STATE OF ILLINOIS
FY2005 RECOMMENDED OPERATING BUDGET
Analysis and Recommendations

Prepared By
The Civic Federation
May 3, 2004

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EXECUTIVE SUMMARY

The State of Illinois proposes a $43.5 billion operating budget for FY2005. The State faces a $1.7 billion deficit, which will be addressed through $1.2 billion in revenue adjustments and $500 million in expenditure reductions.[1]

The Civic Federation offers the following **key findings** on the State of Illinois FY2005 Budget:

- The FY2005 budgeted appropriations will increase by 5.9% from FY2004, from $41.1 billion to $43.5 billion.
- The budget contains $1.2 billion in revenue adjustments: $945 million in new revenue enhancement and $280 million in natural revenue growth.
- $400 million in new revenue enhancements will be derived from proposed changes in sales and business income taxes.
- The budget proposes $515 million in new spending increases, $400 million of which is allocated for elementary and secondary education.
- The number of full-time equivalent (FTE) positions is projected to decrease by 2,293 from 63,303 to 61,010. This 3.6% reduction does not reflect the additional decreases from a proposed ERI target of 2,000 positions. Since FY2003, the number of authorized FTEs is projected to decrease by 7,790 or 11%.
- The number of state agencies will decrease from 51 to 46 as a result of mergers and reorganizations. The number of agencies has declined from 66 in FY2003.
- Revenue projections reflect continued caution about the economic recovery, with General Fund net personal income tax revenues forecast to increase by 2.5%, sales taxes by 2.3% and corporate income tax revenues projected to decline by 10.3%. The net personal and sales tax projections are very close to Illinois Economic and Fiscal Commission (IEFC) forecasts of 2.6% and 2.3% increases respectively. The IEFC is more optimistic with its corporate income tax forecast, projecting a 6.1% decrease.

The Civic Federation **supports** many elements of the FY2005 State Budget:

- The budget contains no broad based income or sales tax increases.
- The State continues to make efforts to control personnel costs by reducing headcount. The budget proposes a 3.6% or 2,293 reduction in authorized positions from FY2004. This is the lowest number of authorized positions since 1972.
- The proposed budget continues work begun last year to improve the State's efficiency of operation through a number of agency consolidations, mergers and reorganizations.
- We commend the Governor for his structural reform proposals to pay vendors within 60 days, require the legislature to identify spending cuts or revenues for budget changes they propose, and increase the size of the State's Rainy Day fund.
- The budget document is vastly improved from previous years, providing citizens with a more user-friendly format.

The Civic Federation has **concerns** about several budget proposals.

- $400 million in business tax changes are proposed in the FY2005 budget. Some of these proposals may well have merit. However, some of the changes appear to represent fundamental changes in Illinois' corporate sales and income tax structures. The Civic Federation believes that these changes require much more public disclosure to measure their economic impact and the validity of their assumed revenue benefits. The lack of information provided in the budget and the extremely short time frame in which the General Assembly and the public is expected to consider these major changes

[1] Unless otherwise noted, all data in this analysis is taken from the State of Illinois FY2005 Operating Budget book.

makes it very difficult to engage in an informed discussion about the merits and/or the drawbacks of the individual proposals. The Civic Federation has particular concerns about three of the most complex proposals which are expected to generate $162 million in new revenues: using straight line instead of accelerated depreciation; extending the sales tax to licensed software; and applying a destination apportionment rule to service companies.

- The State has determined that the original cost of the FY2002 Early Retirement Initiative (ERI) was underestimated by $312 million. The State, however, has not identified how it will fund this increased obligation. The State must fully fund the ERI cost incurred regardless of who is responsible for underestimating this cost. The General Assembly must work with the Governor to correct this error.
- The Civic Federation **strongly opposes** the State's reduction of its certified funding contribution to the historically underfunded pension funds. The Governor's budget reduces pension contributions by $527 million from the $1.95 billion amount originally certified by the state retirement systems to approximately $1.4 billion. The reason for the reduction is twofold: 1) The State is only budgeting $70 million for the annual cost of the FY2002 Early Retirement Initiative even though revised estimates of the ERI's cost are now $382 million and 2) The State is allocating $215 million in "savings" to the retirement systems accrued from the favorable interest rate on the bonds and the actuarially determined 8.5% rate of return on major fund assets. The State will correspondingly reduce its appropriation to the retirement funds by that $215 million amount. Our support for the $10 billion pension obligation bond issue in 2003 was contingent upon the State moving to correct its underfunding problem. This appropriation reduction, while reducing the operating budget deficit in the short-term, does not deal with the State's longer-term problem of the historic underfunding of the State's pension funds. Instead, it repeats the pattern that created the State pension crisis.
- The FY2005 budget proposes a new ERI limited to 2,000 additional positions. The details of this ERI have not been released.

The Civic Federation offers the following **recommendations** to improve the State's financial management:

- The State should fund its pension obligations at the originally certified FY2005 amount of $1.95 billion instead of reducing the pension appropriation by $527 million. The State must meet, not defer, its pension obligations. The Civic Federation supported the $10 billion Pension Obligation Bond issue in 2003 because its intent was to reduce the State's pension liabilities. We believe that the State must fulfill its long-term obligations, regardless of who is at fault for underestimating the 2002 Early Retirement Initiative costs. It is not sound fiscal policy to continue to defer payment of this obligation.
- We caution the General Assembly and the Governor not to approve the proposed Early Retirement Initiative without a full public vetting of the costs and implementation details. The failure to take such a precaution resulted in a $312 million underestimate in the funding of the State's FY2002 Early Retirement Initiative. We cannot afford to make a similar mistake again.
- Due to our concerns about the short time frame remaining and the complexity of certain tax treatments, we strongly urge the Governor and the legislature to hold full public hearings to evaluate the impact of these changes on the corporate tax structure before adoption.
- The State should build on the Governor's FY2005 spending cuts of $500 million by reducing State spending across the board by an additional 1.6%. This would generate $689 million in savings and permit full funding of the FY2005 pension contributions, as well as allow additional time to evaluate the impact and need for the three proposed tax changes listed above.

- The Civic Federation recommends eliminating the State's "pick-up" of employee pension contributions for all employees, including those covered by union contracts. Elimination of the State's 4% pick-up for union employees would generate at least $60 million in savings.[2]
- The Federation applauds the Governor for forming a Blue Ribbon Pension Commission to recommend ways to control State personnel costs and we are pleased to participate. We urge that the Commission's mandate be comprehensive, considering all reasonable options for controlling benefit and compensation costs for union and non-union employees alike. The rate of growth in employee benefits must be curtailed if the State is ever going to slow the rate of growth in spending.
- The Civic Federation supports the creation of a Revenue Estimating Council to achieve consensus on revenue projections between the Economic and Fiscal Commission, the Comptroller's Office, and the Governor's Office of Management and Budget.
- The Civic Federation supports Governor Blagojevich's call for structured transfers to a Rainy Day Fund. However, we believe that Rainy Day Fund contributions should be linked to revenues, not expenditures.

[2] Information provided by Governor's Office of Management and Budget, February 26, 2004.

OVERVIEW OF ANALYSIS

The Civic Federation recently concluded an analysis of financial issues related to the State of Illinois' proposed FY2005 $43.5 billion operating budget. Based upon our review of the Operating Budget, we offer the following comments. The full text of our analysis follows this summary and is also available on our web site at www.civicfed.org.

Governor Blagojevich's proposed FY2005 operating budget for the State of Illinois is a complex policy document, containing over $43 billion in programs, policies and proposals. Based on our analysis, The Civic Federation supports a great part of the Governor's budget. However, we have serious concerns about other elements it contains, particularly some proposals relating to changes in business taxation, pensions and employee benefits.

Issues that The Civic Federation Supports

The Federation is pleased that Governor Blagojevich's proposed FY2005 budget for the State of Illinois does not contain any broad-based tax increases. The ability to maintain current tax rates is due in large part to a number of positive cost containment initiatives undertaken by the administration. A broad-based tax increase could jeopardize efforts to attract and maintain businesses and jobs in Illinois. A prerequisite to any broad based increases in State taxes should be a comprehensive review and determination that the State's current revenues of $53.6 billion are being effectively and efficiently utilized. Such a review has not taken place.

The Federation is also encouraged that the proposed budget controls expenditures through a reduction in the number of State employees of over 2,000, and generates additional efficiencies through merging and reorganizing State agencies. Many of the proposals contained in the FY2005 budget positively advance a necessary and prudent long-term agenda of increasing the efficiency of State government operations and containing mounting costs. The majority of governmental expenses are related to personnel costs including salaries, benefits and pensions. Therefore, shrinking the State's workforce by reducing headcount is an essential step that must be taken if these costs are ever to be contained. This effort will bring the State workforce to its lowest level in three decades. We strongly applaud the Governor for taking this long overdue step.

This budget continues the strategy initiated last year of streamlining operations by reorganizing departments, transferring functions and consolidating agencies. The number of agencies will be reduced by 20 in just 3 years, from 66 in FY2003 to 46 in FY2005. We support this effort toward greater managerial efficiency. Streamlining government operations by reducing duplication is a positive step toward increasing efficiency and, in many cases, reducing costs.

Governor Blagojevich proposed three important structural reforms in his budget. The Balanced Budget Act would require that any legislative action that increases spending would require a counterbalancing financial action. The On-Time Bill Payment Act would give the Governor short-term borrowing authority so that all vendors can be paid within a time frame of 30 to 60 days. These are both commonsense proposals that would help the State better manage its resources. The Civic Federation strongly supports each of them.

The Governor has also proposed The Responsible Spending Act, which would require the Governor to deposit $50 million in the State's Rainy Day Fund for each $1 billion increase in General Revenue spending. The Governor has initially earmarked $50 million for this fund. The Civic Federation supports Governor Blagojevich's call for structured transfers to a Rainy Day Fund. However, we believe that Rainy Day Fund contributions should be linked to revenues, not expenditures. For example, during any year in which General Fund revenues are projected to increase by more than 4%, an amount equal to 0.25% of the additional revenue would be transferred to the Rainy Day Fund. This would require the State to set aside money when revenues increases are high but allow spending flexibility when revenue growth is low.

The Civic Federation is encouraged that the Governor's budget makes elementary and secondary education a top funding priority for the second year in a row by increasing funding. In principle, we agree that increasing education spending to move toward fulfilling the State's constitutional requirement that it be the primary source of school funding is a good step. However, given the State's other pressing obligations, such as the need to increase funding for the retirement systems, it may not be possible to increase school funding by the full amount proposed unless spending is reduced in other areas. To effectively address the challenges of school funding, Illinois must reduce the over-reliance on property taxes to fund education at the local level. The Civic Federation will continue to advocate for this pressing need and streamlining state government expenses is a necessary prerequisite to such funding reform efforts.

The Governor has proposed significant changes to the structure and function of the State Board of Education. Although we share the concerns of many business groups for the need to maintain an independent board for teacher certification, we also understand the frustrations of others who find that the State Board of Education has not been an effective advocate for greater efficiency and cost savings, the promotion of charter schools, and alternative certification for teachers. The Governor's intent to dramatically streamline and consolidate processes such as purchasing is laudatory if it can be achieved while meeting the constitutional requirement of an independent State Board of Education and ensuring appropriate support for greater educational innovation. Furthermore, greater public disclosure is needed as to exactly how the $250 million in annualized savings proposed by the Governor will be generated.

Issues of Concern to The Civic Federation

While there are many positive elements in the FY2005 State budget, The Civic Federation does have serious **concerns** about certain proposals that reduce pension funding obligations and implement a new Early Retirement Initiative. Although several proposals appear to be improvements to the tax code and would be supported by the business community, The Civic Federation is concerned about the lack of a full and transparent discussion of all of the proposed business tax changes.

Reduction in Pension Fund Contributions

The FY2005 budget proposes to reduce state contributions to several of its pension funds to $1.42 billion, down $527 million from the $1.95 billion originally certified for FY2005. The

Governor has argued that the reason for the reduction is twofold: 1) The State is only budgeting $70 million for the annual cost of the FY2002 Early Retirement Initiative even though revised estimates of the ERI's cost are now $382 million annually and 2) The State is allocating $215 million in "savings" to the retirement systems. This amount accrued from the favorable interest rate that was achieved last year when the State issued $10 billion in Pension Obligation Bonds to address the over $35 billion in past underfunding on the bonds and the revised actuarially determined 8.5% rate of return on major fund assets.

The Civic Federation **strongly opposes** closing the State's deficit by reducing funding for the State's pension obligations by $527 million to help fund the State's current operations. Failure to fund these obligations is a return to Illinois' earlier practice of deferring long-term obligations in the mistaken hope that such shortfalls could be afforded in the future. While the Civic Federation believes that the State's overall current debt burden remains manageable, we are concerned with the emerging trend to structure State debt service payments to reduce or eliminate current expenditure obligations. Furthermore, any savings from the $10 billion dollar pension bond issue should be used to reduce pension obligations and not to support current operations. The purpose of the $10 billion bond issue was to remedy past underfunding, not avoid future contributions.

Because of our concern about the State's pension funding situation, we are very pleased to join with the Governor on his Blue Ribbon Commission to recommend ways to control this growing cost driver. The Civic Federation called for the creation of such a Commission in 2003.

New Early Retirement Initiative

The Governor's budget proposes a new ERI limited to 2,000 additional positions. This could be a constructive way to further control long-term costs. However, the details of how this ERI will be implemented have not yet been released.

Business Tax Changes

A total of $400 million in new revenues are proposed in the FY2005 budget from changes in business sales and income taxes. While some of the Governor's proposals to close Corporate Tax "loopholes" can be achieved without causing economic uncertainties, a few of the Governor's proposals appear to represent much more fundamental change in the State's corporate sales and income tax structure and require much more public disclosure to measure their economic impact and the validity of their assumed revenue benefits. We are particularly concerned about three of the more complex proposals which represent fundamental changes: Using Straight Line Instead of Accelerated Depreciation, Extending the Sales Tax to Licensed Software, and Applying a Destination Apportionment Rule to Service Companies.

Unfortunately, 10 weeks after release of the budget, and with less than 30 days remaining in the legislative session, few details about how these tax changes will be implemented have been committed to writing by the administration and publicly released. Businesses, like all taxpayers, have a right to understand how tax changes will impact them before such changes are voted upon by the General Assembly. With such limited time remaining in the legislative session, Governor Blagojevich must release the written details of all his proposed tax changes to allow the public and the General Assembly to engage in an informed discussion about the merits and/or drawbacks of the individual proposals.

We believe that businesses should pay their fair share of taxes and many of the tax proposals may well have merit. For example, The Civic Federation may have no policy objection to the following proposals, but the lack of transparency regarding the statutory language that will be enacted makes it impossible for us to determine their impact:

- Tax All Corporate Income as Business Income;
- Tax the Increase in Value of Company-Owned Life Insurance Policies;
- Make Interest on U.S. Bonds Net of Expenses Taxable;
- Require Partnership or Subchapter S Corporate Withholdings;
- Require Corporations to Pay Tax on Discharged Debt;
- Eliminate the Watercraft Use Tax Loophole;
- Means Test the Farm Chemicals Exemption;
- Eliminate the Motor Fuel Tax Exemption for Non-Farm Non-Highway Vehicles; and
- Implement a new Airport Transportation Tax.

However, even without the Administration providing specific statutory language, we are very concerned about three of the most complex tax proposals that are expected to generate $162 million in new revenues. We believe that much more analysis and discussion is needed to fully understand the implications of these changes and to justify departures from the federal tax code. They are:

- Using Straight Line Instead of Accelerated Depreciation
- Extending the Sales Tax to Licensed Software
- Applying a Destination Apportionment Rule to Service Companies.

Using Straight Line Instead of Accelerated Depreciation: This proposal would decouple Illinois' treatment of depreciation from federal treatment. It would impose burdensome administrative costs to business associated with reprogramming existing software, including the recalculation of gain/loss information on the sale or disposal of assets. When implemented, the proposal will accelerate but not increase the collection of revenues since the useful life of these assets will remain unchanged. The $74 million revenue figure is a revenue projection for the first year when companies value all of their old and new assets. It is likely that the revenues will decrease each year. The complexity for businesses and the State of applying this new treatment to property already invested throughout the U.S. should not be discounted and necessitates disclosure to identify how this will be achieved.

Extending the Sales Tax to Licensed Software: This proposal appears to extend the sales tax on software purchased off the shelf by individuals in a store to also include licensed software. It is unclear how the State of Illinois will implement taxation of licensed software. The State cannot simply repeal current Department of Revenue regulations because the Illinois Supreme Court has already ruled that the Retailer's Occupation Tax cannot be imposed on intangibles such as lease transactions.[3] As a result, the Administration may be forced to propose a new tax on revenues from software licensing. The public needs to see these proposals to evaluate their impact and feasibility, including how the Department will tax Illinois in-state usage of licensed software by multi-state corporations with users and servers around the world.

Applying a Destination Apportionment Rule to Service Companies. This proposal will change the way service companies apportion business income to Illinois. The current apportionment requirement is that 50% or more of a taxpayer's activity in connection with a sale must take place in Illinois. This proposal would eliminate that requirement and, instead, require that apportionment consider all sales activity in Illinois. It represents a fundamental change in how business income is apportioned. Its impact will probably be felt by any company that earns income by providing services to customers in more than one state, including utilities, telecommunications companies, brokerage firms, the mutual funds industry, and professionals providing specialized services such as attorneys, accountants, and computer consultants.

Due to our concerns about the short time frame remaining and the complexity of certain of the tax treatments, we strongly urge the Governor and the legislature to hold full public hearings to evaluate the impact of these changes on the corporate tax structure and Illinois economic climate before adoption.

Finally, The Civic Federation is eager to work with the Governor and his team to achieve our mutual goals of a fair and balanced budget and tax system in Illinois. However, the Federation cautions against the anti-business rhetoric used to describe the various businesses tax changes. Many of the proposed changes represent significant changes in state tax code. Businesses that benefit from theses tax code provisions should not be viewed as suspect. To do so damages Illinois' reputation as a business-friendly state.

<u>Debt Structure</u>

The State of Illinois' General Obligation debt outstanding in FY2005 will be $20.7 billion. Ten million dollars of that amount is for the Pension Obligation bonds and the remainder for capital purposes. In 2003, the State ranked 11th in the nation for tax-supported debt per capita. Similarly, in 2003, net tax-supported debt as a percentage of personal income was 3.2%, a full percentage point above the 50-state median, but below the ratios for New York and Florida. These statistics suggest that the State's overall current debt burden remains manageable. However, we are concerned with the emerging trend toward structuring State debt service payments in a way that reduces or eliminates current expenditure obligations.

Civic Federation Recommendations

The Civic Federation offers several **<u>recommendations</u>** regarding ways to improve the State's financial management and fulfill the State's financial obligations.

[3] *First National Bank of Springfield v. Department of Revenue*, 421 N.E.2d 175 (Ill. 1981).

Fund State Pension Obligations at Certified Amount of $1.95 billion

First and foremost, The Civic Federation believes that the State of Illinois must fund its FY2005 pension fund obligations at the certified amount of $1.95 billion. Reducing appropriations by $527 million reverses progress made through issuance of the Pension Obligation bonds to decrease the State's enormous unfunded pension liabilities. The State must be held accountable for meeting its long-term obligations. Adequately funding the pension funds at the statutorily determined levels is the best and most responsible course of action. The State is only budgeting $70 million for the annual cost of the FY2002 Early Retirement Initiative even though revised estimates of the ERI's cost are now $382 million annually. The General Assembly must work with the Governor to correct this error and fully fund the ERI.

Disclose Details of New Early Retirement Initiative

We caution the General Assembly and the Governor not to approve the proposed Early Retirement Initiative without a full public vetting of the costs and implementation details. The failure to take such a precaution resulted in a $312 million underestimate in the funding of the State's FY2002 Early Retirement Initiative. We cannot afford to make a similar mistake again.

Hold Legislative Hearings on Business Tax Changes

The Civic Federation believes that it will be very difficult for legislators and the public to carefully and thoughtfully evaluate the impact of most of the business tax changes included in the FY2005 budget in the next few weeks. At a minimum, the legislature should hold public hearings to get more and better information about these changes. The State must continue to look at the expense side of the ledger before it raises broad-based taxes. Tax increases should be a last resort only after all other options have been exercised.

Meet Obligations through Further Expenditure Reductions

While the State has made many important strides in containing costs through personnel reductions, management reforms and spending cuts in selected agencies, The Civic Federation is not convinced that all necessary efficiencies have been wrung out of the State's budget. We believe that the State must continue to carefully consider what operations are core activities and which are not in order to prioritize spending. Further expenditure cuts are vastly preferable to increasing broad based taxes on individuals or businesses. To that point, it is imperative that the State continue to eliminate inefficient or non-essential expenditures and conduct focused management audits of all programs.

If the State funds its retirement systems at the $1.9 billion certified level and does not implement the three business tax changes discussed above,[4] an additional revenue gap of $689 million would accrue.

[4] The three proposals are: using straight-line instead of accelerated depreciation, ending exceptions to unitary reporting by domestic subsidiaries and ending foreign tax havens for a total of $135 million in estimated new revenues.

The State's operating budget is projected to increase by 5.9% in FY2005, from $41 billion to $43.5 billion. Finding an additional $689 million would require additional spending cuts of 1.6% in the operating budget. Additional cuts in programs will undoubtedly impose pain. They may even require closure of facilities, reduced hours of service and/or layoffs of personnel. However, the State must fulfill its current obligations and balance its budget responsibly. It can no longer defer costs onto future generations or continue to live beyond its means. In addition, $60 million could be garnered from eliminating the state's pick-up of pension benefits for union employees. Millions of dollars should be generated from the State's FY2005 Early Retirement Initiative if it is constructed in a cost effective manner. However, much of the reduction will still have to come from additional spending cuts.

Eliminate State "Pick-Up" of Employee Pension Contributions

Rising employee salaries and benefits continue to be a major driver of State expenditures. Clearly, if the State is ever to control ballooning budgets, employee-related costs must be contained.

One of the ways Illinois could begin to control mounting personnel costs would be to eliminate the State's pension "pick-up" for unionized employees. Currently, unionized employees have all or some of their pension contributions paid, or "picked-up", by the State. For these employees, the maximum employee contribution is 4% of gross wages, while the total contribution (including State pick-up) is credited to the employee's account.

In the FY2004 budget, the Governor eliminated the State's pension "pick-up" for employees not covered by a bargaining unit. We believe that this policy should be extended to all employees. Elimination of the State's 4% pickup for union employees would generate $60 million in savings.[5]

Direct Commission to Review All Employee Benefits

Because of our concern about mounting personnel expenses, we are very pleased to join with the Governor on his Blue Ribbon Commission to recommend ways to control this growing cost driver. We recommend that the Commission's mandate be comprehensive, considering all reasonable options for controlling benefit and compensation costs for union and non-union employees alike. It is imperative that the rate of growth in employee benefits be curtailed if the State is ever going to slow the rate of growth in spending.

Link Rainy Day Fund Deposits to Revenues, not Expenditure Increases

The Civic Federation supports Governor Blagojevich's call for structured transfers to a Rainy Day Fund. However, we believe that Rainy Day Fund contributions should be linked to revenues, not expenditures. For example, during any year in which General Fund revenues are projected to increase by more than 4%, an amount equal to 0.25% of the additional revenue would be transferred to the Rainy Day Fund. This would require the State to set aside money when revenues increases are high but allow spending flexibility when revenue growth is low.

[5] Information provided by Governor's Office of Management and Budget, February 26, 2004.

FY2005 BUDGET HIGHLIGHTS

Governor Blagojevich has proposed a $43.5 billion operating budget for FY2005. The State faces a $1.7 billion deficit, which will be addressed through $1.2 billion in revenue enhancements and $500 million in expenditure reductions.

Deficit Drivers

The State's $1.7 billion deficit in FY2005 is driven primarily by a $292 million revenue decline and $1.4 billion in increased spending obligations.

DEFICIT DRIVERS IN FY2005 STATE BUDGET ($ millions)	
Beginning FY2005 Deficit	**$ 1,702**
Health Care	$ 497
K-12 Education	$ 240
Pensions Increase	$ 230
Transfers Out	$ 175
Human Services	$ 150
Economic Development	$ 58
Public Safety	$ 30
Other Expenses	$ 30
Revenue Base Decline	$ 292
GRAND TOTAL	**$ 1,702**

Eliminating the $1.7 Billion Deficit: Gap-Closing Measures

The gap-closing measures intended to close the $1.7 billion deficit include $500 million in net expenditure reductions and $1.2 billion in revenue adjustments. The revenue adjustments include $280 million in natural revenue growth from existing revenues, and $945 million in new one-time and recurring revenues. $400 million in new revenues will be derived from proposed changes in business sales and income taxes. The State projects a $23 million surplus in the new fiscal year.

GAP-CLOSING MEASURES IN FY2005 STATE BUDGET (In Millions of Dollars)	
Beginning FY2005 Deficit	**$ (1,702)**
DEFICIT REDUCTION STEPS	**AMOUNT**
Agency Spending Reductions	$ 410
K-12 Educational Accountability	$ (400)
Pension Obligation Bond Savings	$ 215
Debt Refinancing	$ 130
Cost Savings Initiatives	$ 85
Other Spending Increases	$ (115)
Original K-12 Spending Reallocation	$ 175
Subtotal Expenditure Reductions	**$ 500**
Base Revenue Growth	$ 280
New Federal Revenues	$ 140
New Transfers In	$ 200
New Revenues	$ 605
Subtotal Revenue Adjustments	**$ 1,225**
Total Revenue Adjustments & Expenditure Reductions	$ 1,725
Net FY2005 Surplus (Expenditure Reductions & Revenue Adjustments Less Beginning FY2005 Deficit)	**$ 23**

Revenues

Revenues for all funds are projected to decrease by 3.6%, or $1.6 billion, in FY2005, from $44.4 billion in FY2004 to $42.8 billion in FY2005. State tax revenues are expected to increase by only 1.4% due to the lingering effects of the economic downturn. While personal income tax and sales tax receipts are projected to rise by 2.5%, corporate income tax revenues are expected to decline by 10.3%.

ILLINOIS STATE REVENUES: ALL FUNDS (In Millions of Dollars)				
	Est.	**Proj.**	**$ CHG**	**% CHG**
	FY2004	**FY2005**	**FY05-FY05**	**FY05-FY05**
STATE TAXES				
Income Taxes (Net)	$ 7,990.0	$ 8,075.0	$ 85.0	1.1%
Personal	$ 7,109.0	$ 7,285.0	$ 176.0	2.5%
Corporate	$ 881.0	$ 790.0	$ (91.0)	-10.3%
Sales Taxes	$ 6,790.0	$ 6,957.0	$ 167.0	2.5%
Motor Fuel Tax	$ 1,462.0	$ 1,484.0	$ 22.0	1.5%
Public Utility Tax	$ 1,062.0	$ 1,102.0	$ 40.0	3.8%
Other Taxes/Fees	$ 2,493.0	$ 2,448.0	$ (45.0)	-1.8%
Subtotal State Taxes	**$ 19,797.0**	**$ 20,066.0**	**$ 269.0**	**1.4%**
Other Receipts	$ 12,403.0	$ 9,570.0	$ (2,833.0)	-22.8%
Federal Receipts	$ 12,198.0	$ 13,143.0	$ 945.0	7.7%
GRAND TOTAL*	**$ 44,398.0**	**$ 42,779.0**	**$ (1,619.0)**	**-3.6%**

* Excludes Bond Financed Fund receipts

Appropriations

The Governor's FY2005 operating budget recommends total appropriations of $43.5 billion, an increase of 5.9%, or $2.4 billion, over FY2004. The FY2005 total includes $24.0 billion in General Funds, $13.9 billion in Other State Funds, and $5.7 billion in Federal Funds. This Operating Budget does not include debt service or capital projects.

STATE OF ILLINOIS FY2004-FY2005 APPROPRIATIONS (in thousands of dollars)				
Type	FY2004 Enacted Appropriation	FY2005 Recommended Appropriation	**Appropriation $ change 2004 to 2005**	**Appropriation % change 2004 to 2005**
Legislative Agencies	$ 83,201	$ 82,813	$ (388)	-0.5%
Judicial Agencies	$ 377,601	$ 376,938	$ (662)	-0.2%
Elected Officials And Elections	$ 1,681,935	$ 2,241,158	$ 559,224	33.2%
Governor's Agencies	$ 27,691,162	$ 29,503,571	$ 1,812,409	6.5%
Retirement Systems[1]	$ 57,587	$ 50,590	$ (6,997)	-12.1%
Judicial Agencies	$ 377,601	$ 376,938	$ (662)	-0.2%
Elementary And Secondary Education[2]	$ 8,543,690	$ 8,853,413	$ 309,724	3.6%
Higher Education[3]	$ 2,831,481	$ 2,607,177	$ (224,304)	-7.9%
TOTAL General Funds	**$ 23,292,825**	**$ 24,041,904**	**$ 749,079**	**3.2%**
Other State Funds	**$ 12,390,008**	**$ 13,931,748**	**$ 1,541,740**	**12.4%**
Federal Funds	**$ 5,583,824**	**$ 5,742,010**	**$ 158,187**	**2.8%**
Governor's Initiatives	**$ (200,573)**	**$ (211,300)**	**$ (10,727)**	**5.3%**
GRAND TOTAL	**$ 41,066,084**	**$ 43,504,362**	**$ 2,438,278**	**5.9%**

[1]Includes Judges', General Assembly, and State Employees' Retirement Systems
[2]Includes Teachers' Retirement System
[3]Includes State Universities Retirement System

Personnel

The FY2005 budget proposes funding for 61,101 full-time equivalent positions. This will be a 3.6% or 2,293 position reduction from FY2004. The majority of reductions will be achieved by eliminating vacancies. The Governor will continue the hiring freeze instituted last year (with exceptions for frontline positions). The Governor has also proposed a new Early Retirement Initiative (ERI) to further reduce headcount by 2,000 positions.

Pension Issues

Two pension funding issues have a direct impact on the FY2005 State budget:

- The original estimated annual cost for amortization of the FY2002 ERI was $70 million. However, errors in that estimate have led to a recalculation that the actual annual cost will be $382 million. The FY2005 budget only provides for $70 million in funding for this initiative. The Governor has vowed to work with the General Assembly in resolving this issue by developing a funding plan to address the shortfall.
- The State will capture $860 million in additional "savings" from the FY2003 Pension Obligation bond issue. Originally, it was assumed that the interest rate on the Pension Obligation bonds would be 5.8% while the pension funds' asset portfolio rate of return would be 8.0%. However, the bonds were issued at an interest rate of 5.05% while the pension

funds' actuaries are now projecting an 8.5% expected rate of return for the entire asset portfolio. Based on these new figures, the total estimated "savings" generated by the bond issuance are now $3.02 billion, an $860 million increase. In the FY2005 budget, the State proposes to capture $215 million, or 25% of the increase, reserving the remainder for capture in future years. The $215 million "savings" will be used as the basis for reducing the State's pension contribution by a like amount in FY2005.

In FY2005, the State will reduce its pension funds contribution by $527 million from the originally certified FY2005 amount of $1.95 billion because it did not budget for the $312 million in additional ERI costs, and it is forgoing $215 million in contributions due to the unexpected "savings" from the $10 billion pension bond issue.

The Civic Federation employs two measures to present a multi-year evaluation of the fiscal health of the State of Illinois pension funds: funded ratios and the value of unfunded liabilities:

- Funded ratios are projected to decline in FY2005 for all funds; the composite rate for all five funds will decline from 57.2% to 56.1%.
- Unfunded liabilities of the State's pension funds in FY2005 are projected to increase by $3.9 billion or 10.4% from $38 billion to $42 billion. Unfunded liabilities are approximately $1 billion less than they were in FY2003 before the proceeds of the $10 billion Pension Obligation Bond issue were distributed.

Long-term Debt

The State will have $20.7 billion of General Obligation Bonds outstanding in FY2005. Of that amount, $10.7 billion are earmarked for general capital purposes and $10 billion for pension obligations.

Moody's and Fitch reduced the state's bond rating to Aa3 and AA, respectively, in May 2003. Previously, Moody's had rated the State's G.O. debt as Aa2 and Fitch had given an AA+ rating.

Proposed Structural Reforms

Four major structural reforms are proposed in the FY2005 budget:

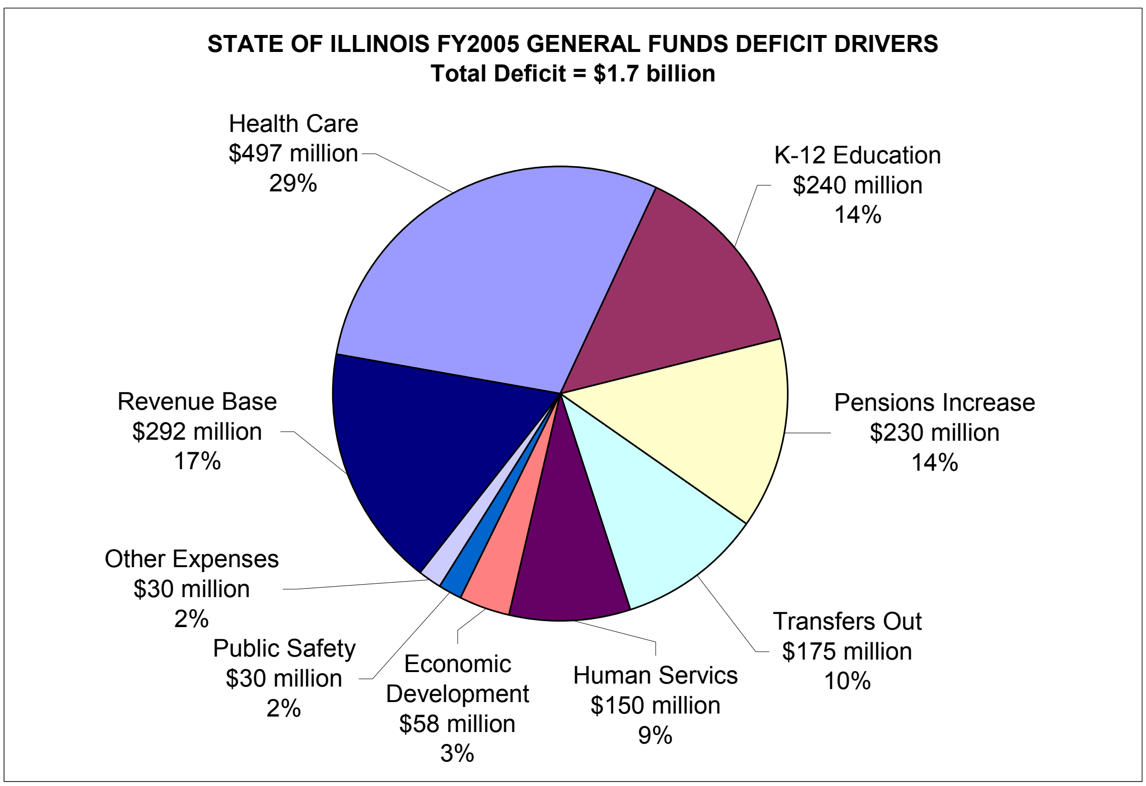
1. The separate release of *Operating and Capital Budget Documents* is intended to ensure that short-term (operating) and long-term (capital spending) trends are independently understood and evaluated.
2. The *Balanced Budget Act* would require that all appropriation bills proposing increased spending also identify a funding source.
3. The *Responsible Spending Act* would require the Governor to deposit $50 million in the State's Rainy Day Fund for each $1 billion increase in General Revenue spending. The administration has earmarked $50 million for this fund initially.
4. The *On-Time Bill Payment Act* would give the Governor short-term borrowing authority to pay bills from vendors within a time frame of no later than 60 days.

THE DEFICIT'S KEY DRIVERS

The $1.7 billion projected General Funds deficit for FY2005 is the result of a $292 million decline in total revenues and a $1.4 billion increase in spending from FY2004. These spending increases are those costs that the State must bear due to mandated obligations and the Governor's budget priorities.

The revenue declines are the result of an approximately $500 million decrease in one-time revenues since FY2004. There were $397 million in one-time Federal Flexible Spending Grants and $106 million in one-time State Corporate Income Tax Amnesty in FY2004 that will not be repeated in FY2005.

The spending increases are the result of priorities and obligations in health care ($497 million), education ($240 million), pensions ($230 million), debt service and local government tax transfers ($175 million), human services ($150 million), economic development ($58 million), and public safety ($30 million). The following chart illustrates the relative burden of each deficit driver, with health care representing almost 30% of the deficit.



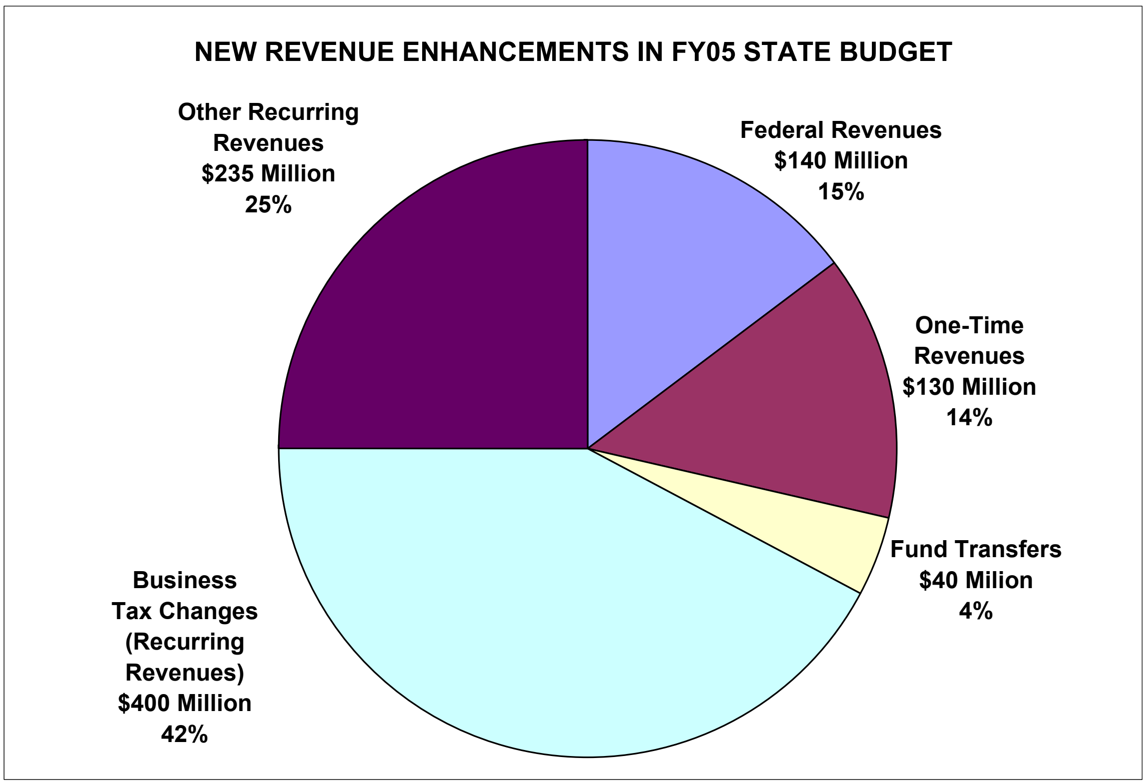
The table below provides detail on the deficit drivers and offsetting revenues.

STATE OF ILLINOIS FY2005 GENERAL FUNDS DEFICIT DRIVERS ($ millions)		
HEALTH CARE		
Additional Medicaid Spending	$	655
Additional Federal Match	*$*	*(328)*
FamilyCare Expansion	$	65
Additional Federal Match	*$*	*(40)*
Group Health Insurance	$	145
TOTAL HEALTH CARE	**$**	**497**
K-12 EDUCATION		
Maintain General State Aid & Mandated Categoricals at FY04 levels	$	105
Early Childhood Education and other Program Expansion	$	70
Chicago Teachers Retirement System	$	65
TOTAL K-12 EDUCATION	**$**	**240**
PENSIONS INCREASE		
Pension Obligation Bonds Debt Service	$	495
Reduction in Contributions for Pension Obligation Bonds Benefits	*$*	*(265)*
TOTAL PENSIONS INCREASE	**$**	**230**
TRANSFERS OUT		
Additional Debt Service	$	95
Local Government Income Tax Transfers	$	80
TOTAL TRANSFERS OUT	**$**	**175**
HUMAN SERVICES		
Department of Human Services Child Care	$	28
Other Department of Human Services Programs	$	122
TOTAL HUMAN SERVICES	**$**	**150**
ECONOMIC DEVELOPMENT		
Opportunity Returns	$	50
Lincoln Library	$	8
TOTAL ECONOMIC DEVELOPMENT	**$**	**58**
PUBLIC SAFETY		
Sheridan & Work Camps Annualization	$	30
TOTAL PUBLIC SAFETY	**$**	**30**
ALL OTHER EXPENSES	**$**	**30**
REVENUE BASE		
Reduced FY05 Federal Receipts for FY04 One-Time Federal Flexible Spending Grants	$	397
Reduced FY05 Base Corporate Income Tax from One-Time Tax Amnesty	$	106
Projected Interest Income Decline	$	5
Individual Income Tax Growth	*$*	*(53)*
Sales Tax Growth	*$*	*(87)*
Public Utility Tax Growth	*$*	*(29)*
Lottery Transfers	*$*	*(23)*
Insurance Taxes	*$*	*(14)*
Intergovernmental Transfers	*$*	*(10)*
TOTAL REVENUE BASE	**$**	**292**
GRAND TOTAL	**$**	**1,702**

GAP-CLOSING MEASURES

The FY2005 Operating Budget proposes a total of $1.2 billion in revenue adjustments and $500 million in expenditure reductions to eliminate the projected $1.7 billion deficit. The gap-closing measures are expected to produce a $23 million surplus.

Seventy-seven percent, or $945 million, of all the revenue adjustments in the budget are new revenue enhancements and 23%, or $280 million, are the result of natural revenue growth from existing revenues. A breakdown of the source of the $945 million in new revenue enhancements is shown in the exhibit below. Forty-two percent of that sum, or $400 million, will be derived from the proposed changes in business sales and income taxes. Twenty-five percent, or $235 million, will come from other recurring revenues such as tax redistributions and user fees.



On the spending side, the FY2005 budget proposes $515 million in new spending increases, reflecting the Governor's new budget priorities. Four hundred million dollars of that sum is allocated for K-12 education. The spending increase is offset by $1 billion in cost savings and spending reductions for a net expenditure reduction of $500 million. Forty-six percent, or $465 million, of the expenditure reductions are derived from cost reductions in agency spending, 17% from a reallocation of K-12 funds, 16% from pension obligation savings and 13% from debt refinancing savings.

WALK-UP OF GAP-CLOSING MEASURES IN FY2005 ILLINOIS STATE BUDGET (In Millions of Dollars)		
Beginning FY2005 Deficit	**$**	**(1,703)**
REVENUE ADJUSTMENTS		
Base Revenue Growth	**$**	**280**
New Revenue Enhancements		
Federal Reimbursement on Retirement	$	80
DHS Fee for Service	$	60
Subtotal New Federal Revenues	**$**	**140**
Fund Transfers	$	40
FY2004 Portion of Hospital Assessment	$	80
Sale of Assets	$	50
Subtotal New One-Time Revenues & Transfers	**$**	**170**
Business Tax Changes	$	400
Tax Redistributions	$	71
User Fees	$	57
Additional Revenues	$	107
Subtotal New Recurring Revenues	**$**	**635**
Total New Revenue Enhancements	**$**	**945**
TOTAL REVENUE ADJUSTMENTS	**$**	**1,225**
SPENDING ADJUSTMENTS		
Additional Spending*	**$**	**(515)**
Expenditure Reductions		
Agency Cost Reductions		
Corrections Reorganization	$	120
Dept. Human Services Cost Reductions	$	120
Group Health Insurance Cost Savings	$	100
Higher Education Cost Savings	$	55
State Police Consolidation/Reorganization	$	28
Public Aid Savings	$	10
Dept of Natural Resources Savings	$	10
Other Agency Cost Savings	$	22
Subtotal Agency Cost Reductions	**$**	**465**
Pension Contribution Reductions		
Teachers' Fund Additional Pension Obligation Bond Savings	$	115
State Universities Fund Additional Pension Obligation Bond Savings	$	35
Judges/General Assembly Pension Obligation Bond Savings	$	10
Subtotal Pension Contribution Savings	**$**	**160**
Debt Financing Savings	**$**	**130**
Cost Savings Initiatives		
Incremental Additional Initiative Savings	$	60
Targeted Headcount Savings	$	25
Subtotal Cost Savings Initiatives	**$**	**85**
Reallocation of K-12 Funding	**$**	**175**
TOTAL EXPENDITURE REDUCTIONS	**$**	**500**
Total Revenue Adjustments & Expenditure Reductions	**$**	**1,725**
Net FY2005 Surplus (Revenue Adjustments & Expenditure Cuts Less Beginning FY2005 Deficit)	**$**	**23**

* Includes $400 million increase for elementary and secondary education & a $50 million transfer to the State's Rainy Day Fund.

REVENUES

The FY2005 budget projects a 3.6% decrease in total receipts. This is a $1.6 billion one-year decline, from $44.3 billion in FY2004 to $42.7 billion in FY2005. Much of this decrease is due to declines in non-state tax receipts such as interest income and miscellaneous taxes, fees, earnings and net transfers.

State tax revenues for all funds are projected to increase by just 1.4%, from $19.8 billion to $20 billion. Modest increases are projected for personal income tax revenues (2.5%), sales taxes (2.3%), motor fuel taxes (1.5%) and public utility taxes (3.8%). A 10.3% decrease is projected for corporate income tax revenues.

ILLINOIS STATE REVENUES: ALL FUNDS
(In Millions of Dollars)

	Est. FY2004	Proj. FY2005	$ CHG FY04-FY05	% CHG FY04-FY05
STATE TAXES				
Income Taxes (Net)	$ 7,990	$ 8,075	$ 85	1.1%
Personal	$ 7,109	$ 7,285	$ 176	2.5%
Corporate	$ 881	$ 790	$ (91)	-10.3%
Sales Taxes	$ 6,790	$ 6,957	$ 167	2.5%
Motor Fuel Tax	$ 1,462	$ 1,484	$ 22	1.5%
Public Utility Tax	$ 1,062	$ 1,102	$ 40	3.8%
Cigarette Taxes	$ 765	$ 693	$ (72)	-9.4%
Liquor Taxes	$ 123	$ 123	$ -	0.0%
Inheritance Tax	$ 240	$ 240	$ -	0.0%
Insurance Taxes/Fees	$ 442	$ 459	$ 17	3.8%
Corporate Franchise Taxes/Fees	$ 175	$ 175	$ -	0.0%
Riverboat Gaming Taxes/Fees	$ 748	$ 758	$ 10	1.3%
Subtotal State Taxes	**$ 19,797**	**$ 20,066**	**$ 269**	**1.4%**
OTHER RECEIPTS				
Motor Vehicle/Operators License Fees	$ 1,290	$ 1,315	$ 25	1.9%
Interest Income	$ 70	$ 63	$ (7)	-10.0%
Revolving Fund Recipts	$ 407	$ 387	$ (20)	-4.9%
Lottery	$ 879	$ 884	$ 5	0.6%
Assessment Funds Receipts	$ 70	$ 1,190	$ 1,120	1600.0%
Intergovernmental Payments	$ 1,482	$ 1,559	$ 77	5.2%
Group Insurance Receipts	$ 1,550	$ 1,573	$ 23	1.5%
Tobacco Settlement Receipts	$ 270	$ 271	$ 1	0.4%
Riverboat Gaming License Sale	$ -	$ 350	$ 350	100.0%
Other Taxes,Fees,Earnings & Net Transfers	$ 6,385	$ 1,978	$ (4,407)	-69.0%
Subtotal Other Receipts	**$ 12,403**	**$ 9,570**	**$ (2,833)**	**-22.8%**
Federal Receipts	$ 12,198	$ 13,143	$ 945	7.7%
GRAND TOTAL*	**$ 44,398**	**$ 42,779**	**$ (1,619)**	**-3.6%**

* Excludes Bond Financed Fund receipts

The next exhibit shows projected changes in **General Funds receipts** between FY2004 and FY2005. It is anticipated that General Fund revenues will increase by 8.6%, from $25.5 billion in FY2004 to $27.7 billion in FY2005. Base revenues from state sources are projected to rise by just 1.2%. There will be a $570 million increase in one-time and recurring deficit reduction sources. The FY2005 budget includes $554 million in recurring revenues plus $80 million in recurring transfers. There were no such recurring General Fund revenues in FY2004. In addition, one-time revenues and transfers of $169 million are projected. This is a 27%, or $64 million decrease in non-recurring revenues.

ILLINOIS STATE REVENUES
GENERAL FUNDS FY2004-FY2005
(In Millions of Dollars)

	Est. FY2004	Proj. FY2005	$ CHG FY04-FY05	% CHG FY04-FY05
BASE REVENUES				
STATE SOURCES				
Income Taxes (Net)	$ 7,990	$ 8,075	$ 85	1.1%
Personal	$ 7,109	$ 7,285	$ 176	2.5%
Corporate	$ 881	$ 790	$ (91)	-10.3%
Sales Taxes	$ 6,280	$ 6,425	$ 145	2.3%
Public Utility Taxes	$ 1,062	$ 1,102	$ 40	3.8%
Cigarette Taxes	$ 450	$ 400	$ (50)	-11.1%
Liquor Taxes	$ 123	$ 123	$ -	0.0%
Inheritance Taxes	$ 240	$ 240	$ -	0.0%
Insurance Taxes & Fees	$ 333	$ 347	$ 14	4.2%
Corporate Frachise Fees & Taxes	$ 175	$ 175	$ -	0.0%
Interest on State Funds & Investments	$ 50	$ 45	$ (5)	-10.0%
Cook County Intergov. Transfer	$ 440	$ 450	$ 10	2.3%
Other State Sources	$ 989	$ 729	$ (260)	-26.3%
Transfers-In				
Lottery	$ 540	$ 563	$ 23	4.3%
Riverboat Gaming Taxes	$ 639	$ 647	$ 8	1.3%
Other Transfers	$ 984	$ 870	$ (114)	-11.6%
10th Riverboat License	$ -	$ 350	$ 350	100.0%
Subtotal State Sources	**$ 20,295**	**$ 20,541**	**$ 246**	**1.2%**
Federal Sources	$ 4,987	$ 4,772	$ (215)	-4.3%
TOTAL BASE REVENUES	**$ 25,282**	**$ 25,313**	**$ 31**	**0.1%**
Deficit Reduction Sources				
One-Time Revenues	$ 233	$ 50	$ (183)	-78.5%
Recurring Revenues	$ -	$ 554	$ 554	100.0%
Recurring Transfers	$ -	$ 80	$ 80	100.0%
One-Time Transfers	$ -	$ 119	$ 119	100.0%
Total Deficit Reduction Sources	**$ 233**	**$ 803**	**$ 570**	**244.6%**
TOTAL REVENUES	**$ 25,515**	**$ 26,116**	**$ 601**	**2.4%**
Pension Obligation Bonds	$ -	$ 1,600		
Short-Term Borrowing	$ -	$ -		
TOTAL RECEIPTS	**$ 25,515**	**$ 27,716**	**$ 2,201**	**8.6%**

3-Year Revenue Trends

The next two exhibits show 3-year revenue trends for all funds and only General Funds. Over this period, total receipts for all funds increased by 9.8% while the State's own source tax revenues rose by 4.0%.

ILLINOIS STATE REVENUES: ALL FUNDS - FY2003-FY2005 (In Millions of Dollars)				
	FY2003	Est. FY2004	Proj. FY2005	% CHG FY05-FY05
STATE TAXES				
Income Taxes (Net)	$ 8,079	$ 7,990	$ 8,075	0.0%
Personal	$ 7,341	$ 7,109	$ 7,285	-0.8%
Corporate	$ 738	$ 881	$ 790	7.0%
Sales Taxes	$ 6,593	$ 6,790	$ 6,957	5.5%
Motor Fuel Tax	$ 1,432	$ 1,462	$ 1,484	3.6%
Public Utility Tax	$ 1,006	$ 1,062	$ 1,102	9.5%
Cigarette Taxes	$ 637	$ 765	$ 693	8.8%
Liquor Taxes	$ 123	$ 123	$ 123	0.0%
Inheritance Tax	$ 237	$ 240	$ 240	1.3%
Insurance Taxes/Fees	$ 370	$ 442	$ 459	24.1%
Corporate Franchise Taxes/Fees	$ 142	$ 175	$ 175	23.2%
Riverboat Gaming Taxes/Fees	$ 670	$ 748	$ 758	13.1%
Subtotal State Taxes	**$ 19,289**	**$ 19,797**	**$ 20,066**	**4.0%**
OTHER RECEIPTS				
Motor Vehicle/Operators License Fees	$ 1,270	$ 1,290	$ 1,315	3.5%
Group Insurance Receipts	$ 1,353	$ 1,550	$ 1,573	16.3%
Other	$ 6,564	$ 9,563	$ 6,682	1.8%
Subtotal Other Receipts	**$ 9,187**	**$ 12,403**	**$ 9,570**	**4.2%**
Federal Receipts	$ 10,471	$ 12,198	$ 13,143	25.5%
GRAND TOTAL*	**$ 38,947**	**$ 44,398**	**$ 42,779**	**9.8%**

* Excludes Bond Financed Fund receipts

General Fund base revenues, which include state own source tax revenues and federal intergovernmental aid, are projected to increase by 10.4% between FY2003 and FY2005, from $22.9 billion to $25.3 billion. Total General Fund receipts are expected to rise from $24.9 billion to $26.1 billion.

ILLINOIS STATE REVENUES GENERAL FUNDS FY2003-FY2005 (In Millions of Dollars)				
	FY2003	Est. FY2004	Proj. FY2005	% CHG FY05-FY05
BASE REVENUES				
STATE SOURCES				
Income Taxes (Net)	$ 8,079	$ 7,990	$ 8,075	0.0%
Personal	$ 7,341	$ 7,109	$ 7,285	-0.8%
Corporate	$ 738	$ 881	$ 790	7.0%
Sales Taxes	$ 6,059	$ 6,280	$ 6,425	6.0%
Public Utility Taxes	$ 1,006	$ 1,062	$ 1,102	9.5%
Cigarette Taxes	$ 400	$ 450	$ 400	0.0%
Liquor Taxes	$ 123	$ 123	$ 123	0.0%
Inheritance Taxes	$ 237	$ 240	$ 240	1.3%
Insurance Taxes & Fees	$ 313	$ 333	$ 347	10.9%
Corporate Frachise Fees & Taxes	$ 142	$ 175	$ 175	23.2%
Interest on State Funds & Investments	$ 66	$ 50	$ 45	-31.8%
Cook County Intergov. Transfer	$ 355	$ 440	$ 450	26.8%
Other State Sources	$ 383	$ 989	$ 729	90.3%
Transfers-In				
Lottery	$ 540	$ 540	$ 563	4.3%
Riverboat Gaming Taxes	$ 554	$ 639	$ 647	16.8%
Other Transfers	$ 733	$ 984	$ 870	18.7%
10th Riverboat License	$ -	$ -	$ 350	100.0%
Subtotal State Sources	**$ 18,990**	**$ 20,295**	**$ 20,541**	**8.2%**
Federal Sources	$ 3,940	$ 4,987	$ 4,772	21.1%
TOTAL BASE REVENUES	**$ 22,930**	**$ 25,282**	**$ 25,313**	**10.4%**
Deficit Reduction Sources				
One-Time Revenues	$ -	$ 233	$ 50	100.0%
Recurring Revenues	$ -	$ -	$ 554	100.0%
Recurring Transfers	$ -	$ -	$ 80	100.0%
One-Time Transfers	$ -	$ -	$ 119	100.0%
Total Deficit Reduction Sources		**$ 233**	**$ 803**	**100.0%**
TOTAL REVENUES	**$ 22,930**	**$ 25,516**	**$ 26,116**	**2.4%**
Pension Obligation Bonds	$ 300	$ 1,600	$ -	-100.0%
Short-Term Borrowing	$ 1,675	$ -	$ -	-100.0%
TOTAL RECEIPTS	**$ 24,905**	**$ 27,116**	**$ 26,116**	**4.9%**

Revenue Enhancements

The FY2005 budget proposes several revenue enhancements, including selected fee increases, the elimination of certain business tax exemptions, the restructuring of other business taxes, additional tax adjustments and new revenues from a hospital assessment surcharge and sale of the 10th casino license.

$57 Million in Fee Increases

The FY2005 budget proposes to raise $57 million from approximately 200 non-consumer fees. The Budget Office released information about these proposed fee increases on March 2, 2004.

The State claims that the average fee paid per person in Illinois is $43 as compared to the national average of $109. The fee increases are based on recommendations contained in a study jointly conducted by the Department of Revenue and the Secretary of State's Office.

The next exhibit shows the location of the various fee increases and the average amount of fee increase per agency or department. Approximately 91% of the new fee revenues will be generated by programs in three agencies: the Secretary of State's Office, the Department of State Police and the Department of Financial and Professional Regulation.

FEE INCREASES BY DEPARTMENT

Department	New Revenues (Net)	% of Total	Average Fee Increase
Secretary of State	$ 23,328,780	40.7%	$ 29
State Police	$ 18,685,000	32.6%	$ 126
Financial & Professional Regulation	$ 10,148,841	17.7%	$ 180
Emergency Management Agency	$ 2,670,550	4.7%	$ 2,962
Revenue	$ 2,050,720	3.6%	$ 20
Natural Resources	$ 296,875	0.5%	$ 20
Human Services	$ 88,200	0.2%	$ 200
TOTAL	**$ 57,268,966**	**100.0%**	

Fees that will generate $500,000 or more are shown in the exhibit that follows. The single largest revenue generator is the increase in the DUI conviction fine from $100 to $500, which is expected to yield $17.2 million. A new late fee for vehicle stickers of $20 (in addition to the standard registration fee of $78) is expected to generate $12 million. Two other vehicle-related fee increases, for registration fees and replacement stickers are estimated to yield $3.2 million combined. Also, the price of a state identification card will be raised from $4 to $20, which will produce an extra $5 million in revenues.[6] Some major fee increase for businesses include:

- An increase from $20 to $30 of Uniform Commercial Code 1 financial statement and Uniform Commercial Code 3 amendments that is projected to raise approximately $1 million and
- An increase in the charge to retailers for lottery sales telephone and modem lines from $5 per week to $10 per week. This is expected to raise $1.8 million.

Many of the fee increases apply to professionals who get licenses from the State. For example, the licensing fee for architects will be raised from $60 to $250 and generate $1.7 million; the license renewal for chiropractors (in-state) will be doubled from $300 to $600 to generate over $646,000; and the license renewal fee for funeral directors and embalmers will be increased from $100 to $340 to generate $608,000.

[6] The information about the fee increases is from the Governor's Office of Budget and Management and Christopher Willis, "Governor Wants 200 Fees Hiked," in the *State Journal Register*, March 2, 2004.

FEE INCREASES YIELDING NET REVENUES OF $500,000 OR MORE				
Fee	Office or Department	Current Fee	New Fee Fee	New Net Revenue
DUI Conviction Fine	State Police	$ 100.00	$ 500.00	$ 17,225,000
Late fee for sticker	Secretary of State	$ -	$ 20.00	$ 12,000,000
Standard ID Card	Secretary of State	$ 4.00	$ 20.00	$ 5,054,141
Registration Transfer Fee	Secretary of State	$ 15.00	$ 20.00	$ 2,146,200
Charge to retailers for lottery sales phone/modem line	Revenue	$5/week	$10/week	$ 1,847,760
License Renewal-Architect	F & PR*	$ 60.00	$ 250.00	$ 1,661,864
Replacement Sticker	Secretary of State	$ 5.00	$ 20.00	$ 1,139,250
UCC 1 Financial Statement/UCC3 Amendments	Secretary of State	$ 20.00	$ 30.00	$ 1,129,042
Charges for Constitutional Officer Security Details	State Police	$ -	varies	$ 750,000
Not for Profit filing fee/annual report	Secretary of State	$ 5.00	$ 25.00	$ 743,807
License Renewal-Chiropractor	F & PR*	$ 300.00	$ 600.00	$ 646,779
License Renewal-Funeral Director/Embalmer	F & PR*	$ 100.00	$ 340.00	$ 608,532
DNA Processing Fee	State Police	$ 200.00	$ 300.00	$ 530,000
License Renewal-Licensed Practical Nurse	F & PR*	$ 49.00	$ 60.00	$ 509,029
Subtotal				**$ 45,991,404**

* Department of Financial & Professional Regulation

Some questions are being raised about the $57 million revenue estimate because of what appear to be over-optimistic revenue projections from fee increases in the FY2004 budget. Last year, the State had projected $421 million in new revenues from fee hikes. However, the Economic and Fiscal Commission has revised its estimate of new fee revenues downward to $344 million, while an Associated Press analysis calculates that revenues might be $100 million short at the close of the fiscal year. The potential revenue shortfalls are attributed to unexpected economic changes, legal problems in implementing some of the fees and over-optimistic fee projections. The Governor's Office disputes the analyses and claims that revenues are on track.[7]

Business Tax Changes

A number of changes to the structure of business taxes are included in the FY2005 budget. Approximately half of the revenues that result from changes proposed in the budget, or $418 million out of a total of $816 million, directly impact businesses.[8]

The five tax changes targeting businesses that are expected to yield the largest receipts are listed below. These changes total $281 million in increased charges.

LARGEST TAX CHANGES TARGETING BUSINESS	
Tax Change	**Amount**
Use Straight Line Instead of Accelerated Depreciation	$ 74,000,000
Eliminating Motor Fuel Exemption for Non-Farm, Non-Highway Vehicles	$ 74,000,000
Collect Sales Tax on Canned Software	$ 64,000,000
Eliminate Foreign Tax Havens	$ 40,000,000
Tax All Corporate Income as Business Income	$ 29,000,000
Total	**$ 281,000,000**

[7] See "Guv's Fee Hikes Falling Short of Goal: Faulty Estimates, Sour Economy to Blame," in *Crain's Chicago Business*, April 14, 2004.

[8] This figure includes $322 million in corporate income and sales tax changes, $74 million derived from the elimination of the Motor Fuel Exemption for Non-Farm, Non-Highway Vehicles and $22 million in fees imposed by the new Department of Financial and Professional Regulation.

10 Proposed Changes to Business Income Tax Structure

The FY2005 budget includes 10 changes to the State's income tax code regarding the taxation of corporate income. A brief description of each, the amount of revenue projected and a description of the assumptions used by the State in determining those projections are presented below.[9]

Use Straight Line Instead of Accelerated Depreciation: $74 Million

This proposal would decouple Illinois from federal provisions that allow businesses to depreciate assets faster over their useful life by means of an accelerated depreciation formula. Instead, businesses would be required to depreciate assets using a straight-line formula, which spreads depreciation evenly over the life of an asset.

Essentially, an accelerated depreciation schedule recognizes that most tangible property loses value early in its life and therefore permits larger depreciation deductions in earlier years and declining amounts in subsequent years. In contrast, a straight line depreciation methodology makes the assumption that all property appreciates uniformly.

Businesses in states using a straight-line methodology employ two different depreciation schedules: an accelerated schedule for federal treatment of assets and a straight line schedule for state treatment of assets. The downside of this type of a dual depreciation system is that it adds a layer of administrative complexity and consequently increases the costs of compliance.

Many states have decoupled their treatment of accelerated depreciation from the federal government's definition. In short, they have decided not to conform to all of the federal regulations on accelerated deprecation, thus adopting a modified approach. However, the Illinois proposal goes beyond these modified approaches toward full straight-line depreciation and thus its potential impact could be quite significant.

The State's estimate of $74 million in new revenues was based on accounting schedules that compared depreciation deductions using the straight line and accelerated depreciation methods. Forecasts for capital spending from Economy.com were used to calculate future depreciation amounts at the national level. This figure was then adjusted to account for the depreciation that is deducted in the state of Illinois. The net difference between the accelerated and straight-line figures was then added back into Illinois taxable income and the tax rate applied.[10]

The estimate of $74 million in new revenues is based on a timing benefit. It is likely that the revenues will decrease each year.[11]

[9] The following discussion of business tax changes has been drawn from the FY2005 Illinois State Budget, the Illinois Chamber of Commerce's Analysis of the 2004 Governor's Budget Address and the Business Tax Proposals and the Chamber's Tax Update of March 9, 2004; and information provided by Fred H. Montgomery, Director, State Tax Planning, Sara Lee Corporation and Garland Allen, State Tax Consultant.

[10] Information provided by Governor's Office of Management and Budget, March 22, 2004.

[11] Information provided by Fred H. Montgomery, Director, State Tax Planning, Sara Lee Corporation, April 13, 2004.

Eliminate Foreign Tax Havens: $40 Million

Corporations would be prevented from transferring patents and trademarks to subsidiaries located in foreign countries in order to reduce the amount of taxable income in Illinois. This proposal would prohibit tax avoidance on intellectual property (i.e. patents and trademarks) by transferring ownership to subsidiaries in other countries or to U.S. territories and possessions. (Currently, the Illinois definition of the "United States" excludes U.S. territories and possessions, in the same manner as federal Internal Revenue Service rules). [12]

Illinois taxes all the separate members of a business group (i.e. entities and subsidiaries) as a single group. A unitary business group for corporate business purposes includes all related companies doing business within the U.S. In 25 states (mostly in the eastern U.S.), however, each corporation (including subsidiaries) that has nexus in the state is taxed separately. Under current Illinois law, businesses that conduct 80% or more of their business activity in a foreign nation are not required to be included in an Illinois unitary business group and thus not taxed. Businesses may decide to transfer a patent or trademark to foreign company or subsidiary. The corporation pays royalties to the foreign company holding the patent or trademark and is then entitled to deduct the royalty as a business expense while that country taxes the income earned by the foreign entity.

Many states, including California, New York and Michigan, currently prohibit tax avoidance on intellectual property through transference of ownership to subsidiaries elsewhere, whether overseas or to tax-haven states such as Delaware.

It is unclear how Illinois proposes to implement this proposal. However, New York State has passed a law adding back any payments made to a corporation that New York does not currently tax. Currently many other states are considering adding back payments in the same way.

State estimates for this enhancement were based on actual returns being audited by the Department of Revenue and projected to all corporate taxpayers.[13]

Tax All Corporate Income as Business Income: $29 Million

This proposal would change the definition of "business income" to require that all business income be taxable under the income tax apportionment formula. The stated purpose is to prevent corporations from structuring operations to shelter a portion of their income from the sale of assets and other transactions from Illinois taxes. In essence, the state income tax would be extended to a business's non-operating (or "non-business") income as well as operating income.

Currently, Illinois is a unitary business state that taxes all the separate members of a business group (i.e. entities and subsidiaries) as a single group. Only the business income from the group that is derived from doing business in Illinois is subject to the State's corporate income tax.

In most states, non-business income from investments or asset sales is treated separately from operating income. These types of income may be taxed by the corporation's state of domicile.

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[12] Information provided at briefing from Illinois Department of Revenue, April 20, 2004.
[13] Information provided by Governor's Office of Management and Budget, March 22, 2004.

Illinois currently permits companies to elect or decide whether they want to: 1) treat all of their income as business income subject to tax apportionment rules or 2) add 100% of their non-operating income to the company's operating income tax base that has already been apportioned.

This proposal raises federal constitutional issues. The U.S. Supreme Court has interpreted the Due Process and Commerce clauses of the Constitution as placing limits on states' ability to tax income from interstate sources. The limits are based on definitions of what can be considered operating versus non-operating business income. Therefore, statutory language and subsequent Department of Revenue regulations must be crafted in such a way that they meet constitutional muster.

The impact of this proposal depends on how non-operating business income will be defined. It could potentially impact all firms engaged in interstate commerce that apportion income among various states.

The revenue estimate of $29 million was generated by a review of all corporate taxpayer data to determine those that distinguished between business and non-business income. Companies that filed an Illinois address and had non-business income were identified, and then this income was apportioned appropriately to Illinois. The State tax rate was then applied to this number.[14]

Strengthen the Rules for Apportionment of Businesses: $24 Million

This proposal will change the way service companies apportion business income to Illinois. The current apportionment requirement is that 50% or more of a taxpayer's activity in connection with a sale must take place in Illinois. This proposal would eliminate that requirement and, instead, require that apportionment consider all sales activity in Illinois. The impact will probably be felt by any company that earns income by providing services to customers in more than one state. This includes utilities and professionals providing specialized services such as attorneys, accountants, and computer consultants.

Estimates of the $24 million in new revenues were based on actual audit cases and projected to all taxpayers.[15]

End the Exception to Unitary Reporting by Domestic Subsidiaries: $21 Million

This measure would repeal the "lockbox" rule approved in 1995 that made changes to the apportionment formula used by financial organizations. Specifically, it excluded:

- Interest income from investments made by customers outside Illinois and
- Interest from Illinois customers mailed to a lock box in another state.

Currently, when companies apportion their multi-state income for income tax purposes, interest income received in another state by a subsidiary is not counted as Illinois interest for apportionment purposes. Interest income must be received in-state from an Illinois customer in order to be considered Illinois interest income and subsequently included in the numerator of the entity's apportionment formula.[16]

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[14] Information provided by Governor's Office of Management and Budget, March 22, 2004.
[15] Information provided by Governor's Office of Management and Budget, March 22, 2004.
[16] Illinois Chamber of Commerce's Analysis of the 2004 Governor's Budget Address, March 9, 2004.

This revenue estimate is based on data obtained from all corporate filer data provided to the Department of Revenue in 2001. Returns were identified by SIC code. Income was then apportioned to Illinois and the tax rate applied.[17]

Adopt Measures to Prevent Corporations from Engaging in Abusive Shelters: $ TBD[18]

This proposal includes measures that:

- Require taxpayers to self disclose participation in "listed" transactions and all other transactions involving a substantial difference between the company's books and tax treatment of the same transaction;
- Establish substantial penalties for taxpayers whose returns are adjusted by the Internal Revenue Service because of sheltering; and
- Establish substantial penalties for promoters of tax shelters found to be abusive.

Make Interest on U.S. Bonds Net of Expenses Taxable: $19 Million

This proposal would eliminate the current exemption from taxation of interest (net of expenses) accruing on U.S. treasury bonds. In short, federal bonds would be treated like state and municipal bonds.

This $19 million estimate is based on Department of Revenue income tax return data that quantifies the total amount of U.S. Government interest subtraction and estimates the amount that would be net of expenses. This figure is then apportioned to Illinois based on the appropriate apportionment formula and the Illinois tax rate is applied.[19]

Tax the Increase in Value of Company-Owned Life Insurance Policies: $9 Million

Currently, a business that buys life insurance on its employees that is payable to the business is not taxed on the benefit paid. This action allows the business to shelter income from State taxation. This proposal would tax the death benefit paid to the business.

The $9 million estimate of revenue to be generated was made based on data available at the federal level. This figure was then stepped down to the state level using the appropriate apportionment formula and tax rate.[20]

Partnership or Subchapter S Corporate Withholdings: $4 Million

Partnership or Subchapter S Corporations would be required to withhold taxes from their partners and shareholders. The intent of this proposal is to ensure that non-resident partners and Subchapter S shareholders pay the same tax as Illinois residents.

The $4 million revenue estimate was derived by using existing Department of Revenue sources for Partnership and S-Corporation data filed under the replacement tax and extrapolating the

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[17] Information provided by Governor's Office of Management and Budget, March 22, 2004.
[18] An estimate of revenues could be derived by examining how much revenue the federal government expects to raise from individuals and corporations as a result of this tax shelter and assigning Illinois a proportionate amount. Information provided by Fred H. Montgomery, Director, State Tax Planning, Sara Lee Corporation, April 13, 2004.
[19] Information provided by Governor's Office of Management and Budget, March 22, 2004.
[20] Information provided by Governor's Office of Management and Budget, March 22, 2004.

number of non-residents that receive income.[21]

Require Corporations to Pay Tax on Discharged Debt: $4 Million
Currently, when a business cannot repay a debt, tax deductions for expenses paid with the borrowed money are permitted for both the lender of that debt and the business unable to repay the debt. The business loss can be carried forward and used in future years. This proposal eliminates the double deduction and brings Illinois into line with federal treatment of discharged debt.

This revenue estimate was based on extrapolating revenue from existing Department of Revenue net operating loss data and applying the appropriate tax rate.[22]

3 Proposed Changes to Business Sales Tax Structure

The FY2005 budget includes 3 changes to the State's sales tax code. A brief description of each and the amount of revenue projected are presented below.

Means Testing the Farm Chemicals Exemption: $27 Million
The sales tax exemption for the purchase of farm chemicals, feed, seed and fertilizer will be phased out for all farms with $1 million or more in adjusted gross receipts. Those with gross annual receipts of less than $1 million will be able to purchase these items tax-free, as they can today. The State claims that this will affect a total of 600 farms.

To determine the amounts in which these exemptions are currently claimed, a sample of ST-1 returns was reviewed by the Department of Revenue. The estimated tax expenditure for these exemptions totaled $200 million for FY2002. To determine the amount attributable to farms with gross annual receipts of $1 million or more, the 1997 Census of Agriculture for the State of Illinois was used. The Census of Agriculture categorizes farms by the value of agricultural products sold. It is assumed that purchases of farm chemicals, feed, seed, and fertilizer, as a percent of sales is similar for all farms. Therefore, the Department assumed that farms with gross annual receipts of $1 million or more account for approximately 13.5% of farm chemicals, feed, seed, and fertilizer purchases.[23]

Collect Sales Tax on Software Licensing Fees: $64 Million
This proposal appears to extend the sales tax on software purchased off the shelf by individuals in a store to also include licensed software. Put another way, this proposal aims to eliminate for taxation purposes distinctions between: 1) canned software sold at retail, which is subject to a sales tax; custom software, which is only taxed on the value of tangible property included with the software such as disks or manuals; and software that is licensed by a software developer and currently not subject to a sales tax.[24]

[21] Information provided by Governor's Office of Management and Budget, March 22, 2004.
[22] Information provided by Governor's Office of Management and Budget, March 22, 2004.
[23] Information provided by Governor's Office of Management and Budget, March 22, 2004.
[24] Illinois State Chamber of Commerce. *The Chamber Tax Update*, March 9, 2004, p. 2.

Current Illinois law provides for taxation of "canned" software, i.e., software purchased by a consumer off the shelf in a retail establishment. However, custom software is subject to the sales tax only "on the actual cost of the tangible materials transferred by the seller of the software"[25] while licensed software is exempt from the sales tax. Therefore, Illinois businesses currently purchasing multiple copies of a computer program are not subject to a sales tax on the licensing fee while individuals purchasing a single copy of the software are taxed on the software purchase.

The Illinois Supreme Court has ruled that licensed software is intangible personal property, which is exempt from taxation.[26] Essentially, a software license is not taxable if:

- It is evidenced by a written agreement signed by the licensor and the customer;
- It restricts the customer's duplication and use of the software;
- It prohibits the customer from licensing, sublicensing or transferring the software to a third party without the permission or control of the licensor;
- The licensor will provide another copy at minimal or no charge if the customer loses or damages the software;
- The customer destroys or returns all software copies to the licensor at the end of the license period.

A total of 19 states, including Texas and Connecticut, currently tax custom software developed for a specific buyer. Most major industrial states, however, such as New York, California, Massachusetts, Michigan, New Jersey, Ohio, Florida and Pennsylvania, do not tax custom software.[27]

It is unclear how the State of Illinois will implement taxation of licensed software. The State cannot simply repeal current Department of Revenue regulations because the Illinois Supreme Court has already ruled that the Retailer's Occupation Tax cannot be imposed on intangibles such as lease transactions. Therefore, it probably would have to create a new tax on revenues from software licensing. There is a precedent for establishing a new lease transaction tax for activity not covered by the General Sales Tax; the Automobile Renting Occupation Tax is imposed on revenues from automobile lease payments. However, structuring the tax in this way may violate the provisions of the pending Streamlined Sales Tax Agreement.

The use of licensed software is an essential business input. Thus, this tax will affect virtually every business in Illinois. In fact, the tax could have a disproportionate fiscal impact on businesses in Illinois versus other states. Because Illinois is the second largest headquarters state in the nation, many corporations load software on their servers located at their main offices for access by other offices out-of-state. The Department argues that it will tax licensed software used by multi-state corporations based on Illinois in-state usage, but it is unclear how this will be accomplished.[28]

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[25] Illinois State Chamber of Commerce. *The Chamber Tax Update*, March 9, 2004, p. 4.
[26] Illinois Department of Revenue Regulations. Title 86 Part 130 Section 130.1935
[27] See *Multistate Corporate Tax Guide*.
[28] Information provided at briefing from Illinois Department of Revenue, April 20, 2004.

The Department of Revenue arrived at a revenue estimate of $64 million from this tax change by reviewing a sample of returns filed by large software and software/hardware retailers in order to estimate deductions these companies were taking for sales of computer software that met the five criteria for a license agreement. Based upon review of these returns, the State estimated that it would realize $64 million in revenues if custom and licensed software were subject to sales tax.[29]

Eliminate Watercraft Use Tax Loophole: $7 Million

This proposal eliminates the sales tax exemption for the acquisition of luxury watercraft by gift transfer, prize or non-retail purchase.

The State estimated that $7 million could be generated by eliminating the watercraft use tax exemption. This figure was determined by calculating the average number of watercraft purchases reported on the ST-556 return and the average number reported on the RUT-25 return over the past three fiscal years. This number was reduced by the average number of tax-exempt purchases of watercraft over the past three fiscal years. Next, the average number of new watercraft registrations reported by the Department of Natural Resources over the past three years was obtained. This figure was reduced by the number of taxable sales in order to determine the number of watercraft sales that were not taxed. The number of sales that went untaxed was multiplied by the average selling price for watercraft ($14,000) over the past three fiscal years, which was calculated using ST-556 reporting. Finally, the state sales tax rate of 5% was applied.[30]

Additional Tax Adjustments

Two additional significant tax adjustments will be included in the revenue stream supporting the FY2005 budget.

Elimination of Motor Fuel Tax Exemption for Non-Farm Non-Highway Vehicles: $74 Million

This proposal would require construction companies and businesses purchasing motor fuel for non-highway use to pay the State's motor fuel tax. The funds would be deposited into the General Fund. This proposal would fundamentally alter the nature of the motor fuel tax. There is currently no formal exemption per se. Rather, these types of vehicles are simply not subject to the tax. Most states do not currently extend the motor fuel tax to these vehicles.

Imposing this tax would primarily impact any business that uses motor fuel for non-highway purposes, including railroads, warehousing facilities, package delivery facilities, airlines and airports.

The Department of Revenue estimates that agricultural use accounts for 30% of total off-highway use of vehicles. In FY2003, sales of fuel for non-farm, non-highway vehicles totaled $103 million, thus exempting only agricultural use would yield revenue of $74 million.[31]

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[29] Information provided by Governor's Office of Management and Budget, March 22, 2004.
[30] Information provided by Governor's Office of Management and Budget, March 22, 2004.
[31] Information provided by Governor's Office of Management and Budget, March 22, 2004.

Airport Transportation Tax: $6 Million
This new tax would be imposed on taxi and limousine companies for trips they make to and from airports in Cook and the 5 Collar Counties.

General Fund Revenue Projections

This section compares General Fund revenue projections used by the Governor's Office of Management and Budget (GOMB) to forecasts from the Illinois Economic and Fiscal Commission (IEFC) and the Institute of Government and Public Affairs (IGPA) at the University of Illinois.

Income Taxes

The GOMB estimates are conservative, estimating a 2.5% increase in net personal income tax revenues and a 10.3% decrease in corporate income tax receipts.[32] The Economic and Fiscal Commission is slightly more optimistic, projecting a 2.6% increase in net personal income tax receipts and a 6.1% decrease in corporate income tax revenues. The IGPA, however, presents far more optimistic revenue projections, forecasting a 2.7% increase in personal income tax receipts and a 4.2% rise in corporate tax revenues.

According to the Budget Office, the steep drop in their corporate tax revenue projections is due to three factors: tax sheltering, the use of the single sales factor method of apportioning federal taxable income and the fact that FY2004 corporate income tax revenues were greater than originally projected. The original projection for FY2004 was for $800 million in net receipts while actual net receipts were $881 million.[33] The differential projections were due, in part, to the effect of the state's Tax Amnesty Program, which generated $332 million in corporate tax income, and to the elimination of certain corporate tax exemptions.

Sales Taxes

The IGPA researchers are more optimistic than the GOMB and the Illinois Economic and Fiscal Commission analysts regarding sales tax revenues for FY2005. They project a 3.5% increase in sales tax receipts, compared to a forecast of 2.3% from both the GOMB and the IEFC.

Utility Tax

The IEFC is more pessimistic than the GOMB regarding utility tax projections for FY2005. The Commission forecasts a 2.4% increase over FY2004 receipts, while the Budget Office predicts a 3.8% increase.

[32] These projections are based on econometric models that employ Illinois manufacturing data, Illinois information industry employment and U.S. before tax corporate profit data.
[33] Illinois FY2005 State Budget, pp. 8-11 and 8-12.

Total State Source Revenues

The Illinois Economic and Fiscal Commission is more optimistic than the GOMB regarding total state source revenues. While the GOMB projects a 1% decline in General Fund revenues in FY2005, the IEFC forecasts a 0.8% increase. For federal and state sources of revenue, the IEFC projects a very slight 0.2% decrease and the Budget Office forecasts a 1.7% decline.

FY2005 General Funds Revenue Estimates (In Millions of Dollars)

	Illinois Economic & Fiscal Commission		Governor's Office of Management & Budget		Institute of Government & Public Affairs	
	Estimate FY2005	% Change from Est. FY2004	Estimate FY2005	% Change from Est. FY2004*	Estimate FY2005	% Change from Est. FY2004
Personal Income Tax (Net)	$ 7,347	2.6%	$ 7,285	2.5%	$ 7,469	2.7%
Corporate Income Tax (Net)	$ 831	-6.1%	$ 790	10.3%	$ 743	4.2%
Sales Tax	$ 6,408	2.3%	$ 6,425	2.3%	$ 6,377	3.5%
Utility Tax	$ 1,055	2.4%	$ 1,102	3.8%		
Cigarette Tax	$ 400	0.0%	$ 400	-11.1%		
Liquor Tax	$ 122	0.0%	$ 123	0.0%		
Vehicle Use Tax	$ 35	0.0%	$ 37	5.7%		
Inheritance Tax (gross)	$ 230	7.0%	$ 240	0.0%		
Insurances Taxes & Fees	$ 352	2.9%	$ 347	4.2%		
Corporate Franchise Fee & Taxes	$ 165	3.1%	$ 175	0.0%		
Interest	$ 50	0.0%	$ 45	-10.0%		
Cook County IGT	$ 450	2.3%	$ 450	2.3%		
Sale of 10th Riverboat License	$ 350	100.0%	$ 350	100.0%		
Other	$ 638	-27.3%	$ 692	-41.7%		
Subtotal	**$ 19,713**	**1.9%**	**$ 19,718**	**0.0%**		
Lottery	$ 550	0.0%	$ 563	4.3%		
Riverboat Transfers/Receipts	$ 634	-3.1%	$ 647	1.3%		
Other	$ 870	-17.0%	$ 870	-22.9%		
TOTAL STATE SOURCES	**$ 21,767**	**0.8%**	**$ 21,798**	**-1.0%**		
Federal Sources	$ 4,772	-4.3%	$ 4,772	-4.3%		
TOTAL FEDERAL & STATE SOURCES	**$ 26,539**	**-0.2%**	**$ 26,570**	**-1.7%**		

*GOMB estimate as adjusted to the IEFC to permit consistent comparisons.
Source: Illinois Economic and Fiscal Commission. Preliminary FY2005 Revenue Estimate.

APPROPRIATIONS

The Governor's FY2005 operating budget recommends total appropriations of $43.5 billion. This total includes $24.0 billion in General Funds, $13.9 billion in Other State Funds, and $5.7 billion in Federal Funds. This operating budget does not include debt service or capital projects.

Major Structural Cost Drivers

The five most significant budgetary cost drivers identified by the Governor's Office of Management and Budget are pensions, Medicaid, group health insurance, K-12 education and employee headcount.

The Illinois Retirement Systems provide pension benefits to roughly 630,000 members and have suffered from chronic underfunding in recent years. Consequently, Illinois now has more unfunded pension liabilities than any other state.

Rapid increases in Medicaid costs are largely due to the rising cost of and demand for prescription drugs. State Medicaid spending is expected to increase by 7.8% in FY2005.

Group Health Insurance costs rose roughly 13% a year from FY2000 to FY2004. This rate is expected to slow to a 4% increase in FY2005 though a number of cost-containment strategies to be implemented by Central Management Services, including using innovative strategies to procure benefits for retirees, accessing regional network discounts and proactive utilization management.

In order to attain recommended levels of state funding for K-12 out-lined by a state board appointed to analyze Illinois' school funding system, significant increases in state education spending are still required. General State Aid payments to school districts will increase from $3.1 billion in FY2001 to $3.5 billion in FY2005.

Finally, personnel services for state employees are a major cost driver that the Governor intends to contain through an ongoing hiring freeze, Early Retirement Initiative (ERI), and the elimination of vacancies. The FY2005 budget appropriates for 61,010 positions, the lowest number since 1972.

Trend Analysis

FY2005 Appropriations Trend

The Governor's FY2005 operating budget recommends a total appropriation of $43.5 billion, an increase of $2.4 billion, or 5.9%, over the FY2004 enacted appropriation of $41.1 billion.

The FY2005 budget continues a trend begun under the Ryan administration of funding more programs with Other State Funds (i.e., Special Revenue Funds) and fewer programs with General Funds. In this budget recommendation, General Funds increase by 3.2% over FY2004, while Other State Funds increase by 12.4%. Over 63% of the increase in appropriations from FY2004 to FY2005, or $1.5 billion, is in Other Funds. Only 31% of the increase, or $749 million, is in General Funds. The movement away from funding a significant portion of the State budget with General Funds is achieved by matching specific revenues with specific projects, thus diminishing the subsidizing of programs from general taxes. "Other Funds" includes a wide range of funds, from the Road Fund to the Salmon Fund. The primary purpose of these funds is to receive either tax revenue distributions or specific revenues such as permit and license fees, which are then dedicated to specific projects. A contributing factor to this trend toward greater utilization of Other Funds was the Illinois FIRST program, scheduled to expire in summer 2004, which dedicated substantial funds to construction projects.

STATE OF ILLINOIS FY2004-FY2005 APPROPRIATIONS
(in thousands of dollars)

Type	FY2004 Enacted Appropriation	FY2005 Recommended Appropriation	Appropriation $ change 2004 to 2005	Appropriation % change 2004 to 2005
LEGISLATIVE AGENCIES				
Legislative Agencies Total	**$ 83,201**	**$ 82,813**	**$ (388)**	**-0.5%**
General Funds	$ 66,978	$ 66,978	$ 1	0.0%
Other State Funds	$ 16,224	$ 15,835	$ (389)	-2.4%
JUDICIAL AGENCIES				
Judicial Agencies Total	**$ 377,601**	**$ 376,938**	**$ (662)**	**-0.2%**
General Funds	$ 350,959	$ 350,297	$ (662)	-0.2%
Other State Funds	$ 23,191	$ 23,191	$ (0)	0.0%
Federal Funds	$ 3,450	$ 3,450	$ -	0.0%
ELECTED OFFICIALS AND ELECTIONS				
Elected Officials And Elections Total	**$ 1,681,935**	**$ 2,241,158**	**$ 559,224**	**33.2%**
General Funds	$ 251,247	$ 250,812	$ (435)	-0.2%
Other State Funds	$ 1,416,937	$ 1,976,650	$ 559,713	39.5%
Federal Funds	$ 13,751	$ 13,697	$ (54)	-0.4%
AGENCIES UNDER THE GOVERNOR				
Governor's Agencies Total	**$ 27,691,162**	**$ 29,503,571**	**$ 1,812,409**	**6.5%**
General Funds	$ 13,829,066	$ 14,519,852	$ 690,786	5.0%
Other State Funds	$ 10,720,506	$ 11,767,270	$ 1,046,764	9.8%
Federal Funds	$ 3,141,590	$ 3,216,449	$ 74,859	2.4%
RETIREMENT SYSTEMS[1]				
Retirement Systems Total	**$ 57,587**	**$ 50,590**	**$ (6,997)**	**-12.2%**
General Funds	$ 40,607	$ 30,200	$ (10,407)	-25.6%
Other State Funds	$ 16,980	$ 20,390	$ 3,410	20.1%
ELEMENTARY AND SECONDARY EDUCATION[2]				
Elementary and Secondary Education	**$ 8,543,690**	**$ 8,853,413**	**$ 309,723**	**3.6%**
General Funds	$ 6,347,307	$ 6,563,064	$ 215,757	3.4%
Other State Funds	$ 122,578	$ 73,699	$ (48,879)	-39.9%
Federal Funds	$ 2,073,806	$ 2,216,650	$ 142,844	6.9%
HIGHER EDUCATION[3]				
Higher Education Total	**$ 2,831,481**	**$ 2,607,177**	**$ (224,304)**	**-7.9%**
General Funds	$ 2,406,662	$ 2,260,700	$ (145,962)	-6.1%
Other State Funds	$ 73,592	$ 54,713	$ (18,879)	-25.7%
Federal Funds	$ 351,227	$ 291,765	$ (59,462)	-16.9%
TOTAL				
General Funds	**$ 23,292,825**	**$ 24,041,904**	**$ 749,079**	**3.2%**
Other State Funds	**$ 12,390,008**	**$ 13,931,748**	**$ 1,541,740**	**12.4%**
Federal Funds	**$ 5,583,824**	**$ 5,742,010**	**$ 158,186**	**2.8%**
Governor's Initiatives	**$ (200,573)**	**$ (211,300)**	**$ (10,727)**	**5.3%**
GRAND TOTAL	**$ 41,066,084**	**$ 43,504,362**	**$ 2,438,278**	**5.9%**

[1]Includes Judges', General Assembly, and State Employees' Retirement Systems
[2]Includes Teachers' Retirement System
[3]Includes State Universities Retirement System

3-Year Appropriations Trend

Examination of FY2003 and FY2005 allows for comparison of Governor Ryan's final year in office with Governor Blagojevich's second year in office.

The Governor's FY2005 operating budget recommends a total appropriation of $43.5 billion, an increase of $4.2 billion, or 10.7%, over the FY2003 enacted appropriation of $39.3 billion. General Fund appropriations have increased by only $1.8 billion, or 8.0%, while Other Funds increased by $2.2 billion, or 18.4%. Over 51% of the increase in appropriations from FY2003 to FY2005, or $2.1 billion, is in Other Funds. Almost 43% of the increase, or $749 million, is in General Funds.

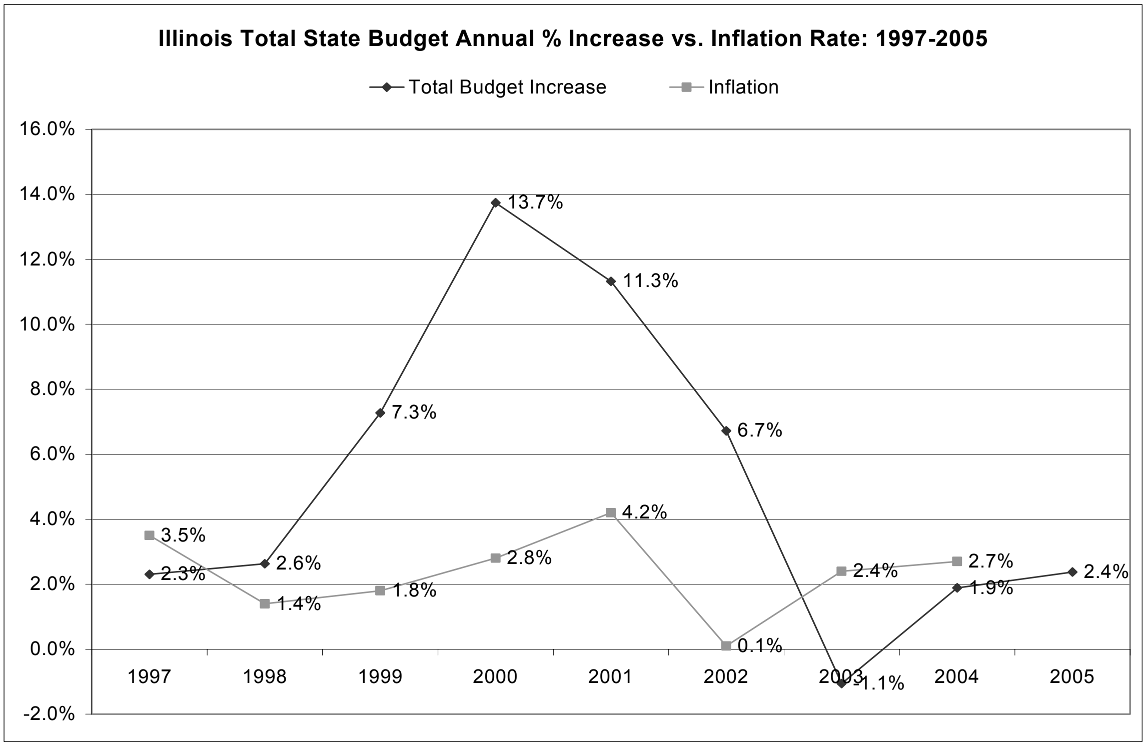
STATE OF ILLINOIS FY2003-FY2005 APPROPRIATIONS
(in thousands of dollars)

Type	FY2003 Enacted Appropriation	FY2005 Recommended Appropriation	**Appropriation $ change 2003 to 2005**	**Appropriation % change 2003 to 2005**
LEGISLATIVE AGENCIES				
Legislative Agencies Total	**$ 83,454**	**$ 82,813**	**$ (640)**	**-0.8%**
General Funds	$ 67,881	$ 66,978	$ (903)	-1.3%
Other State Funds	$ 15,572	$ 15,835	$ 263	1.7%
JUDICIAL AGENCIES				
Judicial Agencies Total	**$ 393,206**	**$ 376,938**	**$ (16,268)**	**-4.1%**
General Funds	$ 363,371	$ 350,297	$ (13,073)	-3.6%
Other State Funds	$ 25,068	$ 23,191	$ (1,877)	-7.5%
Federal Funds	$ 4,768	$ 3,450	$ (1,318)	-27.6%
ELECTED OFFICIALS AND ELECTIONS				
Elected Officials And Elections Total	**$ 1,557,649**	**$ 2,241,158**	**$ 683,510**	**43.9%**
General Funds	$ 267,656	$ 250,812	$ (16,844)	-6.3%
Other State Funds	$ 1,276,551	$ 1,976,650	$ 700,098	54.8%
Federal Funds	$ 13,441	$ 13,697	$ 256	1.9%
AGENCIES UNDER THE GOVERNOR				
Governor's Agencies Total	**$ 26,275,134**	**$ 29,503,571**	**$ 3,228,437**	**12.3%**
General Funds	$ 13,090,818	$ 14,519,852	$ 1,429,034	10.9%
Other State Funds	$ 10,208,598	$ 11,767,270	$ 1,558,672	15.3%
Federal Funds	$ 2,975,717	$ 3,216,449	$ 240,732	8.1%
RETIREMENT SYSTEMS[1]				
Retirement Systems Total	**$ 53,856**	**$ 50,590**	**$ (3,266)**	**-6.1%**
General Funds	$ 33,971	$ 30,200	$ (3,771)	-11.1%
Other State Funds	$ 19,885	$ 20,390	$ 505	2.5%
ELEMENTARY AND SECONDARY EDUCATION[2]				
Elementary And Secondary Education	**$ 8,052,096**	**$ 8,853,413**	**$ 801,317**	**10.0%**
General Funds	$ 5,953,752	$ 6,563,064	$ 609,312	10.2%
Other State Funds	$ 146,260	$ 73,699	$ (72,561)	-49.6%
Federal Funds	$ 1,952,084	$ 2,216,650	$ 264,566	13.6%
HIGHER EDUCATION[3]				
Higher Education Total	**$ 2,892,844**	**$ 2,607,177**	**$ (285,666)**	**-9.9%**
General Funds	$ 2,478,858	$ 2,260,700	$ (218,158)	-8.8%
Other State Funds	$ 77,493	$ 54,713	$ (22,781)	-29.4%
Federal Funds	$ 336,493	$ 291,765	$ (44,728)	-13.3%
TOTAL				
General Funds	**$ 22,256,308**	**$ 24,041,904**	**$ 1,785,596**	**8.0%**
Other State Funds	**$ 11,769,428**	**$ 13,931,748**	**$ 2,162,320**	**18.4%**
Federal Funds	**$ 5,282,503**	**$ 5,742,010**	**$ 459,508**	**8.7%**
Governor's Initiatives		**$ (211,300)**	**$ (211,300)**	**-100.0%**
GRAND TOTAL	**$ 39,308,238**	**$ 43,504,362**	**$ 4,196,123**	**10.7%**

[1]Includes Judges', General Assembly, and State Employees' Retirement Systems
[2]Includes Teachers' Retirement System
[3]Includes State Universities Retirement System

Budget Increases vs. Inflation[34]

The following chart compares annual percentage increases in the total state budget (operating and capital) to annual inflation rates. Between 1998 and 2002, annual budget increases outpaced inflation by as much as 10.9% in 2000. In 2003 and 2004, state appropriations grew at a rate less than inflation.



Selected Agency Appropriations

The analysis below highlights appropriations for certain agencies that saw relatively significant increases or decreases in appropriations for the FY2005 recommended budget. This list of selected agencies is not intended to be exhaustive.

[34] Source for inflation rates: U.S. Bureau of Labor Statistics Consumer Price Index for the Midwest Urban Region (IL, MI, IN, OH, WI, MN, IA, ND, SD, KS, NE, MO).

STATE OF ILLINOIS FY2004-FY2005 SELECTED AGENCY APPROPRIATIONS (in thousands of dollars)				
Type	FY2004 Enacted Appropriation	FY2005 Recommended Appropriation	Appropriation $ change 2004 to 2005	Appropriation % change 2004 to 2005
State Board of Education	$ 7,446,379	$ 7,939,864	$ 493,485	6.6%
Public Universities	$ 4,738,505	$ 4,938,690	$ 200,185	4.2%
Department of Public Aid	$ 10,183,996	$ 11,998,790	$ 1,814,794	17.8%
Department of Agriculture	$ 84,750	$ 78,325	$ (6,425)	-7.6%
Department of Financial and Professional Regulation	$ 99,816	$ 85,835	$ (13,981)	-14.0%
Department of Natural Resources	$ 210,652	$ 190,068	$ (20,584)	-9.8%
Department of Corrections	$ 1,416,727	$ 1,342,873	$ (73,854)	-5.2%
Environmental Protection Agency	$ 1,133,441	$ 1,092,243	$ (41,198)	-3.6%
State Police	$ 370,925	$ 350,291	$ (20,634)	-5.6%

Education: *$396 million more in General Funds for K-12, $28 million less for universities*

State of Illinois funding for public elementary and secondary schools is administered through the State Board of Education. The total FY2005 appropriation for the State Board of Education is $7.9 billion, an increase of $493 million over FY2004. The $7.9 billion budget consists of $5.7 billion in state General Funds, $29 million in Other State Funds, and $2.2 billion in Federal Funds. The General Funds appropriation of $5.7 billion represents 72% of the State Board of Education's total FY2005 budget, and is a 7.5%, or $396 million, increase over the FY2004 appropriation of $5.3 billion. The Governor's recommendation does not specify how the $396 million increase should be allocated, but outlines a number of priorities such as increasing General State Aid to school districts. Other State Funds will be cut 61%, or $46 million, from FY2004. A large number of these cuts correct overappropriations by matching FY2005 appropriations to actual expenditures for FY2004.

The Governor recommends transferring several non-core programs out of the Board of Education and moving them to other agencies: programs that license adult vocational programs, monitor General Education Development (GED) testing, support student scholarships, and support at-risk youth will all be transferred. In addition, the Governor recommends eliminating funding for Washington D.C. lobbyists and public relations firms.

The State of Illinois has nine public universities that are maintained by a combination of state General Funds, tuition revenues, and other university sources (e.g., donations and grants). The total FY2005 state appropriation for public universities is $1.3 billion from General Funds and $2 million from Other State Funds; together, these state appropriations will constitute approximately 26% of total university operating funds in FY2005. In FY2004, enacted state appropriations provided approximately 28% of total university operating funds; and in FY2003, actual state appropriations provided roughly 31% of university operating funds. Following a nationwide trend, Illinois public universities have instituted sizeable tuition increases in recent years in order to compensate for this decline in public funding.

The total FY2005 state appropriation (all funds) for public universities reflects a 2%, or $28 million, decrease from FY2004. This 2% cut is part of an initiative by the Board of Higher Education under which universities analyzed their administrative operations and made plans to reduce administrative costs by 25% over three years.

STATE OF ILLINOIS FY2004-FY2005 SELECTED EDUCATION APPROPRIATIONS (in thousands of dollars)				
Type	FY2004 Enacted Appropriation	FY2005 Recommended Appropriation	**Appropriation $ change 2004 to 2005**	**Appropriation % change 2004 to 2005**
ELEMENTARY AND SECONDARY EDUCATION				
State Board Of Education	**$ 7,446,379**	**$ 7,939,864**	**$ 493,485**	**6.6%**
State General Funds	$ 5,297,356	$ 5,693,705	$ 396,349	7.5%
Other State Funds	$ 75,218	$ 29,509	$ (45,709)	-60.8%
Federal Funds	$ 2,073,806	$ 2,216,650	$ 142,845	6.9%
HIGHER EDUCATION				
Public Universities	**$ 4,738,505**	**$ 4,938,690**	**$ 200,185**	**4.2%**
State General Funds	$ 1,303,575	$ 1,276,427	$ (27,148)	-2.1%
Other State Funds	$ 2,610	$ 2,009	$ (601)	-23.0%
University Income Funds (tuition + fees)	$ 788,971	$ 863,664	$ 74,693	9.5%
University Held Funds (grants, bonds, other revenue)	$ 2,643,349	$ 2,796,590	$ 153,241	5.8%

Department of Public Aid: *$1.8 billion increase for medical assistance*

The State of Illinois Department of Public Aid provides health care coverage for adults who qualify for Medicaid, offers Energy Assistance to low-income families, and enforces child support decisions to ensure that children are financially supported by both parents. In addition, the Department has an Office of Inspector General that reports directly to the Governor.

The Department of Public Aid's total FY2005 appropriation is $12 billion, an increase of $1.8 billion, or 17.8%, over FY2004. The majority of this increase comes from a $1.1 billion, or 27% increase in Other State Funds. State General Funds will increase 12.4%, from $5.6 billion in FY2004 to $6.3 billion in FY2005.

The largest program increase is in Medical Assistance, reflecting the rise in Medicaid costs as well as the expansion of programs such as KidCare and FamilyCare, which provide health care benefits to low-income families. Medical Assistance appropriations will increase $1.8 billion, or 19.2% in FY2005, totaling $11.3 billion.

STATE OF ILLINOIS FY2004-FY2005 DEPARTMENT OF PUBLIC AID APPROPRIATIONS (in thousands of dollars)				
Type	FY2004 Enacted Appropriation	FY2005 Recommended Appropriation	**Appropriation $ change 2004 to 2005**	**Appropriation % change 2004 to 2005**
Department of Public Aid	**$ 10,183,996**	**$ 11,998,790**	**$ 1,814,794**	**17.8%**
BY FUND				
State General Funds	$ 5,577,236	$ 6,266,378	$ 689,141	12.4%
Other State Funds	$ 4,143,755	$ 5,269,647	$ 1,125,891	27.2%
Federal Funds	$ 463,005	$ 462,766	$ (239)	-0.1%
BY PROGRAM				
Medical Assistance	$ 9,505,977	$ 11,330,449	$ 1,824,472	19.2%
Energy Assistance	$ 315,031	$ 312,352	$ (2,680)	-0.9%
Child Support Enforcement	$ 214,402	$ 205,533	$ (8,869)	-4.1%
Office of Inspector General	$ 21,277	$ 19,715	$ (1,562)	-7.3%
Public Aid Recoveries	$ 20,026	$ 28,021	$ 7,994	39.9%
Administration	$ 107,283	$ 102,720	$ (4,563)	-4.3%

Department of Agriculture: *cut $5 million in research grants to public universities*

The Illinois State Department of Agriculture regulates agribusiness and promotes the State agricultural industry through state and county fairs, assistance to 4-H clubs, and marketing of Illinois agriculture products in foreign and domestic markets.

The Department of Agriculture's total FY2005 appropriation is $78 million, a decrease of $6 million, or 7.6%, from FY2004. The majority of this decrease comes from the elimination of $5 million in agricultural research grants to public universities (including administrative costs in the Department of Agriculture). Other State Funds will decrease 2.1%, from $37.6 million in FY2004 to $36.8 million in FY2005.

The Governor recommends the transfer of two programs out of the Department of Agriculture: the Land and Water Resources program will move to the Department of Natural Resources, and Environmental Programs will move to the Illinois Environmental Protection Agency.

STATE OF ILLINOIS FY2004-FY2005 DEPARTMENT OF AGRICULTURE APPROPRIATIONS (in thousands of dollars)				
Type	FY2004 Enacted Appropriation	FY2005 Recommended Appropriation	**Appropriation $ change 2004 to 2005**	**Appropriation % change 2004 to 2005**
Department of Agriculture	**$ 84,750**	**$ 78,325**	**$ (6,425)**	**-7.6%**
BY FUND				
State General Funds	$ 39,588	$ 34,393	$ (5,195)	-13.1%
Other State Funds	$ 37,638	$ 36,847	$ (791)	-2.1%
Federal Funds	$ 7,524	$ 7,085	$ (439)	-5.8%
BY PROGRAM				
Animal Industries	$ 7,657	$ 7,068	$ (589)	-7.7%
Buildings and Grounds	$ 7,753	$ 6,844	$ (910)	-11.7%
County Fairs/ Horseracing	$ 12,637	$ 12,530	$ (107)	-0.8%
DuQuoin State Fair/ Buildings and Grounds	$ 4,267	$ 3,909	$ (358)	-8.4%
Livestock Management Facilities Act and Mosquito Control	$ 371	$ 340	$ (31)	-8.4%
Illinois State Fair	$ 4,733	$ 4,733	$ -	0.0%
Market Services and Development	$ 5,169	$ 4,114	$ (1,055)	-20.4%
Meat and Poultry Inspection	$ 8,033	$ 7,640	$ (393)	-4.9%
Warehouse/ Ag Production Inspection	$ 5,667	$ 5,189	$ (478)	-8.4%
Weights and Measures	$ 4,395	$ 3,761	$ (634)	-14.4%
Administration/ Computer Services	$ 24,067	$ 22,197	$ (1,870)	-7.8%

Department of Financial and Professional Regulation: *new consolidated agency appropriates $14 million less than 5 former agencies*

The Illinois Department of Financial and Professional Regulation (DFPR) is a newly created agency in the FY2005 budget. It is a consolidation of the former Office of Banks and Real Estate, Department of Financial Institutions, Department of Insurance, Department of

Professional Regulation, and administration of the Comprehensive Health Insurance Plan, which provides health insurance coverage to citizens who can afford health insurance coverage but cannot find any due to pre-existing health conditions. The Department oversees licensing and regulation of various financial professionals, and enforces standards of professional practice. The Governor recommends a total of 842 full-time equivalent positions for the DFPR, 121.5 less than were authorized for the five consolidated agencies in FY2004.

The Department's total FY2005 appropriation is $86 million, a decrease of $14 million, or 14%, from the FY2004 total for the five agencies. The Department receives no General Funds, but is funded entirely by $85 million in Other State Funds (professional fee revenues) and $600,000 in Federal Funds.

STATE OF ILLINOIS FY2004-FY2005 DEPARTMENT OF FINANCIAL AND PROFESSIONAL REGULATION APPROPRIATIONS (in thousands of dollars)

Type	FY2004 Enacted Appropriation	FY2005 Recommended Appropriation	**Appropriation $ change 2004 to 2005**	**Appropriation % change 2004 to 2005**
Department of Financial and Professional Regulation	**$ 99,816**	**$ 85,835**	**$ (13,981)**	**-14.0%**
BY FUND				
State General Funds	$ -	$ -	$ -	0.0%
Other State Funds	$ 99,116	$ 85,235	$ (13,881)	-14.0%
Federal Funds	$ 700	$ 600	$ (100)	-14.3%
BY PROGRAM				
Evaluation and Licensing	$ 17,261	$ 14,533	$ (2,728)	-15.8%
Regulations and Supervision	$ 44,806	$ 38,764	$ (6,042)	-13.5%
Investigation and Enforcement	$ 37,749	$ 32,538	$ (5,211)	-13.8%

Department of Natural Resources*: decrease of $20 million, or 10% reduction from FY2004*

The Illinois Department of Natural Resources manages the state's natural and cultural resources while also providing outdoor recreational opportunities for citizens.

The Department of Natural Resources' total FY2005 appropriation is $190 million, a decrease of $20.6 million, or 9.8%, from FY2004. The Governor recommends suspending distribution of the Real Estate Transfer Tax to the Open Space Land Acquisition Fund and the Natural Areas Acquisition Fund, resulting in decreases of $1 million and $5 million, respectively, in operating appropriations from those funds for the Department of Natural Resources. Real Estate Transfer Tax revenues will remain in General Funds. The result of these cuts is that no new grants or land acquisitions will be made in FY2005.[35] The remainder of the cuts comes from a variety of Department programs.

The Governor recommends a total of 1,842 full-time equivalent positions for the Department in FY2005, 148 less than were authorized in FY2004. The Department of Agriculture's Bureau of Land and Water will be merged into the Department of Natural Resources.

[35] Communication from Becky Carroll, Communications Director, Governor's Office of Management and Budget April 15, 2004.

STATE OF ILLINOIS FY2004-FY2005 DEPARTMENT OF NATURAL RESOURCES APPROPRIATIONS (in thousands of dollars)				
Type	FY2004 Enacted Appropriation	FY2005 Recommended Appropriation	**Appropriation $ change 2004 to 2005**	**Appropriation % change 2004 to 2005**
Department of Natural Resources	**$ 210,652**	**$ 190,068**	**$ (20,584)**	**-9.8%**
BY FUND				
State General Funds	$ 107,414	$ 96,428	$ (10,986)	-10.2%
Other State Funds	$ 94,413	$ 85,506	$ (8,907)	-9.4%
Federal Funds	$ 8,825	$ 8,134	$ (690)	-7.8%
BY PROGRAM				
Capital/Conservation	$ 116,229	$ 110,427	$ (5,802)	-5.0%
Resource Management and Public Safety	$ 72,287	$ 59,082	$ (13,204)	-18.3%
Science, Education and Cultural Surveys	$ 22,136	$ 20,559	$ (1,577)	-7.1%

Department of Corrections: *streamlining leads to $73 million in cuts*

The Illinois Department of Corrections provides custody, treatment, and rehabilitation for adult and juvenile offenders committed by the justice system.

The Department of Corrections' total FY2005 appropriation is $1.3 billion, a decrease of $73 million, or 5.2%, from FY2004. This decrease comes from a $91.8 million, or 7.2% cut in state General Funds, partially offset by an $18 million, or 12.4%, increase in Other State Funds. The largest cuts will be made in Juvenile Detention and Administration.

The Governor's budget proposes streamlining the Department through use of a rational staffing model, centralization of certain functions, and use of technology to minimize routine tasks. Inmate population reallocation will permit the closure of Vandalia Correctional Center and the Illinois Youth Center in St. Charles.

STATE OF ILLINOIS FY2004-FY2005 DEPARTMENT OF CORRECTIONS APPROPRIATIONS (in thousands of dollars)				
Type	FY2004 Enacted Appropriation	FY2005 Recommended Appropriation	**Appropriation $ change 2004 to 2005**	**Appropriation % change 2004 to 2005**
Department of Corrections	**$ 1,416,727**	**$ 1,342,873**	**$ (73,854)**	**-5.2%**
BY FUND				
State General Funds	$ 1,269,618	$ 1,177,516	$ (92,103)	-7.3%
Other State Funds	$ 147,109	$ 165,357	$ 18,249	12.4%
Federal Funds	$ -	$ -	$ -	0.0%
BY PROGRAM				
Administration	$ 40,491	$ 35,788	$ (4,703)	-11.6%
Adult Institutions	$ 1,129,649	$ 1,091,269	$ (38,380)	-3.4%
Field Services	$ 111,760	$ 113,242	$ 1,482	1.3%
Juvenile Detention	$ 134,827	$ 102,574	$ (32,253)	-23.9%

Environmental Protection Agency: *appropriations decline by $43 million*

The Illinois Environmental Protection Agency protects and improves Illinois' air, land, and water resources by administering a regulatory system of environmental monitoring, permits, performance standards, compliance inspections, and enforcement.

The Environmental Protection Agency's total FY2005 appropriation is $1.1 billion, a decrease of $41 million, or 3.6%, from FY2004. This decrease comes from a $1 million, or 30.7%, cut in state General Funds and a $43 million, or 4.1%, reduction in Other State Funds, partially offset by a $3.5 million, or 6.2%, increase in Federal Funds. The Governor recommends a total of 1,342 full-time equivalent positions for the Department in FY2005, 15 less than were authorized in FY2004. The Department of Agriculture's Pesticide Control Program and the State Fire Marshal's Petroleum and Chemical Safety Program are being merged into the Environmental Protection Agency.

STATE OF ILLINOIS FY2004-FY2005 ENVIRONMENTAL PROTECTION AGENCY APPROPRIATIONS (in thousands of dollars)				
Type	FY2004 Enacted Appropriation	FY2005 Recommended Appropriation	**Appropriation $ change 2004 to 2005**	**Appropriation % change 2004 to 2005**
Environmental Protection Agency	**$ 1,133,441**	**$ 1,092,243**	**$ (41,198)**	**-3.6%**
BY FUND				
State General Funds	$ 4,250	$ 2,946	$ (1,304)	-30.7%
Other State Funds	$ 1,071,912	$ 1,028,446	$ (43,467)	-4.1%
Federal Funds	$ 57,279	$ 60,851	$ 3,572	6.2%
BY PROGRAM				
Bureau of Air	$ 94,154	$ 93,720	$ (434)	-0.5%
Bureau of Land	$ 173,962	$ 160,283	$ (13,679)	-7.9%
Bureau of Water	$ 835,936	$ 807,364	$ (28,572)	-3.4%
Laboratories	$ 5,794	$ 5,843	$ 49	0.8%
Pesticide Control	$ 5,460	$ 5,173	$ (287)	-5.3%
Petroleum and Chemical Safety	$ 3,214	$ 3,082	$ (133)	-4.1%
Pollution Control Board	$ 1,793	$ 1,948	$ 155	8.6%
Public Safety and Environmental Outreach	$ 13,129	$ 14,831	$ 1,702	13.0%

State Police: *streamlining produces $21 million in cuts*

The Illinois State Police enforces criminal and motor vehicle safety laws, provides forensic services to the justice system and the public, and responds to emergencies and disasters.

The State Police's total FY2005 appropriation is $350 million, a decrease of $21 million, or 5.6%, from FY2004. This decrease comes from a $28 million, or 14%, cut in state General Funds, offset by a $6 million, or 4%, increase in Other State Funds and a $2 million, or 6.9%, increase in Federal Funds. The Interstate Commerce Commission's Special Agents and the Department of Central Management Services' Police will be merged into the State Police. A large part of the reduction in state appropriations reflects these consolidations.

The Governor recommends a total of 3,489 full-time equivalent positions for the Department in FY2005, 145 less than were authorized in FY2004. The Governor recommends adding 400 frontline officers over the next four years. In FY2005, two cadet classes of 110 officers will be funded; one will be funded by the state, and the second will be funded by a federal Community-Oriented Policing Services Universal Grant.

STATE OF ILLINOIS FY2004-FY2005 STATE POLICE APPROPRIATIONS (in thousands of dollars)				
Type	FY2004 Enacted Appropriation	FY2005 Recommended Appropriation	**Appropriation $ change 2004 to 2005**	**Appropriation % change 2004 to 2005**
State Police	**$ 370,925**	**$ 350,291**	**$ (20,634)**	**-5.6%**
BY FUND				
State General Funds	$ 202,107	$ 173,907	$ (28,200)	-14.0%
Other State Funds	$ 142,119	$ 147,834	$ 5,716	4.0%
Federal Funds	$ 26,700	$ 28,550	$ 1,850	6.9%
BY PROGRAM				
Information Technology Command	$ 16,435	$ 14,018	$ (2,416)	-14.7%
Operations	$ 262,601	$ 241,916	$ (20,685)	-7.9%
Racetrack Security	$ 558	$ 600	$ 41	7.4%
Financial Fraud and Forgery	$ 5,144	$ 4,868	$ (276)	-5.4%
Forensic Services and Identification	$ 62,600	$ 61,772	$ (829)	-1.3%
Internal Investigation	$ 2,333	$ 2,106	$ (227)	-9.7%
Administration	$ 21,254	$ 25,012	$ 3,758	17.7%

Note: FY2003 and FY2004 figures include the Illinois Commerce Commission and the Department of Central Management Services police consolidations.

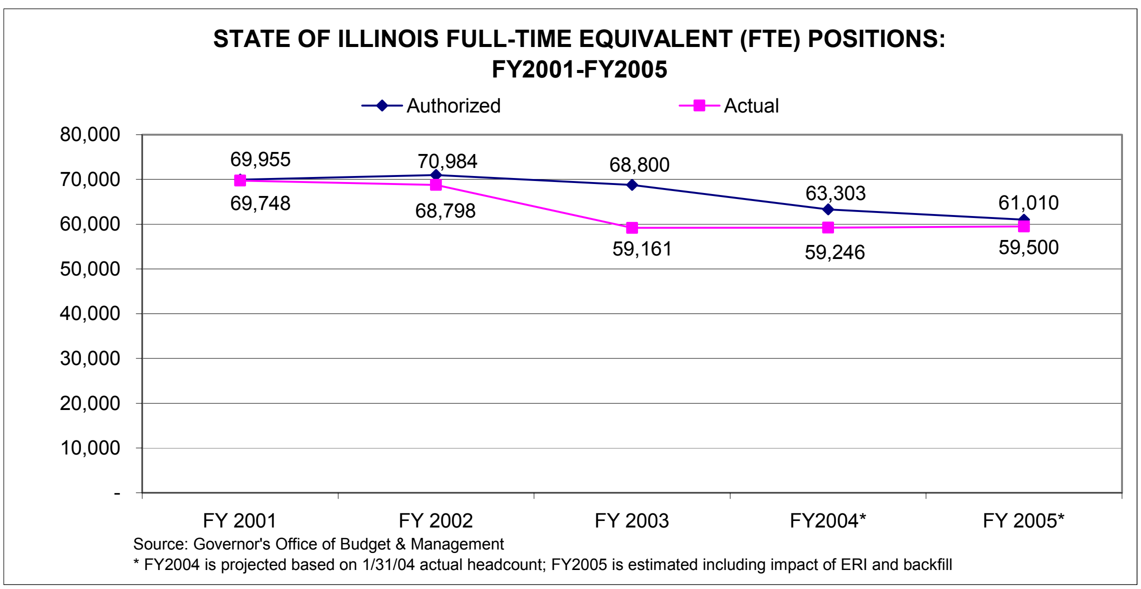
PERSONNEL AND BENEFITS

Upon taking office in 2003, Governor Blagojevich instituted a hiring freeze, making exceptions only for essential frontline and direct service positions. The FY2005 budget will maintain this hiring freeze and exception policy.

The Governor's recommendation calls for 61,010 budgeted full-time equivalent (FTE) positions, a reduction of 3.6%, or 2,293 positions, from FY2004. This is the lowest level of budgeted positions since 1972. The majority of this reduction will be achieved by eliminating vacancies.

STATE OF ILLINOIS FULL-TIME EQUIVALENT (FTE) POSITIONS AUTHORIZED Type	FY 2003 Authorized	FY 2004 Authorized	FY 2005 Recommended	04-05 FTE change	04-05 % change
Human Services	24,800	22,476	22,040	-436	-1.9%
Public Safety	20,847	19,665	18,571	-1,094	-5.6%
Economic Development And Infrastructure	10,525	9,665	9,394	-271	-2.8%
Environment And Business Regulation	5,288	4,959	4,653	-306	-6.2%
Government Services	4,546	4,100	4,017	-83	-2.0%
Public Aid	2,794	2,438	2,335	-103	-4.2%
Total	**68,800**	**63,303**	**61,010**	**-2,293**	**-3.6%**

The number of actual employees is expected to rise by 0.4%, or 254 positions in FY2005, from 59,246 projected in FY2004 to 59,500 projected in FY2005. As a result of Governor Ryan's 2002 ERI initiative, actual employees fell by 14%, or 9,637 positions in FY2003, from 68,798 in FY2002 to 59,161 in FY2003.



In addition to reducing positions by eliminating vacancies, Governor Blagojevich's budget proposes a new ERI program aimed at administrative and non-frontline positions, limited to a maximum of 2,000 employees. The FY2005 recommendation of 61,010 authorized positions does not reflect this new ERI plan, since the FY2005 reduction will be achieved by eliminating currently vacant positions. The new ERI plan is projected to generate $25 million in net savings for FY2005, but both the savings and retirement costs must be more thoroughly analyzed before the plan is formally introduced.

The next three exhibits present the percentage of average annual health insurance premium costs paid by employees and the State of Illinois for the six different plans available. The distribution of the annual cost of insurance for individual employees shows that the State's contribution for different plans ranges from 88% to 91% of premium costs for an average of 89%. This rate is slightly higher than the average contribution rate for Illinois and U.S. private and public sector employees of 83%.

ANNUAL COST OF EMPLOYMENT-BASED HEALTH INSURANCE: MEMBER ONLY 2004*

Plan	Employee Contribution	State Contribution
QCHP	9%	91%
Health Alliance	10%	90%
Health Link	10%	90%
HMO Illinois	12%	88%
Personal Care	10%	90%
Unicare	12%	88%
Average	11%	89%
Illinois Average**	17%	83%
U.S. Average	17%	83%

* Source: Information Provided by Hank Scheff, Research Director, AFSCME Council 31.

** 2001 figures from Kaiser Family Foundation. State Health Facts Online. These figures represent data from private & public employers.

The distribution of the annual cost of insurance for individual employees plus one dependent is shown next. In this case, the State plan average employer contribution rate of 82% is the same as the Illinois average and slightly more than the U.S. average of 80%.

ANNUAL COST OF EMPLOYMENT-BASED HEALTH INSURANCE: MEMBER + 1 DEPENDENT 2004*

Plan	Employee Contribution	State Contribution
QCHP	19%	81%
Health Alliance	17%	83%
Health Link	18%	82%
HMO Illinois	19%	81%
Personal Care	18%	82%
Unicare	19%	81%
Plan Average	18%	82%
Illinois Average**	18%	82%
U.S. Average**	20%	80%

* Source: Information Provided by Hank Scheff, Research Director, AFSCME Council 31.

** 2001 figures from Kaiser Family Foundation. State Health Facts Online. These figures represent data from private & public employers.

The third exhibit presents information about the distribution of health insurance premiums for family insurance plan coverage. Again, the distribution of State plan costs are similar to the Illinois average, with the State paying an average of 81% of family health plan premiums and all Illinois organizations paying an average of 80%. For the entire U.S., the average employer payment is slightly lower, averaging 77%.

ANNUAL COST OF EMPLOYMENT-BASED HEALTH INSURANCE: FAMILY 2004*		
Plan	**Employee Contribution**	**State Contribution**
QCHP	20%	80%
Health Alliance	18%	82%
Health Link	19%	81%
HMO Illinois	19%	81%
Personal Care	18%	82%
Unicare	18%	82%
Plan Average	19%	81%
Illinois Average**	20%	80%
U.S. Average**	23%	77%

* Source: Information Provided by Hank Scheff, Research Director, AFSCME Council 31.

** 2001 figures from Kaiser Family Foundation. State Health Facts Online. These figures represent data from private & public employers.

The following exhibit compares Illinois state employees' percentage contributions to health insurance premiums with that of three other Midwestern States. Illinois state employees pay from 9% to 12% of their single premium costs and from 18% to 20% of their family premium costs. While these ranges are narrower than those of Indiana, Michigan, and Wisconsin, they are in-line with the contributions in other states.

STATE EMPLOYEE HEALTH INSURANCE PREMIUM CONTRIBUTIONS 2004: Illinois, Indiana, Michigan, Wisconsin		
	SINGLE	**FAMILY**
Illinois*	9% to 12%	18% to 20%
Indiana	4% to 33%	6% to 27%
Michigan	0% to 25%	0% to 26%
Wisconsin	0% to 10%	0% to 10%

Note: Premium costs and state employee contributions vary by plan, county and collective bargaining agreement.

Sources: *Hank Scheff, Director of Research, AFSCME Council 31
http://www.in.gov/jobs/openenrollment/ratechart04.pdf
http://www.michigan.gov/documents/HealthInsuranceRates_58162_7.pdf
http://etf.wi.gov/publications/et8902.pdf
http://etf.wi.gov/publications/dc_content/dc_state_2004_rates.pdf

AGENCY REORGANIZATIONS, CONSOLIDATIONS AND MERGERS

The FY2005 budget proposes the reorganization, consolidation and merger of many programs and agencies. In addition to the agency changes described in the budget book, the Governor has also proposed reorganization of the Illinois Board of Education and creation of a new cabinet-level Department of Education, which is described at the end of this section.

STATE OF ILLINOIS FY2004-FY2005 PROPOSED AGENCY CONSOLIDATIONS	
Agencies Consolidated Into…	**… Agencies Receiving Consolidations**
Central Management Services Law Enforcement & Illinois Commerce Commission Law Enforcement	Illinois State Police
Worker's Compensation Programs	Central Management Services
Communications Staff	Central Management Services
Department of Financial Institutions, Office of Banks and Real Estate, Department of Insurance, Department of Professional Regulation, CHIP	Department of Financial and Professional Regulation
Department of Agriculture's Land Division	Department of Natural Resources
Office of the State Fire Marshal's Petroleum and Chemical Safety Division & Department of Agriculture's Environmental Programs	Illinois Environmental Protection Agency
Department of Revenue's Circuit Breaker/Pharmaceutical Assistance Program & Department of Commerce and Economic Opportunity's Low-Income Home Energy Assistance Programs	Department of Public Aid
Illinois Commerce Commission's Railroad Commission	Department of Transportation
Human Rights Commission (administrative function)	Department of Human Rights

Budgetary Consolidations

The following reorganizations and consolidations are outlined in the Governor's proposed FY2005 budget.

Law Enforcement Personnel to Illinois Department of State Police
The Governor proposes transferring Illinois Commerce Commission special agents and Department of Central Management Services (CMS) police to the Department of State Police. In addition, certain sworn officers will be transferred from administrative to frontline duties. Funds will be appropriated for two new cadet classes in order to increase frontline police presence. Cost savings from reorganization will be used to purchase new vehicles and equipment, upgrade information technology, and reduce the backlog on processing rape kit DNA samples.

Worker's Compensation Programs to the Department of Central Management Services
Administration of the State's worker's compensation programs from agencies operating decentralized programs such as the Department of Corrections and Human Services will be

consolidated into the Department of Central Management Services. CMS will invest $1.5 million in third party administration to generate a net savings of $4.2 million in FY2005 by reducing claims and administrative overhead costs.

Consolidation of Communications Staff in Central Management Services
The State's communications staff (i.e. press and public affairs and information services) will be consolidated under Central Management Services. An estimated 25 Public Information Officers from CMS will be assigned to various agencies to work with in-house press liaisons for a total savings of $1 million.[36]

Department of Financial and Professional Regulation
The new Department of Financial and Professional Regulation will consolidate the former Departments of Financial Institutions, Insurance, Professional Regulation and Banks and Real Estate as well as administration of the Comprehensive Health Insurance Plan. This new agency will be responsible for oversight and licensure of banks and financial institutions, real estate businesses and professionals, and insurance companies and various professions. It will also enforce standards of professional practice. The consolidation is estimated to save $13.9 million.

Agriculture Department's Land Division to the Department of Natural Resources
The Department of Agriculture's Land division will be transferred to the Department of Natural Resources.

Environmental & Safety Programs to Illinois Environmental Protection Agency
The Office of the State Fire Marshal's Petroleum and Chemical Safety Division and the Department of Agriculture's environmental programs will be transferred to the Illinois Environmental Protection Agency

Low Income Assistance Programs to Department of Public Aid
The Circuit Breaker/Pharmaceutical Assistance program will be transferred to the Department of Public Aid from the Department of Revenue and the Low-Income Home Energy Assistance Programs will be transferred to IDPA from the Department of Commerce and Economic Opportunity.

Railroad Commission to Department of Transportation
The Illinois Commerce Commission's Railroad Commission will be merged into the Department of Transportation.

Consolidation: Department of Human Rights/Human Rights Commission
The administrative and operations functions of the Human Rights Commission and the Department of Human Rights will be consolidated in order to provide better monitoring and enforcement of the Human Rights Act.

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[36] Communication from Becky Carroll, Communications Director, Governor's Office of Management and Budget March 22, 2004.

Reorganizing Management of the State's Education Function

Governor Blagojevich has proposed comprehensive reorganization of K-12 state management through the creation of a Department of Education and diminution of the State Board of Education's responsibilities. The details of this proposal do not appear in the budget book, but rather in a separate publication.[37]

The Governor recommends creation of a new Illinois Department of Education to assume several functions of the current State Board of Education. The Board of Education is a constitutional agency and will continue on in some capacity. The Governor's reorganization of education management is projected to save approximately $1.1 billion over 4 years. The plan includes general guidelines for administrative streamlining in addition to four specific cost saving centralizations described below.

The Governor's plan has drawn a great deal of criticism. Some opponents counter that the reorganization would not raise test scores or improve student learning because it would not address the daily operations of school districts.[38] Other opponents note that the maintenance of an independent Board of Education with broad fiscal and policy functions is common practice among states and one that works well in preventing education from becoming "politicized".[39] Still others claim that the Governor's proposal violates the expressed intent of the majority of 1970 Illinois Constitutional Convention delegates who created the State Board of Education.[40]

Overall Administrative Streamlining would reduce the rules governing education in Illinois and shorten the school districts' state funding application forms. Excess lobbying, public relations, and consulting contracts will be cancelled. Redundancy, such as the audit of school districts statutorily required to have independent audits by Certified Public Accountants, will be eliminated. Management of information technology, internal auditing, and legal staff will be handled by other state agencies that already manage these functions for the state, such as Central Management Services. The new Department of Education will operate with 80% of the funding and 60% of the headcount in the current State Board of Education.

Regional Administrative Service Centers would provide school districts with regionalized administrative services such as accounts payable, accounting, and auditing.

Projected savings: $48-$80 million over four years.

A Statewide Benefits Purchasing Center would centralize health insurance purchasing and reduce costs by creating a larger risk pool, eliminating premium taxes, and decreasing administrative costs. The pool would still allow districts to determine benefit levels through the collective bargaining process. The purchasing center would also handle TRIP, the retired teachers' health insurance program.

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[37] Department of Education Plan 2004, http://www100.state.il.us/Gov/pdfdocs/2004soseducationplan.pdf.
[38] "Governor won't commit on test scores," Chicago Sun-Times, 6 February 2004, p. 28.
[39] "A Brief History of the Creation of the State Board of Education by the Constitutional Convention and Observations Concerning the Governor's Proposal to Create a Department of Education," Malcom S. Kamin, Delegate to Vith Illinois Constiutional Convention, 27 February 2004.
[40] Letter from David R. Miller, Deputy Director for Research of the Illinois Legislative Research Unit, to Senator Miguel del Valle, 24 February 2004.

Projected savings: $320-$400 million over four years.

A *Statewide Supply Purchasing Center* would centralize school district purchasing of various supplies. An analysis of purchasing found wide variation in the prices paid by districts for identical products, including computers, janitorial items, and art supplies. The statewide center would negotiate contracts with suppliers to purchase bulk supplies at a lower cost and make them available to all school districts.

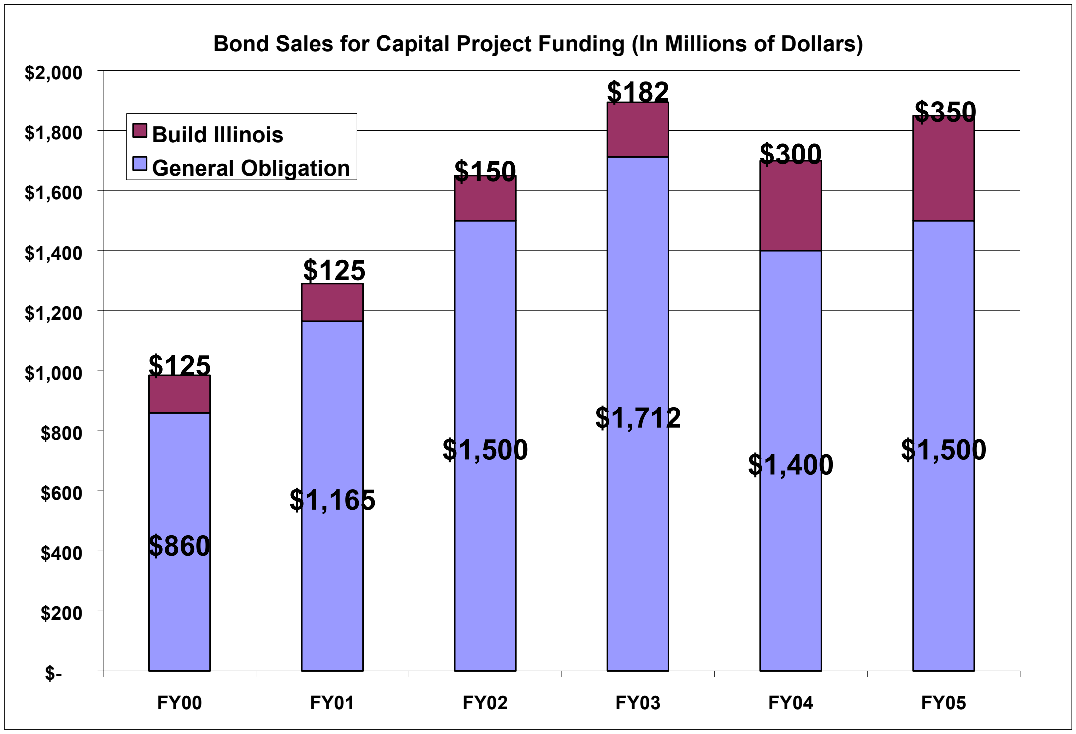
Projected savings: $550 million over four years.

Centralization of School Construction Management would require the Capital Development Board to work with the Department of Education in managing school construction projects. This would reduce costs paid by school districts for construction project management, and allow for the construction of 14 more schools and 350 more classrooms than are currently fundable.

Projected savings: $160 million over four years.

LONG-TERM DEBT TRENDS

The State of Illinois' capital program is financed through the issuance of general obligation bonds as well as Build Illinois revenue bonds secured by state sales tax revenues. The exhibit below shows historical and projected bond sales. It excludes sales for refunding purposes and the pension obligation bonds issued in 2003. As the exhibit shows, bond sales will increase in FY2005, from a total of $1.7 billion to $1.85 billion.



The State will have $10.7 billion of capital purpose General Obligation bonds outstanding in FY2005. The total amount of G.O. bonds for capital purposes and Pension Obligation bonds projected to be outstanding in FY2005 is $20.7 billion.

General Obligation Debt Outstanding (In Millions)					
G.O. Type	**FY01**	**FY02**	**FY03 Est**	**FY04 Est**	**FY05 Proj**
Capital Purposes	$ 6,600.0	$ 7,629.9	$ 8,812.6	$ 9,778.7	$ 10,747.5
Pension Bonds	N/A	N/A	$ 10,000.0	$ 10,000.0	$ 10,000.0
TOTAL	**$ 6,600.0**	**$ 7,629.9**	**$ 18,812.6**	**$ 19,778.7**	**$ 20,747.5**

Bond Rating Information

As of May 2003, the general obligation bond ratings of the State were:

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

Both Moody's and Fitch reduced the state's bond rating in May 2003. Previously, Moody's had rated the State's G.O. debt as Aa2 and Fitch had given an AA+ rating.

Debt Burden Comparison

Comparisons of Illinois' debt burden to that of the other 49 states is provided in the two exhibits that follow. The information is from *Moody's Investors Services Special Comment on 2003 State Debt Medians*.

Illinois ranked 11th in the nation for net tax-supported debt per capita in 2003. The State's per capita amount of $1,040 placed it above the median for all states of $838.

NET TAX-SUPPORTED DEBT PER CAPITA 2003			
Rank	**State**	**Amount**	**Rating**
1	Connecticut	$ 3,440.0	Aa3
2	Massachusetts	$ 3,298.0	Aa2
3	Hawaii	$ 3,111.0	Aa3
4	New Jersey	$ 2,110.0	Aa2
5	New York	$ 2,095.0	A2
6	Delaware	$ 1,599.0	Aaa
7	Rhode Island	$ 1,508.0	Aa3
8	Washington	$ 1,507.0	AA1
9	Mississippi	$ 1,207.0	Aa3
10	Kentucky	$ 1,095.0	Aa2
11	**ILLINOIS**	**$ 1,040.0**	**Aa3**
12	Florida	$ 985.0	Aa2
13	Maryland	$ 977.0	Aaa
14	Wisconsin	$ 958.0	Aa3
15	West Virginia	$ 950.0	Aa3
	MEDIAN	***$ 838.0***	
	MEAN	***$ 606.0***	

Source: Moody's Special Comment. 2003 State Debt Medians

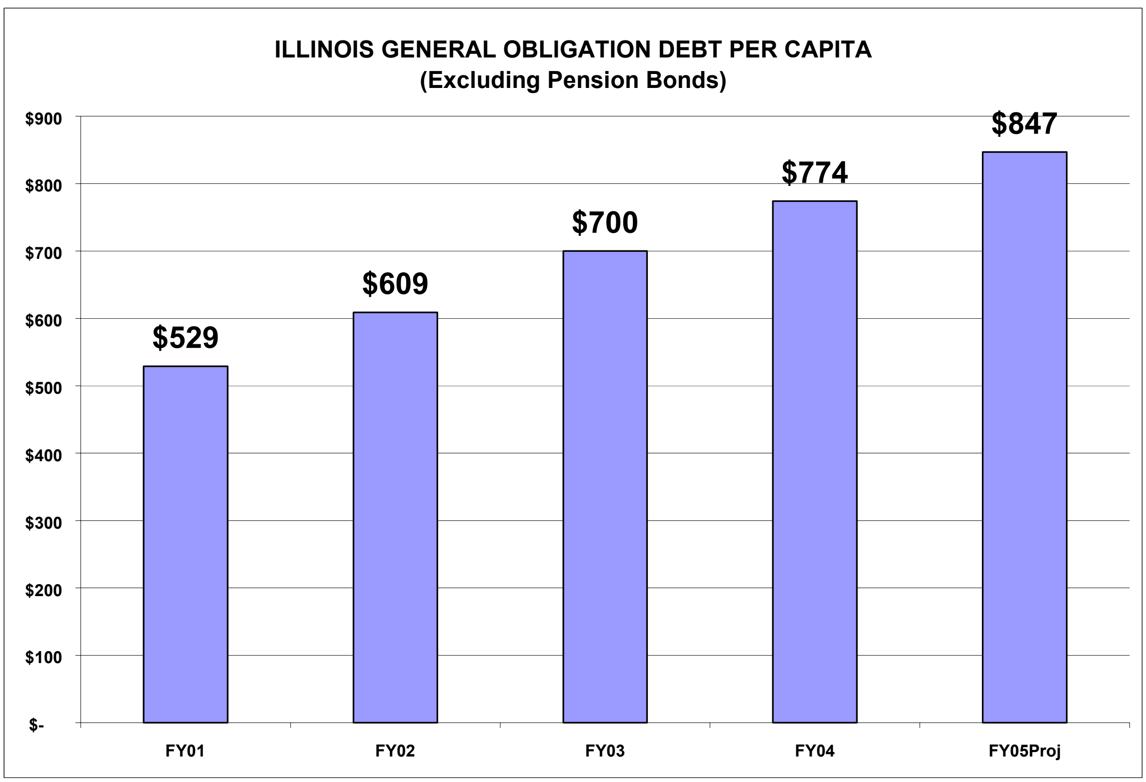
In the next exhibit, net tax-supported debt as a percentage of personal income for the 8 most populous states is compared to the median for all 50 states for the 5-year period between 1999 and 2003. In 2003, Illinois ranked third highest among the 8 states surveyed with a ratio of 3.2%. This was above the median 50-state ratio of 2.2%. The ratio for net tax supported debt as a percentage of personal income increased from 2.6% to 3.2% in the 5-year period analyzed.

NET TAX-SUPPORTED DEBT AS A % OF PERSONAL INCOME					
	1999	**2000**	**2001**	**2002**	**2003**
Texas	1.3%	1.2%	1.0%	0.9%	0.9%
Michigan	1.7%	1.5%	1.6%	1.5%	1.8%
Pennsylvania	2.3%	2.2%	2.2%	2.3%	2.3%
California	2.6%	2.4%	2.5%	2.5%	2.5%
Ohio	2.7%	2.7%	2.6%	2.5%	2.5%
ILLINOIS	**2.6%**	**2.5%**	**2.7%**	**2.8%**	**3.2%**
Florida	3.5%	3.4%	3.3%	3.4%	3.5%
New York	6.6%	6.4%	6.2%	5.9%	5.9%
MEDIAN	**2.0%**	**2.2%**	**2.1%**	**2.3%**	**2.2%**

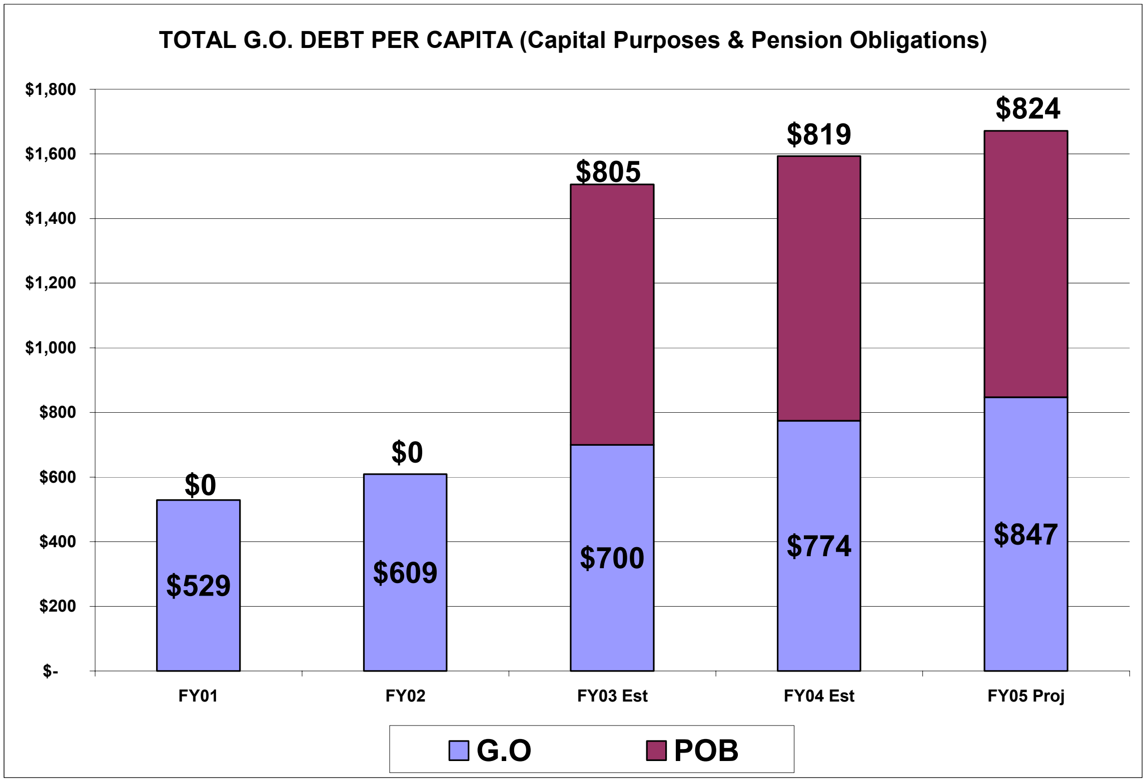
Source: Moody's Special Comment. 2003 State Debt Medians

General Obligation Debt Per Capita

Illinois State General Obligation bond debt per capita (excluding the Pension Obligation bonds) is shown in the following exhibit. Between FY2001 and FY2005, G.O. debt per capita is projected to increase by 60%, from $529 to $847.



The next exhibit shows estimates for total General Obligation debt per capita for capital purposes as well as Pension Obligation debt. Overall per capita GO debt is expected to increase by 216% between FY2001 and FY2005, from $529 to $1671. Approximately 50% of the debt per capita in fiscal years 2003 through 2005 is due to the Pension Obligation debt issue.



STATE OF ILLINOIS RETIREMENT SYSTEMS

The State of Illinois funds five retirement systems for employees and retirees: the State Employees Retirement System, the Teachers' Retirement Employment Retirement System, the State Universities Retirement System, the Judges' Retirement System and the General Assembly Retirement System. A total of 630,928 individuals are currently enrolled in those five systems.

MEMBERS OF ILLINOIS RETIREMENT SYSTEMS		
Pension Fund	**Members**	**Annuitants**
Teachers	230,673	73,336
University	140,133	36,390
State Employees	93,517	54,375
Judges	962	864
General Assembly	295	383
Total	**465,580**	**165,348**

Illinois has historically underfunded its pension funds. In 2003, the state ranked 50th in the nation for the amount of unfunded liabilities in its pension funds. At that time, unfunded liabilities totaled $34.9 billion.[41]

In 1994, 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% of unfunded liabilities" by the year 2044.

$10 Billion in Pension Obligation Bonds Issued in 2003

In 2003, Governor Blagojevich signed Public Act 093-0002 authorizing the issuance of $10 billion of Pension Obligation Bonds. The proceeds of these bonds were to be used to fund current and future unfunded liabilities of the State's five pension funds.

The Civic Federation has traditionally cautioned governments against using long-term debt to address budget shortfalls. However, the Federation recognized the extraordinarily difficult financial position of Illinois and most other state governments. As a result of the dire budget conditions of the State, past funding inadequacies, and historically low interest rates, The Civic Federation supported this proposal.

While supportive of the Governor's proposal, The Civic Federation strongly warned against the practice of debt financing to correct ordinary budget shortfalls or to fund normal operations, which would traditionally include current pension obligations. The Federation also offered the following concerns and suggestions:

- The General Assembly and the public at large should be aware that this financial strategy would not eliminate all the problems associated with the funding of State pensions.

[41] Illinois FY2005 State Budget, p. 7-81.

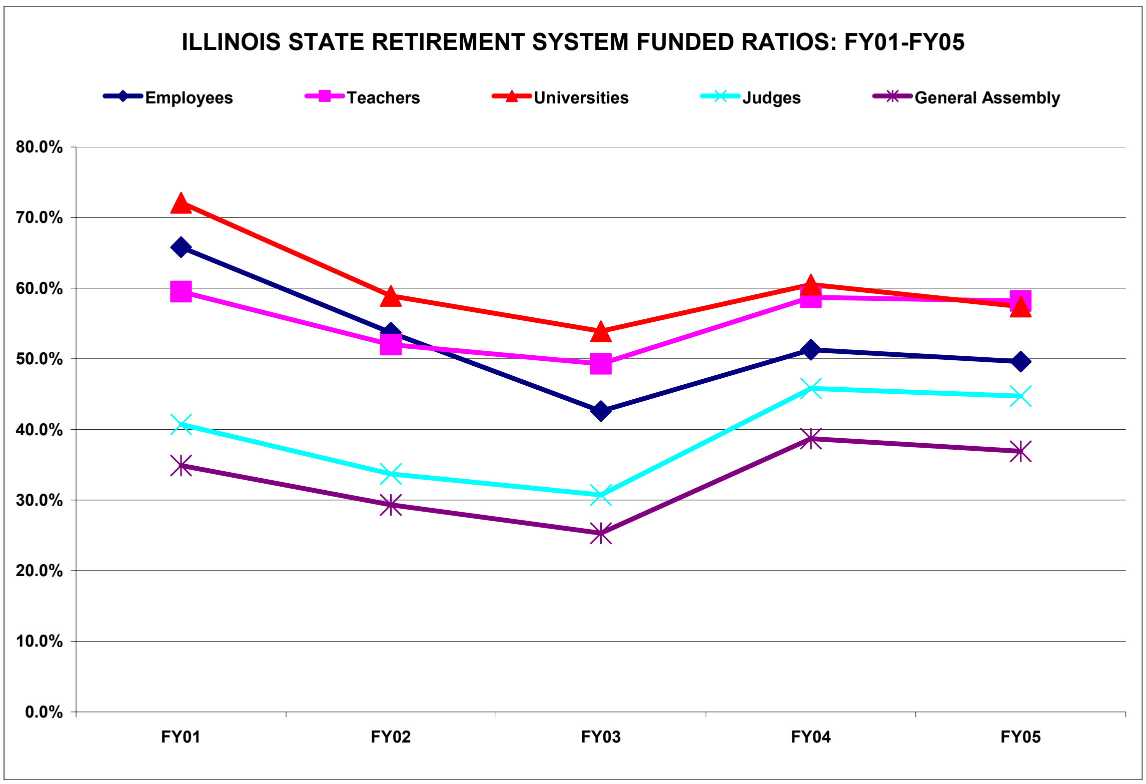
- We strongly encouraged the General Assembly to be mindful of the benefit levels granted to employees.
- In the future, the State should also consider authorizing cost effective, contemporary borrowing techniques such as variable rate obligations.

Pension Fund Indicators

The Civic Federation uses two measures to present a multi-year evaluation of the fiscal health of the State of Illinois pension funds: funded ratios and the value of unfunded liabilities.

Funded Ratios: Projected to Decline in FY2005

Five years of information on actual and projected funded ratios for the State's pension funds are illustrated in the following exhibit. In FY2004, funded ratios increased for all funds because of the distribution of funds from the $10 billion Pension Obligation Bond issue. However, ratios are projected to decline again in FY2005.



The next exhibit shows the impact of the Pension Obligation Bonds on funded ratios in FY2003 when those proceeds were distributed (see "FY2003 after P.O. bonds"). The funded ratios improved significantly for all five funds with the infusion of pension bond proceeds.

ILLINOIS STATE RETIREMENT SYSTEMS FUNDED RATIOS						
	FY2001	FY2002	FY2003	FY2003 After P.O. Bonds	FY2004 Estimate	FY2005 Estimate
State Employees' Retirement System	65.8%	53.7%	42.6%	50.5%	51.3%	49.6%
Teachers' Retirement System-Downstate	59.5%	52.0%	49.3%	58.5%	58.7%	58.2%
State Universities Retirement System	72.1%	58.9%	53.9%	61.8%	60.5%	57.4%
Judges' Retirement System	40.7%	33.7%	30.7%	43.9%	45.8%	44.7%
General Assembly Retirement System	34.9%	29.3%	25.3%	39.0%	38.7%	36.9%
ALL STATE RETIREMENT SYSTEMS	**63.1%**	**53.5%**	**48.6%**	**57.3%**	**57.2%**	**56.1%**

Unfunded Liabilities: Increase of $3.9 Billion Projected in FY2005

The unfunded liabilities of the State's pension funds in FY2005 are projected to be $42 billion. This is a 10.4%, $3.9 billion increase over FY2004. Unfunded liabilities are approximately $1 billion less than they were in FY2003 before the proceeds of the $10 billion Pension Obligation issue were distributed.

STATE PUBLIC EMPLOYEE RETIREMENT SYSTEMS UNFUNDED LIABILITIES (FY01-FY05)						
	FY2001	FY2002	FY2003	FY2003 After P.O. Bonds	FY2004 Estimate	FY2005 Estimate
Judges	$ 555,400	$ 677,100	$ 746,100	$ 604,200	$ 585,900	$ 632,100
General Assembly	$ 115,500	$ 130,500	$ 146,800	$ 119,800	$ 122,600	$ 128,300
State Employees	$ 4,295,500	$ 6,617,100	$ 10,091,900	$ 8,706,000	$ 8,950,000	$ 9,897,100
State Universities	$ 4,162,000	$ 6,839,300	$ 8,310,400	$ 6,878,400	$ 7,836,400	$ 9,290,700
Teachers' -Downstate	$ 15,851,100	$ 20,681,400	$ 23,808,600	$ 19,478,200	$ 20,611,800	$ 22,132,200
TOTAL	**$ 24,979,500**	**$ 34,945,400**	**$ 43,103,800**	**$ 35,786,600**	**$ 38,106,700**	**$ 42,080,400**

Pension Issues Impacting the FY2005 Budget

Three pension funding issues have a direct impact on the FY2005 State budget: an increase in the cost of the FY2002 ERI, the State's capture of $860 million in additional "savings" from its Pension Bond Obligation issue and the Governor's $527 million reduction in recommended pension contributions this year.

Annual Cost of 2002 ERI Balloons from $70 Million to $382 Million

The original estimated annual cost of amortization of the FY2002 ERI was $70 million. However, errors in that estimate have led to a recalculation that the actual annual cost will be $382 million.

The full cost of the ERI was originally assumed to be $622 million in additional unfunded pension liabilities, or approximately $80,000 per employee. However, new calculations have increased that amount to approximately $2.5 billion or $200,000 per employee. This represents an estimated $1.8 billion error.

What were the reasons underlying the dramatic increase in early retirement benefit costs? First, instead of accruing a retirement benefit equal to 1.67% of their final paycheck for the first 10 years of service, as is usually the case, retirees in "high stress" jobs such as public safety positions were credited with a 2.5% accrual rate. Approximately one quarter of state employees are classified as working in "high stress" positions. For all other employees, the ERI package waived the penalty that normally would have reduced annual pension payments by 6% for each year an employee was less than 60 years of age at the time of retirement. Therefore, a 50-year-old employee would reap the same benefits as a 60-year-old employee. These two changes added costs of approximately $62,000 per employee, boosting the average ERI cost of $80,000 to $142,000.[42]

The two changes described above also encouraged younger workers to retire. In fact, about half of retires were 55 or younger. Consequently, the state has to pay this groups' retirement costs for longer period of time than is usually the case because they live longer, thereby further boosting costs. The ERI also had provisions allowing retirees to purchase additional years of service. These two additional factors added an average of $58,000 in costs per retiree for a total average cost of $200,000.[43]

The FY2005 budget only provides for $70 million in funding for this initiative. The Governor has vowed to work with the General Assembly in resolving this issue by developing a funding plan to address the shortfall.

State Captures $860 Million in Additional "Savings" from Pension Bond Issue

Revenues from the pension bonds were intended to provide a massive cash infusion into the State's five pension funds, quickly increasing assets and reducing liabilities. The State would be able to capture the present value of the savings generated. This savings was estimated to be $2.16 billion.

Originally, it was assumed that the interest rate on the pension obligation bonds would be 5.8% while the pension funds' asset portfolio rate of return would be 8.0%. In fact, the bonds were issued at an interest rate of 5.05% while the pension funds' actuaries are now projecting an 8.5% expected rate of return for the entire asset portfolio. Based on these new figures, the estimated "savings" are now $3.02 billion, an $860 million increase. In the FY2005 budget, the State proposes to capture $215 million of the "savings" (25% of the savings increase) and keep the remainder for use in future years. This means that the State will reduce its appropriation to the retirement funds by that $215 million "savings" amount.

Governor's Budget Reduces Pension Contribution $527 Million from Certified Amount

The retirement funds annually certify required fiscal year employer contributions. For FY2005, the systems' certified contributions were $1.95 billion. This amount includes the required FY2005 contribution for the FY2002 ERI for the State Employees and Teachers Retirement Systems as certified in November 2003.[44]

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[42] Information on the cost of the early retirement initiative is from Greg Burns, "Pension Debacle Grows," in *Chicago Tribune*, March 28, 2004.
[43] Greg Burns, "Pension Debacle Grows," in *Chicago Tribune*, March 28, 2004.
[44] The State's total certified retirement system contribution is actually $2.4 billion, a figure that includes approximately $527 million in debt service costs that must be paid under any funding scenario. See Illinois

The Governor's FY2005 budget proposes a contribution of $1.4 billion for the five retirement systems. This is a $527 million reduction in appropriations from the certified amount. Approximately $312 million of that sum is the result of decreasing the State's ERI contribution from $382 million to the originally anticipated $70 million. $215 million of the reduction reflects savings accruing from the favorable interest rate on the bonds and the actuarially determined 8.5% rate of return on major fund assets.[45]

Unless the Continuing Appropriation Act authorizing the State pension funds' current funding plan is amended to permit a reduction from the certified amounts, the pension funds could request the State Comptroller to pay the full amount of the certified contributions.

STATE FUNDED RETIREMENT SYSTEMS FY2005 CERTIFIED CONTRIBUTIONS V. ACTUAL CONTRIBUTIONS (In Millions of Dollars)				
PENSION FUND	**FY2005 Certified Contributions**	**FY2005 Actual Contributions**	**$ CHG**	**% CHG**
Teachers'*	$ 907.0	$ 779.8	$ (127.2)	-14.0%
State Employees	$ 738.7	$ 380.6	$ (358.1)	-48.5%
State Universities	$ 270.0	$ 233.3	$ (36.7)	-13.6%
Judges	$ 32.0	$ 27.8	$ (4.2)	-13.1%
General Assembly	$ 4.7	$ 3.9	$ (0.8)	-17.0%
GRAND TOTAL	**$ 1,952.4**	**$ 1,425.4**	**$ (527.0)**	**-27.0%**

Source: Illinois Economic and Fiscal Commission

* Excludes contributions for Chicago Teachers' Pension Fund

Long-Term Effects of Reduction in Pension Funding: $20.7 Billion

The Illinois Economic and Fiscal Commission has projected what the long-term impact of the Governor's proposed funding reduction for the state retirement systems would be over time. The projections assume the proposed reduction associated with the savings accruing from issuance and sale of the Pension Obligation bonds as well as no funding of the 2002 Early Retirement Initiative greater than the $70 million annual payment originally proposed. Between FY2005 and FY2008, the total impact of the reduction would be nearly $2.1 billion. The long-term cost by 2045, when the systems are supposed to reach a 90% funding ratio, would be $20.7 billion.

Economic and Fiscal Commission, "Long-Term Impact of Governor's FY2005 Retirement Funding Proposals," March 2004, p. 1.

[45] Illinois Economic and Fiscal Commission. *Governor's FY05 Budget Recommendation for the State-funded Retirement Systems* and conversation with Tim Blair, Illinois Economic and Fiscal Commission, February 26, 2004. See also Teachers' Retirement System of Illinois, "Proposed State Budget Falls Short of TRS Funding Requirement," at www.trs.state.il.us.

State-Funded Retirement Systems Impact of FY2005 State Budget Funding Proposals (In Millions of Dollars)						
	Short-Term Impact (2005-2008)			Long-Term Impact (2009-2045)		Long-Term Cost
Pension System	FY2005 Reduction	Total Reduction	Current Break Even	Contribution Increases	Proposed Break Even	
Teachers'*	$ 127.0	$ 508.0	7.04%	$ 7,568.0	7.86%	$ 7,060.0
State Employees	$ 356.5	$ 1,403.0	7.04%	$ 12,844.0	7.93%	$ 11,441.0
State Universities	$ 36.6	$ 146.6	7.04%	$ 2,190.1	7.72%	$ 2,043.5
Judges	$ 4.2	$ 16.8	7.00%	$ 213.4	7.76%	$ 196.6
General Assembly	$ 0.8	$ 3.2	7.00%	$ 40.6	7.76%	$ 37.4
TOTAL	**$ 525.1**	**$ 2,077.6**	**N/A**	**$ 22,856.1**	**N/A**	**$ 20,778.5**

Source: Illinois Economic and Fiscal Commission, "Long-Term Impact of Governor's FY2005 Retirement Funding Proposals," March 2004.

BUDGETARY STRUCTURAL REFORMS

The FY2005 State budget proposes four structural reforms. Each of these reforms is briefly summarized below.

Release of Separate Operating and Capital Budget Documents
Historically, the State's operating and capital budges have been presented in a single document. However, this year the operating and capital budgets will be presented in separate documents. The FY2005 operating budget was released on February 18th while the FY2005 Capital Plan was released on March 23rd. The rationale behind the separation is that long-term capital spending trends can be more clearly understood and evaluated if they are not combined with short-term operating trends.

The Balanced Budget Act
This Act would require that whenever an appropriation bill or any other legislative action that increases spending is introduced, a counterbalancing financial action must be included in that bill. These counterbalancing actions must include either an increase in revenues or a reduction in spending in the same amount as the new spending.

The Responsible Spending Act
The Responsible Spending Act would require the Governor to deposit $50 million in the State's Rainy Day Fund for each $1 billion increase in General Revenue spending. The Governor has initially earmarked $50 million for this fund.

The On-Time Bill Payment Act
This Act amends the Short-Term Borrowing Act to permit periodic issuance and repayment of working cash credit. The purpose of this legislation is to give the Governor the short-term borrowing authorization necessary to be able to pay bills from vendors within a time frame of 30 to 60 days.

CIVIC FEDERATION RECOMMENDATIONS

The Civic Federation offers the following recommendations regarding ways to improve the State's financial management and fulfill the State's financial obligations:

Fund State Pension Obligations at Certified Amount of $1.95 billion

The Governor's FY2005 budget proposes a contribution of $1.4 billion for the five retirement systems. This is a $527 million reduction from the amount originally certified by the State Retirement Systems. Approximately $312 million of that sum is the result of the Governor decreasing the State's ERI contribution from the newly certified $382 million amount to the originally anticipated $70 million. The Governor has vowed to work with the General Assembly in resolving this issue by developing a funding plan to address the shortfall. In addition, $215 million of the reduction reflects savings accruing from the favorable interest rate on the pension obligation bonds and the actuarially determined 8.5% rate of return on major fund assets.[46]

The Civic Federation opposes this $527 million pension reduction. The State must meet, not defer, its pension obligations. The Civic Federation supported the $10 billion Pension Obligation Bond issue in 2003 because its intent was to reduce the State's pension liabilities. We believe that the State must fulfill its long-term obligations, regardless of who is at fault for underestimating the 2002 Early Retirement Initiative costs. It is not sound fiscal policy to continue to defer payment of this obligation.

Disclose Details of New Early Retirement Initiative

The Governor's budget also proposes a new ERI limited to 2,000 additional positions. This could be a constructive way to further control long-term costs. However, the details of how this ERI will be implemented have not yet been released. It is our hope that the full cost of the initiative is thoroughly and accurately vetted and the information made publicly available as soon as possible so that the proposal can be evaluated prior to its implementation. Without public disclosure of the cost and details of the proposed program, neither the public nor the General Assembly can evaluate how this new program will avoid the dramatic cost underestimates of the FY2002 ERI program.

Hold Legislative Hearings on Business Tax Changes

Businesses, like all taxpayers, have a right to understand how tax changes will impact them before such changes are voted upon by the General Assembly. The Civic Federation is very concerned that, by not releasing the detailed language of his tax treatment proposals, Governor Blagojevich is allowing precious little time for the General Assembly or the public to engage in an informed discussion about the merits and/or drawbacks of the individual proposals. In short,

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[46] Illinois Economic and Fiscal Commission. *Governor's FY05 Budget Recommendation for the State-funded Retirement Systems* and conversation with Tim Blair, Illinois Economic and Fiscal Commission, February 26, 2004. See also Teachers' Retirement System of Illinois, "Proposed State Budget Falls Short of TRS Funding Requirement," at www.trs.state.il.us.

we are concerned that this rush to change tax structures suffers from a distressing lack of fairness and transparency.

The Civic Federation has particular concerns about three of the most complex tax proposals that are expected to generate $162 million in new revenues. We believe that much more analysis and discussion is needed to fully understand the implications of these changes and to justify departures from the federal tax code. They are:

- Using Straight Line Instead of Accelerated Depreciation
- Extending the Sales Tax to Licensed Software
- Applying a Destination Apportionment Rule to Service Companies.

Using Straight Line Instead of Accelerated Depreciation: This proposal would decouple Illinois' treatment of depreciation from federal treatment. It would impose burdensome administrative costs to business associated with reprogramming existing software, including the recalculation of gain/loss information on the sale or disposal of assets. When implemented, the proposal will accelerate but not increase the collection of revenues since the useful life of these assets will remain unchanged. The $74 million revenue figure is a revenue projection for the first year when companies value all of their old and new assets. It is likely that the revenues will decrease each year. The complexity for businesses and the State of applying this new treatment to property already invested throughout the U.S. should not be discounted and necessitates disclosure to identify how this will be achieved.

Extending the Sales Tax to Licensed Software: This proposal appears to extend the sales tax on software purchased off the shelf by individuals in a store to also include licensed software. It is unclear how the State of Illinois will implement taxation of licensed software. The State cannot simply repeal current Department of Revenue regulations because the Illinois Supreme Court has already ruled that the Retailer's Occupation Tax cannot be imposed on intangibles such as lease transactions. Therefore, it probably would have to create a new tax on revenues from software licensing. It is also unclear how the Department will tax licensed software used by multi-state corporations based on Illinois in-state usage.

Applying a Destination Apportionment Rule to Service Companies. This proposal will change the way service companies apportion business income to Illinois. The current apportionment requirement is that 50% or more of a taxpayer's activity in connection with a sale must take place in Illinois. This proposal would eliminate that requirement and instead require that apportionment consider all sales activity in Illinois. It represents a fundamental change in how business income is apportioned. Its impact will probably be felt by any company that earns income by providing services to customers in more than one state, including utilities, telecommunications companies, brokerage firms, the mutual funds industry, and professionals providing specialized services such as attorneys, accountants, and computer consultants.

Meet Obligations through Further Expenditure Reductions

While the State has made many important strides in containing costs through personnel reductions, management reforms and spending cuts in selected agencies, the Civic Federation is not convinced that all necessary efficiencies have been wrung out of the State's budget. We believe that the State must continue to carefully consider what operations are core activities and which are not in order to prioritize spending. Further expenditure cuts are vastly preferable to increasing broad-based taxes on individuals or businesses. To that point, it is perhaps appropriate for the State to conduct focused management audits of all programs.

If the State funds its retirement systems at the $1.9 billion certified level and does not implement the three business tax changes discussed above[47], an additional revenue gap of $689 million would accrue. How would the State eliminate that gap? Sixty million dollars of that amount could be garnered from eliminating the state's pick-up of pension benefits for union employees. In addition, millions of dollars should be generated from the State's FY2005 Early Retirement Initiative if it is constructed in a cost effective manner. However, much of the reduction would have to come from additional spending cuts.

The State's combined operating and capital budgets are projected to increase by 2.4% in FY2005, from $52.4 billion to $53.6 billion. Finding an additional $689 million would require spending cuts of 1.3% in the capital and operating budgets combined or 1.6% in the operating budget of $43.5 billion. Additional cuts in programs will undoubtedly impose pain. They may even require closure of facilities, reduced hours of service and/or layoffs of personnel. However, the State must fulfill its current obligations and balance its budget responsibly.

Eliminate State "Pick-Up" of Employee Pension Contributions

The State's unionized employees have all or some of their pension contributions paid, or "picked-up", by the State. For these employees, the maximum employee contribution is 4% of gross wages, while the total contribution (including State pick-up) is credited to the employee's account.

In the FY2004 budget, the Governor eliminated the State's pension "pick-up" for employees not covered by a bargaining unit. This measure was projected to save the State $28.4 million.

The Civic Federation applauded Governor Blagojevich for eliminating the pension pick-up for non-union employees last year and we called for extending the elimination to all employees. We reiterate that recommendation this year. Elimination of the State's 4% pickup for union employees would generate $60 million in savings.[48]

Direct Commission to Review All Employee Benefits

The Federation applauds the Governor for forming a Blue Ribbon Commission to recommend ways to control State personnel costs. We understand that the premise for generous public employee benefits has always been that government workers are not paid as well as private sector employees. However, there is considerable evidence that public sector employees, including State of Illinois employees, are now paid commensurate with the private sector.

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[47] The three are using straight-line instead of accelerated depreciation, ending exceptions to unitary reporting by domestic subsidiaries and ending foreign tax havens for a total of $135 million in estimated new revenues.
[48] Information provided by Governor's Office of Management and Budget, February 26, 2004.

We urge that the Commission's mandate be comprehensive, considering all reasonable options for controlling benefit and compensation costs for union and non-union employees alike. The rate of growth in employee benefits must be curtailed if the State is ever going to slow the rate of growth in spending.

Link Rainy Day Fund Deposits to Revenues, not Expenditure Increases

The Civic Federation supports Governor Blagojevich's call for structured transfers to a Rainy Day Fund. However, we believe that Rainy Day Fund contributions should be linked to revenues, not expenditures. For example, during any year in which General Fund revenues are projected to increase by more than 4%, an amount equal to 0.25% of the additional revenue would be transferred to the Rainy Day Fund. This would require the State to set aside money when revenues increases are high but allow spending flexibility when revenue growth is low.