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CIVIC FEDERATION OPPOSES UNAFFORDABLE FY2009 STATE BUDGET, WITHDRAWS SUPPORT FOR INCOME TAX INCREASE

(CHICAGO) The State of Illinois faces a serious fiscal crisis in FY2009 that the governor and General Assembly must address, the Civic Federation concludes in its 62-page analysis of Governor Blagojevich's proposed budget. The Federation **opposes** the $49.7 billion budget because it does not do enough to tackle the state's existing financial challenges and its proposed spending increases will further weaken the Illinois' fiscal condition. The full analysis will be available to the public at www.civicfed.org on Monday, May 12, 2008.

As the nation enters an economic downturn, the governor's proposed budget relies on an imprudent combination of hefty business tax hikes, a partial asset lease, and billions of dollars in new debt. Moreover, it does not even attempt to make the reasonable pension and retiree health care benefit reforms the state required of the Chicago Transit Authority last year as a precondition to increased funding. For this reason, the Federation **strongly opposes** the governor's plan to issue $16.0 billion in pension obligation bonds. "The governor and General Assembly should follow the advice they gave the CTA and implement reforms to reduce the operating cost of Illinois' extraordinarily generous benefit plans before asking taxpayers to bail out state pensions by borrowing more money," said Laurence Msall, president of the Civic Federation. "To date, the General Assembly has failed to act on needed pension reforms."

The General Assembly and governor's lack of commitment to meaningful reform has led the Civic Federation to withdraw its support for an income tax increase this year. Instead, the Federation believes Illinois should adopt a budget for FY2009 that is based on existing revenues, excludes the governor's proposed spending increases of $1.9 billion, and makes the full pension payment of $3.0 billion required under law. The Federation supported an increase in taxes last year if, and only if, the new funds were tied to significant structural reforms. However, the governor and the General Assembly have failed yet again to address Illinois' colossal financial issues, which include $44 *billion* in unfunded pension liabilities another $24 *billion* in retiree health care liabilities. Until Illinois political leaders dedicate themselves to putting the state's fiscal house in order, Illinois taxpayers and the Civic Federation will not have confidence that any new revenue will be spent effectively.

The governor proposes a $25 billion capital plan funded by a partial concession of the Illinois Lottery. While the Civic Federation believes Illinois needs investment in its infrastructure, we cannot support the concession of the lottery this year because it is not linked to a detailed multi-year capital improvement plan (CIP). We are pleased that the state plans to release a CIP by September 1st, but Illinois citizens deserve both an explanation of the infrastructure needs of the state and a concrete plan to address priorities *before* billions of dollars are appropriated for public projects. Legislators should demand a detailed CIP *before* they agree to approve such a dramatic transformation of the state lottery to fund capital appropriations.

The Civic Federation is able to **support** certain aspects of the governor's budget, such as the 3% across-the-board spending cuts he proposed for non-priority areas. While the Federation has always maintained that targeted cuts based on performance evaluation are the best method of reducing government spending, we are encouraged that Illinois government has made an effort to identify priorities in the budget and reduce spending in other areas. The Federation also supports some of the proposed corporate tax changes and reaffirms its support of the Blagojevich administration's Shared Services plan. Shared Services is an excellent example of how a government can employ business process reforms to reduce administrative costs and improve efficiency. The State of Illinois must focus on similar cost reduction strategies if it is to craft a balanced budget and avoid future financial meltdown.

The Civic Federation is an independent, non-partisan government research organization founded in 1894. The Federation's membership includes business and professional leaders from a wide range of Chicago area corporations, professional service firms and institutions.

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STATE OF ILLINOIS
FY2009 RECOMMENDED OPERATING BUDGET

Analysis and Recommendations

Prepared By
The Civic Federation
May 12, 2008

TABLE OF CONTENTS

EXECUTIVE SUMMARY

The Civic Federation **opposes** the State of Illinois FY2009 Operating Budget and urges dramatic recasting of the State's financial priorities.

Governor Blagojevich has proposed a $49.7 billion operating budget that includes $1.9 billion in new initiatives, $1.0 billion in new business taxes, $16.0 billion in new pension obligation debt, the lease of the State Lottery in the form of a partial concession, and a massive $25.0 billion capital plan. These plans do not adequately address the grim fiscal reality facing the State of Illinois. The Civic Federation **opposes** the Governor's budget because:

- The new program initiatives are unaffordable and imprudent during an economic downturn and will only further the State's inability to meet its existing obligations;
- The pension borrowing plan is not linked to essential long-term cost-cutting reforms that are needed to help offset the $44.5 billion in unfunded liabilities; and
- The partial concession of the Lottery to fund a massive $25.0 billion capital program is not accompanied by a detailed multi-year capital improvement plan that explains what projects will be funded and why they are necessary. Such a plan is essential before approval of a capital program.

There are some important components of the FY2009 budget proposal that the Civic Federation **supports**. We support the Governor's proposal to cut 3% from non-priority agencies. We commend him for holding the line on the number of State personnel for the last five years. We support efforts to reduce the extraordinary number of State special purpose funds and sweep those funds to help balance the State budget. We endorse certain tax changes that eliminate outdated and economically inefficient corporate tax deductions or credits. And we strongly support the Governor's continuing efforts to streamline and modernize the operation of the State government through mechanisms such as the Shared Services program, which will increase efficiency and reduce the costs of operations.

However, we are concerned that in this budget the Governor is not addressing critical long-term issues that are threatening the fiscal stability of the State of Illinois for generations to come.

Illinois and the nation are entering into an economic downturn. The State faces a $750.0 million deficit in its current FY2008 budget. Total state source General Fund revenues will increase by only 0.6%, from $24.7 billion in FY2008 to $24.8 billion in FY2009.[1] Unfunded liabilities of the State's five retirement systems were $44.5 billion in FY2008. In order to comply with its own 1995 pension funding reform law, the State's required contributions to the pension system will rise from $3.3 billion in FY2009 to $4.0 billion in FY2010. The State's pension obligations are already crowding out spending for other state priorities.

The State recently announced that liabilities for other post employment benefits, which are commonly referred to as OPEB liabilities and consist primarily of retiree health insurance costs,

[1] Illinois State Budget FY2009, p.2-38. This statistic compares total State source General Fund projected FY2009 revenues versus the estimated FY2008 amount.

are projected to total approximately $24.0 billion.[2] All of these signs point to the fact that the State of Illinois is in a fiscal crisis. It faces overwhelming financial challenges that neither the Governor's proposed budget nor the General Assembly are addressing.

The Civic Federation believes that the State of Illinois should reject the $417.0 million *Illinois Covered* expansion proposal and the $300.0 million increase for education funding, and begin tightening its spending belt to allow for its full pension payment of $3.3 billion, as required under the 1995 pension funding reform law.[3]

The Civic Federation **opposes** the following issues in the FY2009 State of Illinois operating budget:

- The Governor's proposed $1.9 billion in new initiatives, which include $900.0 million for a child tax credit, $300.0 million for a business tax credit, $417.0 million for an expansion of the *Illinois Covered* healthcare program, and $300.0 million in additional funding for education;
- A long-term partial concession of the State Lottery, which will fund a new $25.0 billion capital budget program entitled *Illinois Works*, because the spending proposal is not accompanied by a detailed multi-year Capital Improvement Plan. Without such analysis, the public and taxpayers have no basis to evaluate whether the plan adequately addresses the State's most critical needs. The Governor estimates that the Lottery proceeds will total $10-$12 billion, with $7.0 billion of the revenue used to fund *Illinois Works*;
- A plan to use the securitization of long-term revenues, such as tobacco settlements, to fund the one-time child and business tax credits proposed for FY2009;
- Certain business tax changes, including expanding the employer payroll tax, repealing the single sales factor and decoupling certain Illinois tax code provisions from the federal income tax code; and
- The Governor's $16.0 billion dollar pension obligation bond issue, because no long-term pension benefit reforms are tied to the extraordinary borrowing initiative and not all of the proceeds would be used to pay down existing pension liabilities.

The Civic Federation does offer its **support** for some important several components of Governor Blagojevich's FY2009 budget:

- The Governor's proposal to implement 3% across-the-board spending cuts in non-priority areas and to decrease personnel counts by 1,464 over FY2008;
- Certain tax changes, including restricting the cost of collection discounts, repealing the research and development credit, eliminating the manufacturer's purchase credit, taxing industrial insurance purchased by large companies from unlicensed international insurance companies, including Puerto Rico and the Outer Continental Shelf in the definition of the U.S., and enforcing withholding on non-resident gaming winnings over $1,000;

[2] Yvette Shields. "Illinois OPEB Smaller but still Daunting," *The Bond Buyer*. April 22, 2008.
[3] The $3.3 billion figure is $446 million more than the FY2009 budget proposal of $280 million. The revenues from the $1.2 billion securitization proposal are not included in the budget. See footnote 3, Illinois State Budget FY2009, p. 2-14.

- The proposed special purpose funds sweeps and the Governor's efforts to consolidate special purpose funds into the General Fund when appropriate; and
- The expansion of the Shared Services plan in an effort to make budget planning and state spending more transparent, as well as to increase efficiency and reduce administrative costs.

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

- The State of Illinois should enact legislation requiring the development and publication of a multi-year Capital Improvement Plan on a biannual basis.
- The State should implement comprehensive pension benefit reforms in order to address the long-term costs and liabilities of its five retirement systems. These reforms should include a moratorium on new pension benefits, a 1% increase in employee contributions, and establishing a more economically reasonable pension plan for employees not yet hired by raising the retirement age for new hires, fixing automatic increases for new hires at the lesser of 2% or the rate of inflation, and requiring balanced pension board membership.
- To contain the rising cost of healthcare, the State must implement employee and retiree health insurance cost saving reforms, much like the ones achieved by the CTA.
- The State should require school district financial management accountability reforms prior to issuing additional funding for education.
- The State should implement a formal long-term financial planning process that includes input by key policymakers and stakeholders.
- The State should improve its performance measurement system by including stated goals and measures of efficiency, effectiveness, and service quality.

OVERVIEW

The Civic Federation recently concluded an analysis of financial issues related to the State of Illinois proposed FY2009 $49.7 billion operating budget. Our positions on the principal components of the budget follow:

The Civic Federation opposes the State of Illinois proposed FY2009 Operating Budget and urges dramatic recasting of the State's financial priorities.

Governor Blagojevich has proposed a $49.7 billion operating budget that includes $1.9 billion in new initiatives, $1.0 billion in new business taxes, $16.0 billion in new pension obligation debt, the lease of the State Lottery in the form of a partial concession, and a massive $25.0 billion capital program. These plans seem to ignore the grim fiscal reality facing the State of Illinois. The Civic Federation **opposes** the Governor's budget because:

- The new program initiatives are unaffordable and imprudent during an economic downturn and will only further the State's inability to meet its existing obligations;

- The $16.0 billion pension borrowing proposal is not linked to essential long-term cost-cutting reforms that are necessary to help offset the $44.5 billion in unfunded liabilities; and

- The partial concession of the State Lottery to fund a massive $25.0 billion capital program is not accompanied by a capital improvement plan that explains to the public how projects will be funded and why they are necessary. Such a plan is essential before approval of a capital program.

Illinois and the nation are entering into an economic downturn. The State faces a $750.0 million deficit in its current FY2008 budget. Total state source General Fund revenues will increase by only 0.6%, from $24.7 billion in FY2008 to $24.8 billion in FY2009.[4] Unfunded liabilities of the State's five retirement systems were $44.5 billion in FY2008. If the State adheres to the 1995 pension funding reform law, its required contributions to the pension system will skyrocket from $3.3 billion in FY2009 to $5.4 billion in just 10 years, a 64.7% increase. The State's pension obligations are already crowding out spending on other state priorities.

Governor Blagojevich recently announced that liabilities for other post employment benefits, which are commonly referred to as OPEB liabilities and consist primarily of retiree health insurance costs, are projected to total $24.0 billion. Furthermore, there is no long-term plan for how these obligations will be funded. All of these signs point to the fact that the State of Illinois is in a fiscal crisis. It faces overwhelming financial challenges that neither the Governor's proposed budget nor the General Assembly are effectively addressing.

In a time of fiscal crisis, it is unreasonable for the State of Illinois to create expensive new programs or even expand existing programs without addressing the State's operating obligations. Doing so only compounds an already precarious fiscal situation.

The State **cannot afford** to spend over $700.0 million for the continued expansion of its *Illinois Covered* healthcare insurance program, in addition to spending new money on education and infrastructure. The Governor proposes that the expansion of the *Illinois Covered* program by $417.0 million be paid for with a new payroll tax that is expected to generate up to $1.0 billion annually when fully operational; presumably the excess funds will allow additional expansions in future years. We reject the payroll tax as an unnecessary and unreasonable burden on Illinois businesses in a time of economic downturn.

The Illinois Child Tax Credit and the Illinois Business Tax Credit are also expensive, one-time incentives that the Governor proposes as part of an economic stimulus package. However, these new tax expenditures may have a limited impact on personal and business spending decisions, especially if implemented with the Governor's proposed tax increases in other areas. Business decisions in particular are rarely based on considerations of one-time state income tax credits. Although it is proposed that these credits will be paid for by securitizing $1.2 billion in resources, such as tobacco settlement funds, such borrowing against future revenues is not devoid of risk. Leaving aside arguments about whether securitization is the best or most

[4]Illinois State Budget FY2009, p.2-38. This statistic compares total State source General Fund projected FY2009 revenues versus the estimated FY2008 amount.

appropriate use of those funds, this proposal borrows against future revenue steams to pay for one-time relief programs of questionable benefit. Given the questionable benefit of these tax credits and their reduction of future state revenue streams, we cannot support them.

The Civic Federation **strongly opposes** the Governor's plan to issue $16.0 billion in pension obligation bonds because the administration and the General Assembly appear to have abandoned the 2005 Blue Ribbon Commission's recommendations on how to address the State's pension funding crisis. Unlike his FY2006 budget proposals, which incorporated most of the Blue Ribbon Commission's recommendations, the Governor does not propose long-term pension benefit reforms in this budget or as part of his new plan to issue pension obligation bonds totaling $16.0 billion. Making significant progress toward reducing the enormous costs and liabilities of the State's five retirement systems will require a continuous effort to reduce pension obligations, such as moving toward a two-tiered system that would allow state employees not yet hired to have more economically-reasonable benefits. In addition, we take exception to the Governor's borrowing proposal because not all of the bond proceeds will be used to pay down existing pension liabilities but would be used to pay a portion of the operating costs of the State's pension benefit program. The State of Illinois must adhere to its pension payment schedule law, established in 1995, and make the payments required by that law.[5] The pension payments mandated by the 1995 law are operating expenses of the State.

We also **oppose** the partial concession of the Illinois State Lottery to help fund capital improvements totaling $25.0 billion because the State has failed to prepare and make publicly available a sufficiently detailed multi-year capital improvement plan that includes criteria used to assess capital needs, a multi-year capital improvement needs inventory, and a multi-year plan that shows when projects will be undertaken and how each will be funded. Citizens deserve concrete multi-year plans *before* being asked to support the extraordinary action of selling a state asset to allow for the appropriation of billions of dollars. Without a detailed and publicly available Capital Improvement Plan and Illinois' history of questionable legislative member initiatives, it is impossible to determine how the $25.0 billion spending program will be prioritized.

The State Has Failed to Take Reasonable Steps to Control Employee Benefit Costs

While the administration proposes new health insurance spending plans, it has failed, along with the General Assembly, to take any significant steps to control two of its major existing budgetary cost drivers: employee pension and healthcare plans.

Last year, General Assembly leaders insisted that the Chicago Transit Authority would have to institute cost-cutting reforms in its overly generous employee pension and healthcare plans as a precondition for approval of financial support.[6] Those reforms were included in HB 656, which was approved by the legislature and signed into law by the Governor. Unfortunately, we have no

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[5] In 1995, Public Act 88-593 established a 50-year schedule of funding requirements to compensate for the State's previous years of underfunding the pension plans. It requires that the State's contribution "equal a percentage of payroll necessary to amortize 90.0% of unfunded liabilities" by the year 2045.
[6] See John Hilkevitch, "CTA plea for aid comes amid last-minute Capitol rush," *Chicago Tribune*, May 30, 2007 and Gary Washburn and Ray Long. "5-year CTA contract comes with a big 'if'", *Chicago Tribune,* June 28, 2007.

evidence that the Governor and General Assembly will apply the same reasonable standard to the State's own generous employee benefit plans. The State will have another opportunity this summer to reduce its employee health and benefit costs as it enters into state labor negotiations. We strongly urge the Governor and the General Assembly to insist on real reform of the State's unaffordable and overly generous employee benefit and health insurance program.

The State's employee healthcare costs, totaling approximately $2.0 billion, exceed the entire FY2009 proposed operating budget of $1.3 billion for the Illinois Department of Children and Family Services and the $1.4 billion budget of the Department of Corrections.[7] By implementing reasonable cost-cutting recommendations proposed by the Civic Federation, the State could reduce its total annual spending on employee and retiree healthcare by between $264.6 and $466.0 million.[8] The Civic Federation's proposals include eliminating the State's costly indemnity plan by placing enrollees in less expensive managed care plans, eliminating free healthcare for retirees, and increasing employee premium contributions. State employee healthcare contributions are lower than employee contribution levels required by other state and local governments, as well as private sector organizations.

The Governor is proposing the extraordinary action of borrowing $16.0 billion to reduce $44.5 billion in unfunded pension liabilities. Such extraordinary borrowing could only be justified if there was evidence that the State is seriously addressing the long-term costs and liabilities of its retirement systems. Those pension benefit reforms might include:

- Imposing a moratorium on **any** new employee benefits until the pension system has achieved a 90.0% funded ratio;
- Requiring all public employees covered by the State's five retirement systems to contribute an additional 1% of their salaries to the cost of their pensions;
- Raising the retirement age for new hires to age 65 to match social security and the private sector; and
- Fixing automatic increases for new hires at the lesser of 2% or the rate of inflation, rather than the current rate of automatic increase for retirement annuities of 3% per year.

All of these proposals were made by the Governor's first Blue Ribbon Commission on Pensions in 2005, and the Governor strongly embraced such changes as necessary to reform the State's pension systems.

Unfortunately, these reasonable, common sense efforts to reduce pension benefit costs are not now included in the Governor's spending proposals and very little action has been taken by the State Legislature.

Civic Federation Withdraws Support for an Income Tax Increase

The Civic Federation believes that the State of Illinois should reject the $417.0 million expansion proposal for *Illinois Covered* and the $300.0 million increase for education funding and begin

[7] Illinois State Budget FY2009, pp. 2-27 to 2-36.
[8] The Civic Federation. *State of Illinois Health Insurance Plans: Analysis and Recommendations for Cost Containment.* April 16, 2007.

tightening its spending belt to allow for its full pension payment of $3.3 billion, as required under the 1995 pension funding reform law.[9]

It has become clear in recent years that neither the Governor nor the General Assembly are willing to take the painful but necessary steps of increasing fiscal accountability to taxpayers and of improving the State's fiscal condition. A case in point is the irresponsible two-year $2.3 billion partial pension holiday taken in FY2006 and FY2007. The funds that should have been used to pay for promises made to state employees were instead used to fund more politically popular program expansions. Given the poor fiscal condition of the State of Illinois' pension system and the recently announced $24.0 billion in future liabilities for retiree health insurance and other post employment benefits, we have seen very little evidence of the State's commitment to exercise fiscal prudence.

Last year the Civic Federation proposed a reasonable 1% income tax increase to provide funds to address the State of Illinois' billions of dollars in unpaid liabilities and to provide money for education and transit. We supported the creation of this new revenue stream if, and only if, such funds were coupled with structural reforms that would reduce employee benefit costs and inject more accountability into the management of school funds. However, the failure of our political leaders to address the enormous fiscal issues faced by the State of Illinois has led us to withdraw our support for any income tax increase. Until the State can clearly demonstrate its dedication to putting its fiscal house in order, the Civic Federation and the public will not be convinced that any new tax dollars will be well spent. A new infusion of tax revenues to provide more money for new expensive programs will do nothing to reduce the enormous obligations that the State of Illinois has already incurred.

FY2009 Budget Issues the Civic Federation Opposes

The Civic Federation **opposes** the following issues in the FY2009 State of Illinois operating budget.

$1.9 Billion in New Initiatives

Governor Blagojevich proposes four new major initiatives in his $1.9 billion FY2009 budget:

1. *The Illinois Child Tax Credit* ($900.0 million): The FY2009 budget includes a one-time income tax credit of $300 per child for all taxpayers who qualify for the federal child tax credit. In order to qualify, taxpayers must have a dependent under the age of 18, earn at least $3,000 per year, and have income less than $75,000 for individual or $150,000 for joint filers.

2. *The Illinois Business Tax Credit* ($300.0 million): The budget includes a one-time 20.0% corporate income tax cut for businesses that paid corporate income taxes in 2007. To be

[9] The $3.3 billion figure is $446 million more than the FY2009 budget proposal of $280 million. The revenues from the $1.2 billion securitization proposal are not included in the budget. See footnote 3, Illinois State Budget FY2009, p. 2-14.

eligible for the tax cut, businesses must maintain or increase their 2007 employment levels.

3. *Illinois Covered expansion* ($417.0 million): *Illinois Covered* is a program designed to provide affordable healthcare for all state residents. It will expand during FY2009 at a cost of $417.0 million.

4. *New school funding* ($300.0 million): An increase of $300.0 million for elementary and secondary education (for a FY2009 total of $2.4 billion) is proposed.

The Civic Federation opposes the first two proposals on policy grounds. The Illinois Child Tax Credit and the Illinois Business Tax Credit are one-time incentives that we believe will have a questionable impact on personal or business spending decisions. Business decisions in particular are rarely based on considerations of a one-time stimulus. The Civic Federation opposes more state spending for any new state programs, including healthcare and education, because the State government is unable and unwilling to pay the bills it already owes; adding new expenses would be fiscally irresponsible. We are very concerned that these major new and expensive program initiatives are being launched at a time when both the State of Illinois and the nation are entering into an economic downturn and Illinois is in a weak financial position.

It is clear that the State of Illinois is in a poor fiscal situation and that the current economic downturn will have a serious impact on economically sensitive state revenues. The FY2008 budget already has a $750.0 million deficit out of a $47.8 billion budget. Also, General Fund revenues for last year (FY2008) are projected to be $1.3 billion less than originally budgeted, or $30.3 billion instead of $31.6 billion.[10] On a budget-to-budget basis, sales tax receipts will decline by 2.7% in FY2009, or from $8.0 billion to $7.8 billion, as consumer spending drops. A major reason for the slowdown in sales tax revenues is that growth in retail sales, which account for 70.0% of total sales tax revenues, are projected to be slightly less than 3.5% in FY2008 compared to 4.5% in FY2007. Illinois consumers are spending less – their state must do the same. The slowdown in sales tax revenues may also be compounded by the imposition of a new 10.25% sales tax rate in the City of Chicago as a result of recent action by the Cook County Board of Commissioners. This increase gives Chicago the distinction of having the highest sales tax rate in the nation.

In addition to weaknesses in its revenue stream, the State of Illinois has accumulated billions of dollars in liabilities, especially for pensions and retiree health insurance.

The Illinois State Comptroller reports that “Section 25” liabilities, which are liabilities for Medicaid and other healthcare costs that are incurred in one fiscal year and then carried over into the next fiscal year (to be paid for from the future year’s appropriations), were approximately $3.4 billion at the end of FY2007, up from $1.8 billion in FY2003. That is an 87.2% increase in just five years. In mid-January 2008, the Illinois Department of Healthcare and Family Services

[10] Examining the General Fund revenue estimates ultimately approved by the General Assembly in August 2007 versus estimated receipts, a similar picture emerges. The legislature approved approximately $30.2 billion in General Fund revenues; receipts are projected to be $29.5 billion. This is a shortfall of $673.0 million. Information in this footnote and the text above provided by the Governor’s Office Management and Budget.

was holding \$1.3 billion in Medicaid bills, \$300.0 million more than at the same point last year. Overall, according to the State Comptroller, the State's total GAAP[11] deficit was \$3.6 billion in FY2007, based on preliminary unaudited estimates, making the State's GAAP deficit the worst in the nation.

The Governor's financial management team strongly disputes the Comptroller's GAAP deficit figures, noting that it follows permissible, yet more conservative accounting practices. The team cites Standard & Poor's recent analysis of the State of Illinois' General Obligation debt, specifically the section of the analysis that points to two accounting rules impacting the State's recognition of its liabilities:

1. The State recognizes certain federal Medicaid reimbursements as deferred, unavailable revenue liabilities, and the early recognition as expenditures of certain statutorily mandated special education appropriations in the fiscal year before actual disbursement. Illinois defers all federal reimbursements into the next fiscal year for Medicaid bills that are not received within 60 days after June 30.

2. Illinois is one of only six states that prerecord mandated categorical educational appropriations with accompanying liabilities as expenditures for the previous fiscal year. These appropriations grow annually and increased to \$1.3 billion in FY2006.

Adjusting the FY2006 general fund GAAP deficit for both accounting rules would reduce the State's deficit to less than \$100.0 million, far less than the \$2.3 billion reported by the State Comptroller.[12]

Whatever accounting rule interpretations are used, it is clear that the State of Illinois has accrued billions of dollars in liabilities for employee benefits and other post employment benefits (OPEB), and millions of dollars in State Medicaid bills that will not be paid for out of current receipts. Unfunded liabilities of the State's five retirement systems were reported to be \$44.5 billion in FY2008, and lackluster returns for that fiscal year may be compounding the situation. If the State of Illinois adheres to the promises of the 1995 pension funding reform law, its required contributions to the pension system will rise from \$3.3 billion in FY2009 to \$5.4 billion in just 10 years, a 64.7% increase. This will reduce spending on other State priorities. Liabilities for OPEBs, which are primarily retiree health insurance, are projected to total \$24.0 billion. Simply put, the State has enormous outstanding liabilities for financial promises it has made to its employees, and it is experiencing serious difficulties in fulfilling those obligations.

The State of Illinois is in a fiscal crisis. It faces overwhelming financial challenges that it is not addressing. Creating expensive new programs or expanding existing programs at this time is only going to exacerbate what is already a precarious situation.

The Civic Federation urges the General Assembly to **reject** the Illinois Child Tax Credit, the Illinois Business Tax Credit, the expansion of the *Illinois Covered* heath insurance initiative, and

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[11] GAAP is an acronym for Generally Accepted Accounting Principles, the rules and conventions governing the accounting profession.
[12] Standard & Poor's. Ratings Direct. Illinois; General Obligation. December 18, 2007, p. 5.

increased funding for education. These four programs, which will cost an estimated $1.9 billion, are unaffordable at this time.

Long-Term Partial Concession of the State Lottery

For the second time, Governor Blagojevich proposes a long-term lease of the Illinois State Lottery to fund a $25.0 billion capital program entitled *Illinois Works*. The second proposal differs from the first in that this time the State is offering only a partial concession of the State Lottery system. A partial concession means that the State would retain a 20.0% ownership stake in the Lottery as well as the ability to regulate the operations of the entire entity. The partial concession will likely last for a 30-year term and is expected to generate between $10-12 billion, $7.0 billion of which will be directly used to fund *Illinois Works*. Approximately $3.5 billion in proceeds from the long-term lease, plus revenues from the 20.0% share retained by the State, will be placed in a Trust Fund to guarantee a continued funding steam for education. These proceeds are expected to generate General Fund revenues of $657.0 million in FY2008 and $664.0 million in FY2009. It is expected that the proceeds will also generate all fund revenues of $986.0 million in FY2008 and $976.0 million in FY2009.[13] The long-term Lottery lease would be the first effort of its kind in the United States.

The Civic Federation **opposes** the long-term partial concession of the State Lottery this year because the proceeds are being used to support a multi-year $25.0 billion capital program that fails to provide the public with sufficiently detailed information about how the funds will be spent and does not include either a needs assessment or information regarding prioritization criteria.

The administration has proposed general categorical topics for its $25.0 billion proposal, including the following proposals:

- $14.4 billion for roads and bridges;
- $3.8 billion for school construction;
- $2.7 billion for public transit;
- $1.1 billion for higher education;
- $1.1 billion for environment, energy, and technology projects;
- $1.0 billion for economic development;
- $600.0 million for State facilities; and
- $500.0 million for airports and rail.

The FY2009 Capital Budget does provide some additional information regarding how future capital dollars will be spent. For example, the FY2009 Capital Budget discusses how the Governor proposes $583.0 million per year for three years for school construction projects that address classroom shortages and facilities requiring repair.[14] There is also some discussion of the use of criteria for inclusion of projects in the State's capital plans; the Department of Transportation reports that it uses "a detailed rating of road and bridge conditions to evaluate

[13] Illinois State Budget FY2009, pp. 2-37 and 2-38. These are estimated figures.
[14] FY2009 State of Illinois Capital Budget, p. 29.

repair needs and prioritize projects."[15] However, information is not publicly accessible and is at best available in parts, not in a comprehensive format.

Regarding the *Illinois Works* proposal, the State has assembled an *Illinois Works* Coalition Steering Committee composed of civic, business, labor, and political leaders. The Steering Committee has provided lists of potential projects and their total costs for different regions of the State. However, while the State may employ some reasonable methods for prioritizing and choosing capital projects, it does not prepare and publicly disclose a formal multi-year Capital Improvement Plan or CIP. The FY2009 Capital Budget notes:

> The CDB [Capital Development Board], along with Central Management Services (CMS) and GOMB [Governor's Office of Management and Budget], is in the process of completing a system of identification and prioritization of capital and repair projects with state owned facilities. The results will be used to establish a multi-year Capital Improvement Program (CIP), and develop a system for providing information for space utilization, energy utilization and property management functions.[16]

Although The Civic Federation is very pleased that the State has announced it is in the process of developing a CIP for capital planning for State facilities, such plans must be completed in advance to evaluate the reasonableness and adequacy of a capital spending plan.
A multi-year CIP plan is essential prior to the approval of a $25.0 billion capital program, and a comprehensive CIP should include all state projects. In short, we believe that much more information is required before a comprehensive capital plan can be effectively debated and approved.

The Civic Federation agrees with the National Advisory Council on State and Local Budgeting that all governments should develop a five-year capital improvement plan (CIP) that identifies priorities, provides a timeline for completing projects, and identifies funding sources for projects. The CIP should be updated annually and have formal approval by the governing body.[17] A formal capital improvement plan includes the following information:

- A five-year summary list of projects, expenditures per project, and funding sources per project;
- Information about the impact of capital spending on the annual operating budget for each project;
- Brief narrative descriptions of individual projects, including the purpose, need, history, and current status of each project; and
- The time frame for fulfilling capital projects and priorities.

Above all, the capital improvement plan should be predicated on a publicly disclosed needs assessment and prioritization process.

[15] FY2009 State of Illinois Capital Budget, p. 23.
[16] FY2009 State of Illinois Capital Budget, p. 3.
[17] National Advisory Council on State and Local Budgeting. Recommended Practice 9.6: Develop a Capital Improvement Plan.

In addition, the CIP should be made publicly available for review by elected officials and citizens. It should be published in the budget or as a separate document. The CIP should be also made available on the government's website.

The citizens of Illinois and the members of the General Assembly should receive a formal CIP before being asked to approve any new revenue sources or the projects are approved. The public deserves and the General Assembly should demand as much information as possible on both the condition of existing infrastructure and the benefits of new investments so that they can make sound decisions about the efficacy of a multi-billion plan that will be paid over a number of years. Absent such a report, it is difficult for citizens and public officials to evaluate or prioritize such capital improvement proposals.

A good CIP model for the State of Illinois to follow can be found in the State of North Carolina's Capital Improvement Plan. North Carolina passed a law in 1997 requiring the preparation and publication of a CIP that is fully integrated with State financial planning and debt management processes. It includes:

- An inventory of facilities owned by State agencies;
- Criteria used to evaluate capital improvement needs;
- A 6-year Capital Improvement needs inventory; and
- A 6-year CIP.

The plan is submitted to the North Carolina legislature every 2 years.[18]

The Civic Federation does not oppose capital improvements for the State of Illinois. The maintenance and construction of infrastructure is critical to the economic vitality of a region. Illinois needs investments in its infrastructure. However, we believe that there must be a serious evaluation of how State money will be used and prioritized **before**, not after, the funds are appropriated.

Securitization of Long-Term Revenues

The Governor proposes to fund the one-time Illinois Child Tax Credit and the one-time Illinois Business Tax Credit via a plan to securitize long-term revenues into up-front payments. Securitization options include using some of the revenues from the existing settlement with the tobacco industry. The administration argues that securitizing these funds will transfer the risk of reduced revenues from the State to private parties. The risk of reduced revenues is tied to possible decreased future consumption as tobacco taxes rise and governments promote anti-smoking measures. Several other states have enacted securitization plans. Overall, the State estimates it will receive $1.2 billion in FY2009 from its securitization plan.

[18] North Carolina Office of State Budget and Management. *North Carolina Capital Improvement Program: Implementation of the Capital Improvement Planning Act*. Six Year Summary FY2007-FY2013. April 2007.

The Civic Federation opposes the securitization proposal for two reasons: 1) we oppose the proposed uses of the securitization proceeds, and 2) we reject issuing debt to pay for operating costs, particularly one-time expenses such as the proposed child and business tax credits.

Certain Business Tax Changes

Governor Blagojevich proposes over $1.0 billion worth of business tax changes in his FY2009 budget. Of the thirteen proposed changes, the Civic Federation opposes five, which are projected to generate $722.0 million. We also have concerns about the proposed implementation of the sales taxes on prewritten licensed software.

<u>Employer Payroll Tax</u>

To fund the expansion of the Governor's *Illinois Covered* plan, the budget proposes levying a 3% payroll assessment on employers who have ten or more employees and who do not spend at least 4% of their payroll on employee healthcare expenses. The payroll tax will generate $417.0 million in FY2009 and up to $1.0 billion per year when fully operational. The Civic Federation opposes this tax largely because we oppose the Governor's expensive new healthcare initiatives, which we believe the State cannot afford now or in the future because of the rapidly escalating costs of healthcare. We also believe that the payroll tax would be an economic disincentive for medium-sized businesses to expand or invest in the Illinois economy.

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

The FY2009 State budget includes proposals to decouple Illinois' treatment of certain corporate income tax regulations from the federal tax code. The Federation believes on principle that Illinois' definition of income should conform to the federal tax code. These specific proposals include:

- Using straight line instead of accelerated depreciation;
- Repealing the deduction for foreign and domestic dividends received by corporations; and
- Decoupling from the Federal Qualified Production Activities Income Deduction.

<u>Repealing the Single Sales Factor</u>

The Civic Federation opposes the State's proposed shift from the single sales factor back to a three factor income tax apportionment. It is critically important that State tax policy be consistent over time so that businesses can make rational economic decisions. Many other states are adopting the single sales factor; repeal of the provision will make Illinois businesses less competitive. Further, we believe that the single sales factor is an important incentive for businesses that export most of their production out-of-state to expand facilities and increase jobs, as well as for attracting businesses that are focused on export-oriented activities.

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

The Civic Federation recognizes that some prewritten licensed software used by businesses is similar to software purchased by individuals off the shelf and therefore should be taxed in the same manner. However, we have concerns about how a sales tax on prewritten licensed software would be implemented. Our support for such a tax would be contingent on the Illinois Department of Revenue basing the tax on point of delivery, a method consistent with the sourcing rules of the Streamlined Sales Tax Project. This is the method used in other states that tax software. Unfortunately, however, the method proposed by the State of Illinois fails to meet this requirement. Any taxation of prewritten licensed software used by businesses that is not similar to off-the-shelf software purchased by individuals should be considered in the larger context of the taxation of business services.

The Governor's Multi-Billion Dollar Pension Obligation Bond Issue

The Governor's FY2009 budget once again proposes a multi-billion dollar pension obligation bond issue. An amount between $12.0 and $20.0 billion in bonds would be issued and the proceeds would be immediately placed in the State's five under-funded retirement systems.

If the State issued $16.0 billion in pension obligation bonds, it could immediately place $15.9 billion of that amount into the pension funds, increasing their total funded ratio from 62.6% to 75.2%. The remaining $100.0 million would be used for administrative costs associated with bond issuance.

The Governor's plan proposes rescheduling pension payments. FY2009 payments would be $280.0 million greater than the payment made in the previous year. In succeeding years, payments would be equal to an amount that was $280.0 million plus a 3% annual increase until the funds achieved a 90.0% funded ratio in 2033, twelve years ahead of the current schedule. Overall, it is estimated that the plan would save the State $55.0 billion in future contributions. This proposal is slightly different than the one made last year; last year's proposal did not include the 3% annual increase in payments in addition to an annual payment of $280.0 million. However, under the new proposal, payments would be less than those made under the current system until FY2015.

Differences in Total Pension Payments
FY2008 - FY2015

	Current Schedule	Proposed New Schedule	Difference
FY2008	$ 2,579,514	$ 2,579,514	$ -
FY2009	$ 3,306,143	$ 2,859,514	$ (446,629)
FY2010	$ 4,045,093	$ 3,147,914	$ (897,179)
FY2011	$ 4,183,069	$ 3,444,966	$ (738,103)
FY2012	$ 4,375,344	$ 3,750,929	$ (624,415)
FY2013	$ 4,521,914	$ 4,066,072	$ (455,842)
FY2014	$ 4,676,836	$ 4,390,668	$ (286,168)
FY2015	$ 4,841,280	$ 4,725,003	$ (116,277)

Source: Illinois State Budget FY2009.

The Civic Federation opposes Governor Blagojevich's plan to issue billions of dollars in new pension obligation debt. We are concerned because:

1. No long-term pension benefit reforms are included in the pension obligation bond proposal. Making significant progress towards reducing the enormous costs and liabilities of the State's retirement systems requires important benefit reforms, such as moving toward a two-tiered system with new hires receiving reduced benefits. It is also imperative that the State refrain from adding any new costly benefits.

2. Not all of the proceeds would be used to pay down existing pension liabilities. The State of Illinois must adhere to the 1995 pension funding reform law's schedule and make the payments required by that law, even if funds from a multi-billion dollar pension obligation bond or asset sale are deposited into the State's retirement systems.

The pension payments mandated by the 1995 pension funding reform law are operating expenses of the State. If the State does not adhere to the funding schedule and use current operating revenues to pay for current operating expenses, it is essentially borrowing money to pay for those expenses. The Civic Federation strongly believes that the State should not borrow money to meet current operating expenses.

In addition, the State has an unfortunate history of avoiding fiscal discipline, a tradition that is not confined to any one administration. A prime example is the irresponsible and ill-considered two-year $2.3 billion partial pension holiday taken in FY2006 and FY2007. The funds that should have been used to pay for promises made to State employees were instead used to fund more politically popular program expansions. Given the poor fiscal condition of the State's pension systems and its inability to address its huge backlog of bills for Medicaid and other expenses, we do not have confidence in the State's commitment to exercise fiscal prudence. Therefore, we cannot support any vehicle that allows the State to avoid paying what it currently owes.

In the future the Civic Federation would consider supporting a proposal to use debt financing to pay down the State's unfunded pension liabilities, but **only** if two conditions are met.

First, the State must pass pension benefit reforms prior to issuing debt. The justification for such borrowing is the continued need to address decades of underfunding the State's pension system. Going forward, the State must also act to control the costs of an employee benefit system that remains unaffordable. This means that the State must couple new funding with significant reforms that will reduce the systems' long term liabilities by capping benefits for new hires and increasing cost sharing from employees and retirees. The Governor's proposal cannot put the State on solid financial footing if the General Assembly grants new benefits to retirees or if the State remains burdened by its overly generous retirement plans.

Second, the State, as would be the case for any government proposing to borrow money to improve the financial health of its pension system, must only use the proceeds from any pension bond borrowing to pay down pre-existing liabilities. In other words, the State must use current revenues to pay for the current operating cost of the State's employee benefit programs.

FY2009 Budget Issues the Civic Federation Supports

The Civic Federation **supports** several components of Governor Blagojevich's FY2009 budget.

Reductions in Personnel and Non-Priority Spending

The Governor proposes 3% across-the-board spending cuts in non-priority areas. The designated priority areas spared the cuts will be education, health, and public safety. The cuts are expected to generate $69.0 million of savings in FY2009.[19]

The Governor's FY2009 budget recommends filling a total of 56,591 full-time equivalent (FTE) positions. This is a 2.5% or 1,464 position decrease from the number of positions filled in FY2008 (58,055). Between FY2005 and FY2008, the State employed an average of 56,791 FTEs. This is far below the 68,798 FTEs employed by the State in FY2002 prior to the enactment of Governor Ryan's early retirement proposal.

The Civic Federation **commends** Governor Blagojevich and his financial team for consistently maintaining personnel levels lower than those in 2002 under the prior gubernatorial administration. Holding the line on personnel is a critical step that must be taken to contain costs in the long-term.

However, across-the-board spending cuts are not an ideal cost reducing mechanism; a better approach would be targeted cuts based on performance evaluation. Unfortunately, the State's lack of a sophisticated performance management system makes this difficult. The Civic Federation is encouraged that the Governor has made an effort to clearly identify his priorities and reduce spending in other areas. This is a necessary and important step toward cost containment.

Certain Tax Changes in the FY2009 Budget

The Civic Federation endorses State efforts to end outdated and economically inefficient corporate tax deductions or credits, often characterized by the Governor as "loopholes." We believe as a matter of principle that tax exemptions and benefits should be sunsetted and their renewals debated and discussed, not continued indefinitely. There should be evidence that tax credits or reductions granted actually produce the benefits promised. In our past analyses of the State operating budget, we have supported many of these efforts. We reiterate our past support of State efforts to eliminate an exemption for gas transported out of State and to include Puerto Rico and the Outer Continental Shelf in the definition of the U.S.

This year we also support the following new business tax changes in the FY2009 budget. Together, these taxes are estimated to yield $273.0 million in FY2009:

[19] Illinois State Budget FY2009, p. 2-36.

- *Restricting the Cost of Collection Discounts*: The automation of records has dramatically reduced the administrative costs associated with collection of various taxes. The discount amounts to a windfall for larger businesses, and many other states limit it;

- *Repealing the Research and Development Credit*: There is little objective evidence that the credit has actually increased research and development activities;

- *Eliminating the Manufacturer's Purchase Credit*: Tax credits should be reviewed regularly and should not be extended unless there is solid evidence of their effectiveness. We have not seen any such evidence for this credit;

- *Taxing Industrial Insurance Purchased by Large Companies from Unlicensed International Insurance Companies*: This proposal would bring Illinois tax law into conformity with 27 other states. It is reasonable that the tax code treat all insurance companies doing business in the State of Illinois the same way; and

- *Enforcing Withholding on Non-Resident Gaming Winnings Over $1,000*: There is no good public policy reason why out-of-state residents should be able to take their gaming winnings without paying Illinois income taxes.

Proposed Special Purpose Funds Sweeps, Efforts to Consolidate Funds

The FY2009 budget includes a proposal to transfer $500.0 million in fund balances from the State's 600+ special purpose funds to the General Funds to help address the $750.0 million deficit in the current FY2008 budget.

More than 600 special purpose funds were created to receive earmarked revenues that are only used for a designated purpose. The General Funds, which include the General Fund and the Common Schools Fund, are used for any purpose that the State deems fit. Over time, the number of special purpose funds has increased, consuming ever larger portions of the State budget. These funds had aggregate balances of approximately $3.0 billion at the end of FY2007.[20]

The special purpose funds will constitute 30.0% of the entire State operating budget, or $14.9 billion in FY2009. This is an increase from FY2008, when these funds accounted for 29.2% of the entire State budget, or $14.3 billion.[21]

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

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

[20] Illinois State Budget FY2009, p. 2-4.
[21] Illinois State Budget FY2009, p. 2-36.

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

In previous years, the administration has "swept" special purpose funds to transfer revenues to the General Funds. In FY2004 the Blagojevich administration began assessing most "Other" funds a 5% fee to pay for the cost of administrative services, such as legal and accounting services, which are provided by the State and paid for out of the General Revenue Fund. The Civic Federation strongly endorsed this measure,[22] and the General Assembly approved it in statute.[23] While Illinois earmarks many fee revenues for special purpose funds, other states deposit those revenues into the General Fund.[24]

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

The Civic Federation **supports** the administration's FY2009 proposed funds sweeps as a reasonable way to help address the FY2008 budget deficit. We also endorse its efforts to consolidate special purpose funds. This is a common sense management proposal that would increase the efficiency of the State's cash management process and put surplus funds to productive use.

Expansion of Shared Services

In FY2007 the Governor's Office of Management and Budget (GOMB) set forth a Shared Services Vision that called for six Shared Service Centers to assume responsibility for State agencies' Administrative Services (e.g.: Human Resources, Payroll and Fiscal), Grants Management (e.g.: Grant Application, Monitoring and Reporting), Customer Service (e.g.: State-wide Call Center and Consolidated Front-Office Service Locations), and Business Portal (e.g.: Business Application and Authorization) functions. The Shared Services Vision also identifies Information Technology Infrastructure, Fleet, and Facilities Management as areas that have been addressed by previous initiatives, but might be made more efficient and cost-effective under the Shared Services organizational structure.[25] The purpose of this initiative is to:

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

[22] The Civic Federation FY2004 Illinois State Budget Analysis, May 20, 2003.
[23] See Sections 8H and 8J of the State Finance Act, 30 ILCS 105/8H-8J.
[24] Illinois State Budget FY2006, p. 3-6.
[25] Illinois State Budget FY2007, pp. 3-5.

The Shared Services plan is intended to make budget planning and State spending more transparent for both public officials and citizens by integrating the reporting systems of Accounts Payable, General Accounting, Travel Vouchers, Purchasing, Accounts Receivable, Fixed Assets, Grants, Inventory Accounting, and GAAP reporting. In addition to improving the State's ability to control costs and plan budgets, the integration of these reporting systems will allow for year-round auditing, enabling both officials and citizens to better track the use of public funds.[26] The integration of reporting systems should also enable the State to institute useful and non-burdensome performance measures.

In FY2008 the Shared Services plan evaluated all State administrative processes, implemented a new web-based hiring system, and continued the reorganization of the fiscal and human resources administration. In FY2009 the plan will expand to include all agencies under the control of the Governor. New social service centers will be created for social service agencies, healthcare agencies, and economic development agencies. These centers will be in addition to the service centers that are currently servicing public safety and administrative agencies. The State will also procure integrated information systems to service these centers.

The Civic Federation is a strong proponent of bringing business process reforms to bear on government operations. Such reforms can significantly reduce administrative costs and improve efficiency. We have been encouraged by the administration's willingness to employ business process reforms in past years. We supported the Shared Services program in FY2007[27]and we reaffirm our strong endorsement for its expansion in FY2009.

Civic Federation Financial Management Recommendations

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

Develop a Multi-Year Capital Improvement Plan (CIP)

The State of Illinois should enact legislation requiring the development and publication of a multi-year Capital Improvement Plan on a biannual basis. The CIP should include:

- An inventory of facilities owned by State agencies;
- Criteria used to evaluate capital improvement needs;
- A five-year Capital Improvement needs inventory;
- A five-year summary list of projects, expenditures per project, and funding sources per project;
- Information about the impact of capital spending on the annual operating budget for each project;
- Brief narrative descriptions of individual projects, including the purpose, need, history, and current status of each project; and

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

- The time frame for fulfilling capital projects and priorities.

Implement Comprehensive Pension Benefit Reforms

The State of Illinois must implement comprehensive pension benefit reforms if it is ever going to seriously address the long-term costs and liabilities of its five retirement systems. A model for sound pension benefit restructuring was provided last year upon the approval of landmark pension and healthcare reforms for the Chicago Transit Authority through HB 656. The General Assembly, as part of omnibus mass transit funding and structural reform legislation, implemented the following pension reforms:[28]

- Increasing employee contributions to the pension fund from 3% of payroll to 6%;
- Reducing the amount of pension benefits available at age 55 with 10 years of service (pension benefits were formerly available at age 55 with 3 years of service); and
- Making full pension benefits available at age 64 with 25 years of service (full benefits were formerly available at age 55).

The Civic Federation proposes a number of reforms, listed below, that focus on capping budgetary costs by creating a two-tiered system with lesser benefits for new hires and reforming the structure of the retirement systems' Boards of Directors.

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

A 1% Increase in Employee Contributions. Employees covered by the State retirement systems contribute a percentage of their compensation for their own pensions and to fund survivors' benefits. For example, for members of the State Employees Retirement System (SERS), employees covered by the regular retirement formula are required to make the following contributions:

- Members with Social Security: 3.5% of compensation (pension) + 0.5% (survivors) = 4% total
- Members without Social Security: 7% of compensation (pension) + 1% (survivors) = 8% total

The Civic Federation believes that all public employees covered by the State's five retirement systems should contribute an additional 1% of their salaries to the cost of their pensions.

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[28] See Illinois P.A. 95-708.

Raise the Retirement Age for New Hires. Members of the State's retirement systems are currently eligible for full retirement benefits when they reach age 60, unlike most private sector retirement systems, which make 65 the minimum age of retirement with full benefits. The Civic Federation believes that the age at which employees become eligible for full benefits should be increased to age 65 for employees with between 8 and 30 years of service, age 62 for employees with between 30 and 35 years of service, and age 60 for employees with 35 or more years of service.

Fix Automatic Increases for New Hires at the Lesser of 2% or the Rate of Inflation. The current rate of automatic increase for retirement annuities is 3% per year. Other retirement systems index the rate of increase to the rate of inflation, limit the dollar amount of increase, or approve new increases on an ad hoc basis. For new hires only, automatic increases should be limited to the lesser of the rate of inflation or 2% and should apply only to the first $12,000 in annual pension payments for retirees covered by Social Security and $24,000 for retirees not covered by Social Security.

Require Balance on Pension Boards Between Employees, Management, and Taxpayers. The State should require a balance of employee, management, and taxpayer interests in the governance of its retirement system Boards. Board seats should be set aside for members with professional expertise or certification in financial asset investment, and all members who do not already possess such expertise should be required to receive some relevant financial training on an annual basis.

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

Implement Employee and Retiree Health Insurance Cost Saving Reforms

The Civic Federation conducted a review of the State of Illinois' employee health insurance program in 2007. The research was published in a separate report, "State of Illinois Employee Health Insurance Plans: Analysis and Recommendations for Cost Containment," which can be accessed at http://www.civicfed.org/articles/civicfed_245.pdf.

Between FY1998 and FY2009, Illinois State health insurance liabilities are expected to rise from $802.8 million to $1.99 billion, a nearly $1.2 billion or 148.1% increase. These liabilities have risen at a much faster rate than the State of Illinois total budgetary appropriations. The average rate of increase for budget appropriations between FY1998 and FY2009 will be approximately 5.5%, while the average rate of increase for health insurance liabilities was 8.5%.[29]

In FY2009 State employee health insurance liabilities represented approximately 4% of the proposed State operating budget of $49.7 billion. This is an increase from 3.4% of the operating budget in FY2007. The State's employee healthcare costs of $1.99 billion exceed the entire FY2009 proposed operating budget of $1.3 billion for the Illinois Department of Children and Family Services, the $1.4 billion budget of the Department of Corrections, and the $1.8 billion budget of the State Treasurer.[30]

The Civic Federation's report found that three features of the State of Illinois Group Health Insurance Plan drive larger State health insurance costs: an expensive indemnity plan, the provision of free health insurance to many retired employees, and employee contributions to premiums that are lower than national private sector averages. To alleviate the fiscal pressures of these enormous costs for State government employees, State university employees, members of the General Assembly and judges, the Civic Federation again makes the following policy recommendations:[31]

- *Eliminate the costly indemnity plan* and place enrollees in HMO or OAP plans that cost significantly less. This measure could save the State between **$176.6** and **$253.4 million** per year (estimated savings in 2007);

- *Eliminate free healthcare for retirees* for a savings of between **$20.7** and **$146.0 million per year** in premium costs (estimated savings in 2007); and

- *Increase employee premium contributions*, which are lower than employee contribution levels required by other state and local governments, as well as private sector organizations. Bringing employee premium contributions in line with national averages could yield as much as **$67.3 million** in savings annually (estimated savings in 2007).

By implementing all of the Federation's recommendations, in 2007 the State could have reduced its total annual spending on employee and retiree healthcare by between **$264.6** and **$466.0 million**. The savings are likely to be even greater today.

Given the State's ongoing fiscal difficulties, it is imperative that its rapidly rising employee healthcare expenditures are contained. The recent reforms negotiated between the Chicago Transit Authority and its labor unions, which were included in omnibus mass transit funding and structural reform legislation approved in 2007 by the General Assembly,[32] provide a realistic model for the State of Illinois and other governments. Those healthcare cost containment reforms included:

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[29] Commission on Governmental Forecasting and Accountability. *Fiscal Year 2009 Liabilities of the State Employees' Group Insurance Program*, March 2008, p. 8.
[30] FY2009 Illinois State Budget, pp. 2-27 to 2-36.
[31] The Civic Federation, "State of Illinois Employee Health Insurance Plans: Analysis and Recommendations for Cost Containment," http://www.civicfed.org/articles/civicfed_245.pdf (April 16, 2007).
[32] See Illinois P.A. 95-708.

- Establishing an independent healthcare trust to manage and provide CTA retiree benefits. After January 1, 2009, the trust will be solely responsible for providing retiree healthcare benefits;
- Requiring active employees to contribute at least 3% of compensation for retiree healthcare on a pre-tax basis (previously they contributed nothing);
- Requiring retirees and dependents to contribute up to 45.0% of coverage (previously retirees paid nothing and dependents paid 20.0% of the cost of coverage);
- Healthcare is available to retirees at age 55 and after 10 years of service (previously 3 years of service); and
- Retiree healthcare benefits are no more than 90.0% in network, 70.0% out of network (previously benefits included 100% indemnity coverage).

The approval of the CTA reforms illustrates that it is politically possible to reach a consensus among employees and governments in order to achieve reforms that protect employee health benefits, adequately fund healthcare obligations, and contain governments' costs.

Implement School District Financial Management Accountability Reforms

While we oppose additional funding this year, if the General Assembly approves increases in funding for elementary and secondary education, we believe that school districts must implement reasonable financial management accountability reforms as a prerequisite to receiving those new state funds.

The Metropolitan Mayors Caucus released a report entitled "Strengthening the Financial Accountability of Illinois School Districts" in 2007. That report outlined a 10-point plan to ensure that school districts provide citizens with transparent financial documents, implement planning procedures, and strengthen internal controls.[33] The report was prepared by the Civic Federation and many of the reforms are included in current legislation, HB 4194. The Civic Federation proposes that the accountability plan be a prerequisite for any new school funding from the State of Illinois. School financial management accountability reforms should include:

1. Preparing a user-friendly Budget Executive Summary that is posted on the school district website;

2. Preparing a full budget document that includes an organizational chart, formal financial policies, a full long-term financial plan or a summary thereof, and a full capital improvement plan or a summary thereof;

3. Requiring that school districts develop and implement publicly-reported performance measures for support services and functions;

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[33] Metropolitan Mayors Caucus. *Strengthening the Financial Accountability of Illinois School Districts*. April 2007.

4. Requiring that school districts adopt strengthened internal controls by creating a strong internal auditor function, implementing more rigorous external audit requirements, and requiring the adoption of formal written internal control policies;

5. Requiring that school districts create formal written financial policies in key policy areas that must be adopted by Boards of Trustees and made publicly available;

6. Requiring that school districts develop and implement long-term financial plans that include multi-year forecasts of revenues, expenditures, and debt;

7. Requiring that school districts adopt, implement, and disclose multi-year capital improvement plans;

8. Requiring that an Office of School District Financial Management Accountability be established within the Illinois State Board of Education (ISBE) to monitor progress made in meeting the reform requirements. ISBE would be empowered to monitor progress, enforce compliance, and impose sanctions for non-compliance, including removal of non-complying administrators; and

9. Earmarking a portion of new school revenues for the implementation of the financial management accountability reforms. Special funding would be made available so that financially distressed school districts could implement these reforms.

The proposed reforms should be phased in to allow sufficient time for ISBE to develop accountability, reporting, and oversight mechanisms. Adequate time should be allotted for school districts to comply with the requirements.

Implement a Formal Long-Term Financial Planning Process

The National Advisory Council on State and Local Budgeting (NACSLB) and the Government Finance Officers Association (GFOA) both recommend that all governments formally adopt a long-term financial plan as a key component of a sound budget process.[34] Internally, the State of Illinois currently employs many of the techniques of a long-term financial planning process, including the projection of multi-year revenue trends and modeling of various revenue and expenditure options. However, the State does not develop a formal plan that is shared with and/or reviewed by key policymakers and stakeholders. The Civic Federation recommends that the State develop and implement a formal long-term financial planning process.

Improve the Performance Measurement System

The FY2009 Illinois State Budget includes five years of performance metrics for each agency. However most of these metrics are workload measures, which are counts of the number or percentage of activities undertaken or services delivered. While these are important statistics, they do not provide information about the goals for the statistics that are being measured. This current system makes it impossible to determine if agencies are meeting, exceeding, or falling

[34] See National Advisory Council on State and Local Budgeting and Government Finance Officers Association

short of program and policy goals. In addition, there are no efficiency, effectiveness, or service quality measures that would permit a focused evaluation of how well agencies and programs are meeting stated goals.

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

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NEW PROGRAM INITIATIVES IN THE FY2009 OPERATING BUDGET

Governor Blagojevich proposes four new program initiatives in his FY2009 budget that are expected to cost over $1.9 billion. The Illinois Child Tax Credit and the Illinois Business Tax Credit are one-time economic stimulus initiatives totaling $1.2 billion. *Illinois Covered* is a program designed to provide affordable healthcare for all Illinois residents, and it will expand during FY2009 at a cost of $417.0 million. The FY2009 State budget also proposes an increase of $300.0 million over the total enacted appropriation for elementary and secondary education in FY2008. The funds will be allocated by the General Assembly.[35]

Illinois Child Tax Credit ($900.0 Million)

Governor Blagojevich proposes a one-time income tax credit of $300 per child for all taxpayers who qualify for the federal child credit. In order to qualify, taxpayers must have a dependent under the age of 18, earn at least $3,000 per year, and have income less than $75,000 for individual or $150,000 for joint filers. It is estimated that approximately 1.3 million families will be eligible for the benefit. This one-time benefit will cost $900.0 million.

Illinois Business Tax Credit ($300.0 Million)

The administration proposes a one-time 20.0% corporate income tax cut for businesses that paid corporate income taxes in 2007. To be eligible for the tax cut, businesses must maintain their current employment levels. The tax cut will cost $300.0 million.

[35] Illinois State Budget FY2009, p. 6-2.

Illinois Covered ($417.0 Million)

The FY2009 budget will provide $417.0 million in funding for an expansion of the *Illinois Covered* program. Funds will be deposited in a new *Illinois Covered* Trust Fund. *Illinois Covered* is the Governor's plan to provide access to healthcare for all Illinois residents. The major programs included in *Illinois Covered* are:

- *FamilyCare Expansion*, which will expand the existing FamilyCare program to provide health insurance to families with eligible children up to 400 percent of the federal poverty level;
- *Illinois Women's Health Expansion*, which will provide for expanded breast and cervical cancer screenings and treatment for all uninsured women in Illinois;
- *Illinois Covered Assist*, which will provide comprehensive healthcare to Illinois residents who live below the poverty level but are otherwise ineligible for Medicaid;
- *AllKids Bridge Program,* which will provide all Illinoisans between ages 19-21 with pre-existing medical conditions access to healthcare at the same costs paid under AllKids; and
- *Illinois Covered Rebate*, which will provide rebates for Illinois residents with incomes between 100% and 300% of the federal poverty level who pay their own health insurance premiums or who contribute part of the premium for their employer-provided health insurance coverage.

New School Funding ($300.0 million)

Governor Blagojevich proposes an increase of $300.0 million for elementary and secondary education (for a FY2009 total of $2.4 billion).

The following chart displays the Governor's four new spending initiatives and their total costs.

New Spending Initiatives in FY2009 Illinois Budget (in $ millions)

Program	Amount
Illinois Child Tax Credit	$ 900.0
Illinois Business Tax Credit	$ 300.0
Illinois Covered	$ 417.0
Education Funding Increases	$ 300.0
Total	**$ 1,917.0**

Source: Presentation to the Civic Federation from State of Illinois Office of Management and Budget, February 26, 2008.

The Governor proposes three new funding streams to provide revenue for the four new program initiatives in FY2009, including:

- ***Securitization of Long-Term Revenues***: The Illinois Child Tax Credit and the Illinois Business Tax Credit, collectively known as the "Protecting Illinois Families" plan, will each be funded via a plan to securitize long-term revenues into up-front payments. Securitization options include utilizing an existing settlement with the tobacco industry.

The State estimates it will receive a one-time payment of $1.2 billion in FY2009 from the securitization plan.

- ***Employer Payroll Tax***: To fund the expansion of the Governor's *Illinois Covered* plan, the budget proposes levying a 3% payroll assessment on employers who have ten or more employees and who do not spend at least 4% of their payroll on employee healthcare expenses. While the payroll tax is only expected to cover the $417.0 million cost of expanding the *Illinois Covered* plan in FY2009, it is expected to generate up to $1.0 billion per year when fully operational.

- ***Increase Gaming Tax Rates and Sell 10th Riverboat License***: To fund the proposed $300.0 million education funding increase, the State proposes to increase riverboat gaming rates and use the funds from the sale of a 10th riverboat license.

State of Illinois Proposed Partial Lottery Concession

In order to fund the State's *Illinois Works* project, a multi-year $25.0 billion capital infrastructure program, the FY2009 budget proposes a partial concession of the Illinois Lottery. As opposed to the full concession of the State's lottery system that was proposed in the FY2008 budget, the partial concession would split the asset, with the private operator obtaining an 80.0% stake in the revenues generated from the lottery. The remaining 20.0% interest would remain under the control of the State, providing the State with adequate revenues to maintain its current level of education funding from lottery proceeds. The State would also retain the ability to regulate the lottery.

The State of Illinois expects to generate between $10.0 and $12.0 billion from the partial concession of the Lottery. The Illinois FY2009 budget plans to use $7.0 billion of the lease proceeds to fund the *Illinois Works* project. According to the Governor's Office of Management and Budget, the use of the lease proceeds to partially fund *Illinois Works* will reduce the borrowing needs of the program by two-thirds. The remaining $3.0 to $5.0 billion of the sale proceeds, as well as the State's 20.0% share of the lottery proceeds, will be placed in a Trust Fund to guarantee a continued funding stream for education. This education funding stream will replace the loss of all Lottery revenues used to maintain existing education funding.[36]

While a partial concession of a state-owned lottery system has never been done before, the idea of leasing lotteries to private operators has precedent both in the United States and abroad.

In the United States, California, Indiana, Texas, and Vermont, in addition to Illinois, have considered leasing their lottery operations to private operators. With assistance from investment banks, officials from each state have drawn up proposals to lease the lotteries. Despite initial failures to pass these proposals, the Governors from each of the States have indicated that they will raise the issue again. Research organizations and individual legislators have raised concerns that privatization could lead to the creation of new, highly addictive games. Revenues from

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[36] Illinois State Budget FY2009, p. 2-5; Personal Communication between the Civic Federation and State of Illinois' Office of Management and Budget, February 26, 2008.

leases have been estimated to range between $56.0 million for Vermont's lottery and $37.0 billion for California's lottery.[37]

The United Kingdom created its National Lottery system in 1993 and immediately conducted a search for a private operator. The selected operator, Camelot, is a consortium of private companies including Cadbury Schweppes and De La Rue Holdings.[38] Camelot held the first National Lottery drawing in November of 1994 and continues to be the only private operator of the system. The National Lottery has issued three private operation licenses since its creation in 1993, all through competitive bidding, yet despite attracting numerous bidders each time, Camelot has been the only winner of the private licenses. Camelot was most recently awarded the license to run the National Lottery through the year 2019.[39]

As managers of the National Lottery infrastructure, Camelot designs new games, develops the marketing support for lottery products, provides services for players and winners, and runs the network that sells tickets to players in partnership with 26,000 retailers in the UK. Camelot has two operating goals: to diversify the National Lottery game portfolio and to improve access to lottery games through new channels of distribution.[40]

According to the National Lottery website, 50.0% of Lottery revenues are distributed to winners of the games. Approximately 28.0% of the revenues are donated to "good causes" or local charities. The government receives 12.0% of Lottery revenues, while 5% of the revenues are distributed to retailers who sell tickets. Finally, 4.5% of the revenues fund operating expenses, and 0.5% goes to the Camelot consortium as profit.[41]

REVENUES

The FY2009 proposed State of Illinois operating budget projects a 2.9% increase in total receipts from the **originally proposed** FY2008 budget.[42] In order to provide an accurate year-to-year comparison, the Civic Federation used the originally proposed budget figures when conducting its analysis. The total FY2009 operating budget is a $1.4 billion increase from the previous fiscal year's receipts of $49.7 billion. State tax revenues are expected to **decrease** by 7.2%, or approximately $2.0 billion. Other receipts, which include non-state tax revenues such as fees and lottery revenues, are expected to increase by 34.8%, and federal revenues are expected to increase by 2.4%.

Projections for elastic revenues in Illinois reflect the concern that the U.S. economy's growth will slow as fiscal year 2009 begins. The State anticipates, though, that the effects of the slow down on Illinois' economy will lag behind the effects on other states' economies because the onset of Illinois' economic gains lagged behind the onset of national growth. Net personal income tax revenues are expected to continue to grow at a strong rate of 9.6% in FY2009, but net

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37 Dave Gram, "States Consider Privatizing Lotteries," *USA Today*, January 20, 2008.
38 "The Rise, Fall and Rise of Camelot" *BBC News*, November 12, 1999.
39 "Race Begins to Run Lottery" *BBC News*, November 30, 1999; "Camelot Gets Nod for UK Lottery" BBC News, August 7, 2007.
40 Camelot Group website at http://www.camelotgroup.co.uk/index.html (last visited on April 10, 2008).
41 National Lottery website at http://www.national-lottery.co.uk (last visited on April 8, 2008).
42 This number includes the failed gross receipt tax proposal from the Governor's initial FY2008 budget.

corporate income taxes are projected to increase by only 1% in FY2009.[43] By comparison, between FY2007 and FY2008 projected corporate income tax revenue increased by 45.4%.

There are three components of the sales tax base: 1) sales taxes from vehicle purchases, 2) taxes from the purchase of motor fuel, and 3) retail sales taxes. The State forecasts sales tax revenues by making its own projections through econometric modeling. It also contracts with two national firms, Economy.com and Global Insight, which provide independently generated economic forecasts. These forecasts are then reviewed by the Council of Economic Advisors (a group of private and public sector finance experts appointed by the Governor), the Governor's Office of Management and Budget, the Department of Revenue, and the Department of Employment Security.

Overall, sales tax revenues are expected to decrease by 2.7% between FY2008 and FY2009, as compared to a projected 7.9% growth rate between FY2007 and FY2008. Retail sales are the main sales tax driver, accounting for 70.0% of total sales tax revenue. Growth in this sector is projected to be slightly less than 3.5% in FY2008, compared to 4.5% in FY2007. The slowdown is attributed to a weakening of household credit conditions, which negatively impacts demand for large durable goods and also leads to the dissipation of wealth gains that accompanied the strong housing market of the previous several years. Based on the recommendation of the Council of Economic Advisors, the FY2008 sales tax revenue projections track more closely with the lower of the two forecasts produced by Global Insight and Economy.com. Global Insight projects only 3.0% retail sales growth, while Economy.com projects 5.0% growth. Vehicle sales are expected to fall by 1.8% in FY2008 (sales taxes from motor vehicles account for 20.0% of all sales tax receipts), and revenue from motor fuel sales is projected to increase slightly, from $1.45 billion to $1.48 (sales taxes from motor fuel account for roughly 10.0% of all sales tax receipts).[44]

Riverboat gaming taxes and fees are expected to fall by 14.8%, decreasing to $717.0 million in FY2009 from $842.0 million in FY2008. The temporary gaming tax increase approved in 2003, which increased the staggered rate structure to a high of 70.0% on adjusted gross receipts over $250.0 million, expired in 2005. The gaming tax rate then reverted to the previous rate structure, which ranges from 15.0% to 50.0% of adjusted gross receipts.

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[43] The corporate income tax increase rate for FY2009 takes the proposed 20.0% income tax credit into account.
[44] Illinois State Budget FY2009, pp. 5-7, 5-9, and 5-10.

Illinois State Revenues for All Funds: FY2008-FY2009 (in $ millions)	Projected FY2008	Projected FY2009	$ change FY08-FY09	% change FY08-FY09
State Taxes				
Income Taxes (Net)	$ 11,252	$ 12,182	$ 930	8.3%
Personal	$ 9,519	$ 10,432	$ 913	9.6%
Corporate	$ 1,733	$ 1,750	$ 17	1.0%
Sales Taxes	$ 8,022	$ 7,803	$ (219)	-2.7%
Gross Receipts Taxes	$ 2,626	$ -	$ (2,626)	-100.0%
Motor Fuel Tax	$ 1,452	$ 1,477	$ 25	1.7%
Public Utility Tax	$ 1,884	$ 1,857	$ (27)	-1.4%
Cigarette Taxes	$ 618	$ 619	$ 1	0.2%
Liquor Taxes	$ 154	$ 161	$ 7	4.5%
Inheritance Tax	$ 255	$ 275	$ 20	7.8%
Insurance Taxes/Fees	$ 413	$ 423	$ 10	2.4%
Corporate Franchise Taxes/Fees	$ 197	$ 208	$ 11	5.6%
Riverboat Gaming Taxes/Fees	$ 842	$ 717	$ (125)	-14.8%
Subtotal State Taxes	**$ 27,715**	**$ 25,722**	**$ (1,993)**	**-7.2%**
Other Receipts				
Motor Vehicle/Operators License Fees	$ 1,282	$ 1,301	$ 19	1.5%
Interest Income	$ 185	$ 206	$ 21	11.4%
Revolving Fund Receipts	$ 683	$ 658	$ (25)	-3.7%
Lottery*	$ -	$ 976	$ 976	-
Assessment Funds Receipts	$ 804	$ 1,364	$ 560	69.7%
Intergovernmental Payments	$ 1,275	$ 1,326	$ 51	4.0%
Group Insurance Receipts	$ 1,396	$ 1,397	$ 1	0.1%
Tobacco Settlement Receipts	$ 288	$ 321	$ 33	11.5%
Other Taxes,Fees,Earnings & Net Transfers	$ 3,043	$ 4,523	$ 1,480	48.6%
Subtotal Other Receipts	**$ 8,956**	**$ 12,072**	**$ 3,116**	**34.8%**
Federal Receipts	$ 13,019	$ 13,333	$ 314	2.4%
Total	**$ 49,698**	**$ 51,127**	**$ 1,429**	**2.9%**

Source: FY2009 State Budget, Table II-A: All Appropriated Funds Revenues by Source, p. 2-37.
FY2008 State Budget, Table II-A: All Appropriated Funds Revenues by Source, p. 2-36.

*In FY2008, no number is reported for the Lottery in All Fund revenue because the State had originally proposed to enact a long-term lease of the Lottery.

The next exhibit shows projected changes in **General Funds receipts** between the original FY2008 budget proposal and the FY2009 budget proposal. The State expects General Fund revenues to fall by 1.7%, from $32.2 billion in FY2008 to $31.7 billion in FY2009, a $560.0 million decrease. Base revenues from State sources are projected to rise by 2.0%, increasing from $29.4 billion to approximately $30.0 billion. However, one-time and recurring revenues are projected to decline by 40.0% from FY2008 figures.

Illinois State Revenues for General Funds: FY2008-FY2009 (in $ millions)	Proj. FY2008	Proj. FY2009	$ change FY08-FY09	% change FY08-FY09
Base Revenues				
State Sources				
Income Taxes (Net)	$ 11,252	$ 12,182	$ 930	8.3%
Personal	$ 9,519	$ 10,432	$ 913	9.6%
Corporate	$ 1,733	$ 1,750	$ 17	1.0%
Sales Taxes	$ 7,577	$ 7,297	$ (280)	-3.7%
Public Utility Taxes	$ 1,105	$ 1,110	$ 5	0.5%
Cigarette Taxes	$ 350	$ 350	$ -	0.0%
Liquor Taxes	$ 154	$ 161	$ 7	4.5%
Inheritance Taxes	$ 255	$ 275	$ 20	7.8%
Insurance Taxes & Fees	$ 317	$ 325	$ 8	2.5%
Corporate Franchise Fees & Taxes	$ 187	$ 205	$ 18	9.6%
Interest on State Funds & Investments	$ 185	$ 180	$ (5)	-2.7%
Cook County Intergov. Transfer	$ 287	$ 256	$ (31)	-10.8%
Other State Sources	$ 480	$ 535	$ 55	11.5%
Transfers-In				
Lottery*	$ 650	$ 664	$ 14	2.2%
Riverboat Gaming Taxes	$ 692	$ 642	$ (50)	-7.2%
Other Transfers	$ 813	$ 678	$ (135)	-16.6%
Subtotal State Sources	**$ 24,304**	**$ 24,860**	**$ 556**	**2.3%**
Federal Sources	$ 5,089	$ 5,108	$ 19	0.4%
Total Base Revenues	**$ 29,393**	**$ 29,968**	**$ 575**	**2.0%**
Increases to Base Revenues				
One-Time Revenues	$ 2,836	$ 665	$ (2,171)	-76.6%
Recurring Revenues	$ -	$ 1,036	$ 1,036	-
Total Adjusting Sources	**$ 2,836**	**$ 1,701**	**$ (1,135)**	**-40.0%**
Total General Fund Revenues	**$ 32,229**	**$ 31,669**	**$ (560)**	**-1.7%**

Source: FY2009 State Budget, Table II-B General Funds Revenues by Source, p. 2-38.
FY2008 State Budget, Table II-B General Funds Revenues by Source, p. 2-37.

*In FY2008 Lottery revenues were included in General Fund revenues due to the tentative nature of the proposed sale of the Illinois Lottery to a private operator.

Projected v. Estimated FY2008 General Funds Revenues

The State originally projected that General Funds revenues in FY2008 would be $31.6 billion. The estimate of General Funds FY2008 revenues has been revised to total $30.3 billion. This represents a $1.3 billion or 4.1% decrease in revenues.

Illinois State Revenues for General Funds FY08 Projected v. FY08 Estimated (in $ millions)				
	Proj. FY2008	Est. FY2008	$ difference	% difference
Base Revenues				
State Sources				
Income Taxes (Net)	$ 11,252	$ 11,798	$ 546	4.9%
Personal	$ 9,519	$ 10,048	$ 529	5.6%
Corporate	$ 1,733	$ 1,750	$ 17	1.0%
Sales Taxes	$ 7,577	$ 7,172	$ (405)	-5.3%
Public Utility Taxes	$ 1,105	$ 1,111	$ 6	0.5%
Cigarette Taxes	$ 350	$ 350	$ -	0.0%
Liquor Taxes	$ 154	$ 159	$ 5	3.2%
Inheritance Taxes	$ 255	$ 315	$ 60	23.5%
Insurance Taxes & Fees	$ 317	$ 320	$ 3	0.9%
Corporate Franchise Fees & Taxes	$ 187	$ 215	$ 28	15.0%
Interest on State Funds & Investments	$ 185	$ 204	$ 19	10.3%
Cook County Intergov. Transfer	$ 287	$ 302	$ 15	5.2%
Other State Sources	$ 480	$ 532	$ 52	10.8%
Transfers-In				
Lottery*	$ 650	$ 657	$ 7	1.1%
Riverboat Gaming Taxes	$ 692	$ 636	$ (56)	-8.1%
Other Transfers	$ 813	$ 945	$ 132	16.2%
Subtotal State Sources	**$ 24,304**	**$ 24,716**	**$ 412**	**1.7%**
Federal Sources	$ 5,089	$ 4,804	$ (285)	-5.6%
Total Base Revenues	**$ 29,393**	**$ 29,520**	**$ 127**	**0.4%**
Decreases to Base Revenues				
Offset of Lottery Revenue*	$ (650)	$ -	$ 650	-100.0%
Increases to Base Revenues				
One-Time Revenues	$ -	$ 500	$ 500	-
Recurring Revenues	$ 2,836	$ 250	$ (2,586)	-91.2%
Total Adjusting Sources	**$ 2,186**	**$ 750**	**$ (1,436)**	**-65.7%**
Total Revenues	**$ 31,579**	**$ 30,270**	**$ (1,309)**	**-4.1%**

Source: FY2009 State Budget, Table II-B General Funds Revenues by Source, p. 2-38.
FY2008 State Budget, Table II-B General Funds Revenues by Source, p. 2-37.

*In FY2008, Lottery revenues are offset due to the proposed leasing of the Ilinois Lottery within this year's budget.

Five-Year Revenue Trends

The next two exhibits show five-year revenue trends for all funds and for General Funds alone. In order to provide an accurate comparison, the figures presented are the **originally proposed** revenues for each fiscal year. From FY2005 to FY2009, total receipts for all funds are expected to increase by 19.5% while the State's own source tax revenues will rise by 28.2%.

Illinois State Revenues for All Funds: FY2005-FY2009 (in $ millions)							
	Proj. FY2005	Proj. FY2006	Proj. FY2007	Proj. FY2008	Proj. FY2009	$ change FY05-FY09	% change FY05-FY09
State Taxes							
Income Taxes (Net)	$ 8,075	$ 9,283	$ 10,572	$ 11,252	$ 12,182	$ 4,107	50.9%
Personal	$ 7,285	$ 8,120	$ 8,884	$ 9,519	$ 10,432	$ 3,147	43.2%
Corporate	$ 790	$ 1,161	$ 1,688	$ 1,733	$ 1,750	$ 960	121.5%
Sales Taxes	$ 6,957	$ 7,362	$ 7,751	$ 8,022	$ 7,803	$ 846	12.2%
Gross Receipts Tax	$ -	$ -	$ -	$ 2,626	$ -	$ -	-
Motor Fuel Tax	$ 1,484	$ 1,450	$ 1,462	$ 1,452	$ 1,477	$ (7)	-0.5%
Public Utility Tax	$ 1,102	$ 1,218	$ 1,333	$ 1,884	$ 1,857	$ 755	68.5%
Cigarette Taxes	$ 693	$ 620	$ 623	$ 618	$ 619	$ (74)	-10.7%
Liquor Taxes	$ 123	$ 146	$ 152	$ 154	$ 161	$ 38	30.9%
Inheritance Tax	$ 240	$ 255	$ 255	$ 255	$ 275	$ 35	14.6%
Insurance Taxes/Fees	$ 459	$ 453	$ 477	$ 413	$ 423	$ (36)	-7.8%
Corporate Franchise Taxes/Fees	$ 175	$ 194	$ 200	$ 197	$ 208	$ 33	18.9%
Riverboat Gaming Taxes/Fees	$ 758	$ 710	$ 802	$ 842	$ 717	$ (41)	-5.4%
Subtotal State Taxes	**$ 20,066**	**$ 21,689**	**$ 23,627**	**$ 27,715**	**$ 25,722**	**$ 5,656**	**28.2%**
Other Receipts							
Motor Vehicle/Operators License Fees	$ 1,315	$ 1,171	$ 1,173	$ 1,282	$ 1,301	$ (14)	-1.1%
Interest Income	$ 63	$ 70	$ 141	$ 185	$ 206	$ 143	227.0%
Revolving Fund Receipts	$ 387	$ 514	$ 563	$ 683	$ 658	$ 271	70.0%
Lottery*	$ 884	$ 924	$ 1,050	$ -	$ 976	$ 92	10.4%
Assessment Funds Receipts	$ 1,190	$ 635	$ 808	$ 804	$ 1,364	$ 174	14.6%
Intergovernmental Payments	$ 1,559	$ 1,409	$ 1,357	$ 1,275	$ 1,326	$ (233)	-14.9%
Group Insurance Receipts	$ 1,573	$ 1,756	$ 1,701	$ 1,396	$ 1,397	$ (176)	-11.2%
Tobacco Settlement Receipts	$ 271	$ 283	$ 295	$ 288	$ 321	$ 50	18.5%
Other Taxes,Fees,Earnings & Net Transfers	$ 1,978	$ 4,151	$ 2,440	$ 3,043	$ 4,523	$ 2,545	128.7%
Riverboat License Sale	$ 350	$ -	$ -	$ -	$ -	$ (350)	-100.0%
Subtotal Other Receipts	**$ 9,570**	**$ 10,913**	**$ 9,528**	**$ 8,956**	**$ 12,072**	**$ 2,502**	**26.1%**
Federal Receipts	$ 13,143	$ 13,040	$ 13,544	$ 13,019	$ 13,333	$ 190	1.4%
Total	**$ 42,779**	**$ 45,642**	**$ 46,699**	**$ 49,698**	**$ 51,127**	**$ 8,348**	**19.5%**

Note: Due to rounding, the FY2008 Grand Total exceeds the sum of the revenues as listed in this table.

Source: FY2009 State Budget, Table II-A: All Appropriated Funds Revenues by Source, p. 2-37.
FY2008 State Budget, Table II-A: All Appropriated Funds Revenues by Source, p. 2-36.
FY2007 State Budget, Table II-A: All Appropriated Funds Revenues by Source, p. 2-34.
FY2006 State Budget, Table II-A: All Appropriated Funds Revenues by Source, p. 1-27.
FY2005 State Budget, Table II-A: All Appropriated Funds Revenues by Source, p. 1-37.

*In FY2008, no number is reported for the Lottery because the State had originally proposed to enact a long-term lease of the Lottery.

General Fund base revenues, including State own source tax revenues and federal intergovernmental aid, are projected to increase by 18.4% between FY2005 and FY2009, from $29.4 billion to nearly $30.0 billion. Total General Fund receipts from all sources will increase by 21.3% or $5.6 billion, from $26.1 billion to $31.7 billion.

Illinois State Revenues for General Funds: FY2005-FY2009 (in $ millions)							
	Proj. FY2005	Proj. FY2006	Proj. FY2007	Proj. FY2008	Proj. FY2009	$ change FY05-FY09	% change FY05-FY09
Base Revenues							
State Sources							
Income Taxes (Net)	$ 8,075	$ 9,281	$ 10,572	$ 11,252	$ 12,182	$ 4,107	50.9%
Personal	$ 7,285	$ 8,120	$ 8,884	$ 9,519	$ 10,432	$ 3,147	43.2%
Corporate	$ 790	$ 1,161	$ 1,688	$ 1,733	$ 1,750	$ 960	121.5%
Sales Taxes	$ 6,425	$ 6,778	$ 7,280	$ 7,577	$ 7,297	$ 872	13.6%
Public Utility Taxes	$ 1,102	$ 1,096	$ 1,075	$ 1,105	$ 1,110	$ 8	0.7%
Cigarette Taxes	$ 400	$ 400	$ 350	$ 350	$ 350	$ (50)	-12.5%
Liquor Taxes	$ 123	$ 146	$ 152	$ 154	$ 161	$ 38	30.9%
Inheritance Taxes	$ 240	$ 255	$ 255	$ 255	$ 275	$ 35	14.6%
Insurance Taxes & Fees	$ 347	$ 366	$ 322	$ 317	$ 325	$ (22)	-6.3%
Corporate Franchise Fees & Taxes	$ 175	$ 194	$ 196	$ 187	$ 205	$ 30	17.1%
Interest on State Funds & Investments	$ 45	$ 45	$ 125	$ 185	$ 180	$ 135	300.0%
Cook County Intergov. Transfer	$ 450	$ 340	$ 309	$ 287	$ 256	$ (194)	-43.1%
Other State Sources	$ 729	$ 436	$ 540	$ 480	$ 535	$ (194)	-26.6%
Transfers-In							
Lottery*	$ 563	$ 628	$ 650	$ 650	$ 664	$ 101	17.9%
Riverboat Gaming Taxes	$ 647	$ 696	$ 692	$ 692	$ 642	$ (5)	-0.8%
Other Transfers	$ 870	$ 916	$ 679	$ 813	$ 678	$ (192)	-22.1%
10th Riverboat License	$ 350	$ -	$ -	$ -	$ -	$ (350)	-100.0%
Subtotal State Sources	**$ 20,541**	**$ 21,577**	**$ 23,197**	**$ 24,304**	**$ 24,860**	**$ 4,319**	**21.0%**
Federal Sources	$ 4,772	$ 4,834	$ 4,835	$ 5,089	$ 5,108	$ 336	7.0%
Total Base Revenues	**$ 25,313**	**$ 26,411**	**$ 28,032**	**$ 29,393**	**$ 29,968**	**$ 4,655**	**18.4%**
Reduction to Base Revenues							
Offset of Lottery Revenue*	$ -	$ -	$ -	$ (650)	$ -	$ -	-
Increases to Base Revenues							
Recurring Revenues and Transfers	$ 634	$ 255	$ 306	$ 2,836	$ 1,036	$ 402	63.4%
Multi-Year Revenues	$ -	$ -	$ 100	$ -	$ -	$ -	-
One-Time Revenues	$ 169	$ -	$ -	**$ -**	$ 665	$ 496	293.5%
Total Adjusting Sources	**$ 803**	**$ 255**	**$ 406**	**$ 2,186**	**$ 1,701**	**$ 898**	**111.8%**
Total	**$ 26,116**	**$ 26,666**	**$ 28,338**	**$ 31,579**	**$ 31,669**	**$ 5,553**	**21.3%**

Source: FY2009 State Budget, Table II-B General Funds Revenues by Source, p. 2-38.
FY2008 State Budget, Table II-B General Funds Revenues by Source, p. 2-37.
FY2007 State Budget, Table II-B General Funds Revenues by Source, p. 2-35.
FY2006 State Budget, Table II-B General Funds Revenues by Source, p. 1-28.
FY2005 State Budget, Table II-B General Funds Revenues by Source, p. 1-38.

*In FY2008, Lottery revenues are offset due to the proposed leasing of the Ilinois Lottery within this year's budget.

Proposed FY2009 Tax Changes

The FY2009 Illinois budget includes a number of tax changes. They are summarized below.

Illinois Child Tax Credit

Illinois proposes a one-time income tax credit of $300 per child for all taxpayers who qualify for the federal child credit. To qualify, taxpayers must have a dependent under the age of 18, earn at least $3,000 per year, and have income less than $75,000 for individual or $150,000 for joint filers. It is estimated that approximately 1.3 million families will benefit from the tax credit. The

State proposes to fund the tax credit with funds from a securitization of certain long-term revenues such as tobacco settlement receipts.[45]

Illinois Business Tax Credit

The Blagojevich administration proposes to provide a one-time 20% reduction in 2008 income taxes paid by Illinois corporations. To receive the reduction, which will be given in the form of a tax credit, corporations must have paid Illinois corporate income taxes in 2007 and must provide evidence that they have maintained or increased employment levels. The tax cut will cost the State approximately $300.0 million, which will be paid for with funds from a securitization of certain long-term revenues such as tobacco settlement receipts.[46]

New Revenue Enhancements

The FY2009 State budget proposes several revenue enhancements totaling over $1.0 billion. They are listed in the exhibit below. Several of these changes have been previously proposed by Governor Blagojevich and rejected by the General Assembly.

FY2009 Revenue Changes in State Budget

Tax Change	Amount
3% Employer Payroll Tax*	$ 417,000,000
Restricting Cost of Collection Discounts	$ 139,000,000
Use Straight Line Instead of Accelerated Depreciation**	$ 100,000,000
Repeal Deduction for Foreign and Domestic Dividends Received by Corporations	$ 100,000,000
Return to Three-Factor Income Tax Apportionment	$ 70,000,000
Collect Sales Tax on Canned Software	$ 65,000,000
Repeal Exemption for Fuel Transported Out of State	$ 45,000,000
Decouple from Federal Qualified Production Activities	$ 35,000,000
Eliminate the Manufacturer's Purchase Credit	$ 30,000,000
Include Puerto Rico and Outer Continental Shelf in definition of U.S.	$ 30,000,000
Tax Industrial Insurance	$ 15,000,000
Repeal Research and Development Credit	$ 10,000,000
Withholding on Gaming Winnings over $1,000	$ 4,000,000
Total	**$ 1,060,000,000**

Source: Governor's Office of Management and Budget.

* When fully operational, the tax will generate $1.0 billion per year. In FY2009, the tax will generate $417.0 million for partial year collections.

** One-time

Employer Payroll Tax: $417.0 Million in FY2009, $1.0 Billion in Subsequent Years

To fund the proposed expansion of the *Illinois Covered* plan, the Governor proposes levying a 3% payroll assessment on employers who have ten or more full-time equivalent employees and who do not spend at least 4% of their payroll on employee healthcare expenses. This tax is

[45] Illinois State Budget FY2009, p. 2-5.
[46] Information provided to the Civic Federation by Brian Hamer, Director of the Illinois Department of Revenue, March 11, 2008.

identical to the one introduced, but not approved, last year. The tax would broadly apply to all corporations; however, those corporations that verify they spend the required amount on employee healthcare would be eligible for a credit in the amount of the tax. In these cases, the credit would negate the impact of the tax.[47]

The employer payroll tax would apply to wages paid on or after July 1, 2008. Due to the fact that collections would lag behind the effective date of implementation, the tax would generate $417.0 million in FY2009. In subsequent years it would yield approximately $1.0 billion.[48]

Restrict Cost of Collection Discounts: $139.0 Million

Retailers currently are allowed to take a discount of 1.75% of the tax receipts collected if they file returns and pay sales taxes owed on time. The discount is intended to be an incentive for prompt payment of the tax and to compensate businesses for administrative costs.[49] However, automation of records has dramatically reduced the administrative costs associated with collection. As a result, 24 states offer no discount. Nine states cap the discount at amounts ranging from $600 to $39,600 per year, and one state caps the amount at $30 per report.[50]

The State of Illinois proposes to cap the various discounts, preserving them for small businesses, but limiting them for large retailers and businesses. The amount of a cap would be negotiated with the General Assembly and would be set at different amounts for different taxes and fees.

Use Straight Line Instead of Accelerated Depreciation: $100.0 Million

This proposal would decouple Illinois' treatment of depreciation for income tax purposes from federal treatment. The $100.0 million revenue figure is a one-time revenue projection, applicable when companies value all of their old and new assets.

Repeal Deduction for Foreign and Domestic Dividends: $100.0 Million

Current law allows Illinois corporations to deduct foreign and domestic dividends they receive from their income tax liability. The Illinois Department of Revenue believes that this deduction would not be unconstitutional because there is no uniformity of treatment for dividends among the States. Twenty nine other states allow a federal deduction for dividends received by a corporation from another corporation, while six states allow deductions only for dividends from controlled, consolidated, or unitary affiliates. Seven states have their own dividends-received deductions, while three states have no dividends-received deductions. Individuals are not afforded this deduction.[51]

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[47] Information provided to the Civic Federation by Brian Hamer, Director of the Illinois Department of Revenue, March 11, 2008.
[48] Illinois State Budget FY2009, p. 2-15.
[49] Illinois Department of Revenue. *Publication 133: Retailer's Overview of Sales and Use Tax,* April 2005, p. 8
[50] 26 states offer retailer's discounts. Federation of Tax Administrators. "State Sales Tax Rates and Vendor Discounts." January 1, 2007. www.taxadmin.org/fta/rate/sale_vdr.html.
[51] Communication to the Civic Federation from John McCaffrey, Illinois Department of Revenue, March 28, 2008.

The State argues that the deduction enables many multinational companies to avoid paying any Illinois income tax. No other state has enacted similar legislation. This tax change is projected to yield $100.0 million per year.[52]

Return to Three-Factor Income Tax Apportionment: $70.0 Million

Corporate income tax is determined on the basis of a firm's in-state sales only. This method was phased in between 1998 and 2000 and replaced a three-part formula that considered in-state sales, the value of a corporation's property, and payroll.[53] Reverting to the three-factor apportionment system is expected to generate $70.0 million annually.

Collect Sales Tax on Prewritten Licensed Software: $65.0 million

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

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

The proposal, which was previously rejected by the General Assembly, would yield an estimated $65.0 million annually.

Eliminate Disparity in Tax Treatment for Gas Stored in Illinois: $45.0 Million

Fuel from Illinois' refineries and pipelines that is used in-state is currently subject to a 1.1 cent per gallon storage tank fee. The funds are used to pay for the cleanup of spills. Fuel from in-state refineries that is moved out-of-state is currently exempt from the tax. This proposal would repeal the exemption for fuel exported out-of-state and would reduce the aggregate rate of the tax to 1.0 cents per gallon.

Decouple from Federal Qualified Production Activities Income Deduction: $35.0 Million

The federal Qualified Production Activities Income (QPAI) deduction allows corporations to claim an income tax deduction based on profits accruing from "qualified production activities."

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[52] Information provided to the Civic Federation by Brian Hamer, Director of the Illinois Department of Revenue, March 11, 2008.
[53] Legislative Research Unit. *Illinois Tax Handbook for Legislators*. July 2007. p. 54.

Essentially, the QPAI deduction allows corporations to deduct an escalating percentage of the gross income they receive from the production of goods in the United States.[54] This production encompasses a wide range of activities, including manufacturing, "food processing, software development, filmmaking, electricity/natural gas production and construction."[55] Eighteen states and the District of Columbia have chosen to decouple from the federal deduction. If Illinois joined these jurisdictions, it is projected that the State would gain $35.0 million annually in recurring revenues.

Eliminate Manufacturer's Purchase Credit: $30.0 million

The Manufacturer's Purchase Credit (MPC) is earned when a manufacturer purchases manufacturing or graphic arts machinery and equipment that qualify for the existing sales/use tax exemptions. The credit may be used to pay state sales or use taxes on future purchases of these types of equipment. The MPC is equal to an amount that is half of the 6.25% state sales tax.[56] The Governor's proposal would eliminate this credit and would generate an estimated $30.0 million per year.

Include Puerto Rico, Outer Continental Shelf in State's Definition of the U.S.: $30.0 million

The State proposes that Illinois treat U.S. territories and the Outer Continental Shelf as part of the United States. Currently, Illinois defines the "United States" as excluding U.S. territories and possessions, in keeping with the federal Internal Revenue Service rules. The State defends this proposal as preventing situations in which corporations do not account for activity in subsidiaries located outside the 50 states and the District of Columbia, thereby reducing income subject to Illinois tax. An example of the "problem" cited in the State of Illinois FY2007 Budget (p. 5-17), when this idea was first proposed, is oil production from the Outer Continental Shelf being placed in a separate subsidiary, thereby reducing Illinois tax liability. A similar proposal was also introduced in FY2005.

Industrial Insurance Tax: $15.0 Million

Illinois imposes a variety of taxes and fees on licensed domestic insurance companies. This includes a broad based premium tax. However, unlike 27 other states, Illinois does not tax insurance purchased by large companies from unlicensed international insurance companies. Governor Blagojevich's proposal would extend Illinois insurance taxes to insurance purchased directly from a foreign insurance company that is not required to be registered in Illinois. It is estimated that the tax would generate approximately $15.0 million annually.[57]

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[54] Information provided to the Civic Federation by the Governor's Office of Management and Budget.
[55] Elizabeth McNichol and Nicholas Johnson. Center on Budget and Policy Priorities. *States are Decoupling from the Federal "Qualified Production Activities Income" Deduction.* September 14, 2005. See www.cbpp.org/9-14-05sfp.htm.
[56] Illinois Department of Revenue at www.revenue.state.il.us/Businesses/TaxInformation/Sales/mpc.htm.
[57] Information provided to the Civic Federation by provided by Brian Hamer, Director of the Illinois Department of Revenue, March 11, 2008.

Repeal Research and Development Credit: $10.0 Million

The Research and Development credit provides taxpayers an income tax credit for businesses that increase research activities. It is equal to 6.5% of qualifying research expenditures.[58] The credit was enacted in 1990, temporarily repealed in 2003, and restored in 2004. The State argues that there is little or no evidence that the credit has actually increased research and development. Furthermore, only a small number of companies apply for the credit annually.[59] Repealing the credit is expected to generate approximately $10.0 million.

Withholding on Non-Resident Gaming Winnings over $1,000: $4.0 million

Non-residents are able to take their gaming winnings without paying Illinois income taxes. Illinoisans, however, must pay taxes to other states when they win at gaming in surrounding states. This proposal would require withholding on all gaming winnings, regardless of residency status.

APPROPRIATIONS

The Governor's FY2009 operating budget recommends a total appropriation of $49.7 billion, an increase of $654.6 million, or 1.3%, over the FY2008 **originally proposed** appropriation of $49.1 billion. This total includes $28.9 billion in the General Funds, $14.9 billion in Other State Funds, and nearly $5.9 billion in Federal Funds. It should be noted that in order to provide an accurate year-to-year comparison, the Civic Federation uses the originally proposed budget figures when conducting its analysis.

FY2008-FY2009 Appropriation Trend

In FY2009 proposed General Funds appropriations will increase by 0.2%, or approximately $50.3 million over the previous year, while Other State Funds appropriations will rise by 4.0%, or approximately $575.0 million.[60]

The largest fund group in the budget is the General Funds, which represent 58.2% of total recommended appropriations. "Other State Funds" encompasses a wide range of funds, including highway funds and other special purpose State funds. The primary purpose of these funds is to receive either tax revenue distributions or specific revenues such as permit and license fees, which are reserved for specific projects. These funds represent approximately 30.0% of the total State operating budget proposal for FY2009.

[58] 35 ILCS 5/201 (k) - Illinois Income Tax Act.
[59] Information provided to the Civic Federation by the Governor's Office of Management and Budget.
[60] Please note that the figures used in this analysis compare the proposed budgets put forth by the State of Illinois for FY2008 and FY2009.

State of Illinois Appropriations by Fund: FY2008-FY2009 (in $ thousands)				
	FY2008 Prop.	FY2009 Prop.	$ change	% change
General Funds	$ 28,858,988	$ 28,909,285	$ 50,297	0.2%
Other Funds	$ 14,333,216	$ 14,908,166	$ 574,950	4.0%
Federal Funds	$ 5,867,905	$ 5,897,232	$ 29,327	0.5%
Total	**$ 49,060,109**	**$ 49,714,683**	**$ 654,574**	**1.3%**

Source: Illinois State Budget FY2008, p. 2-35; Illinois State Budget FY2009, p. 2-36

The next exhibit shows changes in proposed appropriations between FY2008 and FY2009 for major program areas in the State budget. Spending for agencies under the Governor,[61] the largest appropriation category, will increase by 1.8% or $636.1 million, to $35.1 billion in FY2009. Appropriations for elementary and secondary education, the next largest category, will decrease by 0.4%, or $48.6 million from the proposed FY2008 appropriation.

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

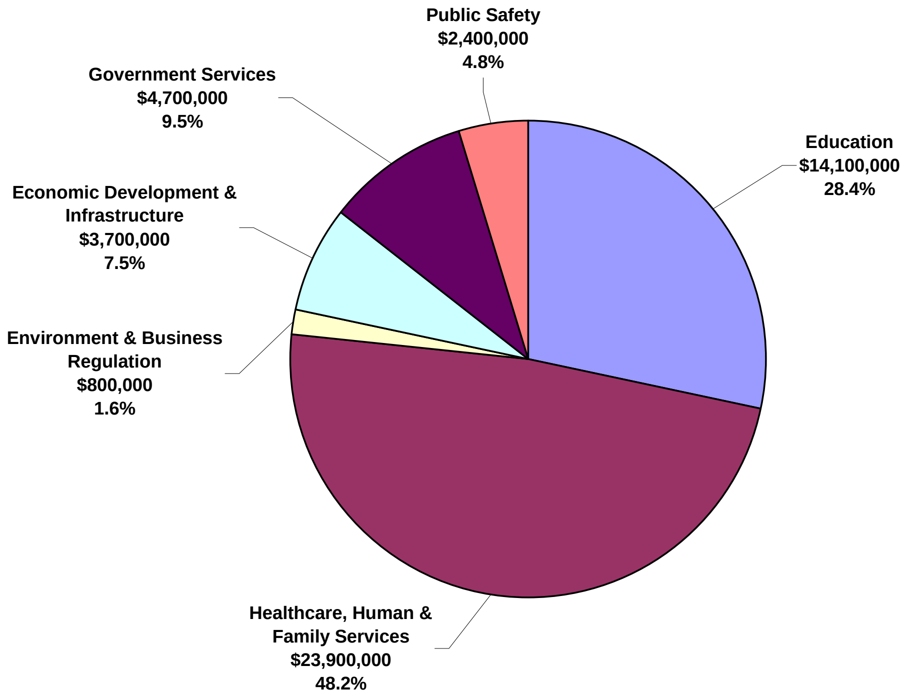
State of Illinois Recommended Appropriations: FY2008-FY2009 (in $ thousands)				
Type	FY2008 Recommended Appropriation	FY2009 Recommended Appropriation	$ change FY2008-FY2009	% change FY2008-FY2009
Legislative Agencies				
Legislative Agencies Total	**$ 99,221**	**$ 109,110**	**$ 9,889**	**10.0%**
General Funds	$ 79,011	$ 89,497	$ 10,486	13.3%
Other State Funds	$ 20,210	$ 19,614	$ (596)	-2.9%
Judicial Agencies				
Judicial Agencies Total	**$ 400,953**	**$ 444,657**	**$ 43,704**	**10.9%**
General Funds	$ 374,018	$ 416,853	$ 42,835	11.5%
Other State Funds	$ 24,710	$ 25,504	$ 794	3.2%
Federal Funds	$ 2,225	$ 2,300	$ 75	3.4%
Elected Officials And Elections				
Elected Officials And Elections Total	**$ 2,387,938**	**$ 2,480,819**	**$ 92,881**	**3.9%**
General Funds	$ 325,296	$ 338,944	$ 13,648	4.2%
Other State Funds	$ 2,052,218	$ 2,131,375	$ 79,157	3.9%
Federal Funds	$ 10,424	$ 10,500	$ 76	0.7%
Agencies Under the Governor				
Governor's Agencies Total	**$ 34,446,846**	**$ 35,082,954**	**$ 636,108**	**1.8%**
General Funds	$ 16,442,928	$ 17,051,450	$ 608,522	3.7%
Other State Funds	$ 14,722,971	$ 14,790,149	$ 67,178	0.5%
Federal Funds	$ 3,280,947	$ 3,241,355	$ (39,592)	-1.2%
Elementary and Secondary Education				
Elementary and Secondary Education	**$ 11,120,785**	**$ 11,072,146**	**$ (48,639)**	**-0.4%**
General Funds	$ 8,909,168	$ 8,738,421	$ (170,747)	-1.9%
Other State Funds	$ 44,517	$ 44,732	$ 215	0.5%
Federal Funds	$ 2,167,100	$ 2,288,994	$ 121,894	5.6%
HIGHER EDUCATION[3]				
Higher Education Total	**$ 2,924,214**	**$ 3,010,852**	**$ 86,638**	**3.0%**
General Funds	$ 2,264,567	$ 2,389,726	$ 125,159	5.5%
Other State Funds	$ 252,438	$ 266,022	$ 13,584	5.4%
Federal Funds	$ 407,209	$ 355,104	$ (52,105)	-12.8%
Revolving Funds	**$ (2,783,848)**	**$ (2,780,128)**	**$ 3,720**	**-0.1%**
Governor's Operating Initiatives	**$ -**	**$ (54,195)**	**$ (54,195)**	**-**
Governor's *Illinois Covered* Initiative	**$ 358,000**	**$ 417,506**	**$ 59,506**	**16.6%**
Agency Across The Board Cuts	**$ -**	**$ (69,038)**	**$ (69,038)**	**-**
Totals				
General Funds	**$ 28,858,988**	**$ 28,909,285**	**$ 50,297**	**0.2%**
Other State Funds	**$ 14,333,216**	**$ 14,908,166**	**$ 574,950**	**4.0%**
Federal Funds	**$ 5,867,905**	**$ 5,897,232**	**$ 29,327**	**0.5%**
GRAND TOTAL	**$ 49,060,109**	**$ 49,714,683**	**$ 654,574**	**1.3%**

Sources: Illinois State Budget FY2008, pp. 2-27 to 2-35, Illinois State Budget FY2009, pp. 2-27 to 2-36.

FY2009 Appropriations by Purpose

The following exhibit shows how FY2009 appropriations are apportioned. Healthcare, Human, and Family Service programs will require 48.2% of the $49.7 billion FY2009 operating budget. Spending for elementary, secondary, and higher education is the second largest category, consuming 28.4% of all appropriations.

FY2009 Illinois State Budget Appropriations by Purpose (in $ thousands)



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

Five-Year Appropriation Trend

The next section presents an analysis of five-year appropriation trends between FY2005 and FY2009. In order to provide an accurate comparison, the figures presented are for the appropriations originally proposed in the budget for each fiscal year.

Proposed operating budget appropriations are expected to increase by 14.3% between FY2005 and FY2009. This represents a $6.2 billion increase from $43.5 billion in FY2005 to $49.7 billion in FY2009. General Fund appropriations will increase by over $4.9 billion, or 20.7%, while Other Funds will increase by $1.1 billion, or 8.0%. Agencies under the control of the Governor, which will account for 70.6% of all operations spending, will rise by 18.9%, from $29.5 billion in FY2005 to $35.1 billion in FY2009. Appropriations for Elementary and Secondary Education are expected to increase by 25.1%, or $2.2 billion.

State of Illinois Recommended Appropriations: FY2005-FY2009 (in $ thousands)				
Type	**FY2005 Recommended Appropriation**	**FY2009 Recommended Appropriation**	**$ change FY2005-FY2009**	**% change FY2005-FY2009**
Legislative Agencies				
Legislative Agencies Total	**$ 82,813**	**$ 109,110**	**$ 26,297**	**31.8%**
General Funds	$ 66,978	$ 89,497	$ 22,519	33.6%
Other State Funds	$ 15,835	$ 19,614	$ 3,779	23.9%
Judicial Agencies				
Judicial Agencies Total	**$ 376,938**	**$ 444,657**	**$ 67,719**	**18.0%**
General Funds	$ 350,297	$ 416,853	$ 66,556	19.0%
Other State Funds	$ 23,191	$ 25,504	$ 2,313	10.0%
Federal Funds	$ 3,450	$ 2,300	$ (1,150)	-33.3%
Elected Officials And Elections				
Elected Officials And Elections Total	**$ 2,241,158**	**$ 2,480,819**	**$ 239,661**	**10.7%**
General Funds	$ 250,812	$ 338,944	$ 88,132	35.1%
Other State Funds	$ 1,976,650	$ 2,131,375	$ 154,725	7.8%
Federal Funds	$ 13,697	$ 10,500	$ (3,197)	-23.3%
Agencies Under The Governor				
Governor's Agencies Total	**$ 29,503,571**	**$ 35,082,954**	**$ 5,579,383**	**18.9%**
General Funds	$ 14,519,852	$ 17,051,450	$ 2,531,598	17.4%
Other State Funds	$ 11,767,270	$ 14,790,149	$ 3,022,879	25.7%
Federal Funds	$ 3,216,449	$ 3,241,355	$ 24,906	0.8%
Elementary and Secondary Education				
Elementary and Secondary Education	**$ 8,853,413**	**$ 11,072,146**	**$ 2,218,733**	**25.1%**
General Funds	$ 6,563,064	$ 8,738,421	$ 2,175,357	33.1%
Other State Funds	$ 73,699	$ 44,732	$ (28,967)	-39.3%
Federal Funds	$ 2,216,650	$ 2,288,994	$ 72,344	3.3%
Higher Education				
Higher Education Total	**$ 2,607,177**	**$ 3,010,852**	**$ 403,675**	**15.5%**
General Funds	$ 2,260,700	$ 2,389,726	$ 129,026	5.7%
Other State Funds	$ 54,713	$ 266,022	$ 211,309	386.2%
Federal Funds	$ 291,765	$ 355,104	$ 63,339	21.7%
Revolving Funds	**$ (2,418,096)**	**$ (2,780,128)**	**$ (362,032)**	**15.0%**
Governor's Operating Initiatives	**$ (211,300)**	**$ (54,195)**	**$ 157,105**	**-74.4%**
Governor's *Illinois Covered* Initiative	**$ -**	**$ 417,506**	**$ 417,506**	**-**
Agency Across The Board Cuts	**$ -**	**$ (69,038)**	**$ (69,038)**	**-**
Totals				
General Funds	**$ 23,955,768**	**$ 28,909,285**	**$ 4,953,517**	**20.7%**
Other State Funds	**$ 13,806,584**	**$ 14,908,166**	**$ 1,101,582**	**8.0%**
Federal Funds	**$ 5,742,010**	**$ 5,897,232**	**$ 155,222**	**2.7%**
GRAND TOTAL	**$ 43,504,362**	**$ 49,714,683**	**$ 6,210,321**	**14.3%**

Sources: Illinois State Budget FY2005, pp. 1-27 to 1-34, Illinois State Budget FY2009, pp. 2-27 to 2-36.

PERSONNEL

The Governor’s FY2009 budget recommends filling 56,591-time equivalent (FTE) positions. This is a 3.8% or 2,243 position decrease from the number of positions originally authorized in FY2008. Since FY2005, the number of FTEs authorized will have decreased by 0.2% or 133 positions, from 56,724 in FY2005 to 58,591 in FY2009.

State of Illinois Employee Count FY2005 - FY2009							
Purpose	FY2005 Actual	FY2006 Actual	FY2007 Actual	FY2008 Authorized	FY2009 Authorized	FY05-FY09 # Change	FY05-FY09 % Change
Human Services	19,752	19,940	20,951	20,952	21,675	1,923	9.7%
Public Safety	18,015	17,702	16,022	17,851	15,996	-2,019	-11.2%
Econ Dev/Infrastructure	8,651	8,461	8,166	8,589	8,356	-295	-3.4%
Government Services	3,960	4,078	4,036	4,417	4,121	161	4.1%
Environ/Business Reg	4,157	4,154	4,142	4,398	3,945	-212	-5.1%
Healthcare/Family Services	2,189	2,313	2,422	2,627	2,498	309	14.1%
Total	**56,724**	**56,648**	**55,739**	**58,834**	**56,591**	**-133**	**-0.2%**

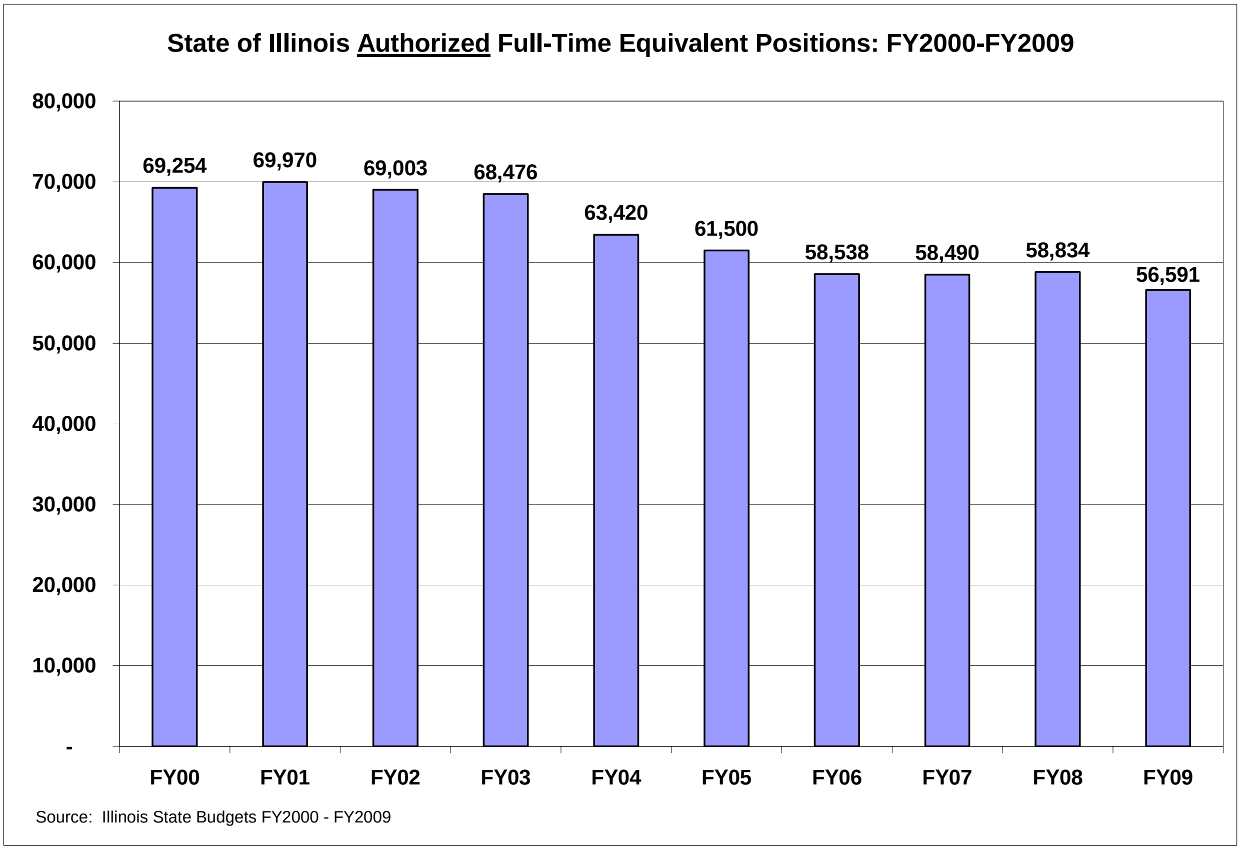
Source: Illinois State Budget FY2009, p. 2-15 and Illinois State Budget FY2008, p. 2-16.

The State does not necessarily fill all of the positions that are authorized in a budget. In FY2008, it is estimated that only 58,055 of the 58,834 positions authorized were actually filled. Comparing the FY2008 estimate with the FY2009 personnel authorization shows that, if all of the authorized positions were filled, the number of FTEs would fall by 2.5% or 1,464 positions.

State of Illinois Employee Count FY2008 Estimated and FY2009 Authorized				
Purpose	FY2008 Estimated	FY2009 Authorized	FY08-FY09 # change	FY08-FY09 % change
Human Services	20,492	21,675	1,183	5.8%
Public Safety	17,473	15,996	-1,477	-8.5%
Econ Dev/Infrastructure	8,718	8,356	-362	-4.2%
Government Services	4,388	4,121	-267	-6.1%
Environ/Business Reg	4,378	3,945	-433	-9.9%
Healthcare/Family Services	2,606	2,498	-108	-4.1%
Total	**58,055**	**56,591**	**-1,464**	**-2.5%**

Source: Illinois State Budget FY2009, p. 2-15.

The next exhibit shows changes in the number of authorized full-time equivalent positions in the 10-year period between FY2000 and FY2009. During that period, the number of authorized FTEs has fallen by 18.3% or 12,663 positions. Since FY2001, the number of positions has declined by 19.1% or 13,379 FTEs.

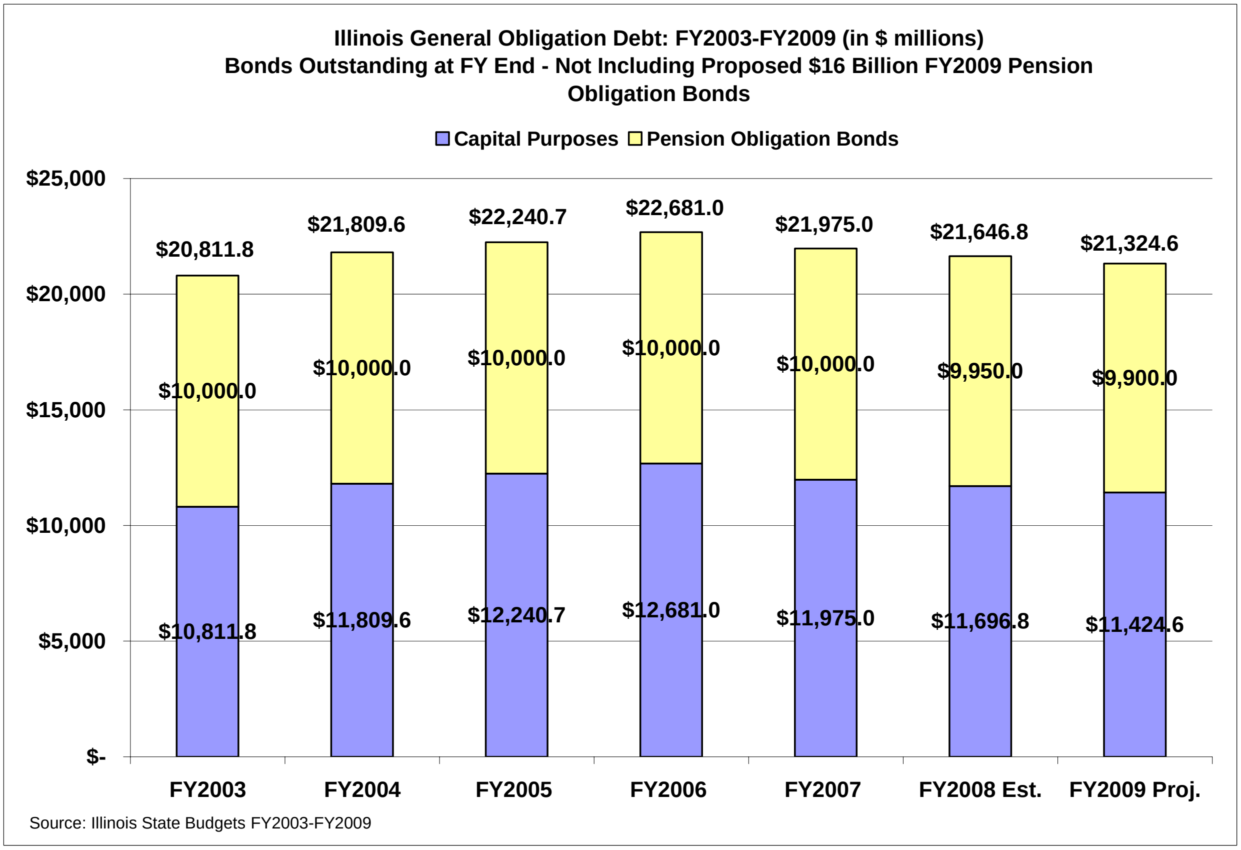


DEBT TRENDS

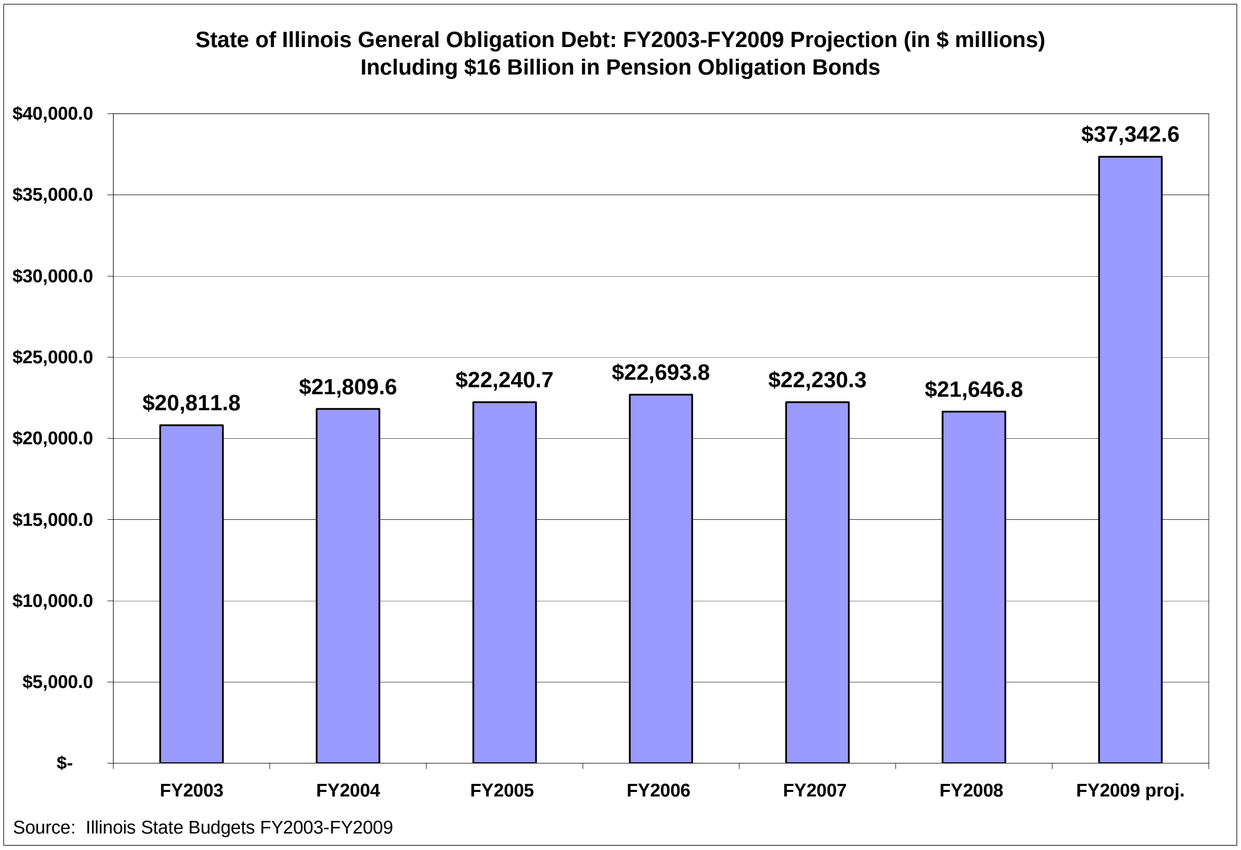
This section of the analysis examines trends in long-term and short-term debt issued by the State of Illinois, as well as bond ratings and an overview of the debt service schedule.

State of Illinois General Obligation Debt

The State of Illinois estimates that it will have $21.3 billion in general obligation (GO) debt outstanding in FY2009. This figure excludes the proposed $16.0 billion pension obligation bond issue proposed for FY2009. Of that amount, $9.9 billion comes from the 2003 pension obligation bond issue and $11.4 billion comes from three different types of capital purpose general obligation debt: GO capital debt, Build Illinois debt, and Civic Center debt. The total amount of GO debt outstanding will rise by 2.5%, or $512.8 million, between FY2003 and FY2009. Since FY2002, GO debt has risen by 123.5%, from $9.5 billion in FY2002 to $21.3 billion in FY2009.

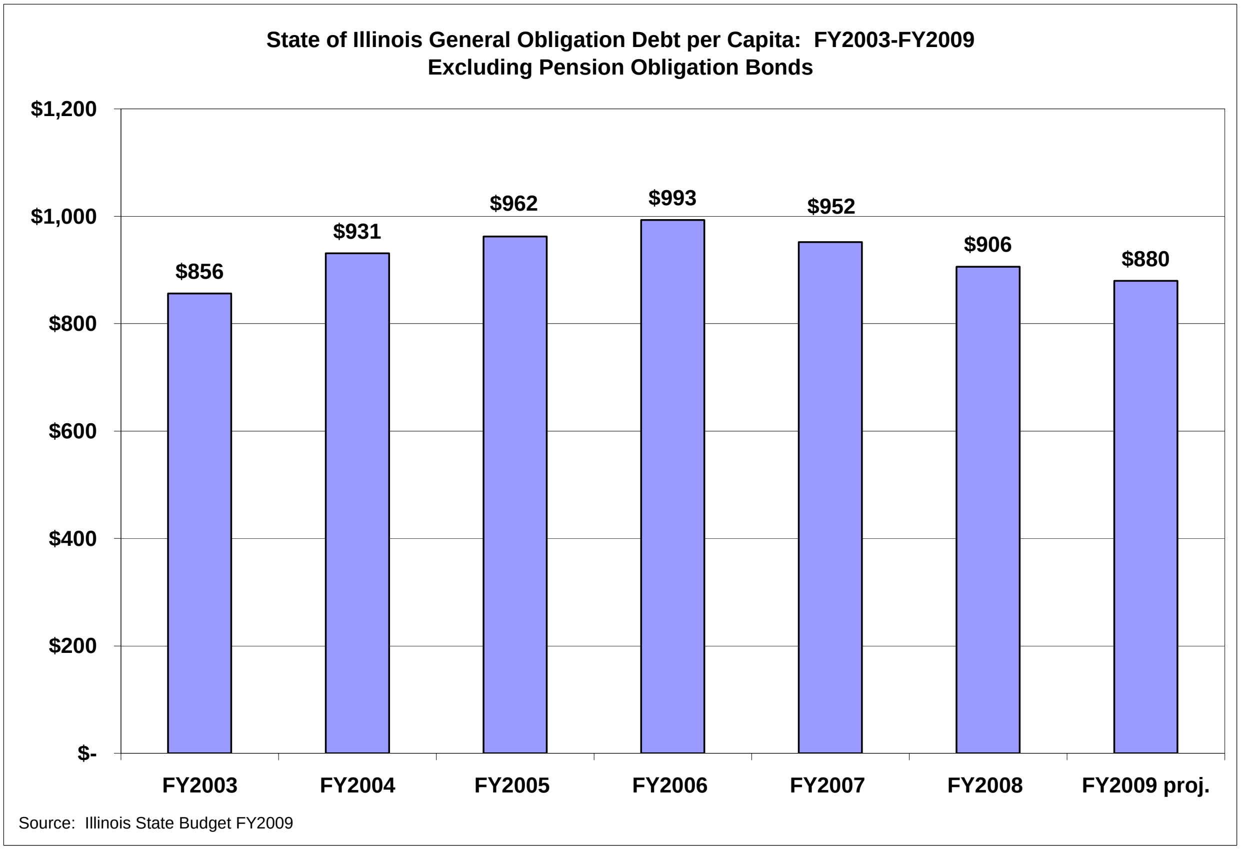


The State of Illinois proposes to issue an additional $12.0 to $20.0 billion in GO bonds in order to increase the assets of the State's pension systems in FY2009. Depending on the amount of debt issued, total GO debt would increase anywhere between 53.9% and 90.9% over FY2008 levels. A $16.0 billion pension obligation bond would increase the total GO debt burden from $21.6 billion in FY2008 to approximately $37.3 billion in FY2009, a 42.1% increase.



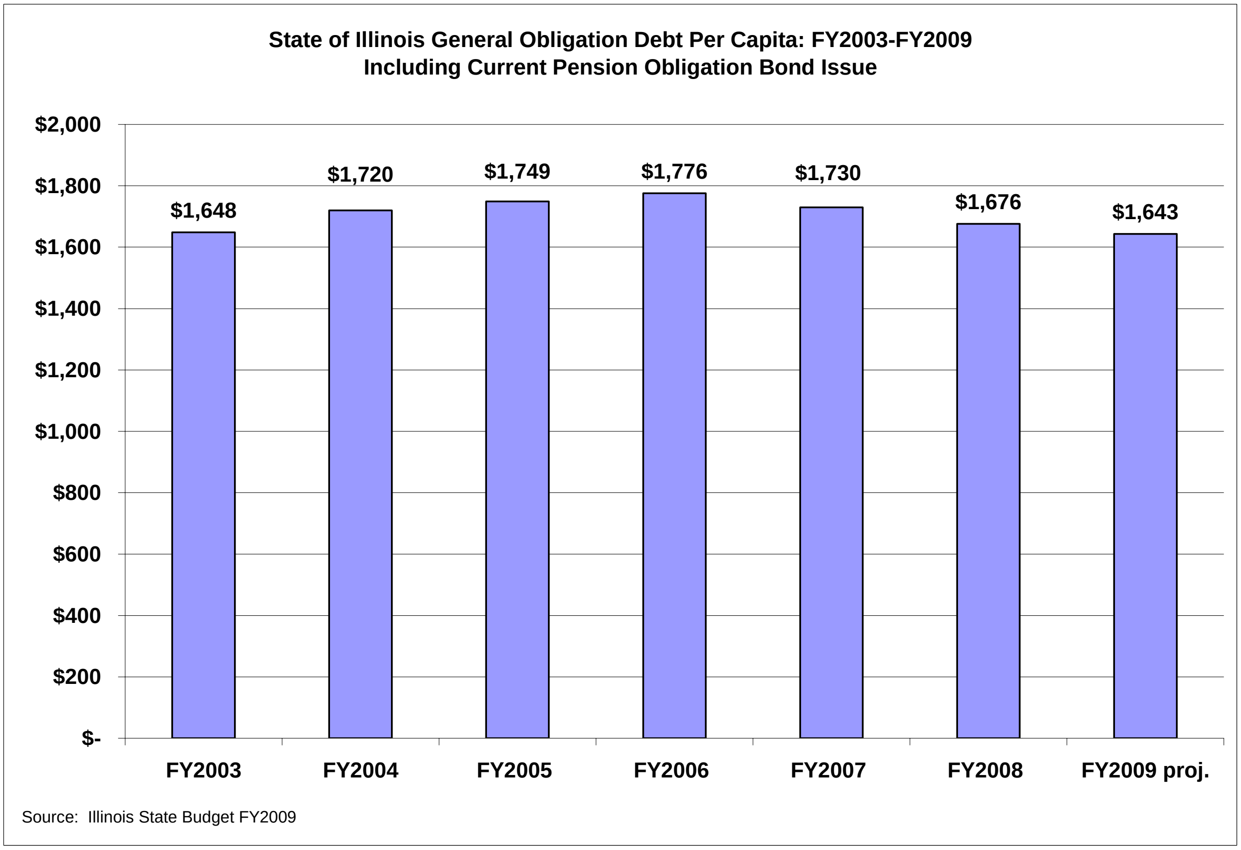
General Obligation Debt Per Capita - Excluding Pension Bonds

Illinois State General Obligation bond debt per capita (excluding the existing pension obligation debt) is shown in the following exhibit. Between FY2003 and FY2009, GO debt per capita for capital purposes is projected to increase by 2.8%, from $856 in FY2003 to $880 in FY2009.



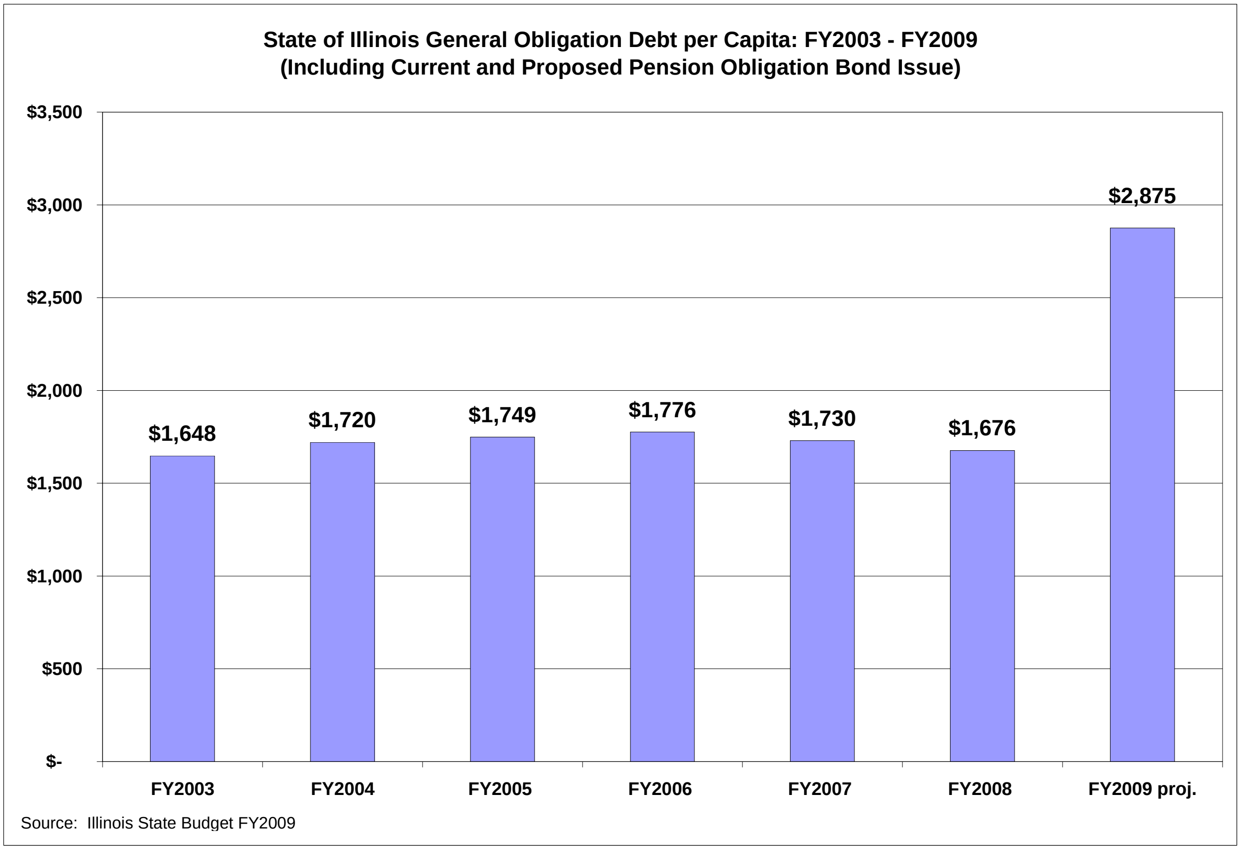
General Obligation Debt Per Capita – Including Current Pension Bond Issue

The next exhibit shows estimates for total GO debt per capita, including both capital debt and existing pension obligation debt. Between FY2003 and FY2009, GO debt per capita is projected to decrease by 0.3%, from $1,648 to $1,643.



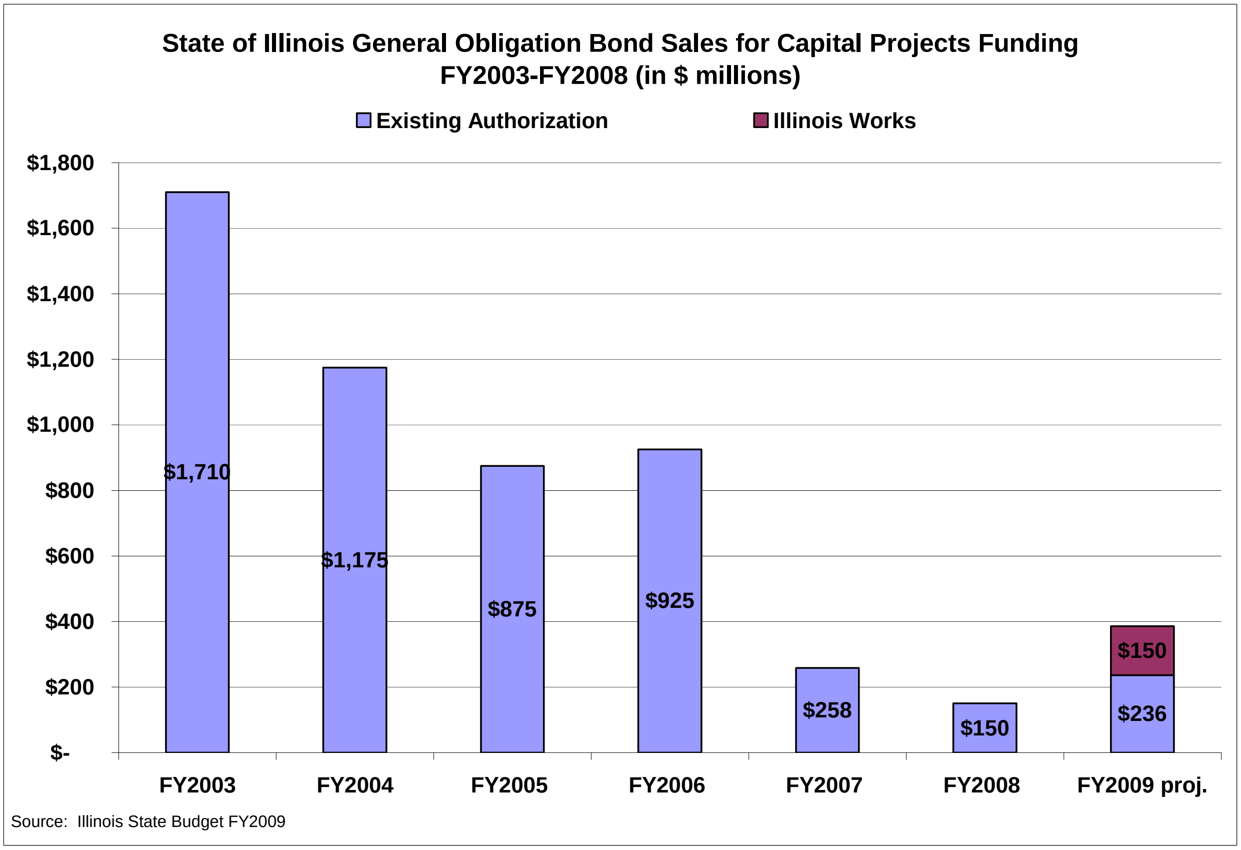
General Obligation Debt Per Capita – Including Proposed Pension Obligation Bond Issue

The next exhibit shows estimates for what total GO debt per capita would be for both capital purposes and pension obligation debt if $16.0 billion in pension obligation bonds were issued by the State of Illinois. Between FY2003 and FY2009, GO debt per capita would be projected to increase by 74.5%, from $1,648 to $2,875. The increase between FY2008 and FY2009 would be 71.6%, from $1,676 to $2,875. A $10.0 billion pension obligation bond (POB) would generate a per capita burden of $2,567, while a $20.0 billion POB would generate a per capita burden of $3,183.



The State of Illinois' capital program is financed primarily through the issuance of general obligation bonds.[62] The exhibit below shows historical and projected bond sales. It excludes sales for refunding purposes and the pension obligation bonds. As the exhibit illustrates, bond sales will increase sharply by 157.3%, from $150.0 million in FY2008 to $386.0 million in FY2009. Of the $386.0 million in bond sales issued in FY2009, $236.0 million have been previously authorized, and $150.0 million will be used for the Governor's new multi-year $25.0 billion *Illinois Works* capital plan.

[62] A small portion of the capital program is financed through the sale of previously issued Build Illinois bonds.



Bond Ratings

The State of Illinois' general obligation bond ratings are: [63]

- Moody's Aa3
- Standard & Poor's AA
- Fitch Ratings AA

Debt Service Schedule

A debt service schedule sets forth the principal and interest amounts due for outstanding bonds. The State projects declining total debt service payments for principal and interest between FY2008 and FY2033, from $2.0 billion to $1.2 billion. However, current Pension Obligation Bond debt service payments are back-loaded and will increase from $546.0 million in FY2007 to over $1.1 billion in FY2033. During the period between FY2008 and FY2033, the State of Illinois will pay a total of $19.9 billion in debt service for the current $10.0 billion pension obligation bond issue and $19.5 billion for all capital projects debt service.[64]

[63] Illinois State Budget FY2009, p. 12-3.
[64] Illinois State Budget FY2009, p. 12-6.

Short-Term Debt

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

The State may issue short-term debt certificates based upon revenue anticipation or shortfall. However, the State may borrow only up to five percent of appropriations for any fiscal year in anticipation of revenues collected for that fiscal year. The anticipation borrowing must be repaid by the close of that year. The State may borrow up to fifteen percent of its appropriations for any fiscal year to compensate for revenue shortfalls. Revenue shortfall borrowing must be repaid within one year. [65]

The following exhibit shows the number of certificates as well as the issuance and retirement dates from July 2002 through November 2007. No certificate issuance was reported between August 1995 and July 2002. The March 2005, February 2007, and September 2007 issuances represent borrowing for Medicaid related purposes. The amount of State short-term debt rose to $1.5 billion in May 2003 and then declined to $765.0 million in March 2005, before increasing to $1.0 billion later that year. In February 2007, short-term debt was $900.0 million. A short term certificate of $1.2 billion was issued in September 2007 and was retired in November of the same year.

State of Illinois Short-Term Debt FY2002-FY2008 (in $ millions)		
Certificate Issuance	Certificate Retirement	Amount
July 2002	June 2003	$ 1,000
May 2003	May 2004	$ 1,500
June 2004	October 2004	$ 850
March 2005*	June 2006	$ 765
November 2005	June 2006	$ 1,000
February 2007*	June 2007	$ 900
September 2007*	November 2007	$ 1,200

Source: Illinois State Budget FY2009, p. 12-6.

* Hospital Assessment Conduit Financings

[65] Illinois State Budget FY2006, p. 10-3.

STATE OF ILLINOIS RETIREMENT SYSTEMS

The State of Illinois funds five retirement systems for employees and retirees: the State Employees Retirement System (SERS), the Teachers' Retirement Employment Retirement System (TRS), the State Universities Retirement System (SURS), the Judges' Retirement System (JRS), and the General Assembly Retirement System (GRS). A total of 695,612 individuals are currently enrolled in these five systems.

Members of Illinois Retirement Systems: Current Enrollment			
Pension Fund	**Members**	**Annuitants**	**Total**
Teachers	258,531	89,269	347,800
University	156,952	43,395	200,347
State Employees	89,598	55,265	144,863
Judges	990	946	1,936
General Assembly	267	399	666
Total	**506,338**	**189,274**	**695,612**

Source: Illinois State Budget FY2009, p. 4-1.

Recent Changes in Pension Funding: 2003 to Present

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

Issuance of $10.0 Billion in Pension Obligation Bonds in 2003

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

Initially, the funds' managers and the Governor's financial team estimated that the pension funds would earn investment income at the traditional long-term actuarial rate of 8.5% and that the pension bond proceeds would earn at least that rate over the 30-year life of the bonds. The financial team forecasted that economic savings would result from issuing the $10.0 billion in bonds at the then-current market rate of approximately 5.8%, as long as the funds earned a long-term actuarial rate of 8.0%. In fact, the bonds were ultimately issued at an interest rate of 5.05% while the pension funds' actuaries ultimately projected an 8.5% expected rate of return for the entire asset portfolio. The State estimated that it would realize $860.0 million in additional "savings" from these favorable rates. In its FY2005 budget, the State proposed to capture $215.0 million, or 25.0% of the increase, reserving the remainder for capture in future years. The $215.0 million "savings" was used as the basis for reducing the State's pension contribution by a similar amount in FY2005.

Governor Blagojevich's FY2006 Pension Funding Reform Proposals

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

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

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

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

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

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

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

The FY2006-FY2007 Partial Pension Holiday

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

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

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

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

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

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

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

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

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

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

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

Governor Blagojevich's FY2008 Pension Funding Proposal

The Governor's FY2008 budget proposed providing the State's five pension plans with $25.9 billion in new assets. This infusion would have provided for an 83.0% funded ratio in FY2008, 34 years ahead of the current 50-year funding schedule, had this proposal been adopted.[66] Under the Governor's proposal, the increase in the funded ratio would have been achieved through two financing mechanisms:

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

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

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

Governor Blagojevich's FY2009 Pension Funding Proposal

The FY2009 budget proposes issuing between $12.0 and $20.0 billion in pension obligation bonds to increase the assets of the State's pension funds. The bonds will be paid for through General Fund revenues.

If the State issued $16.0 billion in pension obligation bonds, it could immediately place $15.9 billion of that amount into the pension funds, thereby increasing the funded ratio from 62.6% to approximately 75.2%. One hundred million dollars would be used for administrative costs associated with bond issuance, pension payments would be rescheduled, and FY2009 payments would be $280.0 million greater than the payment made in the previous year. In succeeding years, payments would be equal to $280.0 million plus a 3% annual increase until the funds achieved a 90.0% funded ratio in 2033, twelve years ahead of the current schedule. Overall, it is estimated that the plan would save the State $55.0 billion in future contributions.[67] The savings would accrue because the interest rate on the pension obligation bonds would be approximately 5.5% while the borrowed funds would earn 8.5% through investment returns. The "savings" represent the spread between interest paid on the bonds and interest earned on the invested funds. The State proposes to use the savings to reduce its pension obligation payments to the amount required under the 1995 pension funding reform law. The following exhibit illustrates the differences in required payments for contributions plus debt service under the current 1995 pension funding law versus under the FY2009 budget proposal.

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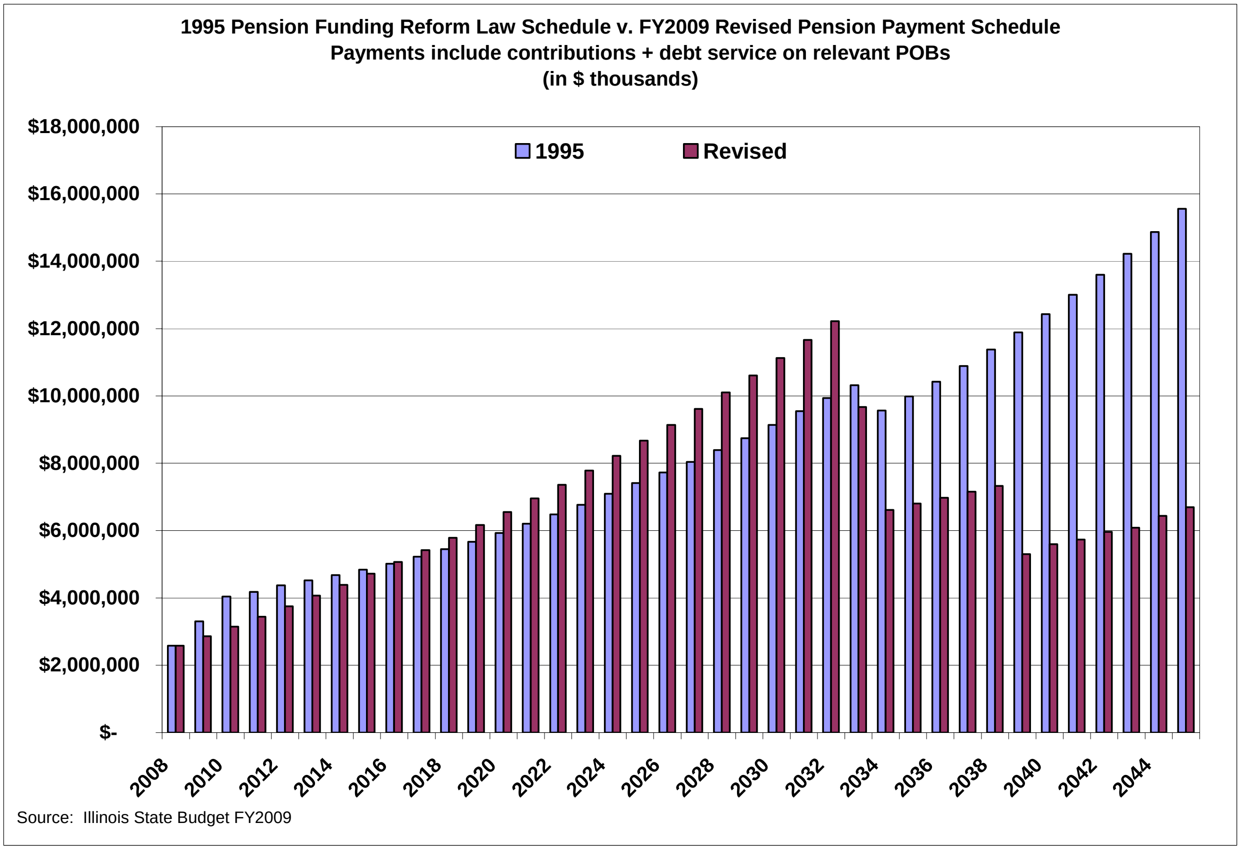
[66] Presentation by John Filan, Chief Operating Officer, State of Illinois, to the Civic Federation, March 14, 2007, p. 25.

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



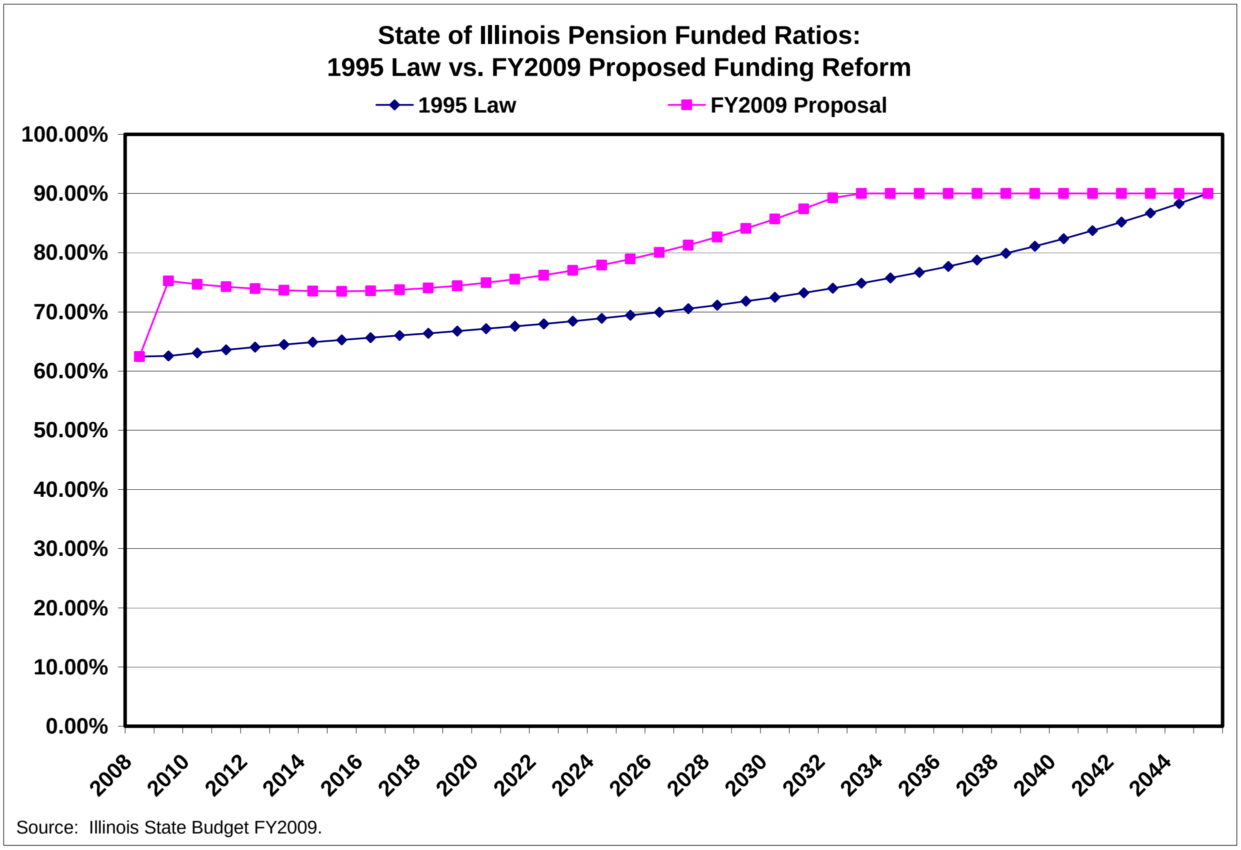
A more detailed presentation of the required payments can be found in the next exhibit. Some key points include:

- With the Governor's FY2009 pension funding reform proposal, total contributions will be less than those made under the current system until FY2015;
- The current system requires $19.9 billion in debt service through FY2033 to pay for the $10.0 billion 2003 pension obligation issue. This contrasts with the $57.6 billion in debt service costs for two pension obligation bond issues (2003 and 2008) under the FY2009 reform proposal; and
- The $55.6 billion in projected "savings" is the difference between the total costs of the State pension system through 2045 ($313.4 billion) and the projected total costs of the State pension system with the FY2009 proposed reforms ($257.8 billion).

Comparison of 1995 Pension Funding Law Requirements vs. FY2009 Pension Funding Reform Requirements							
	1995 Reform Law			FY2009 Pension Funding Proposal			
Year	Trust Contribution	2003 POB Payment	Total State Contribution	Trust Contribution	2003 POB Payment	2008 POB Payment	Total State Contribution
2008	$2,033,314	$546,200	$2,579,514	$2,033,314	$546,200	$0	$2,579,514
2009	$2,761,193	$544,950	$3,306,143	$1,444,179	$544,950	$870,384	$2,859,514
2010	$3,501,543	$543,550	$4,045,093	$1,633,251	$543,550	$971,113	$3,147,914
2011	$3,641,169	$541,900	$4,183,069	$1,909,203	$541,900	$993,863	$3,444,966
2012	$3,785,219	$590,125	$4,375,344	$2,145,317	$590,125	$1,015,488	$3,750,929
2013	$3,935,539	$586,375	$4,521,914	$2,443,709	$586,375	$1,035,988	$4,066,072
2014	$4,094,311	$582,525	$4,676,836	$2,727,781	$582,525	$1,080,363	$4,390,668
2015	$4,262,705	$578,575	$4,841,280	$3,049,641	$578,575	$1,096,788	$4,725,003
2016	$4,441,798	$574,525	$5,016,323	$3,382,855	$574,525	$1,111,988	$5,069,368
2017	$4,630,669	$595,175	$5,225,844	$3,728,826	$595,175	$1,100,063	$5,424,063
2018	$4,829,409	$614,738	$5,444,146	$4,086,525	$614,738	$1,088,138	$5,789,400
2019	$5,037,943	$633,213	$5,671,155	$4,431,271	$633,213	$1,101,213	$6,165,696
2020	$5,257,455	$674,550	$5,932,005	$4,817,019	$674,550	$1,061,713	$6,553,282
2021	$5,488,043	$713,413	$6,201,455	$5,165,420	$713,413	$1,073,663	$6,952,495
2022	$5,730,549	$749,800	$6,480,349	$5,554,722	$749,800	$1,059,163	$7,363,684
2023	$5,984,814	$783,713	$6,768,527	$5,933,835	$783,713	$1,069,663	$7,787,210
2024	$6,250,445	$840,150	$7,090,595	$6,329,578	$840,150	$1,053,713	$8,223,440
2025	$6,523,514	$892,200	$7,415,714	$6,742,796	$892,200	$1,037,763	$8,672,758
2026	$6,807,851	$915,425	$7,723,276	$7,148,318	$915,425	$1,071,813	$9,135,556
2027	$7,103,644	$936,100	$8,039,744	$7,598,174	$936,100	$1,077,963	$9,612,237
2028	$7,411,210	$979,225	$8,390,435	$8,041,331	$979,225	$1,082,663	$10,103,218
2029	$7,724,240	$1,018,525	$8,742,765	$8,504,492	$1,018,525	$1,085,913	$10,608,930
2030	$8,061,049	$1,079,000	$9,140,049	$8,988,300	$1,079,000	$1,062,513	$11,129,812
2031	$8,413,352	$1,134,375	$9,547,727	$9,492,834	$1,134,375	$1,039,113	$11,666,321
2032	$8,781,261	$1,159,650	$9,940,911	$9,993,563	$1,159,650	$1,065,713	$12,218,925
2033	$9,164,447	$1,156,100	$10,320,547	$7,400,428	$1,156,100	$1,114,388	$9,670,916
2034	$9,565,305		$9,565,305	$4,356,443		$2,258,675	$6,615,118
2035	$9,985,398		$9,985,398	$4,545,893		$2,259,225	$6,805,118
2036	$10,426,367		$10,426,367	$4,719,023		$2,253,925	$6,972,948
2037	$10,890,602		$10,890,602	$4,893,126		$2,267,775	$7,160,901
2038	$11,376,762		$11,376,762	$5,080,254		$2,249,313	$7,329,566
2039	$11,887,896		$11,887,896	$5,306,298		$0	$5,306,298
2040	$12,431,433		$12,431,433	$5,594,499		$0	$5,594,499
2041	$13,003,432		$13,003,432	$5,734,442		$0	$5,734,442
2042	$13,601,186		$13,601,186	$5,963,949		$0	$5,963,949
2043	$14,224,087		$14,224,087	$6,089,594		$0	$6,089,594
2044	$14,874,525		$14,874,525	$6,442,663		$0	$6,442,663
2045	$15,554,092		$15,554,092	$6,696,948		$0	$6,696,948
Total	$293,477,771	$19,964,077	$313,441,845	$200,149,814	$19,964,077	$37,710,059	$257,823,935

Source: Governor's Office of Management and Budget.

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



CONCLUSION

The Civic Federation **opposes** the State of Illinois FY2009 Operating Budget and urges dramatic recasting of the State's financial priorities.

The Civic Federation opposes the Governor's budget because the new program initiatives are unaffordable and imprudent during an economic downturn and will only further the State's inability to meet its existing obligations. The Federation does not support the State's pension borrowing plan due to the fact that it is not linked to essential long-term cost-cutting reforms that are necessary to aid in offsetting the $44.5 billion in unfunded liabilities. Finally, the Civic Federation opposes the partial concession of the Lottery to fund a massive $25.0 billion capital program because the administration has not provided any level of detail as to what projects will be pursued and why they are necessary.

The Civic Federation does offer its support for several components of Governor Blagojevich's FY2009 budget, including across-the-board spending cuts in non-priority areas, certain tax changes, the proposed special purpose funds sweeps, and the expansion of the Shared Services plan. The Civic Federation makes several recommendations for improving the Governor's FY2009 budget, including the implementation of comprehensive pension and healthcare benefit reforms, requiring school district financial management accountability reforms, the implementation of a formal, long-term financial planning process, and improvement of the State's performance measurement system.

The State of Illinois faces a serious fiscal crisis in FY2009 and the Federation believes that the $49.7 billion budget does not do enough to address the State's existing and future financial challenges.