the state's FY2012 contribution to the five state-sponsored pension systems will be $4.14 billion. That contribution increases to $5.09 billion in FY2013 under the Governor's proposal, and a virtually identical $5.1 billion under the FY2013 House Proposal. Figure 43 provides a breakdown of GOMB's estimated FY2012 and FY2013 state pension contributions.

FIGURE 43
FY2012 and FY 2013 GOMB Projected Pension Contributions ($ Millions)

	FY2012 Adopted Budget	FY 2013 Proposed Budget
Teachers Retirement System	$2,406	$2,703
State University Retirement System	$980	$1,403
State Employees, Judges & General Assembly Retirement Systems	$978	$1,144
Less: Transfers from State Pension Fund (Unclaimed Property)[40]	(-$230)	(-$160)
Equals: General Fund Pension Contributions (net)	**$4,135**	**$5,090**

Source: FY2013 GOMB Budget Book, Ch. 2-18.

It should be noted that both the FY2012 pension contributions estimated by GOMB and the FY2013 pension contributions proposed by the Governor and the House, are less than the estimates produced by the retirement systems themselves for those two fiscal years by a combined $108 million. Figure 44 compares the GOMB estimates with the retirement systems' estimates. According to GOMB, this $108 million differential over FY2012 and FY2013 will be made up through use of either transfers from special funds (as yet undetermined) or other General Fund appropriations made to the agencies who have members in the respective plans.

Figure 44
FY2012 and FY2013 GOMB Projected Pension Contributions vs. Retirement Systems Projected Pension Contributions ($ Millions)

	FY2012 GOMB Estimate[(i)]	FY2012 System Estimate[(ii)]	FY2013 GOMB Estimate[(i)]	FY2013 System Estimates[(iii)]
Teachers Retirement System	$2,406	$2,406	$2,703	$2,703
State University Retirement System	$980	$980	$1,403	$1,403
State Employees, Judges & General Assembly Retirement Systems[41]	$978	$1,032	$1,144	$1,198
Less: Transfers from State Pension Fund (Unclaimed Property)	($230)	($230)	($160)	($160)
Equals: General Fund Pension Contributions (net)	**$4,135**	**$4,188**	**$5,090**	**$5,144**

Sources:
(i) FY2013 GOMB Budget Book, Ch. 2-18.
(ii) Systems' certified letters contained in COGFA, "A Report on the Financial Condition of the IL State Retirement Systems: Financial Conditions as of June 30, 2010."
(iii) Systems' certified letters contained in COGFA, "A Report on the Financial Condition of the IL State Retirement Systems: Financial Conditions as of June 30, 2011."

In either case, the proposed pension contribution for FY2013 will be a little more than 23 percent greater than in FY2012. This is a significant year-to-year increase, that can be expected to continue under current law. But the primary reason why there will be significant, annual growth in the state's pension contribution is poorly understood. It has nothing to do with increasing benefits for workers, nor any other inherent aspect of the pension systems themselves. By far and away the main reason the state's annual contributions to its pension systems are increasing so much annually is the unrealistic, heavily back-loaded schedule the legislature set back in 1995 for repaying the debt the state owes to its pension systems.

Proof that debt is driving the increase in annual pension payments is easy to establish. Of the estimated $4.135 billion contribution to the five pension systems estimated for FY2012, about $1.613 billion is the normal cost of funding benefits being earned by current workers, whereas more than half, $2.522 billion is repayment of debt. Of the Governor's proposed $5.09 billion contribution to the five pension systems in FY2013, about $1.578 billion is attributable to normal cost of the benefits being earned by current workers, while $3.512 billion is the debt repayment. That means all of the 23 percent year-to-year growth in the pension contribution from FY2012 into FY2013 is due to the repayment schedule.

How did we get here? For decades, Illinois has had a structural deficit (as identified previously in this Report). To paper over—without resolving—the fact that the cost of delivering public services from year-to-year grew at a greater rate than revenue did—decision makers opted to borrow against what they owed the pension systems and use that borrowed revenue to fund delivery of public services. This meant that for decades the pension systems—against their will—were lending money to the state's General Fund to subsidize the cost of delivering current services. This effectively allowed taxpayers to consume public services for over 40 years without having to pay the full cost of those services.

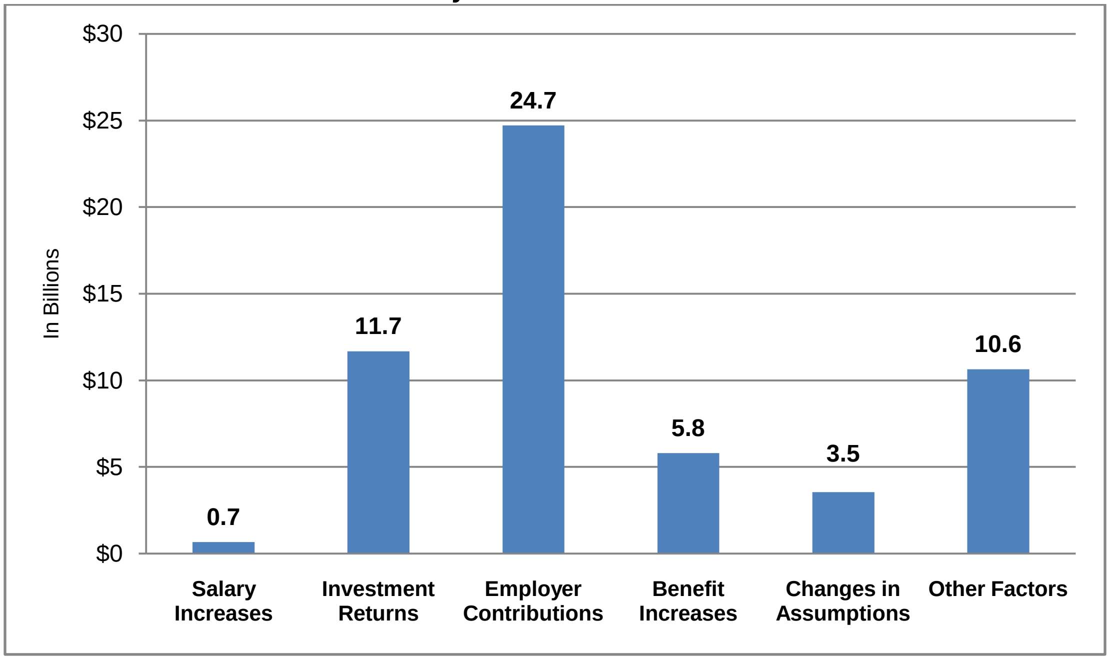
By the end of FY1994, Illinois lawmakers had borrowed so much against the pension systems to fund services that the overall funded ratio of all five systems was just 54.5 percent, and there was a cumulative unfunded liability of $17 billion.[42] Ostensibly to rectify this situation, in FY1995 the General Assembly passed and Governor Edgar signed P.A. 88-0593, which established what became known as the "Pension Ramp." The Pension Ramp mandated that the state's annual pension contributions be made pursuant to a continuing appropriation, and established a repayment schedule for the debt owed to the pension systems which would result in all five systems having 90 percent funded ratios by 2045.

Even though P.A. 88-0593 was allegedly designed to repay the debt owed to and resolve the unfunded liability of the pension systems—by law—the legislation continued the practice of borrowing against contributions owed to the pension systems to subsidize the cost of delivering public services for 15 years after passage. P.A. 88-0593 accomplished this boondoggle by creating the following two-phase repayment schedule:

- **Part 1: Fiscal Years 1996-2010**. During this "15-year phase-in period" the state's annual contributions were calculated as a percentage of payroll significantly below the normal cost of funding benefits for current workers each year. This effectively increased the unfunded liabilities of the five pension systems by $24.7 billion. Figure 45 shows how much all factors contributed to the growth in unfunded liabilities during this period.

- **Part 2: Fiscal Years 2011-2045**. During this period, the state is annually required to contribute a percent of payroll that is sufficient, when added to employee contributions, investment income and other income, to bring the systems to a 90 percent funded ratio by the end of FY2045.

FIGURE 45
Causes of Growth in State Systems' Unfunded Liabilities 1996-2010[43]



Source: COGFA, "A Report on the Appropriateness of the 90% Funding Target of Public Act 88-593." p. 9.

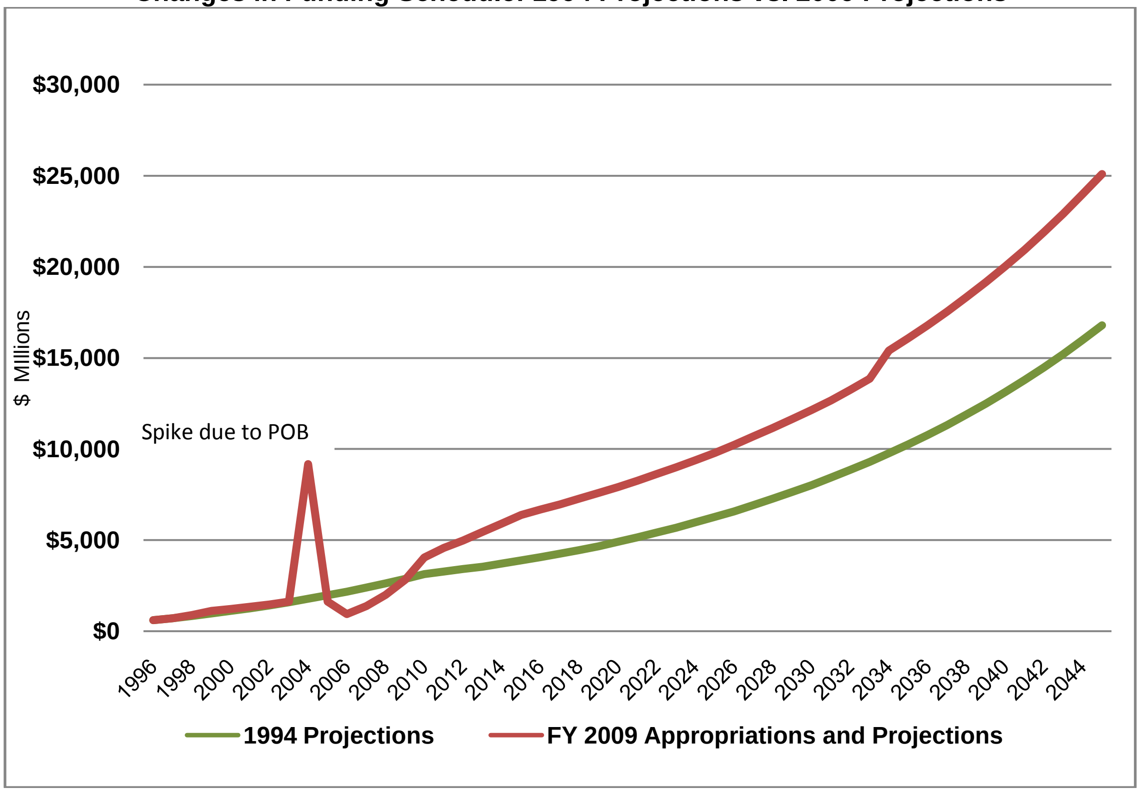
In what can only be described as piling on, legislation enacted during Blagojevich's tenure as governor altered the funding schedule designed by P.A. 88-0593, and resulted in making the already unattainable repayment schedule initially established under the Pension Ramp even worse.

First, the Blagojevich Administration paid a portion of the state's pension contribution for FY2003 and all of its FY2004 contribution with debt proceeds from the sale of $10 billion worth of Pension Obligation Bonds (**2003 POB**). Under this legislation, P.A. 93-0002, the state's annual contributions to the pension systems were reduced by the annual debt service on the bonds.[44] It would be one thing if all the $10 billion in debt proceeds from the 2003 POB were paid into the pension systems to retire existing pension debt. That would have constituted a refinancing at lower interest rates, something businesses do all the time to save money. In this instance, however, the state incurred a debt to pay its current obligations—which had to be repaid over time—ultimately increasing costs to the state, a situation made worse by the reduction in current annual contributions the bill implemented.

Then in 2005, the General Assembly passed P.A. 94-0004, which was designed to reduce the liability growth in the five pension systems, providing future savings. However, that legislation also reduced the state's contributions to the retirement systems for FY2006 and FY2007 by $2.31 billion. The reduction in the state's pension contributions for those two years essentially offset the liability savings that were supposed to result from P.A. 94-0004 over the long-term.[45]

Figure 46 shows the state's annual contributions based on the funding schedule for fiscal years 1996-2045 as it was originally established under the Pension Ramp (in green), compared to how those contributions changed due to growth in unfunded liabilities (in red) caused by both the changes in law enacted during the Blagojevich Administration that resulted in insufficient employer contributions, and the investment losses caused by the financial crisis of 2008.

FIGURE 46
Changes in Funding Schedule: 1994 Projections vs. 2009 Projections

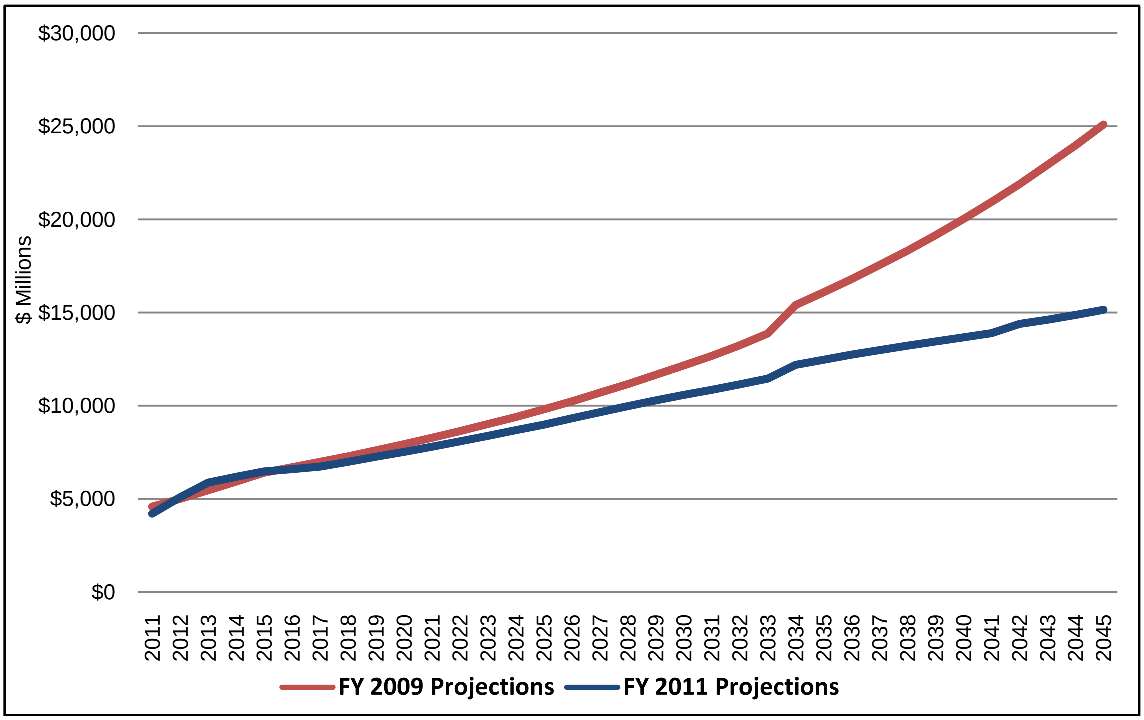


Sources:
(i) COGFA, 2006. "Report on the 90% Funding Target of Public Act 88-0593."
(ii) COGFA, "A Report on the Financial Condition of the IL State Retirement Systems: Financial Conditions as of June 30, 2009."

In 2010, legislators took a new approach to reducing the state's obligation to repay its debt to the pension systems. Rather than replace the existing Pension Ramp with a rational, attainable payment schedule, they decided to have future workers pay for state government's past sins, by creating a second benefit tier under S.B. 1946 (P.A. 96-0889). This legislation requires the new employees who receive lower pension benefits under Tier II, to make contributions to the pension systems that cover more than the cost of their Tier II benefits, in effect assuming part of the state's obligation to repay pension debt. This ultimately reduces the employer contributions required from the state.

Figure 47 shows how Tier II reduces the state's projected employer contributions (the blue line) compared to pre-existing law (the red line).

FIGURE 47
Required State Pension Contributions Before & After Creation of Tier-II



Sources:
(i) COGFA, "A Report on the Financial Condition of the IL State Retirement Systems: Financial Conditions as of June 30, 2009," p. 87.
(ii) COGFA, "A Report on the Financial Condition of the IL State Retirement Systems: Financial Conditions as of June 30, 2011," p. 95.

Of course, the future savings projected from Tier II assume that the state will adhere to the current funding schedule, an assumption which seems overly optimistic. In 2011, the state could not pay its pension contribution from General Fund revenue, so instead it authorized the sale of $4.096 billion worth of bonds, under P.A. 96-1497, to cover that contribution. Of the authorized amount, the state only sold $3.7 billion in bonds, which it used to pay a portion of its FY2011 pension contributions. The state's use of debt—which has to be repaid—to cover its then current pension contribution is nothing new. The proceeds of bond sales authorized under P.A. 96-0043 were similarly used to pay part of the state's required contributions for FY2010. It is just not possible for the state to continue issuing pension bonds to meet its annual contribution requirements going forward. Which means it is highly unlikely the state will continue to meet its annual pension contributions, given the continued growth in both its contribution payment schedule on the one hand, and the structural deficit on the other.

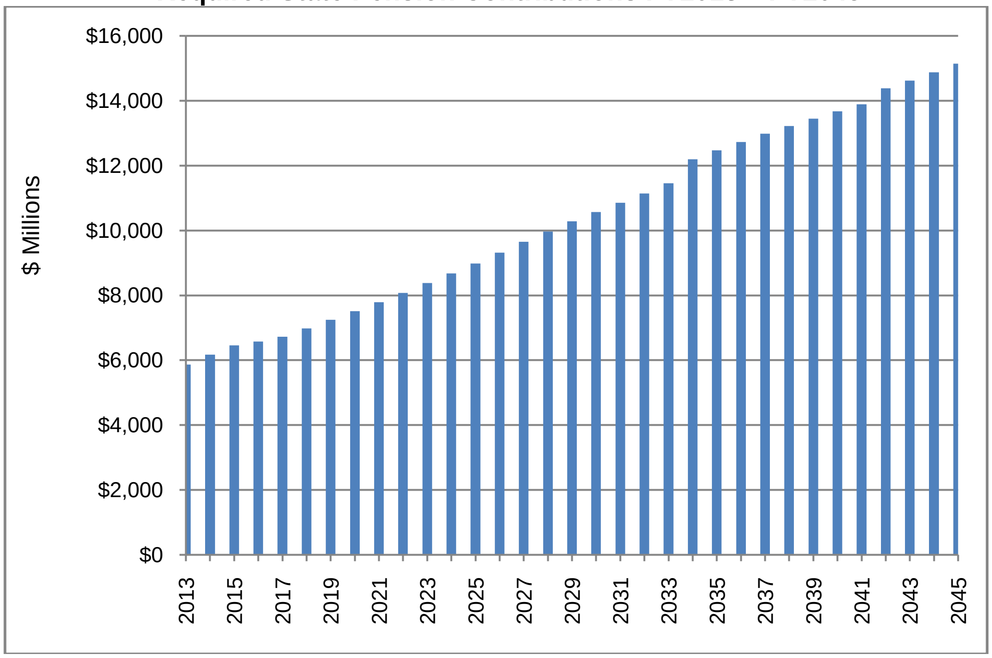
After all the changes in law passed over the prior few years, the remaining payment schedule under the now modified Pension Ramp is still unattainable. To meet the 90 percent funded ratio target by 2045, annual employer contributions will have to grow by 3 percent every year for the remainder of the funding schedule (FY2013 – FY2045).[46]

Figure 48 displays projections of the state's pension contributions for FY2013 through FY2045 under the modified Pension Ramp.

In his FY2013 budget address, Governor Quinn acknowledged that decades of insufficient funding have eroded the pension systems. He further stated that, "We must stabilize and strengthen our pension systems to prevent them from swallowing up our core programs…and to ensure that we can pay all our bills."

While the data support his desire to strengthen the state's pension systems, it does not support his contention that the pension systems are "swallowing up" core programs. Indeed the converse is true.

FIGURE 48
Required State Pension Contributions FY2013 – FY2045



Source: COGFA, "A Report on the Financial Condition of the IL State Retirement Systems: Financial Conditions as of June 30, 2011," p. 95.

The debt Illinois incurred to these systems over time subsidized the cost of service delivery to taxpayers. Now the bill is coming due to repay that debt—a debt that allowed all taxpayers to receive core services for decades at a discount. The payment schedule for repaying that debt is both unrealistic and the cause of the fiscal strain that threatens funding for services.

8. CONCLUSION

Since the Center for Tax and Budget Accountability was formed in 2000, our organization has been analyzing the state of Illinois' fiscal system with a focus on the General Fund. The reason for this focus is simple: the General Fund is what pays for the core services of Education, Healthcare, Human Services and Public Safety demanded by voters and taxpayers. Over this time period, the fiscal condition of the Illinois General Fund has continued to deteriorate from year to year, with deficits growing annually.

Contrary to popular belief, the reason for the state's deteriorating fiscal condition has had nothing to do with runaway spending. Indeed, the state has been cutting real spending on all four categories of core public services for over a decade and ranks well below the national average in critical Education and Human Service spending both in per-capita and capacity terms. The fact is that Illinois has been slowly starving its public sector for years, lowering the quality of life for current residents and diminishing the state's long-term economic competitiveness.

The truth is Illinois' fiscal problems have been primarily caused by its tax policy, which is so flawed it cannot support the provision of the same level of services from one fiscal year into the next. At this juncture, further cuts in spending on core services will invariably fall hardest on school children and the poorest, most vulnerable Illinoisans, severely compromise the states' long term economic development, and ultimately NOT SOLVE THE PROBLEM. There is no magic way out. Illinois must enact comprehensive, meaningful and permanent tax reform that modernizes tax policy, makes it comport with the principles of a sound tax system and raises adequate revenue to fund core services into the future.

The good news is that by expanding the state's sales tax base to include services, amending the constitution to permit graduated income tax rates and taxing some retirement income, Illinois can raise the additional revenue needed to sustain public service investments, while at the same time reducing or not changing the tax burden for the bottom 94 percent of families in Illinois with modest increases in tax burden for the top 6 percent of filers (with incomes of over $150,000).

ENDNOTES

[1] CTBA, Analysis of Proposed Illinois FY2012 Budget, pg. 1
[2] PA 96-1496 signed into law June 30 2011, raised the Illinois Personal Income Tax rate from 3% to 5% and the Corporate Income Tax rate from 4.8% to 7% for 2011 to 2014. These rates are supposed to go back down in subsequent years, eventually to 3.25% and 4.8%, respectively in 2025.
[3] P.A. 88-593 requires the State to make contributions to the State retirement systems so that total assets of the systems will equal 90% of their total actuarial liabilities by Fiscal Year 2045.
[4] *Budgeting for Results Commission Report*; November 2011.
[5] Allan, Ian J. "Evaluating Alternative Revenue Sources" Government Finance Research Center, Government Finance Officers Association, January 1992.
[6] Less than 2% of U.S. Citizens have estates larger than $1.5 million ($3 million for a couple) from "Who Pays the Estate Tax", United for a Fair Economy from 1999 IRS data. As of 2012, the Illinois Estate Tax exempts estates of less than $3.5 million ($4.0 million in 2013 and later).
[7] Based on published reports, the CME Group had a 31.7% average profit margin in 2010 giving it a net income of $951.4 million on $3.0 billion of 2010 revenue. See: http://ycharts.com/companies/CME/historical_data/profit_margin and http://files.shareholder.com/downloads/CME/1466453098x0x438814/8479c49c-8739-46ae-94ce-0d4f68778610/CME_News_2011_2_3_Earnings.pdf . According to a report in the Feb. 25, 2012, *Chicago Tribune,* "Sears Says that it will close 5 Illinois Stores."
[8] P.A. 097-636 Fiscal Note. The tax break for the Chicago Mercantile Exchange is estimated at $85 million in FY2014.
[9] Illinois General Assembly: P.A. 97-0652.
[10] *Institute on Taxation and Economic Policy (ITEP). "Who pays? A Distributional Analysis of the Tax Systems in All 50 States, 3rd Edition." November 2009. The only states with a higher state and local tax burden on the Lowest 20% of families are Washington and Florida, neither of which have a state personal income tax.* .
[11] Taxpayer Accountability and Stabilization Act, Public Act 96-1496, adopted January 13, 2011.
[12] PA 96-1946 signed into law January 13, 2011, raised the Illinois Personal Income Tax rate from 3% to 5% and the Corporate Income Tax rate from 4.8% to 7% for 2011 to 2014. These rates are supposed to go back down in subsequent years, eventually to 3.25% and 4.8% respectively in 2025.
[13] CTBA analysis of Illinois State Board of Education, FY2013 Budget Request, Education Reform Budget Comparison to FY2013 Governor's Budget.
[14] Illinois House Resolution 706 adopted as amended, March 29, 2012.
[15] P.A. 097-636 passed December 16, 2011. Bill Status and Fiscal Note for House Amendment No. 3 (Dept. of Revenue) estimates are $263 million in FY2012 and $325 million in FY2013.
[16] BLS Midwest Urban Medical Care Consumer Price Index average increase from FY2002 to FY2012. Index values for February to June 2012, are estimated as having grown by same rate as index values for February to June 2011 from February to June 2010.
[17] On the Henry J Kaiser Family Foundation State Health Facts website Illinois is ranked ninth lowest in Medicaid reimbursement rates. Link: http://www.statehealthfacts.org/comparetable.jsp?typ=2&ind=916&cat=4&sub=154&sortc=4&o=a.
[18] Illinois Demographic Facts at a glance Link: http://www.statehealthfacts.org/profileglance.jsp?rgn=15#.
[19] Section 1902 of the Social Security Act. In general, to change its Medicaid program a state must either amend its state Medicaid plan or obtain a waiver of requirements set forth in Title XIX from the Secretary of HHS.
[20] Federal Register/ Vo. 75, No. 217/Wednesday, November 10, 2010/Notices 69083. Federal Medical Assistance Percentages.
[21] Henry J. Kaiser Family Foundation State Health Facts, Medicaid Demographics, Federal Medical Assistance Percentage (FMAP) for Medicaid and Multiplier. http://www.statehealthfacts.org/comparetable.jsp?ind=184&cat=4
[22] CTBA, *Funding Our Future*, Op. Cit., Section 3.
[23] Office of Management & Budget (GOMB) "Three Year Budget Projection (General Funds), FY13-FY15," February, 2012.
[24] Illinois Department of Healthcare and Family Services Five Year Medical Assistance Budget Outlook General Revenue and Related Funds Only, "Other Related Funds Spend," March, 2012.
[25] Recovery.Illinois.gov; Illinois' official ARRA website explains: Increased federal matching dollars for Medicaid (Title XIX) services, available from February 2009 through December 2010. Enhanced matching rate is 61.88%. Enhanced matching dollars drawn are based on Medicaid spending.
[26] The most accurate way to estimate long term growth in macroeconomic variables that depend on economic output is to look at two comparable points in the business cycle. FY2002 and FY2009 were the "low points" ("troughs") of the two most recent business cycles.
[27] FY2000 to FY2011 from COGFA FY2012 and earlier Budget Books, and FY 2012 and FY 2013 from COGFA "*FY2013 Economic Forecast and Revenue Update*," February 28, 2012.
[28] State of Illinois, 2011, *Budgeting for Results Commission Report.* Available at http://www2.illinois.gov/budget/Documents/Budgeting%20for%20Results/Related%20Documents/Budgeting%20for%20Results%20Commission%20Report%20Nov%202011.pdf
[29] Powers, E.T., Powers, N.J., & Merriman, D. (2007, March). State funding of community agencies for services provided to Illinois residents with mental illness and/or developmental disabilities. Chicago: Institute of Government and Public Affairs, University of Illinois.
[30] CTBA analysis of Illinois State Board of Education, FY2013 Budget Request, Education Reform Budget Comparison to FY2013 Governor's Budget.
[31] CTBA, "*Money Matters: How the Illinois School Funding System Causes Significant Inequities that Impact Most Students in the State*," Sept. 2008.
[32] Bureau of Economic Analysis, Regional GDP News Release, March 28, 2012.
[33] Funding Our Future, Op. cit., p. 10.

[34] CTBA calculation from COGFA FY2009 Budget Summary, GOMB FY2013 Budget Book, HR706 Enrolled, adopted March 29, 2012, BLS Employment Cost index, DCEO Illinois population estimates.
[35] Jodi S. Cohen. 2012. "*State Runs Out of Financial Aid for College Students*." Chicago Tribune. March 21, 2012.
[36] Recovery.Illinois.gov; Illinois' official ARRA website explains: Increased federal matching dollars for Medicaid (Title XIX) services, available from February 2009 through December 2010. Enhanced matching rate is 61.88%. Enhanced matching dollars drawn are based on Medicaid spending.
[37] Article XIII, Section 5 of the Illinois Constitution. See also: Madir, Eric M. "*Is Welching on Public Pension Promises an Option for Illinois? An Analysis of Article XIII, Section 5 of the Illinois Constitution.*"
[38]COGFA November 2012 Monthly Briefing, p. 9.
[39] Ibid.
[40] Pension contributions for SERS, JRS, and GARS are lumped together as one category because this is how it appears in the FY2013 GOMB Budget Book; however, it should be noted that this category is the sum of three separate pension contributions. In order for comparisons with GOMB figures, the pension contributions for SERS, JRS, and GARS are lumped together as one category elsewhere in this Report.
[41] Figures for General Fund contributions to SERS for FY 2012 and FY2013 were obtain from SERS by CTBA.
[42]Illinois Economic and Fiscal Commission. March 1995. "Fiscal Year 1996 Pension Funding Requirements," p. 3-5
[43] The category 'other factors' covers "miscellaneous actuarial factors such as rates of termination, disability, and pre-and post-retirement mortality" (ibid.).
[44]COGFA.2011. "*A Report on the Financial Condition of the IL State Retirement Systems: Financial Conditions as of June 30, 2010*,"p. 8.
[45]COGFA.2012. "*Report on the Financial Condition of the Illinois Public Employee Retirement Systems*," p. i.
[46] Calculation done by the Center for Tax and Budget Accountability using COGFA's Retirement System Funding Projections from "A Report on the Financial Condition of the IL State Retirement Systems: Financial Conditions as of June 30, 2011." These projections are total state contributions and include both General Fund and non-General Fund contributions.