STATE OF ILLINOIS
FY2006 RECOMMENDED OPERATING BUDGET
Analysis and Recommendations

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The Civic Federation
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EXECUTIVE SUMMARY

The State of Illinois proposes a $43.5 billion operating budget for FY2006. The State faces a $1.1 billion deficit, which will be addressed by means of several revenue enhancements and allocation of the cost savings projected from adoption of pension funding reforms.

The State of Illinois' pension costs are spiraling out of control, and swift legislative action is needed to reform those pension systems before their growing pricetag financially overwhelms the State. The Civic Federation **strongly supports** the pension reforms the governor is proposing. Those reforms must be passed to prevent the ever-increasing cost of these pension systems from devouring the State of Illinois' budget. Without pension reform, there is no tax increase big enough for the State to find more funds for education, transportation, and other state priorities**.** Illinois will not be able to balance future budgets without substantial pension reforms today. These reforms are the necessary first step toward putting our state government on a solid financial footing.

The Civic Federation offers the following **key findings** on the State of Illinois FY2006 Budget:

- The FY2006 budgeted appropriations will increase by 0.8% from FY2005, or from $43.2 billion to $43.5 billion. General Funds appropriations are projected to increase by $839.4 million or 3.5%, from $23.7 billion to $24.5 billion.
- A $420 million School Endowment Fund will be created. It will be funded from surpluses in dedicated funds. $140 million of the Fund will be available for education funding in FY2006, including an increase in the foundation level for elementary and secondary education from $4,964 to a range of $5,004 to $5,009 per pupil.
- The budget contains $302 million in revenue changes: $284 million in new revenue enhancements and $18 million from increased audit enforcement.
- The new revenue enhancements include: $17 million from the repeal of the Retail Rate Law, $57 million from eliminating the exemption from the underground storage tank tax for fuel transported out of state; $65 million from eliminating the sales tax exemption for prewritten, licensed software to be used to fund mass transit; and $145 million from an increase in the state cigarette tax from 98 cents per pack to $1.73 to be used to fund capital expenditures.
- The number of full-time equivalent (FTE) budgeted positions is projected to decrease by 4.1% or 2,472 from 61,010 to 58,538.

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

- We strongly support the Governor's proposal to require the legislature to identify spending cuts or revenues for budget changes they propose in the Pay as You Go Act. Implementing the Act is necessary due to the creative ways past General Assemblies and administrations have finessed their constitutional obligation to produce a balanced budget. The State should also implement performance-based budgeting. The historic practice of not measuring program and expenditure performance compounded by the continued practice of adding new programs without discerning costs and/or increasing benefits can no longer be sustained.
- The budget contains no broad based income or sales tax increases. Until Illinois commits to a plan for evaluating the performance of the current budget and demonstrates the discipline necessary to adequately fund its constitutionally guaranteed employee pension benefits by adopting critical pension funding reforms, there will be little confidence that any additional tax resources will actually address promised priorities. Raising taxes now to generate new revenues without first clearly understanding and prioritizing how the State spends the money it already collects would be irresponsible, if not wasteful.

- The administration's policy of transferring surplus cash balances from the State's hundreds of special purpose funds to the General Fund is a sound and reasonable practice. However, the administration must conduct a publicly disclosed needs assessment for funds to ensure that programs have sufficient resources to perform their statutorily required duties.
- The State continues to make efforts to control personnel costs by reducing headcount, with a 4.1% reduction in authorized positions proposed in FY2006. These staff reductions are in line with the management efficiencies implemented in the private sector and other governments.

The Civic Federation offers **qualified support** for the Governor's pension funding reform proposals as a first step toward the total reform necessary

- The Civic Federation unequivocally supports comprehensive pension funding reform for the State of Illinois. Therefore, we endorse the Governor's proposed changes in Illinois' state pension systems this year. However, we do think that additional reforms, such as a moratorium on new benefits, are also critical if long term savings are ever to be achieved.
- Pension benefit payments are constitutionally mandated and therefore, they have the first claim on State revenues. Failure to address the State's ongoing and mounting pension funding crisis today will make it virtually impossible to fund other State program priorities such as education, public safety, and healthcare tomorrow. This is true even if State revenues grow in future years.
- Any solution to the State's pension funding crisis requires limits on benefits for new hires and therefore, we endorse the creation of a two-tier system.
- The Federation very reluctantly accepts the State's proposal to reduce its certified pension contributions in the FY2006 budget. This reduced pension payment may be the one-time incentive needed for the General Assembly to adopt these necessary pension funding reforms this year. However, we will adamantly oppose any future State budget proposal that fails to make the full certified pension payment. The irresponsible practice of failing to meet this constitutional obligation created the current crisis, and it must end.
- While we can support a one-time reduction in funding for this year only, we caution that it is impossible for the Civic Federation to verify the dollar amount that has been proposed by the State for savings. Many have questioned these amounts and their veracity. However, until and unless the administration fully discloses their actuarial methodology for calculating these savings, this issue will continue to be the subject of debate. Therefore, we urge the administration to reveal its method for calculating savings as soon as possible.

The Civic Federation **opposes** eliminating the **sales tax exemption for prewritten, licensed software** because some implementation issues have not yet fully been resolved and therefore it is unworkable in the time frame proposed. As a result, it may not generate the revenues needed immediately by the Regional Transit Authority and other transit agencies in Illinois.

- Even though this is the second year this proposal has been advanced and little more than a month remains in the scheduled spring legislative session, the Department has not yet fully developed a clear method to apportion, audit and collect this tax.
- We are particularly concerned that a method to apportion usage for companies using software loaded on servers in other states has not been advanced. Practically speaking, much more additional time must be spent in working to develop a reasonable methodology for implementing this tax. Due to this uncertainty, we believe that it is unrealistic to expect Illinois businesses to create new systems to comply with this tax on such a short deadline.
- Further discussions with affected parties and practitioners are needed to resolve the administrative and implementation issues posed by this proposal. The Civic Federation believes it is unsound public policy to extend a new tax without presenting a reasonable, consistent method for taxpayers to comply with it. We think it imperative and reasonable that implementation procedures for complex revenue treatments be fully developed before, not after they are approved.

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

- We call on the Governor to convene a Blue Ribbon Commission on State Spending to conduct a comprehensive review of State spending programs with the ultimate goal of prioritizing those programs. Those programs deemed to be essential to the well being of Illinoisans should be maintained or even enhanced, while non-essential programs may require reduction or elimination.
- The Civic Federation believes that a prioritization review is long overdue given the State's ongoing resource constraints, the administration's pledge to refrain from broad based tax increases and the public's unwillingness to embrace new taxes or enhanced spending without at least some confidence that the State is operating as efficiently and effectively as it should,
- Because of the critical importance of mass transit to the Chicagoland economy and because the CTA's proposed "Doomsday" and "Gridlock" scenarios threaten the region's viability as a logistics and transportation center, we support a short-term mass transit subsidy for the Regional Transportation Authority to allocate among its service boards derived from increased savings elsewhere in the State budget, on condition that the CTA increases fares as proposed and takes action to cut spending and increase efficiency. However, financial support for mass transit should not be derived from the proposed software tax, which is unworkable in the time frame proposed.
- The Governor's pension funding reform proposals are not in themselves sufficient to give the State's pension funds the strong financial footing required by state law and fiscal responsibility. More aggressive steps must also be taken in addition to adopting the reforms. The State of Illinois must adopt a moratorium on any new pension benefit enhancements until such time as substantial progress has been made on reducing the State's billions of dollars in pension liabilities. This may require waiting 10 years until the FY2002 Early Retirement Initiative fiasco is fully paid for.
- Public employees covered by the State's five retirement systems should contribute an additional 1% of their salaries to the cost of their pensions. Current contracts may prevent this increase from being implemented immediately for employees covered by collective bargaining agreements. In this case, the State should, as a matter of policy, require increased contributions in future contracts. In addition, wherever it is legally possible the increase should be implemented immediately, including, new hires and non-union employees.
- The concept of "pay as you go" funding should be extended to include State of Illinois actions that financially impact the pension costs of local governments. If the General Assembly continues to see fit to enhance local government employee benefits, it should identify and provide the requisite funding for those enhancements.
- The Budget Office should improve the performance measurement system currently in place to move beyond the reporting of workload measures to include goal statements as well as efficiency, effectiveness and service quality measures. These are important metrics needed to assess how well State programs operate and to help inform management decisions regarding service changes or improvements.

OVERVIEW OF ANALYSIS

The Civic Federation recently concluded an analysis of financial issues related to the State of Illinois' proposed FY2006 $43.5 billion operating budget. Based upon our review of the Operating Budget, we offer the following comments.

The State of Illinois' pension costs are spiraling out of control, and swift legislative action is needed to reform those pension systems before their growing pricetag financially overwhelms the State. The Civic Federation **strongly supports** the pension reforms the governor is proposing. Those reforms must be passed to prevent the ever-increasing cost of these pension systems from devouring the State of Illinois' budget. Without pension reform, there is no tax increase big enough for the State to find more funds for education, transportation, and other state priorities**.** The State will not be able to balance future budgets without substantial pension reforms today. These reforms are the necessary first step toward putting our state government on a solid financial footing.

The full text of our analysis follows this summary and is also available on our web site at www.civicfed.org. We have prepared a summary of the FY2006 capital budget in a separate report. The Governor has proposed to pay for new capital expenditures with an increase in the state cigarette tax from 98 cents per pack to $1.73 that will generate $145 million.

Issues that the Civic Federation Supports

The Civic Federation supports the Governor's ongoing efforts to manage the State's resources more efficiently and cost-effectively. We especially applaud his restraint and commitment to not raise headcount and control the mounting costs of long-term obligations. These efforts are reasonable and clearly in line with steps being taken by responsible governments and private sector firms all across the nation to better manage their resources.

The Pay as You Go Act

For the second year in a row, Governor Blagojevich has called for the adoption of the Pay as You Go Act. This legislation would require that any legislative action that increases spending be accompanied by an increase in revenues or a reduction in spending in the same amount as the new spending. This is a responsible, common sense proposal that should be enacted immediately by the General Assembly. If it had been enacted decades ago and applied only to the General Assembly's annual increases in pension benefits, Illinois and many local governments would not face the current structural deficit of such an enormous magnitude.

Implementing responsible fiscal strategies such as the Pay as You Go Act are necessary due to the creative ways past General Assemblies and administrations have finessed their constitutional obligation to produce a balanced budget. Illinois government would also benefit from a drive to institute performance based budgeting so that State funding priorities are implemented in a cost effective and efficient manner. The current and unfortunately historic practice of not measuring program and expenditure performance compounded by the continued practice of adding new programs without regarding to discerning costs and/or benefits can no longer be sustained.

No Broad Based Tax Increases

The Civic Federation is very pleased that Governor Blagojevich's proposed FY2006 budget for the State of Illinois does not increase the State's income tax rate, which remains at 3 % for individuals and 4.8 % for corporations, or the State's sales tax rate, which remains at 6.25% on general merchandise and 1% on qualifying foods, drugs, and medical appliances. Until Illinois government commits to an actionable plan for evaluating how the current $43 billion operating budget are benefiting the State and demonstrates the discipline necessary to adequately fund its constitutionally guaranteed employee pension benefits, neither the general public nor the Civic Federation will have the confidence any additional tax resources will actually address promised priorities.

There are many who argue that new revenues are urgently needed to fund a wide variety of enterprises, including increased funding for education, social services, mass transit, economic development and infrastructure. Others argue for property tax relief or even elimination of the Cook County property classification system. Still others believe that tax increases could not only generate billions of dollars in new recurring program funding but also could provide billions of dollars in property tax relief. Many of these are well intentioned ideas, but in almost every case the tax increase advocates fail to identify how their plan will stop the State from continuing to spend more than even the new resources provide or continue to ignore the need to pay for the billions of dollars of "hidden" cost obligations such as employee pensions that the State has already incurred. However, these "hidden" costs are real, constitutionally guaranteed and the primary source of the State's financial difficulties.

Although the Civic Federation supports a regular review of the State's financing and tax structure, such a review must identify both the revenue and expenditure components of the budget. And while it may be attractive for some advocates to argue that increasing taxes will solve its expenditure problems, State financial history refutes such notions. Illinois's financial difficulties have a thirty year history and simply raising taxes now to generate new revenues without first clearly understanding and prioritizing how the State spends the money it already collects would be irresponsible, if not wasteful.

The Civic Federation salutes the Governor and his financial team for taking many laudable and very important steps toward ensuring that the State of Illinois is managed more efficiently. But, because of the long-term, structural problems Illinois faces, we believe that the State must go further. It must undertake a comprehensive review of all of the programs currently provided to determine if they operate as efficiently as effectively as they should. In addition, we think it imperative that the administration, in conjunction with stakeholders, must undertake the painful but necessary task of prioritizing programs and services to determine which of these the State can reasonably afford. This is especially true if the administration or the General Assembly wants to avoid broad based tax increases to fund recurring cost increases of employee benefits and healthcare. Even with likely sales and income tax growth, the unchecked pressure of increasing State pension costs will leave the State with nowhere to turn but cost containment and spending reduction strategies in succeeding years.

Transferring Surplus Special Revenue Fund Balances

The Governor proposes to transfer $420 million in excess cash balances from certain of the State's 650 budget funds to an Educational Endowment Fund in FY2006. Certain funds will be exempt from this transfer, including debt service funds, payments to local governments, federal funds, road funds and the rainy day fund.[1] For four years, beginning in FY2006, 1/3rd of the Educational Endowment Fund will be transferred to the Common School Fund. In FY2006, $140 million in new money from the Endowment will be available for education. A portion of the cash balance in the Fund will be reserved to provide inter-fund loans to funds from which surpluses were drawn if it is needed.[2]

The vast majority of the State of Illinois' hundreds of budget funds were created to pay for a specific purpose and receive earmarked revenues that are not used for any other purpose. The General Funds, which include the General Fund and the Common Schools Fund, in contrast, are used for any purposes the State requires. Over time, the number of special purpose funds has increased, consuming ever larger portions of the State budget. In 2004, these "Other" funds, as they are designated in the budget, constituted 56% of the entire State budget or $29.3 billion. Many fee revenues earmarked for special purpose funds in Illinois are deposited to the General Fund in other states.[3]

In previous years, the administration has "swept" special purpose funds to transfer revenues to the General funds. In FY2004, the Blagojevich began assessing most "Other" funds a 5% fee to pay for the cost of administrative services provided by the State such as legal and accounting services that are currently paid for by the General Revenue Fund, a measure the Civic Federation endorsed[4] and the General Assembly has approved in statute.[5]

The Civic Federation supports the concept of transferring surplus revenues from special purpose to General Funds. It is a common budgetary practice across the U.S. to "sweep" funds and transfer surpluses in segregated funds to help close budget gaps. We see no compelling reason not to also use surplus funds to provide revenues for essential programs. In most cases, segregating revenues into special purpose funds is a practice that only should be used for certain high priority or mandated programs. Unless there is a compelling reason, the State should be afforded maximum flexibility in allocating resources as needed to meet policy priorities. The General Assembly and the voters are free to reject the administration's policy choices through the legislative and electoral processes.

However, while the Civic Federation supports the principle of sweeping funds and transferring excess balances to the General Funds, we do caution that the administration and General Assembly has a responsibility to evaluate and review such transfers. The administration must conduct a needs assessment for special purpose funds supported by targeted user fees and disclose the results of that evaluation in order to be certain that programs have sufficient resources to perform their statutorily required duties and functions. The General Assembly has a

[1] Communication from Governor's Office of Management and Budget, April 6, 2005.
[2] FY2006 Illinois State Budget, p. 1-8.
[3] FY2006 Illinois State Budget, p. 3-6.
[4] The Civic Federation. FY2004 Illinois State Budget Analysis, May 20, 2003.
[5] See Sections 8H and 8J of the State Finance Act, 30 ILCS 105/8H-8J.

corresponding responsibility to review such assessments and determine if proposed appropriations are appropriate for such programs.

Management Reforms

The Civic Federation supports the administration's ongoing efforts to implement management reforms, including the consolidation of programs and departments and the shifting of personnel resources from administration to direct service provision.

This year, the State is reviewing staffing models in the Departments of Corrections and Natural Resources in order to reduce the number of administrative positions and increase the number of employees providing direct service. A similar project was undertaken last year in the Department of Human Services. In addition, the State's capital planning function, which is currently located in various state agencies, is being consolidated into the Capital Development Board.

Continued Headcount Reductions

The Governor's FY2006 budget recommendation calls for 58,538 budgeted full-time equivalent (FTE) positions, a reduction of 4.1%, or 2,472 budgeted positions, from FY2005. This is the lowest level of budgeted positions since 1972 when the State employed 65,575 employees. Because a significant portion of State government expenses are related to personnel costs, shrinking the State's workforce by reducing headcount is a critical step in containing these costs. We are encouraged by the Governor's ongoing commitment to cap personnel costs by continuing to reduce headcount. Such reductions in staff are well in line with the management efficiencies that are regularly implemented in the private sector and the result of improved technology and better business processes.

The Governor's Pension Funding Reform Proposals

Illinois is in a pension funding crisis. This crisis was created over the last 30 years, in which the General Assembly and Governors past and present jointly failed to meet the State's pension fund obligations.

As a result, the State of Illinois faces future financial obligations of staggering proportions. Even after issuance of $10 billion in Pension Obligation Bonds in 2003, the State still must make contributions totaling *$275.1 billion* to the five retirement systems to attain the statutory requirement of a 90% funded ratio by 2045. This sum – some six times greater than the entire proposed FY2006 State operating budget -- will increase even further if the State continues to ignore the financial reality of its flawed pension policies.

Therefore, the Civic Federation **unequivocally supports comprehensive pension reform for the State of Illinois.** It is imperative that the General Assembly take decisive action to control the spiraling costs of state employee pensions and fund the state's pension systems at the levels required by law.

As a first step toward the total reform necessary, we support the Governor's proposed changes in Illinois' state pension systems. Significantly, these proposed reforms address the State's need to reduce the costs of the pension systems over time. The Governor's proposed solutions are not perfect; we would have preferred even greater reforms. However, these proposals, based on the recommendations of the Governor's Pension Commission, represent a targeted, realistic effort at containing mounting expenditures that threaten to crowd out state spending for education, public safety, and healthcare.

The current slate of proposed reforms are not in themselves sufficient to give the state's employee retirement systems the strong financial footing required by both state law and fiscal responsibility. Nevertheless, these modest and equitable solutions will have a profound fiscal impact over time. To maintain the State of Illinois' financial integrity, the General Assembly must embrace and enact these proposed reforms, and must be prepared to take more aggressive steps in the future including a moratorium on any new benefits until a mechanism for adequately funding existing benefits is implemented.

Pension Funds Undermined by Decades of Fiscal Irresponsibility

For decades, the State of Illinois has failed to adequately fund its employee retirement systems. At the same time, it has added an extraordinary array of new benefits without providing funds to pay for these increases. Even after passage of the historic 1995 pension funding reform law, designed to bring the State's pension funds to a 90% funded ratio by 2045, the General Assembly failed to make the actuarially recommended payments into the system, while adding more than $5.8 billion in new unfunded pension enhancements. This lack of fiscal accountability is the principal engine behind the State's current financial situation.

The Civic Federation believes Governor Blagojevich's proposed FY2006 budget includes two important initiatives to control pension costs: It curbs increases in benefits for current employees, and it provides reduced benefits for new hires.

The current retirement system allows for many serious -- and costly -- abuses. For example, school districts and universities may give virtually unlimited end-of-career raises to retiring administrators, resulting in drastically increased pension costs for those retirees that, under current law, the State of Illinois must assume. Alternative-formula pension benefits, originally intended only for sworn police officers and other state employees working in high-risk, physically strenuous jobs, are now offered to one-third of all state employees. The State Universities Retirement System's use of a money purchase option offers employees an unjustified and unrealistically high rate of interest. The Pension Commission's report offered commonsense solutions to these and other abuses, and many of those solutions are adopted under the Governor's proposed reforms.

To Contain Escalating Costs, Benefits for New Employees Must be Reduced

Any solution to the State's pension funding crisis requires limits on benefits for new hires. If state employee pension costs are not contained, the General Assembly will be forced to support a massive tax increase or significantly slash spending for decades to come. Although this move is likely to face opposition from state workers, the private sector -- and many governments – are moving in this direction. It must be noted that, even with the recommended reduction in benefits for new hires, the Illinois state pension systems will still offer generous retirement benefits unavailable to most private-sector employees. Therefore, the Civic Federation strongly supports creating a modestly changed but more reasonable and affordable retirement benefit for future employees.

Pension Reforms May Generate Savings, but Fiscal Restraint Must Continue

Actuaries and consultants for the Governor's Office of Management and Budget estimate these reforms will reduce pension fund liabilities by $100 billion over 40 years, thereby reducing the required State contributions by a total of $55 billion over that time period.

In anticipation of those projected savings, the proposed FY2006 budget would reduce by $819 million the State's required, certified contribution to the five retirement systems. This is a troubling aspect of the Governor's proposal; the Civic Federation calls on the Governor's financial team to provide significantly more detail on the figures and actuarial methodology underlying that savings estimate and the long-term financial impact of the reduced FY2006 pension payment.

The use of the proposed "proportional savings" in this budget marks the second year in a row that the Blagojevich administration has proposed a State operating budget that fails to make the entire certified payment to the pension systems. The Civic Federation is very concerned by any move to alter the funding contribution formula adopted in the 1995 reform law. It is precisely because the State has repeatedly failed to fulfill its constitutional obligations to adequately fund employee retirement systems that the Civic Federation is pessimistic about the State's ability without extraordinary changes to fully control the mounting pension deficit. As a result, the State must both adhere to an inviolable funding schedule as required by the 1995 pension funding reform law and impose a long-term moratorium on any new benefits.

Last year, the State of Illinois' budget similarly failed to meet the entire certified payment amount. The Administration claimed that payment shortfall in part reflected millions of dollars in "savings" to the retirement systems that accrued from the favorable interest rate on the issuance of pension obligation bonds and the actuarially determined 8.5% rate of return on major fund assets. The State also failed to make the full payment required by the unexpectedly high cost to the pension system of the FY2002 Early Retirement Initiative. The Civic Federation opposed both reductions from the State's compliance with the 1995 pension funding law.

Although the Civic Federation continues to support the 1995 funding law, we believe it is essential that the General Assembly enact the Governor's proposed pension reforms. Quite simply, these changes must be made now if the State is to ever break the cycle of deferring, expanding and ignoring its long-term financial obligations. Therefore, we reluctantly accept the State's proposal to reduce its certified pension contributions in FY2006, but only if the Governor's proposed pension reforms, including the establishment of a two tier system, are implemented.

The Civic Federation very reluctantly accepts the State's proposal to reduce its certified pension contributions in the FY2006 budget. This reduced pension payment may be the one-time incentive needed for the General Assembly to adopt these necessary pension funding reforms this year. However, we will adamantly oppose any future State budget proposal that fails to make the full certified pension payment. The irresponsible practice of failing to meet this constitutional obligation created the current crisis, and it must end. We support the Governor's pension proposal only because it includes crucial structural reforms; absent those changes, we would not countenance yet another failure to make the entire certified payment to the State pension systems.

While we can support a one-time reduction in funding for this year only, we caution that it is impossible for the Civic Federation to verify the dollar amount that has been proposed by the State for savings. Many have questioned whether these amounts represent actual "proportional savings" to the State. However, until and unless the administration fully discloses their actuarial methodology for calculating these savings, this issue will continue to be the subject of debate. Therefore, we urge the administration to fully disclose and explain the details of how the $819 million reduction represents proportional savings to the pension system and reveal its method for calculating savings as soon as possible.

If members of the General Assembly oppose using these anticipated future savings to balance the current budget, we strongly urge them to adopt the proposed pension reforms on their own merits and to present alternative spending cuts to close the resulting $819 million gap. Disagreement over the amount of proportional savings or continued adherence to the 1995 law should not be used as an excuse to not adopt comprehensive pension reforms this year.

Issue the Civic Federation Opposes

While there are many positive elements in the FY2005 State budget, The Civic Federation **opposes** the proposed extension of the sales tax to prewritten licensed software, which the Governor has proposed as a mechanism for increasing transit funding.

Eliminating the Sales Tax Exemption for Prewritten Licensed Software

The Civic Federation opposes eliminating the sales tax exemption for prewritten, licensed software because some very important implementation issues have not yet fully been resolved and therefore it appears unworkable in the time frame proposed. As a result, it may not generate the revenues needed immediately by the Regional Transit Authority and other transit agencies in Illinois.

In an attempt to provide increased State funding for public transit, the Governor's budget proposes to make all prewritten, licensed software purchased in Illinois subject to state sales tax, including electronically downloaded and licensed software. The proposal would eliminate the current tax exemption for prewritten software that is licensed to users directly by the software developer. In the case of prewritten software delivered electronically to a company's out-of-state office, only the portion used in Illinois will be taxed. Companies will be required to provide documentation to determine their taxable base.

The Civic Federation greatly appreciates the Department of Revenue's ongoing efforts to address our concerns and the concerns of the business community regarding this proposed tax. However, too many unresolved issues remain regarding implementation and administration of the tax. The administration's proposal has an effective implementation date of July 1 of this year. However, even though this is the second year this proposal has been advanced and little more than a month remains in the scheduled spring legislative session, the Department has not yet fully developed a clear method to apportion, audit and collect this tax. We are particularly concerned that a method to apportion usage for companies using software loaded on servers in other states has not been advanced. Practically speaking, much more additional time must be spent in working to develop a reasonable methodology for implementing this tax. Due to this uncertainty, we believe that it is unrealistic to expect Illinois businesses to create new systems to comply with this tax on such a short deadline.

It should also be recognized that increasing the cost to businesses that purchase software may impact Illinois's efforts to attract and retain corporate technology and other administrative offices.

Further discussions with affected parties and practitioners are needed to resolve the administrative and implementation issues posed by this proposal. The Civic Federation believes it is unsound public policy to extend a new tax without presenting a reasonable, consistent method for taxpayers to comply with it. We think it imperative and reasonable that implementation procedures for complex revenue treatments be fully developed before, not after they are approved.

Additionally, the Civic Federation questions the necessity of this proposed expansion of the state sales tax. We strongly support some short-term funding relief from the State to ease the CTA's budget deficit and to help prevent severe service cuts that could cripple mass transit in Chicago. However, in our analysis of the CTA's FY2005 budget proposals and in this analysis, the Civic Federation has outlined steps the CTA should be required to take to reduce its budget deficit before the State provides increased funding for the Regional Transit Authority and other transit agencies.

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:

Establish a Governor's Commission to Review and Prioritize State Spending

Recognizing the critical need to constrain mounting state pension costs, Governor Blagojevich appropriately established a Blue Ribbon Pension Commission composed of representatives from the business community, labor unions, the General Assembly and civic groups to propose recommendations for funding reform in Illinois. In our view, the Commission successfully met its charge; the State of Illinois was well served by its sound proposals.

The Civic Federation recommends that the Governor follow up on the success of the Pension Commission by convening a Commission on State Spending. The purpose of this Commission would be to conduct a comprehensive review of State spending programs to identify measures of their performance with the ultimate goal of prioritizing those programs. Those programs that are deemed to be essential to the well being of Illinoisans should be maintained or even enhanced. Those programs that are not essential may require reductions or even elimination. Given the State's ongoing resource constraints, the administration's pledge to refrain from broad based tax increases and the public's unwillingness to embrace new taxes or enhanced spending without at least some confidence that the State is operating as efficiently and effectively as it should, we believe that a prioritization review is long overdue. Several states, including Washington and Michigan, have or are in the process of conducting similar prioritization processes.

The framework for a review of State spending should be comprehensive and include the following considerations:

- Cost containment strategies for mandated programs;
- A cap or moratorium on the expansion of State employee benefits;
- No new programs without new revenues or spending cuts; and
- Enhanced accountability for state programs including publicly announced and updated performance measures.

Fund Mass Transit with Spending Reductions and Cost Saving Efforts

Governor Blagojevich has proposed to increase funding for mass transit in Chicago and other communities with $65 million in revenues projected from elimination of the sales tax exemption for prewritten, licensed software by corporations. As of this writing, the State has not disclosed exactly how these funds will be divided among individual transit agencies statewide.

Because of the critical importance of mass transit to the Chicagoland economy and because the CTA's proposed "Doomsday" and "Gridlock" budget scenarios threaten the region's viability as a logistics and transportation center, the Civic Federation supports some incremental State funding for mass transit, including the CTA. However, we oppose the Governor's software tax proposal to fund mass transit because of the difficulty that both the Illinois Department of Revenue and Illinois businesses would have implementing the new tax in the time frame allowed. We believe that funding for a mass transit subsidy should be derived from increased savings elsewhere in the State budget. Such funding also should be conditioned on the Regional Transit Authority taking the steps necessary to ensure appropriate oversight of the CTA's finances. This includes monitoring the need for fare increases and promoting greater efficiency in operations and transparency in financial reporting, especially in the areas of personnel, pension funding and management reforms such as privatization and outsourcing. In our view, increased State support for the CTA should supplement -- not replace -- cost cutting and revenue enhancement strategies by that agency, including a fare increase.

In testimony on October 27, 2004 on the CTA's FY 2005 budget, the Civic Federation argued that the agency should increase fares by 25 cents to generate $20-$25 million, eliminate owl service to save $2.3 million and implement the $49 million in reasonable cost-cutting and revenue enhancement measures proposed in its "Gridlock" Budget. We urged the CTA to use these strategies as a means of avoiding service cuts, which can leads to permanent reductions in transit operations to the detriment of citizens and the regional economy.

Unfortunately, the CTA delayed adoption of its FY2005 for six months, pending action by the State to provide additional funding, and declined to implement any cost-cutting measures in the meantime. This move lessens the financial impact of any deficit-closing measures the agency may ultimately adopt, and thus increases the size of its anticipated budget deficit – which the agency has not yet disclosed.

On April 13, 2005, the CTA Board of Trustees voted to approve a budget that will increase cash fares to $2 and make sweeping service cuts, effective July 17, if the State does not increase funding to close the agency's deficit.

The Civic Federation supports the CTA fare increase although we believe that the system's reported financial condition requires that it should impose a 25 cent increase on all fares to generate additional revenues. However, we still believe that deep service cuts should be avoided if possible even if it means additional fare increases for peak time users. Instead, the originally proposed cost-cutting and revenue enhancement issues considered last year should be implemented, and State of Illinois should provide funding to close any remaining budget deficit.

The State's increased share of funding for the CTA should be derived from the elimination of redundant State programs and reduced funding for lesser priorities and activities that are more appropriately funded by the other entities, such as universities, local governments or the private sector. Some immediate options for the General Assembly to consider include, but are not limited to:

- Eliminating the State subsidy for Coal Development and Marketing could yield $23.6 million annually;
- Eliminating General Fund subsidies of the salaries of local assessors, supervisors of assessment and coroners could save up to $5.7 million per year;
- Eliminating State college tuition waivers granted by members of the General Assembly scholarships would generate up to $2.3 million in revenues;
- Ending State grants to local Soil and Water Conservation Districts for salaries, education and promotion assistance could save $5.2 million annually;
- Eliminating agricultural research grants to public universities could save up to $3.5 million annually; and/or
- Ending the State subsidy for the DuQuoin State Fair, the State's second state fair, could save $1.1 million per year.

There are many other areas in the State's $43 billion operating budget that should be reviewed. Unfortunately, there is little in the Governor's proposed budget or other publicly accessible documents that identify and measure the performance of most State programs.

Solving the CTA's short-term budget gap, however, does not address the long-term funding problems faced by transit agencies in northeastern Illinois. Public transportation is a vital economic asset to the entire Chicagoland region. Adequate funding of the CTA as well as Metra and Pace is essential for carrying out the very important role of congestion relief for commuters and to ensure that the region continues as a key transportation and logistics center. We look forward to the research and recommendations that will be offered later this year by the Illinois House Special Committee on Mass Transit for Northeastern Illinois, chaired by Representative Julie Hamos. That Committee has already released an important summary of the current transit funding situation and identified specific areas for further attention. It is expected that this committee will be charged with the responsibility to analyze and possibly rewrite the transit funding formula and ensure that operating revenues and funding correspond to transit service provided in all parts of the region.

The Civic Federation believes that any solution to the long-term funding problems of the transit agencies of northeastern Illinois requires that the following issues be considered:

1. The RTA funding formula should be reviewed. Any changes made should include a sunset clause to ensure future review of the RTA Act at appropriate intervals.

2. Paratransit costs should be excluded from the CTA's recovery ratio calculation. This calculation imposes a costly burden on the CTA for a service it is required to provide by federal law.

3. The Regional Transit Authority (RTA) must assume a more responsible role in solving the regional transit funding crisis, and avoid the potential cannibalization of one service board's resources by another.

4. There is a leadership void at the RTA because of that body's failure to appoint a new Chair. It is imperative that a new RTA Chair be appointed without delay to begin providing the guidance so sorely needed on regional transit funding and planning issues.

Impose a Moratorium on New Pension Enhancements

The Governor's Blue Ribbon Pension Commission recommended that not only should any new pension enhancements be accompanied with an identified source of funding, but they should also sunset after a period of time. We concur with both of these sound proposals. It is certainly proper to discuss, review and reconsider benefits for new employees at any time. However, the Civic Federation believes that even more rigorous cost control efforts are essential.

The Governor has proposed a "Pay as You Go" Act that would require any appropriation bill that includes new spending to identify new revenues or reduced spending in order to pay for the initiative. We urge the General Assembly to approve this Act as a means of capping runaway long-term obligation costs. We were disappointed that the legislature failed to take up a similar proposal by Governor Blagojevich last year.

If the General Assembly fails to adopt the Pay as You Go Act, new pension enhancements may be approved by the legislature without identified funding. Adding more benefits without funding would, of course, negate the financial benefits that accrue from adopting any or all of the Governor's pension reforms.

However, even if the Pay as You Go Act is approved, spending could still rise. The legislature could simply increase benefits and find new ways to pay for them. While this is a more fiscally responsible approach, it still keeps the State on a never-ending treadmill of continuously expanding benefits and costs.

The Civic Federation believes that the time has come to stop expanding employee pension benefits. Therefore, we call on the legislature to reject and the Governor to veto any new pension enhancements whether they are funded or not. In addition, the State must adopt a moratorium on any new benefit enhancements until such time as substantial progress has been made on reducing the State's billions of dollars in pension liabilities. This may require waiting at least 10 years until the FY2002 Early Retirement Initiative fiasco is fully paid for.

Require Employees to Increase Pension Contributions by 1%

The Federation believes all public employees covered by the State's five retirement systems should contribute an additional 1% of their salaries to the cost of their pensions. This increase should be required immediately for new hires and non-union employees. Although current contracts may prevent this increase from being implemented immediately for employees covered by collective bargaining agreements, the State should, as a matter of policy, require increased contributions in future contracts. Stratospheric pension costs pose a serious threat to the financial future of the State of Illinois and its residents, and containing those costs must be a shared, ongoing, focused effort. We do not believe a single percentage point increase is onerous or unreasonable, especially when balanced against the generous retirement benefits state employees receive.

Study the Costs and Benefits of a Defined Contribution Pension Plan

The Commission recommended that once the State stabilizes the funding of its pension system, it should consider replacing all or part of its Defined Benefit pension plans for new hires with Defined Contribution (DC) Plans. DC plans, which are the predominant form of retirement benefit provided to the average American worker, can significantly reduce unfunded liabilities over time and offer employees greater flexibility as they change jobs.

In reviewing the past thirty years, we have seen no evidence that the General Assembly has the requisite fiscal discipline to transparently execute a well funded Defined Benefit retirement system. For that reason, we think that a shift to a Defined Contribution system must be seriously considered for new hires when it is financially feasible. We understand that the transition costs for the shift could be expensive because of the current dramatic underfunding of the retirement systems. However, the Civic Federation urges the Governor, the Pension Commission and the legislature to undertake a study of this option to determine both costs and benefits. This study should include consideration of transition funding mechanisms because the cost savings and benefits of a shift to a DC plan in the long term may outweigh short-term expenses. While the Civic Federation opposes the issuance of any new Pension Obligation bonds to fund current or future State of Illinois pension obligations, there may be the potential for issuing such bonds for the sole purpose of funding the transition costs to a defined contribution plan. This would, of course, be contingent upon financial feasibility and the identification of real, substantial cost savings over time.

The State Should Not Mandate Local Pension Enhancements without Providing Funding

The General Assembly frequently approves legislation increasing the level and scope of local government employee pension benefits. However, no funding is provided for what amounts to yet another costly unfunded mandate for cash strapped local governments. We believe that the concept of "pay as you go" funding should be extended to include State of Illinois actions that financially impact the pension costs of local governments. If the General Assembly sees fit to enhance benefits, it should identify and provide the requisite funding for those enhancements.

Fully Disclose all Pension Information in Budget Book

The FY2006 Budget Book does not include full information about the amount requested for appropriations for the State Employee' Retirement System, nor does it include information about the proposed allocation of $819 million savings per system if the Governor's pension funding reform proposals are adopted. The public needs full and accurate financial information in order to understand and evaluate the Governor's budget proposals, particularly on an important issue such as pension funding. The Civic Federation calls upon the State to fully disclose to the public all relevant fiinancial information about contribution levels for all retirement systems in the pension section of future budget books.

Improve Performance Measures

The Civic Federation agrees with the International City Management Association (ICMA), the Government Finance Officers Association (GFOA) and the National Advisory Council on State and Local Budgeting (NACSLB) that all governments should evaluate the performance of programs and services they provide. This is the best way to determine if they are accomplishing intended program goals and making efficient use of resources. Evaluating and reporting on program results helps keep policymakers and taxpayers alike informed about actual results compared to expectations.[6]

The FY2006 Illinois State Budget includes five years of performance metrics for each agency. However, most of these metrics are workload measures, that is counts of the number or percentage of activities undertaken or services delivered. These are important statistics. But, they provide no information about the goals the statistics are measuring; this makes it impossible to determine if agencies are meeting, exceeding or falling short of program and policy goals. In addition, there are no efficiency, effectiveness or service quality measures that would permit a focused evaluation of how well agencies and programs are meeting stated goals.

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

The Civic Federation is keenly aware that producing reams of measures (particularly workload measures) that are not linked to goals or objectives, utilized to inform management decisions, or developed without the support of management and staff can be costly and have limited efficacy. However, using a few well-chosen measures, particularly those measuring efficiency and effectiveness that are produced consistently and developed with the support of staff can be a valuable tool in assisting the State to improve its management and operations.

ACKNOWLEDGEMENTS

The Civic Federation would like to express appreciation to Governor's Office of Management and Budget (GOMB) Director John Filan, Illinois Department of Revenue Director Brian Hamer, GOMB Communications Director Becky Carroll and the respective staffs of the Governor's Office of Management and Budget and the Illinois Department of Revenue for their hard work in preparing this budget and their willingness to answer many of our budget and revenue questions.

We would further like to **congratulate** Governor Blagojevich, Director Filan and the financial management team at the Governor's Office of Management and Budget for their ongoing efforts to substantially improve the format of the State operating budget to reflect many of the more user-friendly guidelines recommended by the Government Finance Officer's Association Distinguished Budget Awards Program. We commend the State of Illinois for receiving the GFOA Distinguished Budget Award for the first time for the FY2005 operating budget document.

[6] See Recommended Practice 11.1 "Monitor, Measure, and Evaluate Program Performance," in National Advisory Council on State and Local Budgeting. *Recommended Budget Practices: A Framework for Improved State and Local Budgeting* (Chicago: GFOA, 1998).

FY2006 BUDGET HIGHLIGHTS

Governor Blagojevich proposes a FY2006 operating budget of $43.5 billion. This represents a 0.8% increase from FY2005. The proposed General Funds Budget will be $24.5 billion, a 3.5% increase from FY2005

Cost Drivers of the $1.1 Billion Deficit

The budget deficit in FY2006 was $1.1 billion. This gap was reduced from initial reports of $2.1 billion because of the infusion of $500 million in additional federal Medicaid funds and over $500 million in better than expected revenue growth. The primary drivers of the deficit were threefold:[7]

1. Certified (required) pension costs will increase from approximately $2.1 billion to $2.6 billion in FY2006, increasing overall required pension contributions by $470 million. (The certified costs are expected to increase to $4 billion in 2010 if pension funding reforms are not adopted).
2. Medicaid expenses are projected to rise by $480 million. Medicaid costs are increasing by an average of 10% each year.
3. Employee healthcare costs are expected to increase by $160 million in FY2006.

Revenues: 6.7% Increase Projected

The FY2006 budget projects a 6.7% increase in total receipts. This is a $2.8 billion increase, from $42.7 billion in FY2005 to $45.6 billion in FY2006. Non-state tax receipts such as interest income and miscellaneous taxes, fees, earnings and net transfers are projected to increase by nearly $1.7 billion in FY2006, from $2.4 billion to $4.1 billion.

State tax revenues for all funds are projected to increase by 2.5% in FY2006, from $21.1 billion to $21.6 billion. This reflects a gradually improving economy and, correspondingly, an improved fiscal situation as State tax and fee collections improve. Net personal income tax revenues are expected to rise by 4.4%, net corporate income taxes by 8.2%, sales taxes by 3.7%, motor fuel taxes by 0.8% and corporate franchise fees and taxes by 2.1%.

In FY2006, there will be over $1 billion in increased General Fund revenues. These revenues include $800 million in natural revenue growth from existing revenues and $255 in projections for new revenues. The new 75 cent per pack cigarette tax is expected to generate $155 million; the increase will be from 98 cents to $1.73/pack. These revenues will be used to fund capital projects. The new tax on prewritten licensed software is expected to generate $65 million; these revenues are earmarked for funding of the CTA and other mass transit agencies. Eliminating the storage tank fee exemption for fuel from Illinois refineries transported out of state is expected to generate $57 million. Those revenues will be used to fund the State's federally mandated vehicle emissions testing and underground storage tank inspection programs.

Personnel: Lowest Number of Positions Since 1972

[7] The deficit driver figures are derived from the Governor's Budget Address, February 16, 2005.

The FY2006 budget provides for 58,538 positions. This is 10.7% fewer positions than in 1972, when 65,575 positions were budgeted. The number of positions in FY2006 will be 17.6% fewer than the 71,045 positions budgeted in FY1981.

Pensions: Adoption of Reforms Could Decrease State Contributions by $819 Million

The certified amount for pension funding in FY2006 is $2.6 billion. Based upon the recommendations of the Governor's Pension Commission, the Blagojevich administration has proposed a number of pension funding reform proposals that could reduce retirement fund liabilities by $100 billion over 40 years and yield cost savings of as much as $55 billion.

If the Governor's reform proposals are adopted, the State will reduce its FY2006 contribution to the State's five retirement systems by $819 million. Additional savings will accrue in future fiscal years. This will reduce the State's required FY2006 contribution to $1.8 billion.

Creation of a School Endowment Fund

The Governor proposes to create a $420 million School Endowment Fund to be funded from surpluses in dedicated funds. Funding for the Endowment will be recurring, as every third year, it will be replenished from dedicated fund surpluses.[8]

For each of four years, beginning in FY2006, 1/3rd of the School Endowment Fund will be transferred to the Common School Fund. In FY2006, $140 million in new money from the Endowment will be available for education, including funding of an increase in the foundation level for elementary and secondary education from $4,964 to a range of $5,004 to $5,009 per pupil.

GAP CLOSING MEASURES

The sources of the FY2006 State of Illinois budget deficit are shown in the exhibit below. Reductions in certain base revenues were responsible for $465 million. Funds sweeps, the cigarette tax and administrative chargeback's on special purpose funds generated $365 million less than anticipated while the voluntary compliance program for illegal tax shelters was a one-time program that was not carried over from FY2005 to FY2006.

On the spending side of the ledger, expenditure increases for mandated programs such as Medicaid, pensions and employee group health insurance were expected to increase by nearly $1.7 billion. However, over $1 billion generated from the State's ability to access additional federal Medicaid dollars and a $550 million increase in projected base revenues reduced the size of the deficit from $2.1 billion to $1.1 billion.

[8] Information provided in a communication from the Governor's Office of Management and Budget, March 23, 2005.

SOURCES OF FY2006 STATE OF ILLINOIS BUDGET GAP (In Millions of Dollars)	
Reductions in Certain Base Revenues	
Funds Sweeps	$ 265.0
Cigarette Tax	$ 50.0
Chargebacks	$ 50.0
Voluntary Compliance Program	$ 100.0
Total Reductions	**$ 465.0**
Mandated Spending Increases	
Medicaid	$ 960.0
Pensions	$ 487.0
Group Health Insurance	$ 150.0
Other	$ 100.0
Total Spending Increases	**$ 1,697.0**
Additional Federal Medicaid Reimbursement	**$ (480.0)**
Increase in Base Revenues (January Estimate)	**$ (550.0)**
TOTAL BUDGET GAP	**1,132.0**

Source: Governor's Office of Management and Budget.

The second exhibit details how the State closed its $1.1 billion budget gap in FY2006. New revenue adjustments totaling $255 million and $39 million from base revenue growth contributed $294 million to close the budget gap. It is anticipated that the remaining $838 million budget gap will be closed with budgetary savings from adoption of pension reforms and Medicaid reform.

GAP-CLOSING MEASURES IN FY2006 ILLINOIS STATE BUDGET (In Millions of Dollars)		
Beginning FY2006 Deficit	**$**	**1,132**
REVENUE ADJUSTMENTS		
Base Revenue Growth	**$**	**39**
New Revenue Enhancements		
Increased Tobacco Taxes	$	155
Eliminate Tax Disparity in Fuel Storage Fees	$	65
Additional Revenue from new DOR auditors	$	18
Retail Rate Law Repeal	$	17
Total New Revenue Enhancements	**$**	**255**
TOTAL REVENUE ADJUSTMENTS	**$**	**294**
SPENDING ADJUSTMENTS		
FY06 Spending Increases Paid for with Base Revenue Increases*	$	(267)
FY06 Expenditure Reductions		
Pension Reform Savings	$	745
Medicaid Reform Savings	$	360
TOTAL SPENDING ADJUSTMENTS	**$**	**838**
TOTAL REVENUE AND SPENDING ADJUSTMENTS	**$**	**1,132**

* Spending increases for mass transit and K-12 education will be paid for with earmarked revenues so there is no net spending increase in those specific instances.
Source: Governor's Office of Management and Budget.

REVENUES

The FY2006 budget projects a 6.7% increase in total receipts. This is a $2.8 billion one-year increase, from $42.7 billion in FY2005 to $45.6 billion in FY2006. Much of this increase is due to a sharp rise in the amount of non-state tax receipts such as interest income and miscellaneous taxes, fees, earnings and net transfers. These resources are projected to increase by nearly $1.7 billion in FY2006, from $2.4 billion to $4.1 billion.

Reflecting a gradually improving economy, state tax revenues for all funds are projected to increase by 2.5% in FY2006, from $21.1 billion to $21.6 billion. Net personal income tax revenues are expected to rise by 4.4%, net corporate income taxes by 8.2%, sales taxes by 3.7%, motor fuel taxes by just 0.8% and corporate franchise fees and taxes by 2.1%. Decreases are projected for public utility taxes (-1.2%) and inheritance taxes (-3.8%). The Budget Book reports a 13.5% decrease in riverboat gaming taxes and fees. However, the Department of Revenue reports that this is a transcription error; in fact, gaming revenues will be flat.[9]

[9] Communication from Illinois Department of Revenue, March 18, 2005.

ILLINOIS STATE REVENUES: ALL FUNDS FY05-FY06 (In Millions of Dollars)				
	Est. FY2005	Est. FY2006	$ CHG FY05-FY06	% CHG FY05-FY06
STATE TAXES				
Income Taxes (Net)*	$ 8,854	$ 9,283	$ 429	4.8%
Personal Income Taxes	$ 7,781	$ 8,120	$ 339	4.4%
Corporate Income Taxes	$ 1,073	$ 1,161	$ 88	8.2%
Sales Taxes	$ 7,098	$ 7,362	$ 264	3.7%
Motor Fuel Taxes	$ 1,438	$ 1,450	$ 12	0.8%
Public Utility Taxes	$ 1,233	$ 1,218	$ (15)	-1.2%
Cigarette Taxes	$ 653	$ 620	$ (33)	-5.1%
Liquor Taxes	$ 145	$ 146	$ 1	0.7%
Inheritance Tax	$ 265	$ 255	$ (10)	-3.8%
Insurance Taxes/Fees	$ 459	$ 453	$ (6)	-1.3%
Corporate Franchise Taxes/Fees	$ 190	$ 194	$ 4	2.1%
Riverboat Gaming Taxes/Fees	$ 821	$ 710	$ (111)	-13.5%
Subtotal State Taxes	**$ 21,156**	**$ 21,689**	**$ 533**	**2.5%**
OTHER RECEIPTS				
Motor Vehicle/Operators License Fees	$ 1,171	$ 1,171	$ -	0.0%
Interest Income	$ 70	$ 70	$ -	0.0%
Revolving Fund Recipts	$ 441	$ 514	$ 73	16.6%
Lottery	$ 901	$ 924	$ 23	2.6%
Assessment Funds Receipts	$ 715	$ 635	$ (80)	-11.2%
Intergovernmental Payments	$ 1,457	$ 1,409	$ (48)	-3.3%
Group Insurance Receipts	$ 1,613	$ 1,756	$ 143	8.9%
Tobacco Settlement Receipts	$ 300	$ 283	$ (17)	-5.7%
Other Taxes,Fees,Earnings & Net Transfers	$ 2,452	$ 4,151	$ 1,699	69.3%
Subtotal Other Receipts	**$ 9,120**	**$ 10,913**	**$ 1,793**	**19.7%**
Federal Receipts	$ 12,505	$ 13,040	$ 535	4.3%
GRAND TOTAL	**$ 42,781**	**$ 45,642**	**$ 2,861**	**6.7%**

* Net = less refunds and taxes that are uncollected.

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

The next exhibit shows projected changes in **General Funds receipts** between FY2005 and FY2006. It is anticipated that General Fund revenues will increase by 4.1%, from $25.6 billion in FY2005 to $26.6 billion in FY2006. This is less than half the rate of growth projected for the previous year (8.6% versus 4.1%). Base revenues from state sources are projected to rise by 3.1%, increasing from $25.6 billion to $26.4 billion. There will be a $255 million increase in recurring revenues, including revenues from the cigarette tax increase, the proposed tax on custom software, reforming the retail rate law and eliminating the existing disparity in tax treatment for gas stored in Illinois.

ILLINOIS STATE REVENUES GENERAL FUNDS FY2005-FY2006 (In Millions of Dollars)				
	Est. FY2005	Est. FY2006	$ CHG FY05-FY06	% CHG FY05-FY06
BASE REVENUES				
STATE SOURCES				
Income Taxes (Net)	$ 8,854	$ 9,281	$ 427	4.8%
Personal	$ 7,781	$ 8,120	$ 339	4.4%
Corporate	$ 1,073	$ 1,161	$ 88	8.2%
Sales Taxes	$ 6,530	$ 6,778	$ 248	3.8%
Public Utility Taxes	$ 1,101	$ 1,096	$ (5)	-0.5%
Cigarette Taxes	$ 450	$ 400	$ (50)	-11.1%
Liquor Taxes	$ 145	$ 146	$ 1	0.7%
Inheritance Taxes	$ 265	$ 255	$ (10)	-3.8%
Insurance Taxes & Fees	$ 371	$ 366	$ (5)	-1.3%
Corporate Frachise Fees & Taxes	$ 190	$ 194	$ 4	2.1%
Interest on State Funds & Investments	$ 45	$ 45	$ -	0.0%
Cook County Intergov. Transfer	$ 433	$ 340	$ (93)	-21.5%
Other State Sources	$ 486	$ 436	$ (50)	-10.3%
Transfers-In				
Lottery	$ 588	$ 628	$ 40	6.8%
Riverboat Gaming Taxes	$ 700	$ 696	$ (4)	-0.6%
Other Transfers	$ 945	$ 916	$ (29)	-3.1%
Subtotal State Sources	**$ 21,103**	**$ 21,577**	**$ 474**	**2.2%**
Federal Sources	$ 4,519	$ 4,834	$ 315	7.0%
TOTAL BASE REVENUES	**$ 25,622**	**$ 26,411**	**$ 789**	**3.1%**
Deficit Reduction Sources				
Recurring Revenues	$ -	$ 255	$ 255	100.0%
Total Deficit Reduction Sources	**$ -**	**$ 255**	**$ 255**	**100.0%**
TOTAL REVENUES	**$ 25,622**	**$ 26,666**	**$ 1,044**	**4.1%**
Pension Obligation Bonds	$ -	$ -		
Short-Term Borrowing	$ -	$ -		
TOTAL RECEIPTS	**$ 25,622**	**$ 26,666**	**$ 1,044**	**4.1%**

Source: FY2006 State Budget, Table II-B General Funds Revenues by Source.

3-Year Revenue Trends

The next two exhibits show 3-year revenue trends for all funds and just the General Funds. Over this period, from FY2004 to FY2006, total receipts for all funds increased by 8.8% while the State's own source tax revenues rose by 8.0%.

ILLINOIS STATE REVENUES: ALL FUNDS FY04-FY06 (In Millions of Dollars)					
	FY2004	**Est. FY2005**	**Est. FY2006**	**$ CHG FY04-FY06**	**% CHG FY04-FY06**
STATE TAXES					
Income Taxes (Net)	$ 8,209	$ 8,854	$ 9,283	$ 1,074	13.1%
Personal	$ 7,272	$ 7,781	$ 8,120	$ 848	11.7%
Corporate	$ 936	$ 1,073	$ 1,161	$ 225	24.0%
Sales Taxes	$ 6,739	$ 7,098	$ 7,362	$ 623	9.2%
Motor Fuel Tax	$ 1,424	$ 1,438	$ 1,450	$ 26	1.8%
Public Utility Tax	$ 1,204	$ 1,233	$ 1,218	$ 14	1.2%
Cigarette Taxes	$ 760	$ 653	$ 620	$ (140)	-18.4%
Liquor Taxes	$ 127	$ 145	$ 146	$ 19	15.0%
Inheritance Tax	$ 222	$ 265	$ 255	$ 33	14.9%
Insurance Taxes/Fees	$ 466	$ 459	$ 453	$ (13)	-2.8%
Corporate Franchise Taxes/Fees	$ 163	$ 190	$ 194	$ 31	19.0%
Riverboat Gaming Taxes/Fees	$ 775	$ 821	$ 710	$ (65)	-8.4%
Subtotal State Taxes	**$ 20,088**	**$ 21,156**	**$ 21,689**	**$ 1,601**	**8.0%**
OTHER RECEIPTS					
Motor Vehicle/Operators License Fees	$ 1,162	$ 1,171	$ 1,171	$ -	0.8%
Interest Income	$ 82	$ 70	$ 70	$ -	-14.6%
Revolving Fund Recipts	$ 353	$ 441	$ 514	$ 73	45.6%
Lottery	$ 880	$ 901	$ 924	$ 23	5.0%
Assessment Funds Receipts	$ 74	$ 715	$ 635	$ (80)	758.1%
Intergovernmental Payments	$ 1,332	$ 1,457	$ 1,409	$ (48)	5.8%
Group Insurance Receipts	$ 1,460	$ 1,613	$ 1,756	$ 143	20.3%
Tobacco Settlement Receipts	$ 296	$ 300	$ 283	$ (17)	-4.4%
Other Taxes,Fees,Earnings & Net Transfers	$ 4,008	$ 2,452	$ 4,151	$ 1,699	3.6%
Subtotal Other Receipts	**$ 9,647**	**$ 9,120**	**$ 10,913**	**$ 1,793**	**13.1%**
Federal Receipts	$ 12,198	$ 12,505	$ 13,040	$ 535	6.9%
GRAND TOTAL	**$ 41,933**	**$ 42,781**	**$ 45,642**	**$ 2,861**	**8.8%**

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

General Fund base revenues, which include state own source tax revenues and federal intergovernmental aid, are projected to increase by 4.3% between FY2004 and FY2006, from $25.3 billion to $26.4 billion. Total General Fund receipts are expected to decrease by 4.3% or $1.1 billion, from $26.8 billion to $25.6 billion.

ILLINOIS STATE REVENUES GENERAL FUNDS FY2004-FY2006 (In Millions of Dollars)					
	FY2004	Est. FY2005	Proj. FY2006	$ CHG FY04-FY06	% CHG FY04-FY06
BASE REVENUES					
STATE SOURCES					
Income Taxes (Net)	$ 8,208	$ 8,854	$ 9,281	$ 1,073	13.1%
Personal	$ 7,272	$ 7,781	$ 8,120	$ 848	11.7%
Corporate	$ 936	$ 1,073	$ 1,161	$ 225	24.0%
Sales Taxes	$ 6,331	$ 6,530	$ 6,778	$ 447	7.1%
Public Utility Taxes	$ 1,079	$ 1,101	$ 1,096	$ 17	1.6%
Cigarette Taxes	$ 400	$ 450	$ 400	$ -	0.0%
Liquor Taxes	$ 127	$ 145	$ 146	$ 19	15.0%
Inheritance Taxes	$ 222	$ 265	$ 255	$ 33	14.9%
Insurance Taxes & Fees	$ 362	$ 371	$ 366	$ 4	1.1%
Corporate Frachise Fees & Taxes	$ 163	$ 190	$ 194	$ 31	19.0%
Interest on State Funds & Investments	$ 55	$ 45	$ 45	$ (10)	-18.2%
Cook County Intergov. Transfer	$ 428	$ 433	$ 340	$ (88)	-20.6%
Other State Sources	$ 428	$ 486	$ 436	$ 8	1.9%
Transfers-In					
Lottery	$ 570	$ 588	$ 628	$ 58	10.2%
Riverboat Gaming Taxes	$ 661	$ 700	$ 696	$ 35	5.3%
Other Transfers	$ 1,111	$ 945	$ 916	$ (195)	-17.6%
Subtotal State Sources	**$ 20,145**	**$ 21,103**	**$ 21,577**	$ 1,432	**7.1%**
Federal Sources	$ 5,189	$ 4,519	$ 4,834	$ (355)	-6.8%
TOTAL BASE REVENUES	**$ 25,334**	**$ 25,622**	**$ 26,411**	**$ 1,077**	**4.3%**
Deficit Reduction Sources					
Recurring Revenues	$ -	$ -	$ 255	$ 255	100.0%
Total Deficit Reduction Sources	**$ -**	**$ 25,622**	**$ 26,666**	**$ 26,666**	**100.0%**
TOTAL REVENUES	**$ 25,334**	**$ 25,622**	**$ 26,666**	**$ 1,332**	**5.3%**
Pension Obligation Bonds	$ 1,489	$ -	$ -	$ (1,489)	-100.0%
Short-Term Borrowing	$ -	$ -	$ -	$ -	0.0%
TOTAL RECEIPTS	**$ 26,823**	**$ 25,622**	**$ 25,666**	**$ (1,157)**	**-4.3%**

Source: FY2006 State Budget, Table II-B General Funds Revenues by Source.

Revenue Enhancements

The FY2006 budget proposes several revenue enhancements totaling approximately $302 million. They are listed in the exhibit below.

FY2006 REVENUE CHANGES IN STATE BUDGET	
Revenue Change	**Revenues Generated**
Increase Audit Enforcement	$ 18,000,000
Reform Retail Rate Law	$ 17,000,000
Eliminate Disparity in Tax Treatment for Gas Stored in Illinois	$ 57,000,000
Collect Sales Tax on Custom Software	$ 65,000,000
Increase State Cigarette Tax from 98 cents/pack to $1.73/pack	$ 145,000,000
GRAND TOTAL	**$ 302,000,000**

Increase Audit Enforcement: $18 Million in New Revenues

The Illinois Department of Revenue proposes to hire 105 new employees in FY2006 to increase enforcement efforts. These positions will primarily be auditors.

Collect Sales Tax on Prewritten Licensed Software

This proposal makes all prewritten licensed software purchased in Illinois subject to the state sales tax, including electronically downloaded and licensed software. Put another way, this proposal aims to eliminate the current exemption for licensed prewritten software. Custom software remains exempted from the tax extension, along with software used to run exempt machinery. That portion of prewritten software that requires customization is exempt if it is separately invoiced.

Customized or modified licensed software will be taxed only on the prewritten portion of the transaction. Regarding prewritten software delivered electronically to a company's out of state offices, only the portion used in Illinois will be taxed. In order to apportion usage, the State's proposal adopts the language drafted by the Streamlined Sales Tax Project (SSTP) for Multiple Points of Use (MPU); the apportionment must be reasonable, consistent and uniform using business records as they exist at the time of sale. If software is purchased in a state that doesn't tax it, such as North Carolina, companies can use some reasonable apportionment method for paying the tax in Illinois. Companies will be required to provide documentation to determine their taxable base.[10] According to the Department of Revenue, 26 states currently tax prewritten software delivered electronically.[11]

Current Illinois law provides for taxation of "canned" software, i.e., software purchased by a consumer off the shelf in a retail establishment, as tangible personal property. 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"[12] while licensed software is exempt from the sales tax. Therefore, Illinois businesses currently electronically downloading a computer program for use in several locations are not subject to a sales tax, while individuals purchasing a single copy of the software in a retail establishment are taxed on the software purchase.

Repeal Retail Rate Law: $17 Million in New Revenues

This proposal would repeal the State's Retail Rate Law, which subsidizes the production of electricity from alternative energy sources such as methane.

The Retail Rate Law, which is administered by the Illinois Commerce Commission, was enacted in 1987 to encourage the development of alternate energy production facilities.[13] The Law provides that companies certified as Qualified Solid Waste Energy Facilities (QSWEFs) are entitled to enter into 10-year contracts with utilities companies. The utilities must purchase electricity from the QSWEF at a rate that is equivalent to "the average cost per kilowatt-hour paid from time to time by the unit of local government in which the electricity generating facilities are located."[14] The retail rate is much higher than the wholesale rate the utilities would

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[10] The proposal is tied to language drafted by the Streamlined Sales Tax Project in order to ensure conformity to the statutory language of other states. However, proposals have been advanced to change the SSTP language.
[11] Presentation by Illinois Department of Revenue to the Civic Federation, March 18, 2005.
[12] Illinois State Chamber of Commerce. *The Chamber Tax Update*, March 9, 2004, p. 4.
[13] 220 ILCS 5/8-403.1(a) (West 2000).
[14] 220 ILCS 5/8-403.1(c) (West 2000).

normally pay for electricity.[15] In return for purchasing the electricity from the QSWEF, the utility receives State tax credits:

> …in an amount equal to the difference between the "retail rate" paid to the QSWEF and the "avoided cost" were the utility to generate such electricity itself. The QSWEF then must reimburse the State for the value of the issued tax credits after retirement of the debt incurred to finance its construction.[16]

The Blagojevich administration proposes to repeal the Retail Rate Law because it is viewed as an unnecessary tax loophole. The new revenues derived from its repeal will be used to increase staffing in the Department of Natural Resources and to fund certain environmental and conservation programs.

Eliminate Disparity in Tax Treatment for Gas Stored in Illinois: $57 Million in New Revenues

Fuel from Illinois refineries that is moved out of state is subject to a 1.1 cent per gallon storage tank fee; the funds are used to pay for the clean up of spills. However, fuel from in-state refineries that is transported out of state is exempt from the fee. This law would eliminate these current fee disparities based on final destination. The revenues generated from this action will be used to fund the State's federally mandated vehicle emissions testing and underground storage tank inspection programs.

Increase Cigarette Tax

The Governor proposes to raise the State cigarette tax by 77%, from 98 cents per pack to $1.73 per pack. This proposal is expected to generate as much as $145 million in FY2006. Revenues from the increase will be used to provide funding for the State's capital program.

The State estimated that a simple increase in the volume of cigarettes sold would generate approximately $225 million. However, factoring in the potential for declining revenues as smokers either purchased cigarettes in lower tax neighboring states or ceased smoking, the revenue amount was adjusted to $145 million.[17]

General Fund Revenue Projections

This section compares General Fund revenue projections made by the Governor's Office of Management and Budget (GOMB) to forecasts from the Commission on Government Forecasting and Accountability (CGFA).[18] GOMB forecasts for personal income, corporate income and sales tax were compiled primarily by using econometric modeling. Its forecasts for other revenues were developed using trend analyses. [19]

The Civic Federation compares State forecasts with those published by the CGFA, which is a legislative agency, to determine whether they reasonably track one another. Typically, there are

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[15] CGE Ford Heights v. Miller, 306 Ill. App. 3d 431, 433, 714 N.E.2d 35 (1999).
[16] 220 ILCS 5/8-403.1(d) (West 2000).
[17] Speech by John Filan, Director of the Governor's Office of Management and Budget, on March 3, 2005, to the City of Club of Chicago.
[18] Formerly known as the Illinois Economic and Fiscal Commission (IEFC).
[19] State of Illinois. FY2006 Operating Budget, page 3-8.

differences between different forecasts, widely divergent forecasts raises concerns about the assumptions being used to project revenues by different entities and ultimately can raise questions about the conservatism and accuracy of certain of the projections.

Personal Income Taxes

The GOMB estimates are slightly more optimistic than that of the CGFA with respect to net personal income tax revenue growth. The GOMB projects net personal income tax growth of 4.4% whereas the CGFA projects a rate of 4.2%, or a difference of $87 million.

Corporate Income Taxes

The GOMB projections for FY2006 net corporate income tax growth are slightly more conservative than the CGFA. The GOMB projects an 8.2% growth rate as compared to the 8.9% growth rate estimated by the CGFA. This is a difference of $11 million.

Sales Taxes

The GOMB projections are slightly more pessimistic than those prepared by the CFGA. GOMB analysts project a 3.8% increase in sales tax revenues while CGFA estimates 4.0%. The value of the difference between these two projections is $95 million.

Utility Taxes

There is very little difference between GOMB and CGFA estimates for FY2006 utility tax receipts. The GOMB projects a 0.5% decrease, or $6 million, whereas the CGFA projects no change from the $1.1 billion level of FY2005.

Total State Tax and Fee Revenues

The GOMB and the CGFA state tax and fee revenues forecasts are quite close with the GOMB estimated an overall 2.5% increase and the CGFA estimating a 2.7% increase. This represents a difference of $21 million.

Total Transfers

There are substantial differences in the GOMB and CGFA estimates regarding lottery and riverboat transfers. The difference is due in part to GOMB's higher projection for lottery revenues. For FY2006, GOMB projects lottery revenue growth of 6.8% as compared to CGFA projection of 2.6%, or a difference of $25 million. GOMB cites the Department of Revenue's campaign to improve lottery marketing as a key factor in their more optimistic projection.[20]

Total State Own Source Revenues

When lottery and riverboat transfers are included, the GOMB estimates for total state own source revenues result in more optimistic growth expectations than that of the CGFA. GOMB projects state source revenues to increase by 2.2% whereas CGFA projects growth of only 0.7%.

[20] State of Illinois. FY2006 Operating Budget, page 9-78.

FY2006 General Funds Revenue Estimates (In Millions of Dollars)						
	Commission on Government Forecasting and Accountability			Governor's Office of Management & Budget		
REVENUE	**March-05 Estimate FY2005**	**Projected FY2006**	**% Change from Est. FY2005***	**March-05 Estimate FY2005**	**Projected FY2006**	**% Change from Est. FY2005**
Personal Income Tax (Net)	$ 7,708	$ 8,033	4.2%	$ 7,781	$ 8,120	4.4%
Corporate Income Tax (Net)	$ 1,076	$ 1,172	8.9%	$ 1,073	$ 1,161	8.2%
Sales Tax	$ 6,545	$ 6,805	4.0%	$ 6,530	$ 6,778	3.8%
Utility Tax	$ 1,090	$ 1,090	0.0%	$ 1,101	$ 1,096	-0.5%
Cigarette Tax	$ 450	$ 400	-11.1%	$ 450	$ 400	-11.1%
Liquor Tax	$ 147	$ 148	0.7%	$ 145	$ 146	0.7%
Vehicle Use Tax	$ 34	$ 35	2.9%	$ -	$ -	n/a
Inheritance Tax (gross)	$ 285	$ 285	0.0%	$ 265	$ 255	-3.8%
Insurances Taxes & Fees	$ 391	$ 391	0.0%	$ 371	$ 366	-1.3%
Corporate Franchise Fee & Taxes	$ 180	$ 185	2.8%	$ 190	$ 194	2.1%
Interest	$ 60	$ 75	25.0%	$ 45	$ 45	0.0%
Cook County IGT	$ 433	$ 340	-21.5%	$ 433	$ 340	-21.5%
Other	$ 452	$ 399	-11.7%	$ 486	$ 436	-10.3%
Subtotal Taxes, Fees, and Other	**$ 18,851**	**$ 19,358**	**2.7%**	**$ 18,870**	**$ 19,337**	**2.5%**
Lottery	$ 588	$ 603	2.6%	$ 588	$ 628	6.8%
Riverboat Transfers/Receipts	$ 713	$ 588	-17.5%	$ 700	$ 696	-0.6%
Other Transfers	$ 963	$ 715	-25.8%	$ 945	$ 916	-3.1%
Subtotal Transfers	**$ 2,264**	**$ 1,906**	**-15.8%**	**$ 2,233**	**$ 2,240**	**0.3%**
TOTAL STATE SOURCES	**$ 21,115**	**$21,264**	**0.7%**	**$21,103**	**$ 21,577**	**2.2%**
Federal Sources	**$ 4,519**	**$ 4,834**	**7.0%**	**$ 4,519**	**$ 4,834**	**7.0%**
TOTAL FEDERAL & STATE SOURCES	**$ 25,634**	**$26,098**	**1.8%**	**$25,622**	**$ 26,411**	**3.1%**

* CGFA estimate as adjusted to permit consistent comparisons with GOMB estimates.
Sources: Commission on Government and Forecasting Accountability and FY2006 State Operating Budget Book

Comparison of FY2005 Revenue Projections to FY2005 Current Estimates

The following table compares the GOMB FY2005 revenue projections with their current FY2005 revenue estimates. The information demonstrates that, for the most part, the FY2005 projections appear to have been conservative. With the exception of the Cook County Intergovernmental transfer and the other revenue category, current revenue estimates closely approximate or exceed FY2005 projections.

Comparison of FY2005 State Revenue Projections with FY2005 Current Projections			
REVENUE	CURRENT EST. FY2005	PROJ. FY2005	% DIFFERENCE FROM (UNDER) INITIAL PROJ.
Personal Income Tax (Net)	$ 7,781	$ 7,285	6.8%
Corporate Income Tax (Net)	$ 1,073	$ 790	35.8%
Sales Tax	$ 6,530	$ 6,425	1.6%
Utility Tax	$ 1,101	$ 1,102	-0.1%
Cigarette Tax	$ 450	$ 400	12.5%
Liquor Tax	$ 145	$ 123	17.9%
Vehicle Use Tax	$ 37	$ 37	0.0%
Inheritance Tax (gross)	$ 265	$ 240	10.4%
Insurances Taxes & Fees	$ 371	$ 347	6.9%
Corporate Franchise Fee & Taxes	$ 190	$ 175	8.6%
Interest	$ 45	$ 45	0.0%
Cook County IGT	$ 433	$ 450	-3.8%
Other	$ 486	$ 692	-29.8%
Subtotal Taxes, Fees, and Other	**$ 18,907**	**$ 18,111**	4.4%
Lottery	$ 588	$ 563	4.4%
Riverboat Transfers/Receipts	$ 700	$ 647	8.2%
Other Transfers	$ 945	$ 870	8.6%
Subtotal Transfers	**$ 2,233**	**$ 2,080**	**7.4%**
TOTAL STATE SOURCES	**$ 21,140**	**$20,191**	**4.7%**
Federal Sources	$ 4,519	$ 4,772	5.6%
TOTAL FEDERAL & STATE SOURCES	**$ 25,659**	**$ 24,963**	**2.8%**

Sources: State of Illinois FY2005 and FY2006 Operating Budget Books

APPROPRIATIONS

The Governor's FY2006 operating budget recommends a total appropriation of $43.5 billion, an increase of $300 million, or 0.8%, over the FY2005 enacted appropriation of $43.2 billion. This total includes $24.5 billion in the General Funds, $13.4 billion in Other State Funds, and $5.6 billion in Federal Funds.

FY2005-FY2006 Appropriation Trend

The FY2006 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. This is being achieved by matching specific revenues with specific projects, thus diminishing the subsidizing of programs from general taxes. In FY2006, General Funds appropriations increase by 3.5% over FY2005, while Other State Funds appropriations decrease by 2.9%, or $403 million.

The largest fund group in the budget is the General Funds which represent 56% of total recommended appropriations. "Other State Funds" includes a wide range of funds, including highway funds and other special state funds. The primary purpose of these funds is to receive either tax revenue distributions or specific revenues such as permit and license fees, which are then dedicated to specific projects.[21]

STATE OF ILLINOIS FY2005-FY2006 APPROPRIATIONS (in thousands of dollars)				
Type	FY2005 Enacted Appropriation	FY2006 Recommended Appropriation	**Appropriation $ change 2005 to 2006**	**Appropriation % change 2005 to 2006**
LEGISLATIVE AGENCIES				
Legislative Agencies Total	**$ 88,346**	**$ 83,371**	**$ (4,975)**	**-5.6%**
General Funds	$ 70,042	$ 67,536	$ (2,506)	-3.6%
Other State Funds	$ 18,304	$ 15,835	$ (2,469)	-13.5%
JUDICIAL AGENCIES				
Judicial Agencies Total	**$ 442,278**	**$ 384,757**	**$ (57,521)**	**-13.0%**
General Funds	$ 389,430	$ 358,105	$ (31,325)	-8.0%
Other State Funds	$ 47,983	$ 23,202	$ (24,781)	-51.6%
Federal Funds	$ 4,864	$ 3,450	$ (1,414)	-29.1%
ELECTED OFFICIALS AND ELECTIONS				
Elected Officials And Elections Total	**$ 2,335,199**	**$ 2,358,987**	**$ 23,788**	**1.0%**
General Funds	$ 274,998	$ 268,030	$ (6,968)	-2.5%
Other State Funds	$ 2,046,489	$ 2,079,064	$ 32,575	1.6%
Federal Funds	$ 13,712	$ 11,893	$ (1,819)	-13.3%
AGENCIES UNDER THE GOVERNOR				
Governor's Agencies Total	**$ 30,919,934**	**$ 31,811,963**	**$ 892,029**	**2.9%**
General Funds	$ 14,012,781	$ 14,955,919	$ 943,138	6.7%
Other State Funds	$ 13,651,693	$ 13,640,864	$ (10,829)	-0.1%
Federal Funds	$ 3,255,460	$ 3,215,170	$ (40,290)	-1.2%
ELEMENTARY AND SECONDARY EDUCATION[2]				
Elementary and Secondary Education	**$ 9,101,906**	**$ 8,860,821**	**$ (241,085)**	**-2.6%**
General Funds	$ 6,850,725	$ 6,680,324	$ (170,401)	-2.5%
Other State Funds	$ 31,842	$ 26,373	$ (5,469)	-17.2%
Federal Funds	$ 2,219,340	$ 2,154,125	$ (65,215)	-2.9%
HIGHER EDUCATION[3]				
Higher Education Total	**$ 2,735,857**	**$ 2,626,746**	**$ (109,111)**	**-4.0%**
General Funds	$ 2,175,228	$ 2,204,022	$ 28,794	1.3%
Other State Funds	$ 297,008	$ 154,865	$ (142,143)	-47.9%
Federal Funds	$ 263,622	$ 267,859	$ 4,237	1.6%
TOTAL				
General Funds	**$ 23,687,068**	**$ 24,526,491**	**$ 839,423**	**3.5%**
Other State Funds	**$ 13,785,232**	**$ 13,381,989**	**$ (403,243)**	**-2.9%**
Federal Funds	**$ 5,756,998**	**$ 5,652,497**	**$ (104,501)**	**-1.8%**
GRAND TOTAL	**$ 43,229,298**	**$ 43,560,977**	**$ 331,679**	**0.8%**

Source: State of Illinois FY2006 Budget, P. 1-15 to 1-26.

FY2004-FY2006 Appropriation Trend

The next section presents an analysis of 3-year appropriation trends between FY2004 and FY2006. This trend analysis permits comparison of Governor Blagojevich's three budget proposals.

The Governor's FY2006 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.

[21] State of Illinois. FY2006 Budget, P. 1-9.

General Fund appropriations have increased by $1.2 billion, or 5.4%, while Other Funds increased by $1.0 billion, or 8.7%. Since FY2004, appropriations for Elected Officials and Elections have increased by 40.0% and the appropriations for Elementary and Secondary Education have increased by 1.9%. The appropriations for Higher Education have decreased by $204 million or 7.2%

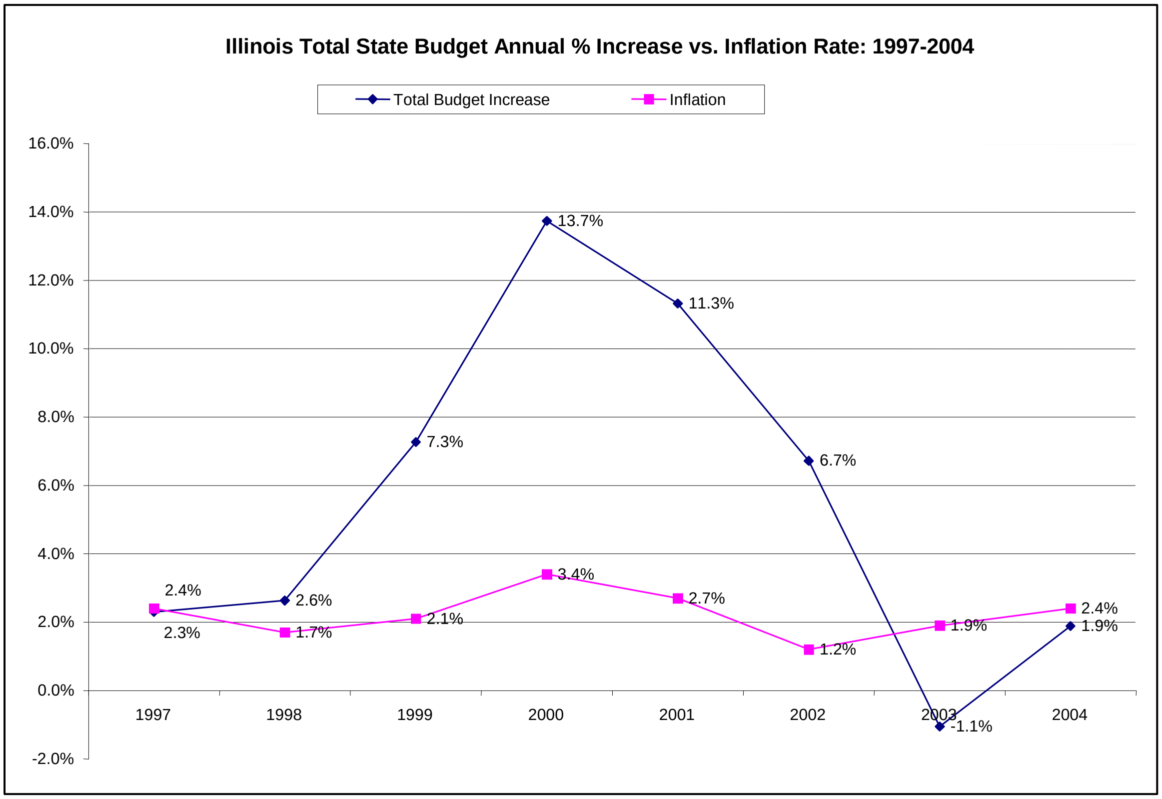
STATE OF ILLINOIS FY2004-FY2006 APPROPRIATIONS (in thousands of dollars)					
Type		FY2004 Enacted Appropriation	FY2006 Recommended Appropriation	Appropriation $ change 2004 to 2006	Appropriation % change 2004 to 2006
LEGISLATIVE AGENCIES					
Legislative Agencies Total		**$ 88,949**	**$ 83,371**	**$ (5,578)**	**-6.3%**
	General Funds	$ 72,425	$ 67,536	$ (4,889)	-6.8%
	Other State Funds	$ 16,525	$ 15,835	$ (690)	-4.2%
	Federal Funds	**$ -**	**$ -**		#DIV/0!
JUDICIAL AGENCIES					
Judicial Agencies Total		**$ 430,051**	**$ 384,757**	**$ (45,294)**	**-10.5%**
	General Funds	$ 399,893	$ 358,105	$ (41,788)	-10.4%
	Other State Funds	$ 26,562	$ 23,202	$ (3,360)	-12.6%
	Federal Funds	$ 3,597	$ 3,450	$ (147)	-4.1%
ELECTED OFFICIALS AND ELECTIONS					
Elected Officials and Elections Total		**$ 1,684,821**	**$ 2,358,987**	**$ 674,166**	**40.0%**
	General Funds	$ 251,481	$ 268,030	$ 16,549	6.6%
	Other State Funds	$ 1,419,584	$ 2,079,064	$ 659,480	46.5%
	Federal Funds	$ 13,756	$ 11,893	$ (1,863)	-13.5%
AGENCIES UNDER THE GOVERNOR					
Governor's Agencies Total		**$ 29,589,583**	**$ 31,811,963**	**$ 2,222,380**	**7.5%**
	General Funds	$ 13,710,192	$ 14,955,919	$ 1,245,727	9.1%
	Other State Funds	$ 12,735,642	$ 13,640,864	$ 905,222	7.1%
	Federal Funds	$ 3,143,749	$ 3,215,170	$ 71,421	2.3%
ELEMENTARY AND SECONDARY EDUCATION					
Elementary/Secondary Education		**$ 8,692,878**	**$ 8,860,821**	**$ 167,943**	**1.9%**
	General Funds	$ 6,494,370	$ 6,680,324	$ 185,954	2.9%
	Other State Funds	$ 124,702	$ 26,373	$ (98,329)	-78.9%
	Federal Funds	$ 2,073,806	$ 2,154,125	$ 80,319	3.9%
HIGHER EDUCATION					
Higher Education Total		**$ 2,830,821**	**$ 2,626,746**	**$ (204,075)**	**-7.2%**
	General Funds	$ 2,407,012	$ 2,204,022	$ (202,990)	-8.4%
	Other State Funds	$ 99,882	$ 154,865	$ 54,983	55.0%
	Federal Funds	$ 323,927	$ 267,859	$ (56,068)	-17.3%
	Federal Funds	**$ -**	**$ -**	$ -	0.0%
TOTAL					
	General Funds	**$ 23,265,741**	**$ 24,526,491**	**$ 1,260,750**	**5.4%**
	Other State Funds	**$ 12,309,990**	**$ 13,381,989**	**$ 1,071,999**	**8.7%**
	Federal Funds	**$ 5,558,834**	**$ 5,652,497**	**$ 93,663**	**1.7%**
GRAND TOTAL		**$ 41,134,565**	**$ 43,560,977**	**$ 2,426,412**	**5.9%**

Source: State of Illinois FY2006 Budget, P. 1-15 to 1-26

Budget Increases vs. Inflation[22]

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 10.3% in 2000. In 2003 and 2004, state appropriations grew at a rate less than inflation.

[22] Source for inflation rates: U.S. Bureau of Labor Statistics Annual Consumer Price Index for the Midwest Urban Region. Note that the State Fiscal year is July 1 – July 30, while the annual CPI represents a January to December average.



Selected Agency Appropriations: FY2004-FY2006

The analysis below presents FY2004 through FY2006 appropriations for certain agencies that saw relatively significant increases or decreases in appropriations for the FY2006 recommended budget. This list of selected agencies is not intended to be exhaustive.

STATE OF ILLINOIS FY2004-FY2006 SELECTED AGENCY APPROPRIATIONS (in thousands of dollars)				
Type	FY2004 Enacted Appropriation	FY2006 Recommended Appropriation	Appropriation $ change 2004 to 2006	Appropriation % change 2004 to 2006
State Board of Education	$ 7,446,379	$ 8,128,686	$ 682,307	9.2%
Public Universities	$ 4,738,505	$ 6,264,605	$ 1,526,100	32.2%
Department of Healthcare and Family Serv.	$ 13,741,255	$ 15,284,643	$ 1,543,388	11.2%
Department of Agriculture	$ 84,750	$ 96,976	$ 12,226	14.4%
Department of Financial and Professional	$ 99,816	$ 92,466	$ (7,350)	-7.4%
Department of Natural Resources	$ 210,652	$ 192,802	$ (17,850)	-8.5%
Department of Corrections	$ 1,416,727	$ 1,335,254	$ (81,473)	-5.8%
Environmental Protection Agency	$ 1,133,441	$ 330,912	$ (802,529)	-70.8%
State Police	$ 370,925	$ 383,131	$ 12,206	3.3%
Department on Aging	$ 398,153	$ 446,315	$ 48,162	12.1%
Central Management Services	$ 3,430,023	$ 1,035,441	$ (2,394,582)	-69.8%

Source: State of Illinois FY2006 Budget, P. 1-15 to 1-26, State of Illinois FY2005 Budget 1-27 to 1-34.

Elementary and Secondary Education: $682 million increase

Slightly more than 26% of the state's total operating budget, or $11.5 billion, is dedicated to educational purposes. State of Illinois funding for public elementary and secondary schools is administered through the State Board of Education. The total FY2006 appropriation for the State Board of Education is $8.1 billion, an increase of $682 million since FY2004. The $8.1 billion budget consists of $5.9 billion in state General Funds, $26 million in Other State Funds, and $2.1 billion in Federal Funds.[23] The General Funds appropriation of $5.9 billion represents 73% of the State Board of Education's total FY2006 budget, and is a 12.3%, or $650 million, increase since the FY2004 appropriation of $5.3 billion. Other State Funds will be cut by 65%, or $46 million, from FY2004.

In FY2006, the Governor has proposed creating a school endowment fund. The fund makes $140 million available for educational priorities. Beginning in FY2006 and every three years thereafter, the accumulated excess fund balances will be transferred to this endowment fund, and one third of this balance will be transferred to the Common School Fund. As in the FY2005 budget, specific spending allocations are not proposed but priorities for these funds include general state aid, early childhood education and mandated categorical programs. In 2004, Governor Blagojevich's first year in office, the foundation level was increased by $250 to $4,810 per pupil and in FY2005 the foundation level was increased by $154 to $4,964 per pupil. In FY2006 the foundation level is projected to increase $40-$45, or to $5,004 to $5,009 per pupil, resulting in a total increase of $444 to $449 per pupil over three years.[24]

STATE OF ILLINOIS FY2004-FY2006 ELEMENTARY AND SECONDARY EDUCATION APPROPRIATIONS (in thousands of dollars)				
Type	FY2004 Enacted Appropriation	FY2006 Recommended Appropriation	**Appropriation $ change 2004 to 2006**	**Appropriation % change 2004 to 2006**
ELEMENTARY AND SECONDARY EDUCATION				
State Board Of Education	**$ 7,446,379**	**$ 8,128,686**	**$ 682,307**	**9.2%**
State General Funds	$ 5,297,356	$ 5,948,189	$ 650,833	12.3%
Other State Funds	$ 75,218	$ 26,373	$ (48,846)	-64.9%
Federal Funds	$ 2,073,806	$ 2,154,125	$ 80,319	3.9%

Source: State of Illinois FY2006 Budget, P. 4 -1, State of Illinois FY2005 Budget, P. 2-2.

Public Universities: Increase of 32.2 %

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 FY2006 state appropriation for public universities is $6.2 billion; an increase of $1.5 billion or 32.2% since FY2004. This includes $2.2 billion from General Funds and $154 million from Other State Funds; together, these state appropriations will constitute approximately 37% of total university operating funds in FY2006.[25] In FY2004, enacted state appropriations provided approximately 28% of total 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.

[23] State of Illinois. FY2006 Budget, P. 4-1.
[24] State of Illinois. FY2004 - FY2006 Budgets.
[25] State of Illinois. FY2006 Budget, P. 4-9.

The total FY2006 proposed state appropriation (all funds) for public universities reflects a 1.6% or $77.7 million increase from the FY2004 enacted appropriation. University Income Funds increased during that period by 12.7%, reflecting a shift to greater reliance on own source revenues. Through improvements to the Monetary Award Program, an additional 4,000 students receive tuition aid through the state's primary financial aid program.

STATE OF ILLINOIS FY2004-FY2006 PUBLIC UNIVERSITIES APPROPRIATIONS (in thousands of dollars)				
Type	FY2004 Enacted Appropriation	FY2006 Recommended Appropriation	**Appropriation $ change 2004 to 2006**	**Appropriation % change 2004 to 2006**
Public Universities	**$ 4,738,505**	**$ 4,816,218**	**$ 77,713**	**1.6%**
State General Funds	$ 1,303,575	$ 1,304,960	$ 1,385	0.1%
Other State Funds	$ 2,610	$ 2,009	$ (601)	-23.0%
University Income Funds (tuition + fees)	$ 788,971	$ 889,272	$ 100,301	12.7%
University Held Funds (grants, bonds, other revenue)	$ 2,643,349	$ 2,619,976	$ (23,373)	-0.9%

Source: State of Illinois FY2006 Budget, P. 4 -9, State of Illinois FY2005 Budget, P. 2-16.

Department of Healthcare and Family Services (formerly Department of Public Aid): $646 million increase, or 4%

The recommended FY2006 appropriation of $15.3 billion represents an increase over the FY2005 appropriation levels of 4%. As discussed below, these amounts reflect adjustments made to FY2005 and FY2004 for additional expenses to be incurred by the newly formed Department of Healthcare and Family Services which were previously incurred by other departments.

The State of Illinois Department of Healthcare and Family Services 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. [26]

With the FY2006 proposed budget, the former *Department of Public Aid* becomes the *Department of Healthcare and Family Services*. The change in name reflects further efforts to consolidate government and to achieve efficiencies. In a major initiative to consolidate the State's healthcare purchasing power and stem increasing health care costs, the Department of Healthcare and Family Services will now direct procurement and management for all state administered healthcare plans including the state employee health insurance program.[27]

This reorganization affects the budget presentations and the comparability of Departmental appropriation trends. The FY2004 actual spending and the FY2005 enacted appropriations have been adjusted to include items previously housed in other state departments. For example, the state's group health insurance program FY2006 appropriations, formerly reported in the Department of Central Management Services budget, totals $2.8 billion.[28] Therefore, prior year appropriations of the Department of Public Aid are not directly comparable to that of the new Department of Healthcare and Family Services.

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[26] State of Illinois. FY2006 Operating Budget, page 5-13.
[27] Governor Rod Blagojevich, "FY2006 Budget Address Transcript." February 16, 2005. State of Illinois Press Release. February, 23 2005 www.illinois.gov/gov/transcript2005.cfm.
[28] State of Illinois. FY2006 Operating Budget, page 1-26.

The following table compares the FY2005 enacted appropriations to the FY2006 recommended appropriations as adjusted for additional expenses to be incurred by the newly formed Department of Healthcare and Family Services.[29]

STATE OF ILLINOIS FY2005-FY2006 HEALTHCARE AND FAMILY SERVICES APPROPRIATIONS (in thousands of dollars)				
Type	FY2005 Enacted Appropriation	FY2006 Recommended Appropriation	Appropriation $ change 2005 to 2006	Appropriation % change 2005 to 2006
Department of Healthcare and Family Services	**$ 14,638,434**	**$ 15,284,643**	**$ 646,209**	**4.4%**
BY FUND				
State General Funds	$ 6,927,407	$ 7,670,348	$ 742,941	10.7%
Other State Funds	$ 7,248,108	$ 7,251,215	$ 3,107	0.0%
Federal Funds	$ 462,919	$ 363,080	$ (99,839)	-21.6%
BY PROGRAM				
Medical Assistance	$ 11,233,019	$ 11,667,113	$ 434,095	3.9%
Energy Assistance	$ 312,505	$ 319,780	$ 7,275	2.3%
Other Operations	$ 158	$ 158	$ -	0.0%
State Employees Health Insurance	$ 2,735,223	$ 2,945,526	$ 210,304	7.7%
Child Support Enforcement	$ 208,227	$ 209,328	$ 1,102	0.5%
Office of Inspector General	$ 19,652	$ 18,764	$ (888)	-4.5%
Public Aid Recoveries	$ 28,585	$ 27,217	$ (1,368)	-4.8%
Administration	$ 101,065	$ 96,755	$ (4,310)	-4.3%

Source: State of Illinois FY2006 Budget, P. 4 -9, State of Illinois FY2005 Budget, P. 5-13.

Note: FY2005 amounts used due to comparability issue arising from consolidation of former Department of Public Aid and Department of Central Management Services.

The total FY2005 appropriation for the Department of Health and Family Service is $15.3 billion, an increase of $646 million, or 4.4%. State General funds increase by $742.9 million while Federal Funds fall by $100 million. Increases totaling $653 million and decreases totaling $6.6 million are divided among program areas.

Three program areas show moderate decreases in recommended appropriations:

- Administration (- 4.3%)
- Public Aid Recoveries (- 4.8%)
- Office of the Inspector General (- 4.5%)

Four program areas show increases in recommended appropriations:

- Medical Assistance (+3.9%)
- Energy Assistance (+2.3%)
- Child Support Enforcement (+0.5%)
- State Employees Health Insurance (+7.7%).

The largest program increase is the State Employees Health Insurance Plan, which, as discussed above, represents a new area of responsibility for this department.

[29] State of Illinois. FY2006 Operating Budget, pages 5-13 & 5-16.

Department of Agriculture: $3 million in additional federal funds appropriated

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 also preserves the safety of the state's food supply to protect the citizens of the state.

The Department of Agriculture's total FY2006 appropriation is $97 million, an increase of $12 million, or 14.4%, from FY2004. Other State Funds have increased by 22.4%, from $37.6 million in FY2004 to $46.0 million in FY2006, and federal funds have increased by 37.8%, from $7 million to $10 million. The majority of this increase is due to advances in public safety and homeland security which include the implementation of a livestock premise identification registry and national animal identification system. These systems will be used during foreign animal disease outbreaks and for the purposes of coordinating with the state's emergency response plan.

Further, the Governor recommended the transfer of two programs out of the Department of Agriculture in FY2005: the Land and Water Resources program moved to the Department of Natural Resources, and Environmental Programs moved to the Illinois Environmental Protection Agency.

STATE OF ILLINOIS FY2004-FY2006 DEPARTMENT OF AGRICULTURE APPROPRIATIONS (in thousands of dollars)				
Type	FY2004 Enacted Appropriation	FY2006 Recommended Appropriation	**Appropriation $ change 2004 to 2006**	**Appropriation % change 2004 to 2006**
Department of Agriculture	**$ 84,750**	**$ 96,976**	**$ 12,226**	**14.4%**
BY FUND				
State General Funds	$ 39,588	$ 40,548	$ 960	2.4%
Other State Funds	$ 37,638	$ 46,063	$ 8,425	22.4%
Federal Funds	$ 7,524	$ 10,365	$ 2,841	37.8%
BY PROGRAM				
Animal Industries	$ 7,657	$ 6,872	$ (785)	-10.3%
Buildings and Grounds	$ 7,753	$ 7,094	$ (659)	-8.5%
County Fairs/ Horseracing	$ 12,637	$ 12,559	$ (78)	-0.6%
DuQuoin State Fair/ Buildings and Grounds	$ 4,267	$ 5,040	$ 773	18.1%
Livestock Management Facilities Act and Mosquito Control	$ 371	$ 5,609	$ 5,238	1411.9%
Illinois State Fair	$ 4,733	$ 4,715	$ (18)	-0.4%
Market Services and Development	$ 5,169	$ 4,464	$ (705)	-13.6%
Meat and Poultry Inspection	$ 8,033	$ 8,769	$ 736	9.2%
Warehouse/ Ag Production Inspection	$ 5,667	$ 5,160	$ (507)	-9.0%
Weights and Measures	$ 4,395	$ 3,721	$ (674)	-15.3%
Administration/ Computer Services	$ 24,067	$ 21,283	$ (2,784)	-11.6%
Natural Resources	$ -	$ 11,690	$ 11,690	100.0%

Source: State of Illinois FY2006 Budget, P. 8-1, State of Illinois FY2005 Budget, P. 6-2.

Department of Financial and Professional Regulation: Decrease of $7 million

The Illinois Department of Financial and Professional Regulation (DFPR) is a recently created agency, established in the FY2005 budget. It was a result of 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. As a result of the FY2005 consolidation, the Department streamlined a substantial portion of the state's regulatory and consumer protection functions, thereby achieving a significant cost savings of $14 million.[30]

The Department's total FY2006 appropriation is $92 million, a decrease of $7 million, or 7.4%, from the FY2004 total for the five agencies. The Department now receives $1.3 million in General Funds, but it is still funded primarily by $91.6 million in Other State Funds (professional fee revenues) and $800,000 in Federal Funds.

STATE OF ILLINOIS FY2004-FY2006 DEPARTMENT OF FINANCIAL AND PROFESSIONAL REGULATION APPROPRIATIONS
(in thousands of dollars)

Type	FY2004 Enacted Appropriation	FY2006 Recommended Appropriation	Appropriation $ change 2004 to 2006	Appropriation % change 2004 to 2006
Department of Financial and Professional Regulation	**$ 99,816**	**$ 92,466**	**$ (7,350)**	**-7.4%**
BY FUND				
State General Funds	$ -	$ 1,310	$ 1,310	0.0%
Other State Funds	$ 99,116	$ 91,666	$ (7,450)	-7.5%
Federal Funds	$ 700	$ 800	$ 100	14.3%
BY PROGRAM				
Evaluation and Licensing	$ 17,261	$ 21,570	$ 4,309	25.0%
Regulations and Supervision	$ 44,806	$ 38,111	$ (6,695)	-14.9%
Investigation and Enforcement	$ 37,749	$ 32,786	$ (4,963)	-13.1%

Source: State of Illinois FY2006 Budget, P. 7-10, State of Illinois FY2005 Budget, P. 5-10.

Department of Natural Resources: Decrease of $17 million, or 9% 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. In FY2005, the Governor recommended 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 remained in General Funds and the Department of Agriculture's Bureau of Land and Water merged into the Department of Natural Resources.[31]

The Department of Natural Resources' total FY2006 appropriation is $193 million, a decrease of $17.8 million, or 8.5%, from FY2004. In addition to the continuing construction of the new World Shooting and Recreational complex near Sparta and the restoration of natural resource damage, the department's budget restores full funding to the Conservation 2000 program and the public museum grant program and permits the re-hiring of 50 park workers.

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[30] State of Illinois. FY2006 Budget, P. 7-10.
[31] State of Illinois. FY2005 Budget, P. 5-24.

STATE OF ILLINOIS FY2004-FY2006 DEPARTMENT OF NATURAL RESOURCES APPROPRIATIONS (in thousands of dollars)				
Type	FY2004 Enacted Appropriation	FY2006 Recommended Appropriation	**Appropriation $ change 2004 to 2006**	**Appropriation % change 2004 to 2006**
Department of Natural Resources	**$ 210,652**	**$ 192,802**	**$ (17,850)**	**-8.5%**
BY FUND				
State General Funds	$ 107,414	$ 89,010	$ (18,404)	-17.1%
Other State Funds	$ 94,413	$ 96,061	$ 1,648	1.7%
Federal Funds	$ 8,825	$ 7,730	$ (1,095)	-12.4%
BY PROGRAM				
Capital/Conservation	$ 116,229	$ 108,346	$ (7,883)	-6.8%
Resource Management and Public Safety	$ 72,287	$ 64,354	$ (7,933)	-11.0%
Science, Education and Cultural Surveys	$ 22,136	$ 20,102	$ (2,034)	-9.2%

Source: State of Illinois FY2006 Budget, P. 7-26, State of Illinois FY2005 Budget, P. 5-24.

Department of Corrections: Streamlining leads to $81 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 FY2006 appropriation is $1.3 billion, a decrease of $81 million, or 5.8%, from FY2004. This decrease comes from a $36 million, or 24% cut in Other State Funds. The largest cuts will be made in Juvenile Detention and Administration. The state will provide funding for increases to parole officers managing sex offenders, as well as the expansion of Graduate Equivalency Degree (GED) programs to double the number of GEDs awarded and for Operation Ceasefire, an anti-gun violence program.

STATE OF ILLINOIS FY2004-FY2006 DEPARTMENT OF CORRECTIONS APPROPRIATIONS (in thousands of dollars)				
Type	FY2004 Enacted Appropriation	FY2006 Recommended Appropriation	**Appropriation $ change 2004 to 2006**	**Appropriation % change 2004 to 2006**
Department of Corrections	**$ 1,416,727**	**$ 1,335,254**	**$ (81,473)**	**-5.8%**
BY FUND				
State General Funds	$ 1,269,618	$ 1,223,946	$ (45,672)	-3.6%
Other State Funds	$ 147,109	$ 111,308	$ (35,801)	-24.3%
Federal Funds	$ -	$ -	$ -	0.0%
BY PROGRAM				
Administration	$ 40,491	$ 29,389	$ (11,102)	-27.4%
Adult Institutions	$ 1,129,649	$ 1,076,143	$ (53,506)	-4.7%
Field Services	$ 111,760	$ 107,029	$ (4,731)	-4.2%
Juvenile Detention	$ 134,827	$ 122,693	$ (12,134)	-9.0%

Source: State of Illinois FY2006 Budget, P. 6-1, State of Illinois FY2005 Budget, P. 4-1.

Environmental Protection Agency: Appropriations decline by $802 million or 70.8%

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 FY2006 appropriation is $330 million, a decrease of $802 million, or 71% since FY2004. This decrease comes primarily from a $1 million, or 30.7%, cut in state General Funds and a $43 million, or 4.1%, reduction in Other State Funds in FY2005. Further, in FY2005 the Department of Agriculture's Pesticide Control Program and the State Fire Marshal's Petroleum and Chemical Safety Program were merged into the Environmental Protection Agency.

STATE OF ILLINOIS FY2004-FY2006 ENVIRONMENTAL PROTECTION AGENCY APPROPRIATIONS (in thousands of dollars)				
Type	FY2004 Enacted Appropriation	FY2006 Recommended Appropriation	**Appropriation $ change 2004 to 2006**	**Appropriation % change 2004 to 2006**
Environmental Protection Agency	**$ 1,133,441**	**$ 330,912**	**$ (802,529)**	**-70.8%**
BY FUND				
State General Funds	$ 4,250	$ 847	$ (3,403)	-80.1%
Other State Funds	$ 1,071,912	$ 270,977	$ (800,935)	-74.7%
Federal Funds	$ 57,279	$ 59,089	$ 1,810	3.2%
BY PROGRAM				
Bureau of Air	$ 94,154	$ 97,165	$ 3,011	3.2%
Bureau of Land	$ 173,962	$ 156,358	$ (17,605)	-10.1%
Bureau of Water	$ 835,936	$ 55,449	$ (780,487)	-93.4%
Laboratories	$ 5,794	$ 4,256	$ (1,538)	-26.5%
Pollution Control Board	$ 1,793	$ 2,092	$ 299	16.7%
Public Safety and Environmental Outreach	$ 13,129	$ 15,591	$ 2,462	18.8%

Source: State of Illinois FY2006 Budget, P. 7-3, State of Illinois FY2005 Budget, P. 5-3.

Several factors account for the dramatic decrease in appropriations for this agency. In FY2005, the Drinking Water Loan Program was decreased by 37.1%, from approximately $133 million in FY2004 to $84 million.[32] Further, the Reimbursements for leaking Underground Storage Tanks program decreased by almost 6%, from $549 million to $517 million. These reductions alone total an $82.4 million decrease in general funds.

Since FY2004, two programs were eliminated which were funded from other state funds: the Development of Environmental Planning Activities, and the expenses related to the Market-Based Pollution Reduction Program.[33] Appropriations for these programs totaled $230.7 million and $281.7 million respectively. In addition, in FY2004, all grants relating to the Brownfields Redevelopment, as well as the Brownfields Redevelopment fund, were cut. These cuts represent approximately $48 million in reductions. The aforementioned reductions alone account for $560 million.

State Police: Streamlining produces $12 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 Interstate Commerce Commission's Special Agents and the Department of Central Management Services' Police merged into the State Police in FY2005.[34] A large part of the reduction in state appropriations reflects these consolidations.

[32] FY2005 State of Illinois Budget, P. 7-6.
[33] FY2006 State of Illinois Budget, P. 7-6.
[34] State of Illinois. FY2005 Budget, P. 4-33.

The State Police's total FY2006 appropriation is $383 million, a decrease of $12 million, or 3.3%, from FY2004. This decrease comes from a $16 million, or 7.7%, cut in state General Funds, offset by a $21 million, or 14.9%, increase in Other State Funds and a $7 million, or 25%, increase in Federal Funds**.** In FY2006, two new cadet classes will be added in furtherance of the Governor's 2005 commitment to increase the number of frontline police by four hundred over four years. In addition to expanding frontline service, the Department of State Police will receive continued funding for the Combined DNA Identification System and the coordinated training with Homeland Security.[35]

STATE OF ILLINOIS FY2004-FY2006 STATE POLICE APPROPRIATIONS (in thousands of dollars)

Type	FY2004 Enacted Appropriation	FY2006 Recommended Appropriation	**Appropriation $ change 2004 to 2006**	**Appropriation % change 2004 to 2006**
State Police	**$ 370,925**	**$ 383,131**	**$ 12,206**	**3.3%**
BY FUND				
State General Funds	$ 202,107	$ 186,457	$ (15,650)	-7.7%
Other State Funds	$ 142,119	$ 163,274	$ 21,155	14.9%
Federal Funds	$ 26,700	$ 33,400	$ 6,700	25.1%
BY PROGRAM				
Information Technology Command	$ 16,435	$ 13,065	$ (3,370)	-20.5%
Operations	$ 262,601	$ 282,892	$ 20,291	7.7%
Financial Fraud and Forgery	$ 5,144	$ 5,159	$ 15	0.3%
Forensic Services and Identification	$ 62,600	$ 60,203	$ (2,397)	-3.8%
Internal Investigation	$ 2,333	$ 2,066	$ (267)	-11.5%
Administration	$ 21,254	$ 19,747	$ (1,507)	-7.1%

Source: State of Illinois FY2006 Budget, P. 6-33, State of Illinois FY2005 Budget, P. 4-33.

Department on Aging: Increase of 12.1% since FY2004

The Department on Aging is responsible for providing a comprehensive service delivery system to serve the states 1.9 million seniors in coordination with 13 Area Agencies on Aging (AAAs).

The Department on Aging's total FY2006 appropriation is $446 million, an increase of $48 million, or 12.1%, from FY2004. Other State Funds have decreased by 73.6%, from $38.0 million in FY2004 to $10.0 million in FY2006, and State General Funds have increased by 23.7%, from $294 million to $363 million. In FY2006, the department will receive funding to offset cost increases and increased utilization associated with its senior homemaker visitation program. In addition, federal grant funds from the Centers for Medicare and Medicaid Services will assist seniors to access new state and federal prescription drug benefit programs.[36] The FY2006 budget request also includes a $1.1 million increase to support elder abuse and neglect investigations.

[35] State of Illinois. FY2006 Budget, P. 6-33.
[36] State of Illinois. FY2006 Budget, P. 5-1.

STATE OF ILLINOIS FY2004-FY2006 DEPARTMENT ON AGING APPROPRIATIONS (in thousands of dollars)				
Type	FY2004 Enacted Appropriation	FY2006 Recommended Appropriation	**Appropriation $ change 2004 to 2006**	**Appropriation % change 2004 to 2006**
Department on Aging	**$ 398,153**	**$ 446,315**	**$ 48,162**	**12.1%**
BY FUND				
State General Funds	$ 294,033	$ 363,666	$ 69,634	23.7%
Other State Funds	$ 38,050	$ 10,036	$ (28,014)	-73.6%
Federal Funds	$ 66,070	$ 72,612	$ 6,542	9.9%
BY PROGRAM				
Home and Community Care	$ 234,752	$ 280,312	$ 45,559	19.4%
Elder Rights	$ 7,217	$ 10,041	$ 2,825	39.1%
Circuit Breaker/Pharmaceutical	$ 67,907	$ 62,116	$ (5,791)	-8.5%
Supportive Services	$ 76,803	$ 81,810	$ 5,006	6.5%
Employment Services	$ 3,667	$ 3,661	$ (6)	-0.2%
Training and Staff Development	$ 193	$ 193	$ -	0.0%
Central Management	$ 7,613	$ 8,182	$ 569	7.5%

Source: State of Illinois FY2006 Budget, P. 5-1, State of Illinois FY2005 Budget, P. 3-1.

Central Management Services: Consolidation results in decrease of $2.4 billion

The Department of Central Management Services (CMS) provides a wide array of programs and services both to other state agencies and the general public including employee benefits and property management. In FY2005, the Workers' Compensation functions and certain Information Technology functions. In assuming an essential role in agency consolidation, the state will recap additional savings and realize efficiencies in FY2006 and beyond. In FY2006, CMS consolidations will have yielded the state over $53 million in incremental savings.[37]

The total FY2006 appropriation for Central Management Services is $1 billion, a decrease of $2.4 billion, or 69.8%, since FY2004. The $1 billion budget consists of $94 million in state general funds, $940 million in Other State Funds. Since FY2004 the State general funds have decreased by 91%, from $1 billion to $94 million. The Other State Funds have decreased by 60.3%, from $2.3 billion to $940 million. In FY2006 CMS will transfer certain responsibilities to the Department of Healthcare and Family Services while retaining essential employee service and intake responsibilities. At the same time the two departments will work together to renegotiate contracts with hospitals on a cost-based basis which could reduce liability by as much as $30 million. In addition, efforts to expand the public's access to contracts within state government will continue with expanded vendor outreach programs and easier methods to access state job listings and applications.

[37] State of Illinois. FY2006 Budget, P. 9-45.

STATE OF ILLINOIS FY2004-FY2006 CENTRAL MANAGEMENT SERVICES APPROPRIATIONS (in thousands of dollars)				
Type	FY2004 Enacted Appropriation	FY2006 Recommended Appropriation	**Appropriation $ change 2004 to 2006**	**Appropriation % change 2004 to 2006**
Central Management Services	**$ 3,430,023**	**$ 1,035,441**	**$ (2,394,583)**	**-69.8%**
BY FUND				
State General Funds	$ 1,059,355	$ 94,906	$ (964,449)	-91.0%
Other State Funds	$ 2,370,668	$ 940,535	$ (1,430,133)	-60.3%
Federal Funds	$ -	$ -	$ -	0.0%

Source: State of Illinois FY2006 Budget, P. 9-45, State of Illinois FY2005 Budget, P. 7-49.

An Overview of the Illinois Medicaid Program

Medicaid is one of the most significant expenditure drivers in the Illinois State Budget. Approximately $480 million or 44% of the $1.1 billion FY2006 deficit faced by the State is attributable to increases in Medicaid costs.[38]

Because Medicaid provides health related services, state Medicaid spending is tied to the rising healthcare costs seen in both the private and public sectors nationwide. However, structural features of the program itself also determine Medicaid spending as well as how each state chooses to implement the program.

In Illinois, total Medicaid spending is proportionate to its population and in line with U.S. averages (see "Medicaid Spending as Compared to Other States, below.) However, efforts to expand the number of beneficiaries result in considerably lower spending per enrollee. The FY2006 budget continues efforts to expand Medicaid coverage while reducing the structural deficit by capturing more federal dollars and by implementing cost containment measures.

The Medicaid Program

Medicaid is an open-ended, federal matching fund program that reimburses states for providing medical and health related services to certain categories of low-income persons.[39]

The Federal Medical Assistance Percentage ("FMAP")

The amount that a state receives for eligible Medicaid expenses is determined by a formula that takes into account the average per capita income for each State relative to the national average.[40] This formula, known as the Federal Medical Assistance Percentage ("FMAP"), is set by law at a minimum of 50%.[41] Since 2005, Illinois' FMAP has been 50%.[42] This means that for every dollar Illinois spends in qualifying Medicaid expenditures Illinois receives 50 cents.

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[38] Governor Rod Blagojevich, "FY2006 Budget Address Transcript." State of Illinois Web Site. February 16, 2005. State of Illinois. February 23, 2005 www.illinois.gov/gov/transcript2005.cfm.
[39] "Medicaid Primer." U.S. Department of Health and Human Services Health Resources and Services Administration. www.hrsa.gov/medicaidprimer.
[40] "Medicaid Primer." U.S. Department of Health and Human Services Health Resources and Services Administration. www.hrsa.gov/medicaidprimer.
[41] In 2004, Illinois's FMAP was 52.95% due to a temporary increase 2.95% of the FMAP that was in effect from April 2003 to June 2004 as part of state fiscal relief provided by the Jobs and Growth Tax Relief Reconciliation Act of 2003. "2003 State Expenditure Report." National Association of State Budget Officers. Page 46. www.nasbo.org/Publications/PDFs/2003ExpendReport.pdf.

Medicaid Spending in Illinois

The Illinois' Department of Healthcare and Family Services (formerly the Department of Public Aid) administers the State's Medicaid program and incurs the majority of Medicaid expenses. ***Medical Assistance***, the expense category that includes Medicaid, *KidCare*, and *FamilyCare*, accounts for $11.67 billion, or 27% of the State's $43.56 billion FY2006 budget. [43] (See also "Selected Agency Appropriations: Department of Healthcare and Family Services" in this report.)

Medicaid Spending as Compared to Other States

In terms of overall dollars, Illinois' Medicaid spending appears to be proportionate to its population and in line with U.S. averages. In 2003, the most recent year for which we have comparable data, Illinois, ranked 5th in population [44] and 7th in Medicaid spending, with a total spending of $9.5 billion. However, in terms of dollar amount per enrollee, Illinois ranked 27th with spending of $6,175 per enrollee as compared to the U.S. average of $6,579.[45]

ILLINOIS MEDICAID SPENDING AS COMPARED TO U.S. AVERAGE						
State	Population Estimates July, 2003	Rank	Total Medicaid Spending, FY2003	Rank	Per Enrollee	Rank
Illinois	12,649,087	5	$9,452,254,632	7	$6,175	27
U.S.	290,788,976	--	$266,817,101,410	--	$6,579	--
Medicaid Spending Source: "State Health Facts: Data Tables." The Kaiser Foundation. Population Estimates Source: U.S. Census Bureau						

As a percentage of total State expenditures, Medicaid expenses are considerably higher in Illinois than the national average. In 2004, Medicaid was 28.1% of the State's total expenditures as compared to 21.9% for all states. In fact, between 2002 and 2004, the increases in Illinois Medicaid as a percentage of total expenditures outpaced that of other states. [46] The following table, listing comparable states in descending order of Medicaid as a percentage of total expenditures, illustrates this trend.

[42] "State Health Facts: Data Tables." The Kaiser Foundation. www.statehealthfacts.org.
[43] State of Illinois. FY2006 Operating Budget, page 5-16.
[44] "Annual Estimates of the Population for the United States and States, and for Puerto Rico: April 1, 2000 to July 1, 2004. July 1, 2003." U.S. Census Bureau. www.census.gov.
[45] "State Health Facts: Data Tables." The Kaiser Foundation. www.statehealthfacts.org. Figures for spending per enrollee were calculation by dividing Total Medicaid Spending, FY2003 by Monthly Enrollment, June, 2003. Resulting per enrollee ranking proves comparable to Total Medicaid Spending per Enrollee, FY2000.
[46] "2003 State Expenditure Report." National Association of State Budget Officers. Page 50.

MEDICAID EXPENDITURES AS A PERCENT OF TOTAL EXPE			
State	2002	2003	2004
Pennsylvania	28.5%	28.8%	29.5%
New York	25.7%	28.4%	28.3%
Illinois	22.5%	25.4%	28.1%
Texas	22.1%	23.0%	25.1%
Ohio	21.2%	23.1%	24.8%
Indiana	20.8%	20.5%	21.6%
Michigan	19.1%	20.0%	21.5%
New Jersey	20.4%	20.6%	20.1%
California	19.3%	18.5%	17.6%
Wisconsin	11.7%	12.6%	17.4%
All States	20.7%	21.4%	21.9%
Source: National Association of State Budget Officers, 2003 State Expenditure Report			

Cost Control Measures in Illinois

Like other states, Illinois has pursued a variety of measures to control Medicaid costs over the past several years. The FY2006 budget includes measures that, in total, are expected to save the State $300 million annually.[47] These measures include:

- Reducing reimbursements for over-the-counter purchases
- Implementing controls to protect the state against fraudulent and/or medically unnecessary prescriptions
- Enrolling more seniors in Medicaid in order maximize federal financial participation [48]

Expanding Medicaid Coverage/Maximizing Federal Reimbursement

Illinois is among the few states that have expanded coverage in recent years.[49] Medicaid beneficiaries are determined by qualifying category and income eligibility. Federal law provides considerable flexibility to States to cover optional services and eligibility groups as well expand income eligibility.[50] Some options are available through waivers while others are statutorily defined.[51]

Illinois has utilized federal provisions to expand Medicaid coverage in terms of both services and income levels. However, it is important to note that many of these initiatives are specifically designed to capture federal funds. For example, as noted above, the State's efforts to integrate Medicaid with Medicare are designed to maximize federal financial participation.

The aim of integrating the Medicaid and Medicare programs is to ensure that seniors who currently receive their prescription drugs through Medicaid program will receive prescription

[47] State of Illinois. FY2006 Operating Budget, page 1-5.
[48] State of Illinois. FY2006 Operating Budget, page 1-4.
[49] "Gov. Blagojevich signs legislation intended to pump $430 million into Illinois' health care network." State of Illinois. February 3, 2004. www.illinois.gov/PressReleases/ShowPressRelease.cfm.
[50] Income eligibility is expressed as a percentage of Federal Poverty Level ("FPL") or Social Security Income ("SSI").
[51] "Medicaid Primer." U.S. Department of Health and Human Services Health Resources and Services Administration. www.hrsa.gov/medicaidprimer.

drugs through the Medicare program under Part D of the Medicare Prescription Drug Improvement and Modernization Act (MMA). The MMA, which became law on December 8, 2003, included a new outpatient prescription drug benefit that will be implemented beginning January 1, 2006.

While the Bush administration has emphasized that the shift in drug coverage from Medicaid to Medicare will result in savings to states, the legislation includes a clawback provision. This provision requires states to pay the federal government a portion (90% in calendar year 2006 and reduced evenly over nine years to 75%) of the savings according to the clawback formula. There is some concern that this formula may over-estimate the state's prior costs and thus over-estimate the payments that must be submitted to the federal government.[52] In addition, Illinois will continue to provide "wrap-around" coverage to ensure that seniors do not see a reduction in benefits. Another factor which could negatively impact the State of Illinois' Medicaid spending is reduction in funds from drug rebates through the Preferred Drug List.[53] It is yet unclear what the net impact of Part D of the Medicare Prescription Drug Improvement and Modernization Act (MMA) will be on the State's Medicaid costs over the near and long term.

Another example of the State's efforts to maximize federal dollars is the addition of "Hospital Access Improvement Payments" to the States receipt of federal funds. Approved by the U.S. Department of Health and Human Services in December of 2004, [54] this arrangement provides Illinois with an additional $490 million in federal funding.[55] Under a hospital assessment waiver, Illinois hospitals pay the State tax levies that the State uses to receive reimbursements from the federal government. The hospital assessment is a one-year agreement renewable annually. [56]

Continuation of the hospital assessment agreement and other federal reimbursement opportunities however, recently became more uncertain when the Bush administration announced its intention to achieve federal budget savings by closing "loopholes" that the states have used to maximize federal Medicaid funding.[57]

Finally, Illinois has expanded coverage to optional services and eligibility groups and has also increased income eligibility through its *KidCare* and *FamilyCare* programs. For example, in 2004, Illinois expanded coverage to an additional 78,000 parents by increasing the income limit to 133% from 100% of the Federal Poverty Level ("FPL") under its *FamilyCare* program. In 2006, the limit will be raised again to 185% FPL, making an additional 74,000 parents eligible for the program.[58]

The *KidCare* and *FamilyCare* programs utilize the State's allotment of the State Children's Health Insurance Program Funds. As discussed below, the federal matching rate for SCHIP funds is 65% - considerably higher than the Medicaid federal matching rate of 50%. By

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[52] "Part 'D' Stands for 'Deficit'" How the Medicare Drug Benefit Affects Medi-Cal." Elizabeth G. Hill. Legislative Analysts Office. State of California.
[53] State of Illinois. FY2006 Operating Budget, page 1-5.
[54] State of Illinois. FY2006 Operating Budget, page 1-4.
[55] Illinois State Operating Budget, page 5-13.
[56] Judith Graham. "State may lose Medicaid cash: Federal Funds could fall by $500 million." Chicago Tribune. March 9, 2005.
[57] Judith Graham. "State may lose Medicaid cash: Federal Funds could fall by $500 million." Chicago Tribune. March 9, 2005.
[58] State of Illinois. FY2006 Operating Budget, pages 5-13; 14.

expanding coverage through the SCHIP program, Illinois is capturing federal money at a higher rate.

The State of Illinois Children's Health Insurance Program ("SCHIP")

The State Children's Health Insurance Program ("SCHIP") was authorized under Title XXI of the Balanced Budget Act of 1997 in order to expand health insurance to children whose families earn too much to be eligible for Medicaid, but too little to purchase health private insurance.

Unlike Medicaid, which is an *open* matching fund program, federal funds annually appropriated for SCHIP are *limited and divided* among the states, the District of Columbia, and U.S. Territories.[59] Out of the total funds appropriated each year, each state receives an allotment that is available to match eligible SCHIP expenditures.[60] Each state's allotment is based upon a formula that considers:

- **Number of Children** (50% of the number of low-income children and 50% of the number of low-income ***uninsured*** children)
- **State Cost Factor** (a geographical cost factor based upon annual wages in the healthcare industry for each state)[61]

Although SCHIP is separate from Medicaid, it is a Federal/State partnership compatible with Medicaid and States may implement SCHIP through an expansion of its Medicaid program. Illinois has, in fact, elected this option for its *KidCare* program.

Illinois' KidCare and FamilyCare Programs

Illinois' *KidCare* and *FamilyCare* programs extend services and/or expand eligibility to groups not covered by Medicaid.

- ***KidCare*** is a state program that uses Illinois' allotment of SCHIP funds, to provide insurance to children whose families earn too much to be eligible for Medicaid, but too little to purchase private health insurance.[62]

- ***FamilyCare*** is a state program that accesses the unused portion of its SCHIP allotment via a Health Insurance Flexibility and Accountability ("HIFA") waiver to provide premium assistance and direct coverage to low-income parents.[63]

Illinois' Allotment of SCHIP Funds

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[59] "State Children's Health Insurance Program; Final Allotments to States, the District of Columbia, and U.S. Territories and Commonwealths for Fiscal Year 2005." Federal Register: 52700.
[60] "State Children's Health Insurance Program." Centers for Medicare & Medicaid Services. www.cms.hhs.gov/schip/regulations/allotments/fy05allotment.pdf.
[61] "State Children's Health Insurance Program." Centers for Medicare & Medicaid Services. www.cms.hhs.gov/schip/about-SCHIP.asp.
[62] "State Children's Health Insurance Program." Centers for Medicare & Medicaid Services. www.cms.hhs.gov/schip/about-SCHIP.asp.
[63] "Illinois: Family Care Waiver." October 2004. The Commonwealth Fund. 23 Feb. 2005 www.cmwf.org/tools/tools_show.htm?doc_id=235059.

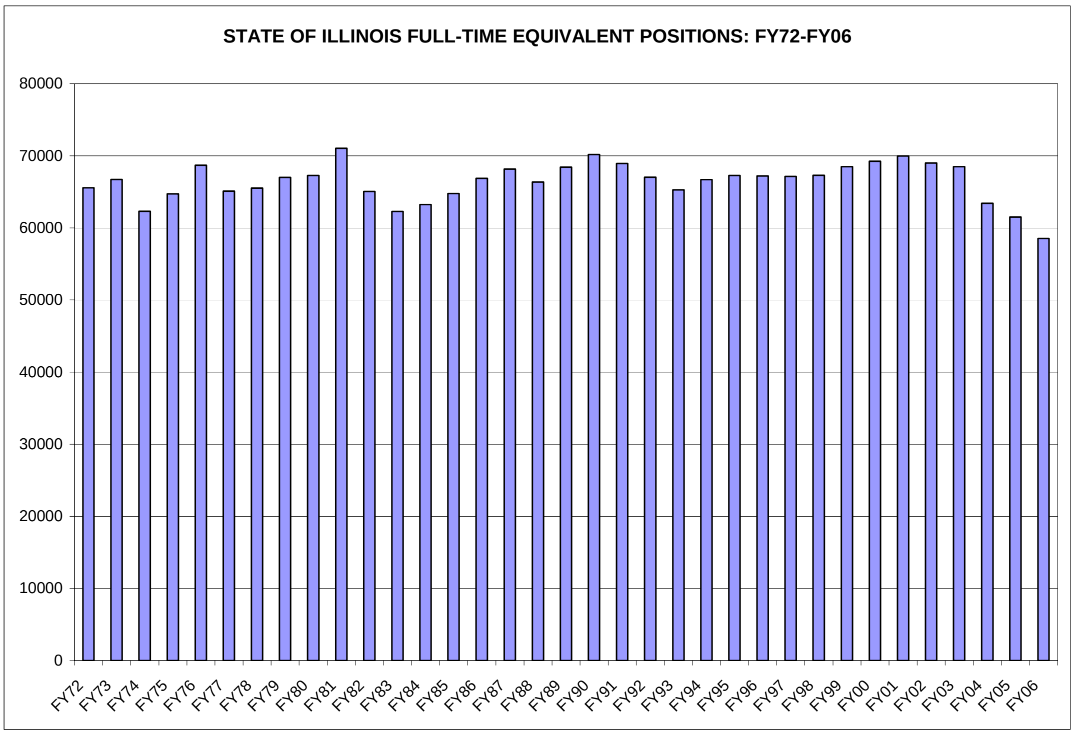
In 2004, Illinois' SCHIP allotment of $164.9 million was 4.1% percent of the $4 billion in SCHIP funds available to the states.[64] Like Medicaid, the amount of federal matching dollars a state receives is determined by a FMAP. In 2006, Illinois' FMAP for the SCHIP program was 65%.[65] In other words, for every dollar Illinois spends on SCHIP eligible expenses, Illinois receives 65 cents in federal funding.

SCHIP Spending in Illinois

SCHIP funds account for a relatively small portion of Illinois' Medical Assistance Expenditures. For example, in 2004, Illinois' SCHIP allotment of $164.9 million[66] was equal to only 1.6%, of the $10.4 billion in total Medical assistance spending in FY2004.[67]

PERSONNEL

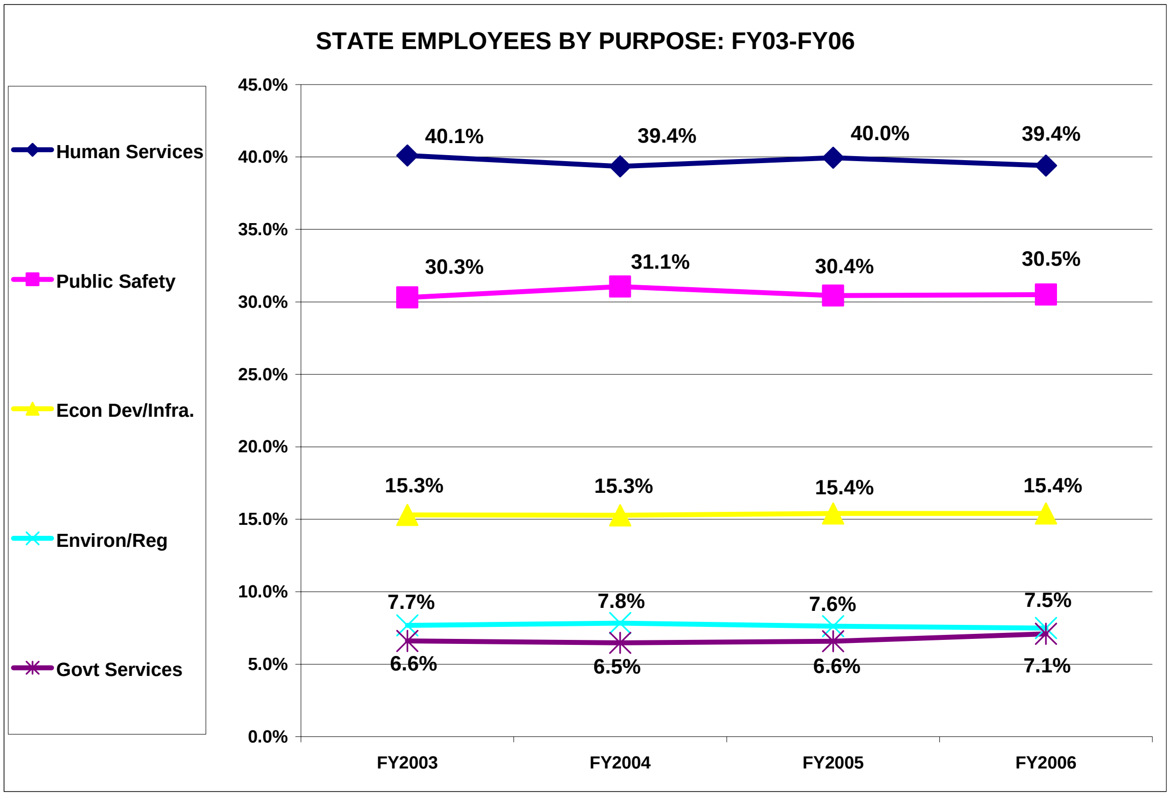
The Governor's FY2006 budget recommendation calls for 58,538 budgeted full-time equivalent (FTE) positions, a reduction of 4.1%, or 2,472 budgeted positions, from the FY2005 figure of 61,010. This is the lowest level of budgeted positions since at least 1972 when the State employed 65,575 employees. Since FY1981, when the State budgeted for 71,045 FTEs, State employment has declined by 17.6%. This represents a reduction of 12,507 positions.



The next exhibit shows the distribution of employees by major purpose since FY2003. The percentage of employees per category has remained relatively constant even as the total number of employees has shrunk. The areas of Human Services and Environment/Business Regulation

[64] (2004). Notices. Federal Register, 69(166), 52700-52705.
[65] "State Health Facts: Data Tables." The Kaiser Foundation. www.statehealthfacts.org.
[66] (2004). Notices. Federal Register, 69(166), 52700-52705.
[67] State of Illinois. FY2006 Operating Budget, page 5-16.

have seen slight percentage deadlines while the remaining categories have all experienced very slight percentage increases.



Employee Health Insurance Expenses

According to the Governor, $160 million of the $1.1 billion FY2006 deficit faced by the State is attributable to increases in employee health insurance expenses.[68] Illinois has taken several measures to reduce costs relating to employee health insurance expenses.

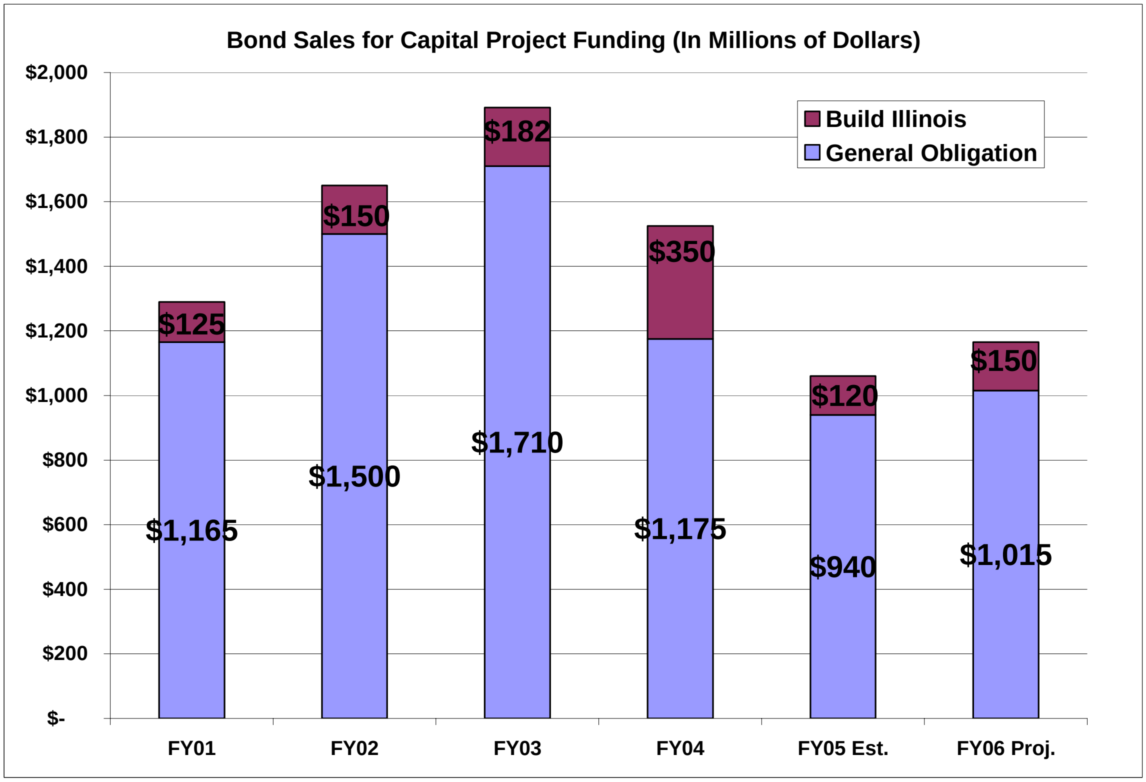
One important measure is the consolidation of the procurement and management for all four state administered healthcare plans under the newly formed Department of Healthcare and Human Services: the state employee insurance plan, a self-insured risk-pool for units of local government, the Teacher's Retirement Insurance Program, and the College Insurance Program. These plans together cover approximately 420,000 people.[69] Concentrating and leveraging the State's purchasing power for healthcare services is expected to yield substantial savings.

As with efforts toward integrating the Medicare and Medicaid programs as described above, Illinois will create greater savings by mandating that Medicare eligible retirees enroll in Medicare while the State provides the "wrap-around" coverage through its group health insurance. Similarly, the State will offer younger retirees a rebate to decline State provided coverage when it is available from other sources such as spousal employers. [70]

[68] Governor Rod Blagojevich, "FY2006 Budget Address Transcript." State of Illinois Web Site. February 16, 2005. State of Illinois. February, 23 2005 www.illinois.gov/gov/transcript2005.cfm.
[69] State of Illinois. FY2006 Operating Budget, page 9-46.
[70] State of Illinois. FY2006 Operating Budget, page 1-5.

LONG-TERM DEBT

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.[71] It excludes sales for refunding purposes and the pension obligation bonds. As the exhibit shows, bond sales will increase modestly in FY2006, from a total of $1.06 billion to $1.17 billion.



The State will have $10.4 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 FY2006 will be $20.4 billion.[72]

General Obligation Debt Outstanding (In Millions)					
G.O. Type	FY02	FY03	FY04	FY05 Est.	FY06 Proj.
Capital Purposes	$ 7,629.9	$ 8,812.6	$ 9,556.3	$ 9,958.0	$ 10,405.0
Pension Bonds	N/A	$ 10,000.0	$ 10,000.0	$ 10,000.0	$ 10,000.0
TOTAL	**$ 7,629.9**	**$ 18,812.6**	**$ 19,556.3**	**$ 19,958.0**	**$ 20,405.0**

Bond Rating Information

As of March 2005, the general obligation bond ratings of the State were: [73]

Moody's Aa3

[71] State of Illinois. FY2006 Operating Budget, page 10-1.
[72] State of Illinois. FY2006 Operating Budget, page 10-10.
[73] State of Illinois. FY2006 Capital Budget, page 49.

Standard & Poor's	AA
Fitch Ratings	AA

Both Moody's and Fitch reduced the State's bond rating in May 2003 citing factors such as weakened economy, decline in pension fund conditions,[74] debt burden and debt service structure.[75] Previously, Moody's had rated the State's G.O. debt as Aa2 and Fitch had given an AA+ rating. [76] Standard & Poor's rating carries a negative outlook while Fitch and Moody's ratings outlooks are stable.

Debt Service Schedule

A debt service schedule sets forth the principal and interest amounts due for bonds outstanding. Generally, state and local debt service schedules are expected to have level payments, that is, roughly equal amounts due each year. While the Pension Obligation bonds have increasing debt service payments, when taken as a whole, the State of Illinois debt service schedule for all bonds outstanding has gradually declining debt service. [77]

Debt Burden Comparison

The two following exhibits compare Illinois' debt burden to that of the other 49 states. The information is from *2004 Moody's Investors Services Special Comment on State Debt Medians* as updated for current state ratings. Illinois ranked 6th in the nation for net 2003 tax-supported debt per capita, climbing from a previous ranking of 11th. [78] The State's per capita amount of $1,943 placed it well above the median of $701 for all states.

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[74] State of Illinois. FY2006 Capital Budget, page 49.

[75] Yvette, Shields. "Borrowing, Illinois Style: Partisans Split Over State's New Approach." The Bond Buyer March 2004:

[76] "State of Illinois. FY2005 Recommended Operating Budget: Analysis and Recommendations." May 3, 2005. The Civic Federation. www.civicfed.org. Page 55.

[77] State of Illinois. FY2006 Operating Budget, page 10-10.

[78] "State Debt Medians." Moody's Investors Service Special Comment. April, 2004. As updated for ratings current as of February 22, 2005.

NET TAX-SUPPORTED DEBT PER CAPITA 2004			
Rank	**State**	**Amount**	**Rating**
1	Connecticut	$3,553	Aa3
2	Massachusetts	$3,338	Aa2
3	Hawaii	$3,101	Aa3
4	New York	$2,420	A1
5	New Jersey	$2,382	Aa3
6	**Illinois**	**$1,943**	**Aa3**
7	Delaware	$1,800	Aaa
8	Washington	$1,583	Aa1
9	Rhode Island	$1,385	Aa3
10	Wisconsin	$1,325	Aa3
11	Oregon	$1,281	Aa3
12	Mississippi	$1,169	Aa3
13	Kentucky	$1,119	Aa2
14	Maryland	$1,077	Aaa
15	California	$1,060	A3
	MEDIAN	***$701***	
	MEAN	***$944***	

Source: Moody's Special Comment. 2004 State Debt Medians

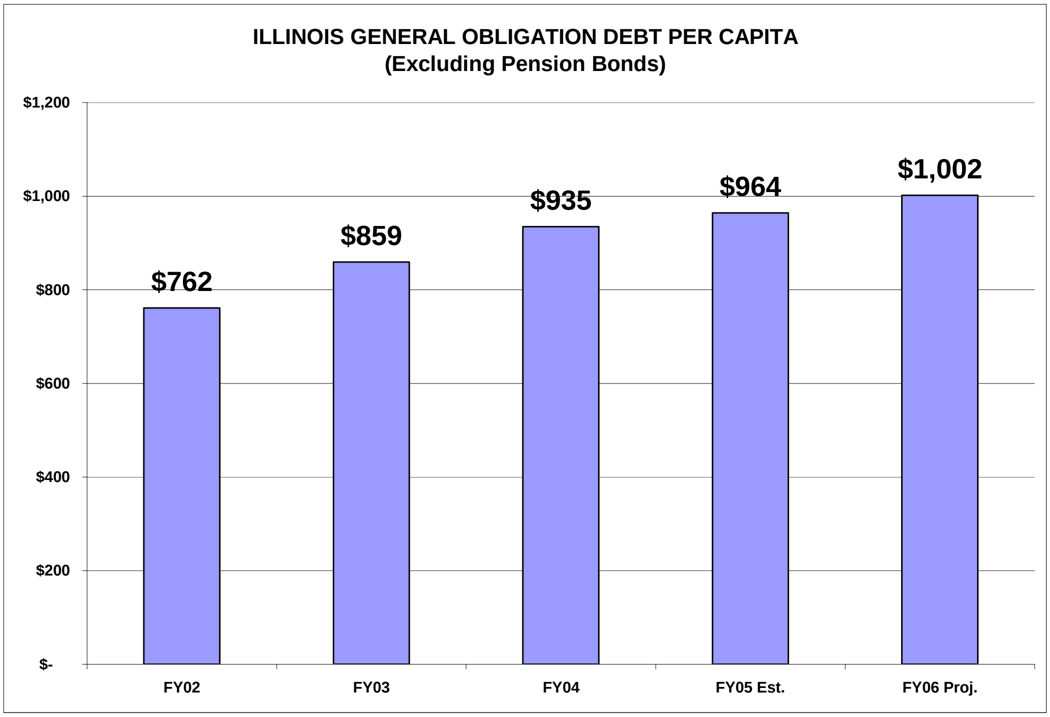
The next exhibit shows the top 15 states when ranked by net 2003 tax-supported debt as a percentage of 2002 personal income. Illinois ranked 6th with net tax-supported debt equal to 5.8% of personal income, a ratio more than double the 50-state median of 2.4%.

NET TAX-SUPPORTED DEBT AS A % OF 2002 PERSONAL INCOME		
1	Hawaii	10.4%
2	Massachusetts	8.5%
3	Connecticut	8.4%
4	New York	6.7%
5	New Jersey	5.9%
6	**ILLINOIS**	**5.8%**
7	Delaware	5.6%
8	Mississippi	5.2%
9	Washington	4.9%
10	Oregon	4.5%
11	Wisconsin	4.5%
12	Rhode Island	4.4%
13	Kentucky	4.4%
14	New Mexico	4.1%
15	West Virginia	3.6%
	MEDIAN	**2.4%**

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

General Obligation Debt Per Capita - Excluding Pension Bonds

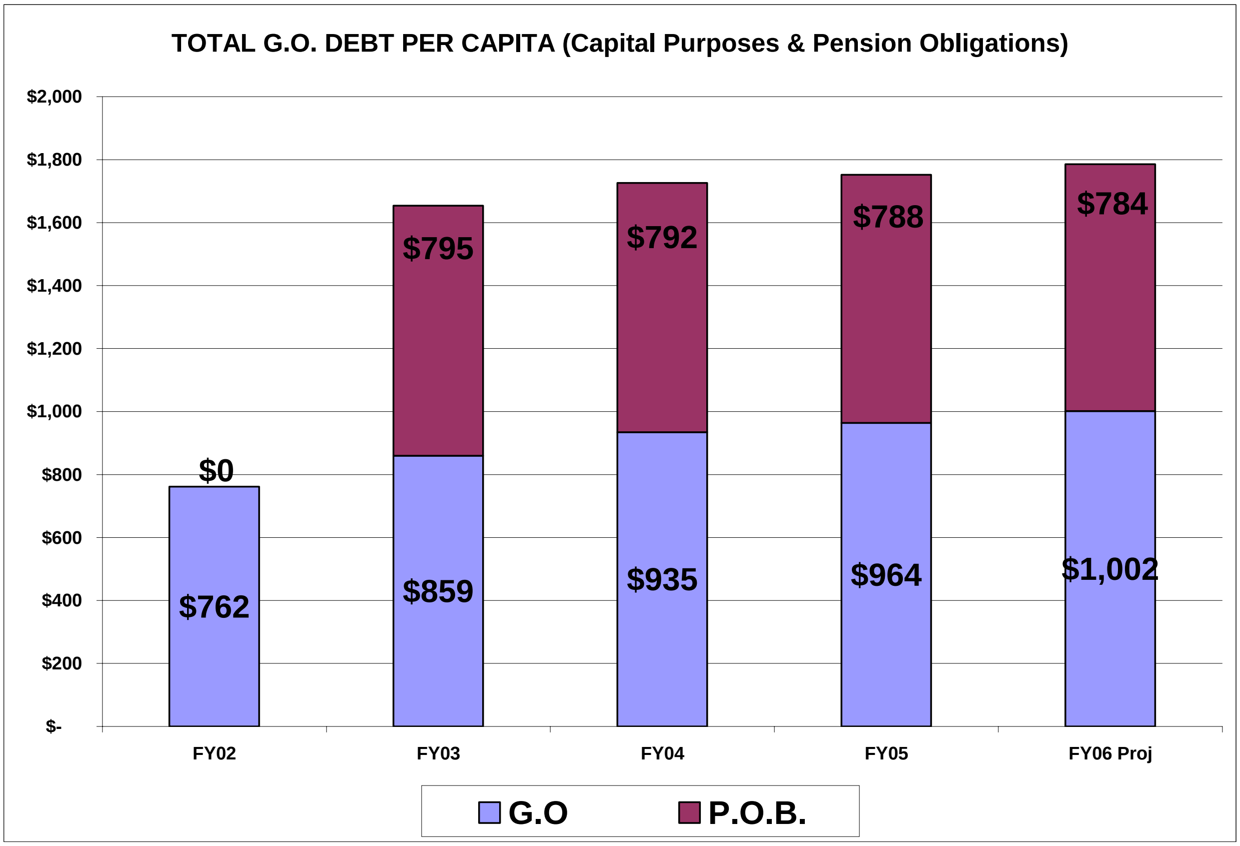
Illinois State General Obligation bond debt per capita (excluding the Pension Obligation bonds) is shown in the following exhibit.[79] Between FY2002 and FY2006, G.O. debt per capita for capital purposes is projected to increase by 32%, from $762 to $1,002.



General Obligation Debt Per Capita - Including Pension Bonds

The next exhibit shows estimates for total General Obligation debt per capita for capital purposes as well as Pension Obligation debt. [80] Between FY2002 and FY2006, General Obligation debt per capita is projected to more than double, increasing from $762 to $1,786. Approximately 50% of the debt per capita in fiscal years 2003 through 2005 is due to Pension Obligation debt issuance.

[79] State of Illinois. FY2006 Operating Budget, page 10-10.
[80] State of Illinois. FY2006 Operating Budget, page 10-10.



Moral Obligation Debt

Seven State of Illinois authorities are authorized to issue moral obligation bonds. Moral obligation debt is secured by a moral but not a legal pledge from a government entity. The primary source of debt service payments is typically a specific revenue source. If revenues are insufficient, the issuer promises to use other revenue to cover the shortfall.[81] The purpose of moral obligation bonds is to provide access to credit markets for entities or enterprises that would not otherwise have ready access. In Illinois, they are used primarily to promote economic development projects with a broad public purpose.

The State of Illinois' moral obligation pledge requires that the authorities issuing moral obligation debt must certify the amount of a deficiency in the case of a default. The various authorities must also certify any amounts withdrawn from bond reserve funds to pay for principal and interest on the moral obligation bonds. The Governor then must inform the General Assembly of the certified amounts and is permitted to recommend an appropriation at his or her discretion. Because a moral obligation pledge is not a legally enforceable obligation, the Governor is not required to recommend an appropriation for moral obligation debt nor is the General Assembly required to appropriate any such funds. However, funds can be appropriated if the Governor and General Assembly so decide.

[81] A John Vogt. *Capital Budgeting and Finance: A Guide for Local Governments* (Washington: International City/County Management Association, 2005), pp. 209-210.

Currently, the various State bonding authorities have issued $285.2 million in outstanding moral obligation debt. Debt service on these bonds is estimated to be $34.1 million in FY2006. Approximately $28.8 million of outstanding moral obligation debt, or 10.1% of the total, is in default.

The next exhibit shows the percentage of moral obligation debt in default by authority as of January 1, 2005. Approximately 8.7% of the debt outstanding issued by the Upper Illinois River Valley Development Authority was in default while 44.8% of the debt outstanding issued by the Southwestern Illinois Development Authority was in default.

MORAL OBLIGATION BONDS IN DEFAULT			
Authority	Project Name	Appropriation Request for Debt Service Payments as of 2/1/05 ($ Thousands)	Amount Outstanding as of 1/1/05 ($ Thousands)
Southwestern Illinois Development Authority	Waste Recovery-Illinois	$ 360,700,000	$ 2,700,000,000
Upper Illinois River Valley Authority	Waste Recovery-Illinois	$ 571,000,000	$ 2,130,000,000
Southwestern Illinois Development Authority	Spectrulite Consortium, Inc.	$ 737,000,000	$ 3,565,000,000
Southwestern Illinois Development Authority	Laclede Steel	$ -	$ 12,970,000,000
Southwestern Illinois Development Authority	Alton Business Center Park	$ 1,950,000,000	$ 7,449,600,000
TOTAL		**$ 3,618,700,000.00**	**$ 28,814,600,000**

Source: FY2006 Illinois State Budget Book, p. 10-8.

SHORT TERM DEBT

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

The State of Illinois may issue short-term debt certificates based upon revenue anticipation or shortfall and failure in revenues. However, the State may borrow only up to five percent of State appropriations for any fiscal year in anticipation of revenues collected for that fiscal year which will repay the borrowing by the close of that year. The State may borrow up to fifteen percent of the state's appropriations for any fiscal year due to revenue shortfalls. Revenue shortfall borrowing must be repaid within one year. [82]

The following exhibit shows amount of certificates as well as the issuance and retirement dates from July of 2002 through March of 2005. No certificate issuance was reported between August of 1995 and July of 2002. The March of 2005 issuance represents borrowing for Medicaid related purposes. The amount of State short-term debt decreased by 23.5% between FY2002 and FY2006, from $1 billion to $765 million. This is a positive sign.

ILLINOIS SHORT-TERM DEBT FY02-FY06			
Certificates Issues	Certificates Retired	Approx. Months	Amount ($ mil)
July 2002	June 2003	11	$ 1,000
May 2003	May 2004	12	$ 1,500
June 2004	October 2004	4	$ 850
March 2005	June 2006	3	$ 765

Source: FY2006 Illinois State Budget, Page 10-3

[82] FY2006. State of Illinois. Operating Budget, page 10-3.

Interest Rate Management

In addition to short term borrowing for revenue management, Public Act 93-9, which became effective on June 4, 2003, grants the State the ability to issue variable rate debt and enter into interest rate exchange agreements.[83] The use of these techniques is governed by the State's interest rate risk management policy.[84] As of February 16, 2005, the State had a total of $600 million in interest rate exchange agreements outstanding, or 2.6% of the State's $22.8 billion in bonded debt.[85] These agreements, representing a total of five counterparties, convert variable rate debt to approximate net fixed rate debt. The agreements were entered into for the purpose of achieving a lower total rate of interest than would have been possible with a traditional fixed rate financing.[86]

STATE OF ILLINOIS RETIREMENT SYSTEMS

The State of Illinois funds five retirement systems for employees and retirees: the State Employees Retirement System (SERS), the Teachers' Retirement Employment Retirement System (TRS), the State Universities Retirement System (SURS), the Judges' Retirement System (JRS) and the General Assembly Retirement System (GRS). A total of 647,038 individuals are currently enrolled in these five systems.

MEMBERS OF ILLINOIS RETIREMENT SYSTEMS

Pension Fund	Members	Annuitants	Total
Teachers	239,210	71,165	310,375
University	147,969	38,487	186,456
State Employees	93,418	54,298	147,716
Judges	941	873	1,814
General Assembly	280	397	677
Total	**481,818**	**165,220**	**647,038**

Illinois has historically underfunded its pension funds. In 2004, Wilshire Associates reported that the state ranked 49th in the nation for the amount of unfunded liabilities in its pension funds. At that time, unfunded liabilities totaled $43.1 billion.[87]

In 1995, Public Act 88-593 established a 50-year schedule of funding requirements to compensate for the State's previous years of underfunding the pension plans. It requires that the state's contribution "equal a percentage of payroll necessary to amortize 90% of unfunded liabilities" by the year 2045. However, since 1995, succeeding Governors and General Assemblies have added $5.8 billion in new pension benefit enhancements, further increasing the State's pension liabilities.

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[83] State of Illinois. FY2006 Operating Budget, page 10-3.

[84] See www.state.il.us/budget/Intr_Rate_Policy_October2003Final.pdf for the full text of the interest rate risk management policy.

[85] Includes *Build Illinois*, Civic Center, Capital Purpose G.O., and Pension bonds. Source: State of Illinois. FY2006 Operating Budget, pages 10-3; 10.

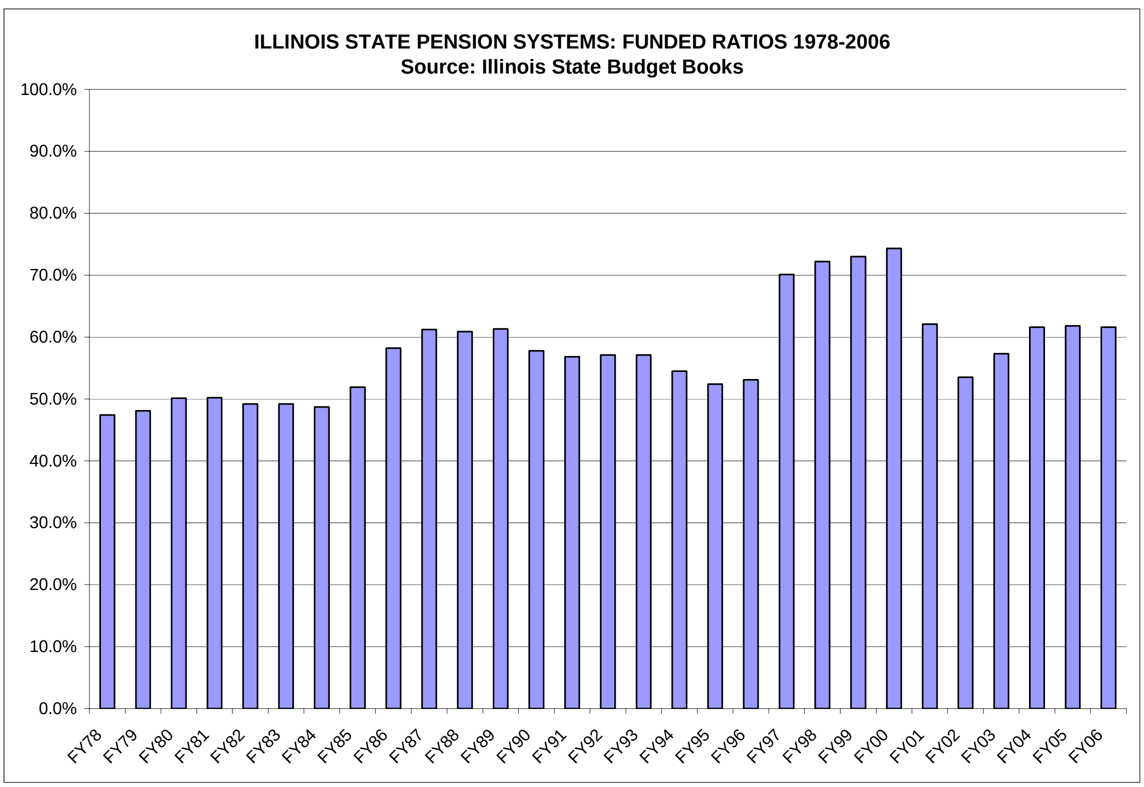
[86] State of Illinois. FY2006 Operating Budget, page 10-3.

[87] State of Illinois. FY2006 State Budget, p. 2-1.

ILLINOIS STATE PENSION ENHANCEMENTS ADDED SINCE 1995 LAW		
YEAR	BENEFIT	COST
1995	TRS Early Retirement Incentive	$ 150,000,000
1997	SURS Conversion from Step Rate to Flat Formula	$ 180,000,000
1998	TRS Conversion from Step Rate to Flat Formula	$ 1,000,000,000
1998	SERS Conversion from Step Rate to Flat Formula; Alternative formula final rate of pay conversion from average of final 4 years to pay on final day	$ 1,250,000,000
2001	SERS Rule of 85 added; alternative formula conversion from Step Rate to Flat Formula	$ 650,000,000
2002	SURS added 30 years of service and out provision	$ 60,000,000
2002	SERS added highway maintainers and DHS security to alternative formula	$ 170,000,000
2003	SERS Early Retirement Incentive	$ 2,370,000,000
	TOTAL	**$ 5,830,000,000**

Source: FY2006 Illinois State Budget, p. 2-2.

The exhibit that follows shows historic funding ratios for the State of Illinois' five retirement systems between FY1978 to FY2006 as projected. Until FY1984, ratios rarely rose higher than 50%. After passage of the 1995 funding reform law, funded ratios rose to a high of 74.3% in FY2001 before falling once again. Clearly, the State has fallen short in its efforts to adequately fund its pension systems.



$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.
- 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: Slight Projected Decrease for All Funds

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. Between FY2005 and FY2006:

- The projected funded ratio for the State Employees' Retirement System will increase from 53.4% to 54.3%;
- The projected funded ratio for the Teachers' Retirement System will remain at the 61.7%, ratio reported the previous year;
- The State Universities Retirement System projected ratio will decline slightly from 65.0% to 64.4%;
- The Judges' Retirement System will decline from a funded ratio of 45.6% to 45.2%;
- The General Assembly Retirement System will decrease from a funded ratio of 38.6% to 37.2%.

ILLINOIS STATE RETIREMENT SYSTEMS FUNDED RATIOS					
	FY2002	FY2003*	FY2004	FY2005 Estimate	FY2006 Estimate
State Employees' Retirement System	53.7%	50.5%	54.2%	53.4%	54.3%
Teachers' Retirement System-Downstate	52.0%	58.5%	61.9%	61.7%	61.7%
State Universities Retirement System	58.9%	61.8%	66.0%	65.0%	64.4%
Judges' Retirement System	33.7%	43.9%	46.2%	45.6%	45.2%
General Assembly Retirement System	29.3%	39.0%	40.0%	38.6%	37.2%
ALL STATE RETIREMENT SYSTEMS	**53.5%**	**57.3%**	**61.6%**	**61.8%**	**61.6%**

* Includes proceeds of Pension Obligation Bonds on a pro forma basis.
Source: FY2006 Illinois State Budget, p. 2-9.

Unfunded Liabilities: Increase of $2.1 Billion Projected in FY2006

The unfunded liabilities of the State's five pension funds are projected to be $37.7 billion in FY2006. This is approximately a 6.2%, $2.1 billion increase over FY2005. Since FY2002, unfunded liabilities have increased by 7.9%, or from $34.9 billion to $37.7 billion. The use of proceeds from the FY2003 issue of $10 billion in Pension Obligation Bonds did reduce unfunded liabilities between FY2003 and FY2004 by $1.6 billion. However, unfunded liabilities are projected to increase again in FY2006 in part because of the need to pay for unanticipated costs of the FY2002 Early Retirement Initiative.

STATE PUBLIC EMPLOYEE RETIREMENT SYSTEMS UNFUNDED LIABILITIES (FY02-FY06) - $ Millions							
RETIREMENT SYSTEM	FY2002	FY2003	FY2004 Estimate	FY2005 Estimate	FY2006 Estimate	$ CHG FY02-FY06	% CHG FY02-FY06
State Employees'	$ (6,617.1)	$ (8,706.0)	$ (8,452.5)	$ (8,965.0)	$ (9,284.0)	$ (2,666.9)	40.3%
Teachers' Retirement	$ (20,681.4)	$ (19,478.2)	$ (19,402.8)	$ (20,672.7)	$ (21,911.2)	$ (1,229.8)	5.9%
State Universities	$ (6,839.3)	$ (6,878.4)	$ (6,495.3)	$ (6,991.4)	$ (7,449.7)	$ (610.4)	8.9%
Judges'	$ (677.1)	$ (604.2)	$ (621.5)	$ (661.6)	$ (701.8)	$ (24.7)	3.6%
General Assembly	$ (130.5)	$ (119.8)	$ (124.4)	$ (129.3)	$ (134.2)	$ (3.7)	2.8%
TOTAL	**$ (34,945.4)**	**$ (35,786.6)**	**$ (34,145.0)**	**$ (35,501.0)**	**$ (37,691.9)**	**$ (2,746.5)**	**7.9%**

Source: FY2006 Illinois State Budget, p. 2-9.

The Governor's FY2006 Pension Funding Reform Proposals

Governor Blagojevich proposed a number of pension funding reform proposals in the FY2006 State of Illinois Budget. These proposals were all originally recommended by the Governor's Blue Ribbon Pension Commission, which is composed of representatives from the General Assembly, business, labor and civic groups. The Commission issued an interim report prior to release of the budget.

Several of the Commission's recommendations have been slightly modified and the difference between the Commission's proposal and the Governor's recommendation is identified below.

Actuaries and consultants for the Governor's Office of Management and Budget estimate that the reform proposals in the FY2006 budget will generate approximately $55 billion in cost savings over 40 years. The cost savings are expected to accrue because of reductions in State contributions to the five retirement systems required to meet the 90% funded ratio goal by 2045. Over 40 years, the reforms are expected to reduce pension fund liabilities by $100 billion.

1. Link Automatic Annual Increase to CPI (New Hires Only)

The current rate of automatic increase for retirement annuities is 3% per year. Other retirement systems index the rate of increase to the CPI, limit the dollar amount of increase, or approve new increases annually.

Proposal: *For new hires only, automatic increases would be limited to the lesser of the change in CPI or 3% and apply only to the first $12,000 in annual pension for retirees covered by Social Security and $24,000 for retirees not covered by Social Security.*

Projected Savings: $19 billion over 40 years

Difference from Commission Recommendation: *The Commission had recommended that the annual rate of automatic increase be limited to 2% or CPI.*

2. Cap the State's Obligation to Assume Pension Costs for End-of-Career Salary Increases

Currently, school district and universities can grant teachers, faculty and administrators large salary increases in the final years of their career. Pension benefits for these employees are based on the salary received in the final four years of employment. Because the State assumes the cost of these pension increases through the Teachers Retirement System and State Universities Retirement System, these costs gave risen substantially over time.

Proposal: *For purposes of determining the State's share of pension benefits only, end-of-career employee raises would be capped at 3% per year. School districts and universities would assume the burden of paying for pension increases above the 3% cap.*

Projected Savings: $17 billion over 40 years

Difference from Commission Recommendation: *The Commission had recommended that end-of-career employee raises would be capped at no more than 5% per year*

3. Recalculate the Money Purchase Option Interest

The SURS Board determines the interest rate applied to employee contributions for money purchase option calculations based on its interpretation of relevant statutes. During the 5-year period ending June 30, 2004, the SURS Board determined the applicable interest rate was 9% even though the actual rate of return for SURS investments was less than 3.3%.

Proposal: *Defining the interest credit under the Money Purchase Option as the long-term rate of return, bit not to exceed either the most recent 5 or 10 year rates of return.*

Projected Savings: $10 billion over 40 years

4. Change Retirement Ages (New Hires Only)

Members of the state's retirement systems are currently eligible for full retirement benefits when they attain age 60, unlike most private sector retirement systems that require retirement at age 65.

Proposal: *The eligibility for full benefits would be increased to age 65, with 8 years or more of service; age 62 with 30 years or more of service; or age 60 with 35 years or more of service.*

Projected Savings: $5.5 billion over 40 years

5. Eliminate Money Purchase Option for SURS Annuitants (New Hires Only)

Members of the State Universities Retirement System (SURS) may have their benefits calculated under basic plan provisions or the Money Purchase Option and opt for that calculation which brings the higher benefit.

The Money Purchase Option aggregates employee contributions and provides an annual interest credit, which is determined by the SURS Board. When the employee retires, the accumulated contributions plus interest are then marched by the State at 140%.

Proposal: *For new hires only, the Money Purchase Option would be eliminated.*

Projected Savings: $2.5 billion over 40 years

6. *Limit Eligibility for Alternative Formula Pension Benefits (New Hires Only)*

State Employees Retirement System (SERS) provides a higher benefit formula and earlier retirement eligibility for certain employees in "high risk" jobs. However, the high risk category has been expanded over time from sworn police officers to 1/3rd of all state workers.

Proposal: *Limit alternative formula to police officers and employees who meet defined risk criteria.*

Projected Savings: $1.5 billion over 40 years

7. No New Pension Benefits without Funding

One of the reasons for the steady increases in unfunded liabilities over time is the practice by succeeding Governors and General Assemblies of approving increases in retirement benefits without also providing for additional funding to pay for those new benefits.

The Pension Commission had recommended that no new benefits for state employees without a new funding source identified at the time of adoption. An explicit sunset provision should be attached to any new pension benefit.

The Governor has reintroduced his Balanced Budget Act this year. The Act would require that any appropriation bill that includes new spending would require identification of new revenues or reduced spending in order to pay for the initiative. This proposal would address the Commission's concern that no new pension benefits be added without corresponding revenues. However, the Governor has not embraced the sunsetting of new pension enhancements.

Funding Reform Concepts Rejected

Governor Blagojevich has explicitly rejected two concepts considered by the Pension Commission:

- Requiring employees to increase the percentage of salary they pay into the retirement systems or
- Any consideration of shifting to a Defined Contribution (DC) Plan.

1. Increase Employee Contributions by 1%

Employees covered by the state retirement systems contribute a percentage of their compensation for their own pensions and to fund survivor's benefits. For example, members of the State Employees Retirement System (SERS), employees covered by the regular retirement formula are required to make the following contributions:

- Members with Social Security: 3.5% of compensation (pension) + .5% (survivors') = 4.0% total
- Members without Social Security: 7.0% of compensation (pension) + 1.0% (survivors') = 8.0% total

The Commission recommended that employee contributions to each of the five retirement systems be increased by 1%.

2. Consider Defined Contribution Plans for New Hires

The State's five retirement systems provide defined benefit (DB) plans. Certain SURS members can, however, opt to join a defined contribution (DC) plan.

The Commission recommended that once the State stabilizes the funding of its pension system, it should consider replacing all or part of its Defined Benefit pension plans for new hires with Defined Contribution Plans. DC plans can significantly reduce unfunded liabilities over time.

Impact of the Proposed Pension Funding Reforms on the FY2006 Budget

The Pension Commission recommended that the State's 1995 pension funding plan be amended to reflect reductions in accrued liabilities and reduced state contributions resulting from adoption and implementation of any pension reforms. *This recommendation was contingent upon adoption of all or most of the Commission's proposals.*

Implementing the reforms outlined above will reduce required State of Illinois contributions to the five retirement systems by approximately $55 billion over 40 years. The FY2006 budget reflects these reductions in the total amount of $819 million.

Adopting the Governor's funding reform proposals without changing the current funding plan would result in a reduction of $80.9 million. The remaining $738.5 million in reductions result from the Governor's plan to change the current funding plan by allocating proportional savings from adoption of the reforms to the budget this year.[88]

The FY2006 budget includes the following pension funding principles:

- The State will maintain the 1995 plan's goal of a 90% funded ratio in 2045
- The pension funding plan will provide for a ramping of contributions to a constant percent of payroll by 2011 (including the 2002 Early Retirement Initiative amendment to the 1995 funding plan)
- Continuing appropriation authority for pension contributions will be provided.
- Any savings produced by the proposed pension reforms will be "proportionately" allocated for required contributions for each retirement fund from 2006 through 2045.

The exhibit below shows the difference between the original amount certified by the individual retirement systems and the amount proposed by the Blagojevich administration in the FY2006 budget.

FY2006 CERTIFED CONTRIBUTIONS VS. BUDGET BOOK RECOMMENDATIONS (In Millions of Dollars)

	Certified Contributions			Budget Book Recommendations			Budgeted Reduction from Certified Amount
System	Retirement System	Debt Service	Total State Cost	Retirement System	Debt Service	Total State Cost	
TRS	$ 1,058.5	$ 293.7	$ 1,352.2	$ 591.6	$ 293.7	$ 885.3	$ (466.9)
SERS	$ 759.3	$ 24.8	$ 784.1	$ 553.7	$ 24.8	$ 578.5	$ (205.6)
SURS	$ 324.7	$ 97.2	$ 421.9	$ 184.4	$ 97.2	$ 281.6	$ (140.3)
JRS	$ 38.0	$ 9.6	$ 47.6	$ 32.3	$ 9.6	$ 41.9	$ (5.7)
GARS	$ 5.5	$ 1.8	$ 7.3	$ 4.6	$ 1.8	$ 6.4	$ (0.9)
Total	**$ 2,186.0**	**$ 427.1**	**$ 2,613.1**	**$ 1,366.6**	**$ 427.1**	**$ 1,793.7**	**$ (819.4)**

Sources: FY2006 Illinois State Budget Book, Commission on Government Forecasting and Accountability

BUDGETARY STRUCTURAL REFORM

The FY2005 State budget proposes one major structural reform, the Pay as You Go Act.

The Pay as You Go 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.

This proposal was introduced into the General Assembly last year as the Balanced Budget Act, but it was not approved.

[88] Commission on Government Forecasting and Accountability, Monthly Briefing, February 2005, p. 16

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:

Establish a Governor's Commission to Review and Prioritize State Spending

Recognizing the critical need to constrain mounting state pension costs, Governor Blagojevich appropriately established a Blue Ribbon Commission composed of representatives from the business community, labor unions, the General Assembly and civic groups to propose recommendations for funding reform. In our view, the Commission successfully met its charge; the State of Illinois was well served by its sound proposals.

The Civic Federation recommends that the Governor follow up on the success of the Pension Commission by convening a Commission on State Spending. The purpose of this Commission would be to conduct a comprehensive review of State spending programs with the ultimate goal of prioritizing State programs. Those programs that are deemed to be essential to the well being of Illinoisans should be maintained or even enhanced. Those programs that are not essential may require reductions or even elimination. Given the State's ongoing resource constraints, the administration's pledge to refrain from broad based tax increases and the public's unwillingness to embrace new taxes or enhanced spending without at least some confidence that the State is operating as efficiently and effectively as it should, we believe that a prioritization review is long overdue. Many states, including Washington and Michigan, have or are in the process of conducting similar prioritization processes.

The framework for a review of State spending should be comprehensive and include the following considerations:

- Implement cost containment strategies must be considered for mandated programs;
- There must be a cap or moratorium on the expansion of State employee benefits;
- The State cannot implement new programs without new revenues or spending cuts;
- There must be enhanced accountability for state programs; providing accountability

Fund Mass Transit with Spending Reductions and Cost Saving Efforts

The Civic Federation opposes the Governor's software tax proposal to fund mass transit as unworkable in the time frame proposed. However, we do support a smaller, short-term mass transit subsidy for the Chicago Transit Authority and other agencies with funding derived from increased savings elsewhere in the State budget, on condition that the CTA increases fares as proposed and takes action to cut spending and increase efficiency. Increased State support for the CTA should supplement -- not replace -- cost cutting and revenue enhancement strategies by that agency, including a fare increase.

The Civic Federation supports the CTA's action on April 13, 2005 to increase cash fares to $2, although we believe that the increase should have been imposed on all fares to generate additional revenues. However, we still have great concerns about the deep service cuts approved at that meeting. Instead of opting for those cuts, the originally proposed cost-cutting and revenue enhancement issues considered last year by the CTA should be implemented, and State of Illinois should provide funding to close any remaining budget deficit.

The Civic Federation believes that funding for a mass transit subsidy should be derived from increased savings from other parts of the State budget. We also believe that such funding should be conditioned on the Regional Transit Authority taking the steps necessary to ensure appropriate oversight of the CTA's finances. This includes monitoring the need for fare increases and promoting greater efficiency in operations and transparency in financial reporting, especially in the areas of personnel, pension funding and management reforms such as privatization and outsourcing.

In lieu of the software tax, a brief review of the FY2006 budget reveals several possible sources of full or partial funding for mass transit. The sources selected all generate savings from elimination of redundant programs and reduced funding for activities that are more appropriately funded by other entities, such as universities, local governments or the private sector. These options include:

- Applying a portion of the savings generated from a 1% increase in employee contributions to the State retirement systems. This action could generate savings of as much as $145 million in FY2006;
- Eliminating the State subsidy for Coal Development and marketing could yield $23.6 million annually;
- Eliminating General Fund subsidies of the salaries of local assessors, supervisors of assessment and coroners could save up to $5.7 million per year;
- Eliminating State college tuition waivers granted by members of the General Assembly scholarships would generate up to $2.3 million in revenues;
- Ending State grants to local Soil and Water Conservation Districts for salaries, education amend promotion assistance could save $5.2 million annually;
- Eliminating agricultural research grants to public universities could save up to $3.5 million annually; and/or
- Ending the State subsidy for the DuQuoin State Fair, the State's second state fair, could save $1.1 million per year.

Impose a Moratorium on New State Employee Pension Enhancements

The Governor's Blue Ribbon Pension Commission recommended that not only should any new pension enhancements be accompanied with an identified source of funding, but they should also sunset after a period of time. We concur with both of these sound proposals. It is certainly proper to discuss, review and reconsider benefits for new employees at any time. However, the Civic Federation believes that even more rigorous cost control efforts are essential.

The Governor has proposed a "Pay as You Go" Act that would require any appropriation bill that includes new spending to identify new revenues or reduced spending in order to pay for the initiative. We urge the General Assembly to approve this Act as a means of capping runaway long-term obligation costs. We were dismayed that the legislature failed to take up a similar proposal by Governor Blagojevich last year.

If the General Assembly fails to adopt the Pay as You Go Act, new pension enhancements may be approved by the legislature without identified funding. Adding more benefits without funding would, of course, negate the financial benefits that accrue from adopting any or all of the Governor's pension reforms.

However, even if the Pay as You Go Act is approved, spending could still rise. The legislature could simply increase benefits and find new ways to pay for them. While this is a more fiscally responsible approach, it still keeps the State on a never-ending treadmill of continuously expanding benefits and costs.

The Civic Federation believes that the time has come to stop expanding employee pension benefits. Therefore, we call on the legislature to reject and the Governor to veto any new pension enhancements whether they are funded or not. In addition, the State must adopt a moratorium on any new benefit enhancements until such time as substantial progress has been made on reducing the State's billions of dollars in pension liabilities and will likely require waiting at least 10 years until the FY2002 Early Retirement Initiative fiasco is full paid for.

Require Employees to Increase Pension Contributions by 1%

The Federation believes all public employees covered by the State's five retirement systems should contribute an additional 1% of their salaries to the cost of their pensions. This increase should be required immediately for new hires and non-union employees. Although current contracts prevent this increase from being implemented immediately for employees covered by collective bargaining agreements, the State should, as a matter of policy, require increased contributions in future contracts. Stratospheric pension costs pose a serious threat to the financial future of the State of Illinois and its residents, and containing those costs must be a shared, ongoing, focused effort. We do not believe a single percentage point increase is onerous or unreasonable, especially when balanced against the generous retirement benefits state employees receive.

Study the Costs and Benefits of a Defined Contribution Pension Plan

The Commission recommended that once the State stabilizes the funding of its pension system, it should consider replacing all or part of its Defined Benefit pension plans for new hires with Defined Contribution (DC) Plans. DC plans, which are the predominant form of retirement benefit provided to the average American worker, can significantly reduce unfunded liabilities over time and offer employees greater flexibility as they change jobs.

In reviewing the past thirty years, we have seen no evidence that the General Assembly has the requisite fiscal discipline to transparently execute a well funded Defined Benefit retirement system. For that reason, we think that a shift to a Defined Contribution system must be seriously considered for new hires when it is financially feasible. We understand that the transition costs for the shift could be expensive because of the current dramatic underfunding of the retirement systems. However, the Civic Federation urges the Governor, the Pension Commission and the legislature to undertake a study of this option to determine both costs and benefits. This study should include consideration of transition funding mechanisms because the cost savings and benefits of a shift to a DC plan in the long term may outweigh short-term expenses. While the Civic Federation opposes the issuance of any new Pension Obligation bonds to fund current or future State of Illinois pension obligations, there may be the potential for issuing such bonds for the sole purpose of funding the transition costs to a defined contribution plan. This would, of course, be contingent upon financial feasibility and the identification of real, substantial cost savings over time.

The State Should Not Mandate Local Pension Enhancements without Providing Funding

The General Assembly frequently approves legislation increasing the level and scope of local government employee pension benefits. However, no funding is provided for what amounts to yet another costly unfunded mandate for cash strapped local governments. We believe that the concept of "pay as you go" funding should be extended to include State of Illinois actions that financially impact the pension costs of local governments. If the General Assembly sees fit to enhance benefits, it should identify and provide the requisite funding for those enhancements.

Fully Disclose all Pension Information in Budget Book

The FY2006 Budget Book does not include full information about the amount requested for appropriations for the State Employee' Retirement System, nor does it include information about the proposed allocation of $819 million savings per system if the Governor's pension funding reform, proposals are adopted. The public needs full and accurate financial information in order to understand and evaluate the Governor's budget proposals, particularly on an important issue such as pension funding. The Civic Federation recommends that the State full disclose all relevant financial information about contribution levels for all retirement systems in the Pension section of future Budget Books.

Improve Performance Measures

The Civic Federation agrees with the International City Management Association (ICMA), the Government Finance Officers Association and the National Advisory Council on State and Local Budgeting that all governments should evaluate the performance of programs and services they provide. This is the best means extant to determine if they are accomplishing intended program goals and making efficient use of resources. Evaluating and reporting on program results helps keep policymakers and taxpayers alike informed about actual results compared to expectations.[89]

The FY2006 Illinois State Budget includes five years of performance metrics for each agency. However, most of these metrics are workload measures, that is counts of the number or percentage of activities undertaken or services delivered. These are important statistics. But, they provide no information about the goals the statistics are measuring; this makes it impossible to determine if agencies are meeting, exceeding or falling short of program and policy goals. In addition, there are no efficiency, effectiveness or service quality measures that would permit a focused evaluation of how well agencies and programs are meeting stated goals.

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

[89] See Recommended Practice 11.1 "Monitor, Measure, and Evaluate Program Performance," in National Advisory Council on State and Local Budgeting. *Recommended Budget Practices: A Framework for Improved State and Local Budgeting* (Chicago: GFOA, 1998).

The Civic Federation is keenly aware that producing reams of measures (particularly workload measures) that are not linked to goals or objectives, utilized to inform management decisions, or developed without the buy-in of management and staff can be costly and have limited efficacy. However, using a few well-chosen measures, particularly those measuring efficiency and effectiveness that are produced consistently and developed with the buy-in of staff can be a valuable tool in assisting the State to improve its management and operations.