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# GOVERNOR RAUNER'S FY2019 GENERAL FUND BUDGET PROPOSAL NEITHER BALANCES NOR ADDRESSES LONG-TERM STRUCTURAL FISCAL ISSUES

May 24, 2018


# *Governor Rauner's FY2019 General Fund Budget Proposal Neither Balanced Nor Addresses Long-Term Structural Fiscal Issues*

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***ABOUT CTBA***

Founded in 2000, the Center for Tax and Budget Accountability is a non-profit, bi-partisan research and advocacy think tank committed to ensuring that tax, spending and economic policies are fair and just, and promote opportunities for everyone, regardless of economic or social status.


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# 1. INTRODUCTION

Fiscal Year (**FY**) 2019 marks the fourth General Fund Budget proposed by Governor Bruce Rauner. For the first two years of Governor Rauner's administration, FY2016 and FY2017, the state went without a full General Fund Budget. That gave Illinois the dubious honor of going the longest that any state in the country had ever gone without a budget.[1] This budget impasse led to an explosion in the state's deficit under Governor Rauner's watch. The state's backlog of bills was $5.97 billion on July 1, 2015, when the impasse began. By the end of FY2017, the state's accumulated deficit in its General Fund had grown to $16.87 billion, a $10.9 billion, or 183 percent, increase over just two years.

In FY2018, the General Assembly ignored the General Fund Budget proposal of Governor Rauner—and instead passed a spending plan that included new revenue. This alternative budget with new revenue was first passed by the Senate. On July 2, 2017, the House of Representatives, on a bipartisan basis, passed both the General Fund Budget spending proposal (Senate Bill (**SB**) 6), and revenue increase (SB 9) previously approved in the Senate.[2]

Governor Rauner elected to ignore this bipartisan budget compromise, vetoing both bills (along with SB 42, the Budget Implementation Act (**BIMP**)) on July 4, 2017.[3] However, Governor Rauner's veto was overridden in the Senate subsequently that day, and in the House two days later. After 737 days, Illinois finally had a General Fund Budget.

FY2018 was the state's first full year General Fund Budget since FY2015. In the two years that the state went without a full enacted General Fund Budget, FY2016 and FY2017, roughly two-thirds or 66 percent of its total spending—which primarily covered core services like Healthcare, Human Services, and Public Safety—were made pursuant to the authority granted by court orders and consent decrees, rather than the standard budgetary process. That means no public hearings, no vote by legislators for or against, and no final sign-off or veto by the Governor. The net result of budgeting by court order in FY2016 and FY2017 was significant reductions in the state's spending on Human Services, Healthcare, and Public Safety.[4] In other words, essential services for the most vulnerable Illinoisans were cut, without any public hearing, any vote in the General Assembly, or any action by the Governor.

While the FY2018 General Fund Budget that passed over Governor Rauner's veto represented a significant improvement over the non-budget years of FY2016 and FY2017, it did not materially improve the state's fiscal condition. Indeed, as shown in Section 4 of this report, the accumulated deficit in the General Fund actually would have been worse in FY2018 than the $16.83 billion deficit of FY2017, if the state hadn't incurred $6 billion in bond debt to pay past due bills.

Against this backdrop, Governor Rauner introduced a budget proposal for FY2019 that, if enacted as is, would increase the state's accumulated budget deficit from FY2018 levels by over $500 million. So no, his FY2019 budget proposal is not balanced. That $500 million figure, however, understates how out of balance the Governor's FY2019 budget proposal truly is. That's because to support his proposed FY2019 spending, Governor Rauner relies on the following items that aren't likely to happen—and for various good government and/or constitutional reasons either should not or cannot happen:

- $615 million in pension savings;
- $240 million in revenue from the sale of the James R. Thompson Center;
- $125 million in revenue from the continued proration of the Local Government Distributive Fund;
- $175 million in savings from changes to Medicaid reimbursement rates to providers; and

- $470 million in employee healthcare cuts.

Moreover, the Governor's FY2019 General Fund Budget proposal fails to account for a $300 million year-to-year increase in state worker compensation. Collectively, these items blow an additional $2.03 billion hole in the Governor's FY2019 budget proposal. Worse, as the Governor freely admits, his FY2019 General Fund proposal does nothing to address the long-term structural shortcomings in the state's fiscal system.

Following is an analysis of the Governor's FY2019 General Fund Budget proposal, in context of the recent, two-year budget impasse, and the structural fiscal problems laid bare in the FY2018 budget that passed over his veto.

## 2. KEY FINDINGS

- FY2018 was the first Fiscal Year Illinois had a final, comprehensive, enacted General Fund Budget since FY2015.
    - In the two years that the state went without a full enacted General Fund Budget, roughly two-thirds or 66 percent of its total spending—which primarily covered core services like Healthcare, Human Services, and Public Safety—were made pursuant to the authority granted by court orders and consent decrees, rather than the standard budgetary process.
    - Failure to pass a comprehensive General Fund Budget resulted in significantly lower levels of authorized and actual spending in FY2016 and FY2017 when compared to FY2015.
    - Authorized state spending on General Fund Services declined by $2.38 billion (9.3 percent) during this budget impasse.

- Actual spending on General Fund Services in FY2016 was $20.016 billion, $5.831 billion less than in FY2015.

- Actual General Fund spending on services in FY2017 increased from FY2016 levels, but was still $3.5 billion less than in FY2015.

- This means billions in essential services for the most vulnerable Illinoisans were cut, without any public hearings, any vote by legislators for or against, or any sign-off or veto by the Governor.

- Despite the material spending cuts implemented over the FY2016-FY2017 sequence, during the first two years of Governor Rauner's administration, the state's accumulated General Fund deficit almost tripled from FY2015 levels—reaching an estimated $16.87 billion by the end of FY2017, compared to the $5.97 billion deficit existing at the end of FY2015.
    - For context, this means that fully 75 percent of all General Fund spending on Current Services in FY2017 was deficit spending. That is highly troubling, given over $9 out of every $10 spent on Current Services through the General Fund goes to Education, Healthcare, Human Services and Public Safety.

- In July of 2017, lawmakers—on a bipartisan basis—passed SB 9, which raised new, annual revenue, by increasing the state's personal and corporate income tax rates and ending some tax expenditures.
    - The state will net an additional $5.179 billion in new annual revenue in FY2018, after accounting for both the revenue enhancements and tax relief in SB 9 that passed over the Governor's veto in 2017.[5]

- In FY2018, Illinois borrowed $6 billion to pay back roughly 40 percent of the $16.87 billion backlog of bills that remained at the end of FY2017.[6] This indebtedness will be repaid over the next 12 years at an average interest rate of 3.5 percent, though the amount, maturity of the bonds, and interest rates vary.[7]

- The issuance of bonds to pay past due bills is generally not a sound fiscal practice, however, in this instance it will save taxpayers money. According to Comptroller Mendoza, the savings are $730 million annually—because the state will pay a lower interest rate on the newly bonded debt (3.5 percent) than it was paying on the past due bills incurred during the FY2016-FY2017 budget impasse.
- There is no fiscal plan to pay the remaining nearly $10 billion bill backlog, and Governor Rauner's FY2019 General Fund Budget proposal, by his own admission, also fails to address the state's long-term, structural fiscal shortcomings.[8]

- When compared in real, inflation-adjusted dollars, the level of spending for every major service category except Early Childhood Education that is appropriated in the FY2018 General Fund Budget that passed over Governor Rauner's veto is less than spending was in FY2000.
  - In the aggregate, General Fund spending on core services in FY2018 is scheduled to be over 20 percent, or $7.015 billion less in real, inflation-adjusted dollars than in FY2000.
    - Higher Education and Human Services have seen the largest cuts over this sequence, of 52.3 percent and 24.9 percent respectively.

- Governor Bruce Rauner did not introduce a balanced General Fund Budget proposal for FY2019.
  - **After stripping away the Governor's assumptions in his FY2019 proposed budget, the $334 million surplus would become a $1.679 billion deficit.**
  - **Illinois is projected to have an accumulated General Fund deficit of $11.188 billion in FY2019 under Governor Rauner's proposed budget, if the assumptions Governor Rauner makes in his FY2019 proposal are not enacted, which is likely.**
    - This is an increase of $1.434 million from the projected deficit at the end of FY2018.

- Illinois' structural deficit is driven by two items: poorly designed revenue policy and debt payments, particularly pension debt payments.
  - Of the $110.15 billion in pension debt that the state has generated since FY1996, $47.86 billion, or nearly 43 percent, is the result of the state borrowing from the pension systems to pay for other expenditures.[9]
  - The state's current repayment plan for the debt owed to the five state pension systems embodied in P.A. 88-593 that passed during the Edgar Administration and is known as the "Pension Ramp," is so materially back-loaded that it cannot be funded without implementing significant cuts to current core services including Education, Healthcare, and Human Services.
  - The repayment schedule established under the Pension Ramp is not based on actuarial assumptions or actuarial requirements. It instead represents a political attempt to defer the responsibility to repay pension debt from the mid-1990s to the current day, through utilization of an artificially, unaffordable back-loaded repayment structure.
  - By FY2045, Illinois would have to cut $11 billion in annual General Fund spending on Current Services, or raise an equivalent amount of revenue, simply to meet the artificially back-loaded payment schedule under the Pension Ramp.

# 3. THE GOVERNOR'S FY2019 BUDGET PROPOSAL FAILS TO REDUCE THE ACCUMULATED DEFICIT OR ADDRESS LONG-TERM STRUCTURAL PROBLEMS

## 3.1 The Failure to Reach a General Fund Budget Over the FY2016-FY2017 Sequence Worsened the State's Fiscal Condition

Governor Rauner was faced with numerous fiscal challenges when he crafted his FY2019 General Fund Budget proposal. Some of these challenges came from the continued impact of long-term structural problems that have been inherent in the state's fiscal system for generations and are detailed subsequently in this report. Others, however, are of more recent origin, and can be traced to the failure of the Governor and General Assembly to pass a full General Fund Budget for either FY2016 or FY2017.

In both of those years, roughly two-thirds of all current General Fund Services were funded through court orders and consent decrees.[10] This should be deeply troubling for all state residents, given that more than nine out of ten dollars of Current Service expenditures under the General Fund go to the core areas of Education, Healthcare, Human Services, and Public Safety.[11] During the FY2016-FY2017 sequence, the only General Fund spending that went through the normal appropriation process and thereby received both legislative and gubernatorial sign-off was for Early Childhood, K-12 Education, and Higher Education, as well as some relatively small Human Services appropriations. In addition to the aforesaid items, General Fund spending on certain "Hard Costs" which was authorized under preexisting legislation occurred over the FY2016-FY2017 sequence ($12.071 billion in FY2016 and $12.667 billion in FY2017).[12] What constitutes "Hard Costs" versus "Current Services" spending is delineated with more specificity in Section 4.1 of this Report.

Overall, state spending on General Fund Services was scheduled to decline by $2.38 billion (9.3 percent) during this two-year budget impasse. As shown in Figure 1, the amount of current expenditures authorized for all major service categories, other than Early Childhood and K-12 Education, saw significant cuts from FY2015 levels.

**Figure 1**
**FY2015 Enacted General Fund Appropriations Compared to General Fund Spending Authorized in FY2016 and FY2017, When No Final General Fund Budget Was Passed ($ Millions)**

| Category | FY2015 | FY2016 Authorized Spending | FY2017 Authorized Spending | FY2015 to FY2017 Difference | FY2015 to FY2017 % Difference |
|---|---|---|---|---|---|
| Healthcare | $7,303 | $6,950 | $6,910 | -$393 | -5.4% |
| Early Childhood Education | $300 | $315 | $394 | $94 | 31.3% |
| K-12 Education | $6,454 | $6,193 | $6,814 | $360 | 5.6% |
| Higher Education | $1,946 | $627 | $726 | -$1,220 | -62.7% |
| Human Services | $5,336 | $5,072 | $5,079 | -$257 | -4.8% |
| Public Safety | $1,704 | $1,317 | $1,977 | $273 | 16.0% |
| Group Health | $1,232 | $0 | $0 | -$1,232 | -100.0% |
| Other | $1,239 | $1,010 | $1,238 | -$1 | -0.1% |
| ***Legal Authorization Total*** | **$25,514** | **$21,484** | **$23,138** | -$2,376 | -9.3% |

Source: FY2015: *It Is All About the Revenue: Why Both Current FY2016 General Fund Budget Proposals Fall Short*, FY2016: *Illinois General Fund Spending in FY2016: How Elected Officials Cut Billions in Core Service Expenditures While Worsening the Deficit—All Without Casting a Vote,* FY2017 CTBA analysis of data obtained from the Comptroller's office.

To be clear, Figure 1 shows the amount of Current Service expenditures that were ***authorized***—whether through an appropriation, court order, or consent decree—for FY2016 and FY2017, not what was actually spent. Typically, when passing the final budget, the General Assembly and Governor include an item for "Unspent Appropriations." The Unspent Appropriations line provides the Governor with the authority to reduce actual spending below what was appropriated, up to the total dollar amount identified therein. Since no final comprehensive budget was enacted for either FY2016 or FY2017, there was no line item for Unspent Appropriations granting the Governor authority to reduce final expenditures from what was authorized. However, despite this lack of executive authority to spend less than what was authorized, CTBA, using data from the State's Comptroller, found that actual expenditures in both FY2016 and FY217 were less than what was legally authorized.

As shown in Figure 2, actual spending on General Fund Services in FY2016 was $20.016 billion, which was $1.468 billion less than what was authorized, and fully $5.831 billion less than in FY2015. Actual General Fund spending on services in FY2017 did increase from FY2016 levels, but nonetheless was still $792 million less than what was authorized, and still $3.5 billion less than in FY2015. The failure to spend the full authorized amounts on vital services is troubling as it is unclear who made the decision to spend less on Healthcare, Human Services, and Public Safety than was authorized by court order and consent decree; under what legal authority these decisions were made; and how and why the particular programs subjected to these cuts were chosen.

**Figure 2**
**FY2015, FY2016, and FY2017 Actual Spending**

| Category | FY2015 | FY2016 Actual Expenditures | FY2017 Actual Expenditures | Difference, FY15 to FY17 | % Difference, FY15 to FY17 |
|---|---|---|---|---|---|
| Healthcare | $7,303 | $6,207 | $6,044 | -$1,259 | -17.2% |
| Early Childhood Education | $300 | $315 | $394 | $94 | 31.2% |
| K-12 Education | $6,454 | $6,193 | $6,817 | $363 | 5.6% |
| Higher Education | $1,946 | $622 | $1,853 | -$93 | -4.8% |
| Human Services | $5,336 | $4,496 | $4,642 | -$694 | -13.0% |
| Public Safety | $1,704 | $1,244 | $1,419 | -$285 | -16.7% |
| Group Health | $1,232 | $0 | $0 | -$1,232 | -100.0% |
| Other | $1,239 | $939 | $1,177 | -$62 | -5.0% |
| ***Actual Expenditures*** | **$25,514** | **$20,016** | **$22,346** | **-$3,167** | **-12.4%** |

Source: FY2015: *It Is All About the Revenue: Why Both Current FY2016 General Fund Budget Proposals Fall Short*, FY2016: *Illinois General Fund Spending in FY2016: How Elected Officials Cut Billions in Core Service Expenditures While Worsening the Deficit—All Without Casting a Vote,* FY2017 CTBA analysis of data obtained from the Comptroller's office.

The bottom line: failure to pass a comprehensive General Fund Budget resulted in significantly lower levels of authorized and actual spending for Healthcare, Human Services, Higher Education, and Public Safety in both FY2016 and FY2017, from the FY2015 enacted spending levels.

One key factor contributing to the budget impasse over FY2016 and FY2017 was the fiscal pressure created by the General Fund revenue loss in those years associated with the decline in the state's personal and corporate income tax rates that occurred under the Taxpayer Accountability and Budget Stabilization Act (**TABSA**) (Public Act (**PA**) 96-1496). Recall that when it passed, TABSA temporarily increased state income tax rates beginning in FY2011—then by law began phasing those increased rates down in FY2015. When fully phased in over a complete fiscal year, this created a $5 billion loss in annual General Fund revenue. This revenue loss was so significant that, despite the material spending cuts implemented over the FY2016-FY2017 sequence, by the end of FY2017 the state's accumulated General Fund deficit almost tripled from FY2015 levels—reaching an estimated $16.87 billion.[13] **Overall, it meant that fully 75.5 percent of all General Fund spending on Current Services in FY2017 was deficit spending, as shown in Figure 3**.

The $16.87 billion General Fund deficit for FY2017 was "up" from $9.45 billion in FY2016, and $5.7 billion FY2015.[14]

**Figure 3**
**FY2017 General Fund Budget Deficit Walk-Down ($ Billions)**

| Step | Revenue | $ Billions | Spending | $ Billions | Remaining Revenue (Revenue – Spending) |
|---|---|---|---|---|---|
| (i) | FY2017 Revenue | $29.41 | FY2017 Hard Costs (Current Law) | $12.67 | $16.74 |
| (ii) | Revenue After Hard Costs | $16.74 | Estimated Accumulated Deficit Carry Forward from FY2016 | ($9.45) | $7.29 |
| (iii) | Projected Net FY2017 General Fund Revenue Available for Services | $7.29 | General Fund Service Spending (Net) | $22.35 | ($15.06) |
| (iv) | Surplus/Deficit Remaining after General Fund Service Spending (Net) | ($15.06) | FY2017 Group Health Liability | $1.81 | ($16.87) |
| **Projected Accumulated FY2017 General Fund Deficit Range** | | **($16.87)** | | | |
| Projected Deficit as a Percentage of General Fund Service Appropriations | | -75.5% | | | |

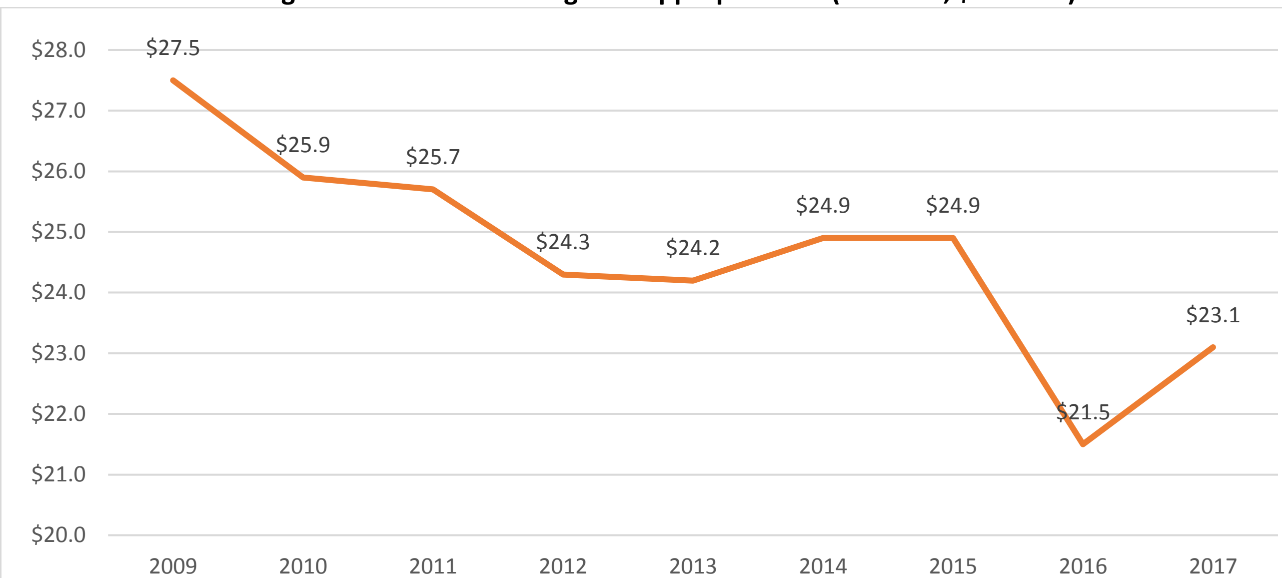
Sources: COGFA, Monthly Briefing: June 2017; COGFA, State of Illinois Budget Summary Fiscal Year 2018; CTBA analysis of data obtained from the Comptroller's office

As Figure 3 shows, the state realized approximately $29.41 billion in General Fund revenue in FY2017.[15] Of that amount, $12.67 billion had to be spent to cover the "Hard Costs" (pension and retiree healthcare, statutory transfers, and debt service) which have to be paid by law. This left just $16.74 billion in revenue for the year. However, most of that balance had to be used to pay the past-due bills left over from FY2016, which together constituted the carry-forward deficit from FY2016 of $9.45 billion.[16] Paying those past-due bills left only $7.29 billion in FY2017 General Fund revenue to cover expenditures on current FY2017 services. General Fund spending on current year services in FY2017, however, came to $22.35 billion, creating an initial deficit of $15.06 billion for the year. On top of that, the state incurred a $1.8 billion Group Health liability for FY2017.[17] When these expenditures are netted against the General Fund revenue remaining after payment of FY2017 Hard Costs, and past-due bills remaining from FY2016, the accumulated FY2017 General Fund deficit reaches $16.87 billion.

### 3.2 Additional Revenue from the Income Tax Increase Helped Resolve the Two Year Budget Impasse in FY2018

Obviously, the $5 billion loss in annual General Fund revenue created by the phase-down of the 2011 temporary income tax rate increases under TABSA, was making it nearly impossible for decision makers to craft a comprehensive General Fund Budget. Indeed, the fact that revenue loss—rather than exorbitant spending—was the driving cause of the state's fiscal stress is clearly illustrated in Figure 4, which details General Fund spending on services, in nominal, non-inflation adjusted dollars, from the end of the Great Recession in FY2009, through FY2017.

**Figure 4**
**Change in General Fund Budgeted Appropriations (Nominal, $ Billions)**




As shown in Figure 4, spending on Current Services in FY2017 was $4.4 billion—or 16 percent—less than in FY2009—without even adjusting for inflation. Yet despite this significant cut in spending, the accumulated deficit in FY2017 had grown by $10.9 billion from FY2015 levels.

To address this problem head-on and generate sorely needed revenue, lawmakers—on a bipartisan basis—passed SB 9, which raised just over $5 billion in new, annual revenue, by increasing the state's personal and corporate income tax rates and ending some tax expenditures.[18] Governor Rauner vetoed this bipartisan legislation on July 4, 2017, but his veto was overridden on July 6, 2017, passing SB 9 into law as P.A. 100-0022.

P.A. 100-0022 increased the state's personal income tax rate from 3.75 percent to 4.95 percent, and the corporate income tax rate from 5.25 percent to 7 percent.[19] Under P.A. 100-0022, three items that reduced state income tax liability—the standard personal exemption, the Illinois property tax credit, and the K-12 education expense credit—all became means tested for the first time. Hence, the value of each of these tax relief measures was reduced and/or eliminated for higher income taxpayers.[20] P.A. 100-0022 also raised revenue by: eliminating a number of tax expenditures, including the Domestic Production Activities Deduction (also known as the Qualified Production Activities Income Deduction), the noncombination rule, and the gasohol discount; and changing the definition of "United States" to eliminate the "continental shelf" exemption.[21]

Finally, the new law raised additional revenue through the creation of the State Tax Lien Registry and by changing some rules regarding unclaimed property. As shown in Figure 5, these changes are projected to increase gross revenue by $5.992 billion in FY2018.

**Figure 5**
**FY2018 Gross and Net Additional Revenue Raised Through P.A. 100-0022**

| New Revenue Source | $ in Millions |
|---|---|
| Individual Income Tax Increase from 3.75 to 4.95 Percent | $4,948 |
| Corporate Income Tax Increase from 5.25 to 7 Percent | $623 |
| Elimination of Domestic Production Activities Deduction | $75 |
| Require Combined Reporting | $25 |
| Require "Continental Shelf" Exemption | $25 |
| State Tax Lien Registry | $40 |
| Revised Uniform Unclaimed Property Act | $60 |
| Means Test Tax Credit for Property Taxes & Educational Expenses | $96 |
| End the Gasohol Discount | $100 |
| **Gross New Revenue** | **$5,992** |
| **New Revenue Reductions** | **$ in Millions** |
| EITC Expansion | $94 |
| K-12 Education Expense Credit | $35 |
| Research and Development Credit | $70 |
| Graphic Arts Machinery Exemption | $10 |
| **Total Tax Relief** | **$209** |
| Refund Fund | $604 |
| **Net New Revenue** | **$5,179** |

Source: COGFA, *State of Illinois Budget Summary Fiscal Year 2018*.

In addition to generating new revenue, P.A. 100-0022 also provides some targeted tax relief by increasing the value of three pre-existing tax credits, and one pre-existing exemption. As shown in Figure 5, the greatest tax relief of $94 million annually is created by the legislation's expansion of the Earned Income Tax Credit (**EITC**), which P.A. 100-022 increases in value from its prior level of 10 percent of the dollar value a taxpayer claims under the federal EITC, to 14 percent thereof in calendar year 2017, and 18 percent thereof in calendar year 2018 and thereafter.[22] The legislation also increased the K-12 Education Expense Credit (for married couples who earn less than $500,000) to $750 from $500, starting on January 1, 2018.[23] Finally, it reinstated the Research and Development Credit (retroactive to 2016) and expanded the manufacturing and assembling machinery exemption to include graphic arts machinery and equipment.[24] Figure 5 shows that the total cost of this tax relief will be the loss of $209 million in annual revenue. Finally, by law the state's income tax refund fund has to increase whenever the state's income tax rates increase, and that will absorb $604 of the new revenue raised under P.A. 100-0022.[25]

As shown in Figure 5, the state will net an additional $5.179 billion in new annual revenue in FY2018 after accounting for both the revenue enhancements and revenue reductions that passed over the Governor's veto in 2017.

As Figure 6 shows, revenue estimates for FY2018 were only $30.93 billion prior to the passage of P.A. 100-0022.[26] Given the growth in the accumulated deficit in the state's General Fund over the last decade—which occurred despite a $4.4 billion cut in spending on core services, the revenue enhancements that passed under P.A. 100-0022 were essential for Illinois to start to get its finances in order. This additional revenue is crucial to begin stabilizing investment in core services, like Higher Education and Public Safety, which had been neglected during the budget impasse, and begin to build its investment in K-12 Education funding, an area Illinois has traditionally lagged nationally.

**Figure 6**
**FY2018 Revenue Estimate ($ Millions)**

| Revenue Source | Initial FY2018 Revenue Projection | New Revenue from P.A. 100-0022 | FY2018 Revenue Projection After P.A. 100-0022 |
|---|---|---|---|
| Personal Income Tax | $15,688 | $4,948 | $20,636 |
| Corporate Income Tax | $1,900 | $623 | $2,523 |
| Sales Taxes | $8,380 | $100 | $8,480 |
| Ending of Tax Expenditures | $0 | $221 | $221 |
| Other Sources | $3,180 | $100 | $3,280 |
| Transfers In | $1,723 | $0 | $1,723 |
| Federal Sources | $3,556 | $0 | $3,556 |
| Transfer Out: Refund Fund | -$1,902 | -$604 | -$2,506 |
| Expansion of Tax Credits | $0 | -$209 | -$209 |
| Transfer Out: Local Governmental Distributive Fund | -$1,146 | $0 | -$1,146 |
| Transfers Out: Sales Tax Distributions | -$449 | $0 | -$449 |
| **Total General Funds** | **$30,930** | **$5,179** | **$36,109** |

Source: COGFA, *State of Illinois Budget Summary Fiscal Year 2018*

However, P.A. 100-0022 does not solve Illinois' fiscal problems. While the additional revenue will help stabilize the state's fiscal position in the short term, there are still two major policy issues the state must address. First, while the new revenue will help pay for General Fund Services in FY2018 and in years to come, none of the additional revenue is going towards paying down the state's backlog of bills. The state's deficit surpassed $16 billion at the end of FY2017, and while lawmakers did pass a $6 billion bond issuance in FY2018 to pay some of those bills, roughly $10 billion in backlogged bills remain.

Second, decision makers still have yet to devise a viable solution to paying off the state's pension debt, which stood at over $128.9 billion at the start of FY2018.[27] As delineated in Section 6.3 of this Report, the state's current statutory framework for repaying that pension debt grows by unaffordable increments on a year-to-year basis. If not altered, over time, this unrealistic repayment plan will divert increasing amounts of General Fund revenue away from covering General Fund Services.

Finally, on a technical note, P.A. 100-0023 (SB 42) changed the makeup of the General Fund. Previously, income tax revenue was removed from the General Fund and distributed to the Fund for the Advancement of Education and the Commitment to Human Services Fund. P.A. 100-0023, however, merged those two funds into the General Fund. To allow an "apples-to-apples" long-term comparison, CTBA has included these two funds in the General Fund for FY2018, and for historical consistency has revised previous revenue and appropriation estimates to include these funds in the General Fund lines for K-12 Education and Human Services.

# 4. THE FY2018 GENERAL FUND BUDGET AS PASSED OVER GOVERNOR RAUNER'S VETO

## 4.1 Paying Hard Costs and Setting General Fund Spending Priorities

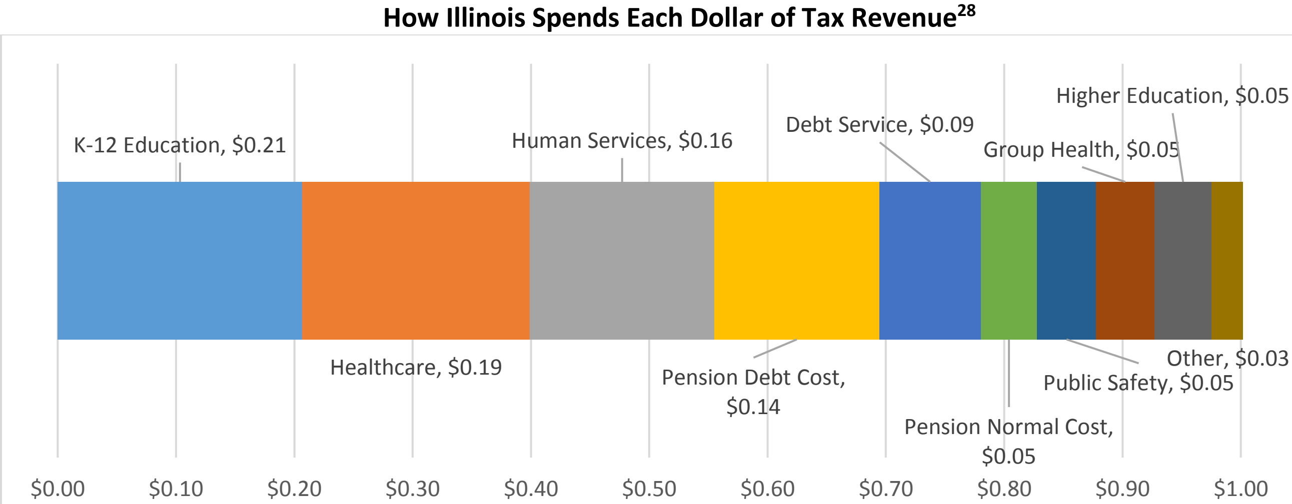
The General Fund Budget consists of two primary elements: "Hard Costs" and "Current Services." Hard Costs are mandatory spending obligations over which decision makers have no discretion, such as debt service payments to bondholders. In the FY2018 General Fund Budget, $12.559 billion, or 33.5 percent, of the $37.553 billion in total, gross expenditures are for Hard Costs. Section 4.2 of this report has the full breakdown of the FY2018 budget, including a detailed description of all Hard Costs. "Current Services" cover spending on public services over which elected officials generally have at least some discretion. In Illinois' General Fund, over $9 out of every $10 spent on Current Services goes to four main categories: Education, Healthcare, Human Services, and Public Safety.

After accounting for nondiscretionary Hard Costs in FY2018, the budget that passed over the Governor's veto appropriated $27.902 billion to spending on Current Services—however, $809 million of that amount has been dedicated to cover unpaid bills left over from FY2017. This results in a total of $26.832 billion for the delivery of Current Services in FY2018.

This spending is "primarily" rather than "entirely" discretionary for a number of reasons. For instance, transfers of funds from the federal government to Illinois are restricted, and hence can only be used for the specific program generating the transfer (like Medicaid). Moreover, the state has to operate certain facilities, like correctional facilities, or provide certain services, like the protection of abused and neglected children, subject to court orders which typically require specific staffing and funding minimums. Last, every year an amount of total, gross appropriations are intentionally left unspent. While the Governor's Office of Management and Budget (**GOMB**) provides an estimate of how much of the total Current Services appropriation will not actually be spent, GOMB does NOT provide any detail about which specific appropriations will not be spent.

Figure 7 provides a breakdown of how every $1 in revenue collected from taxpayers will be spent under the gross appropriations authorized in the enacted FY2018 General Fund Budget, including both Hard Costs and Current Services spending.

**Figure 7**
**How Illinois Spends Each Dollar of Tax Revenue[28]**




Source: CTBA analysis of PA100-0021 and CTBA analysis of P.A. 100-0021, COGFA, *State of Illinois Budget Summary: Fiscal Year 2018*. Not shown: $0.01 on Early Childhood Education and statutory transfers out.

As shown in Figure 7, for every $1 in taxes paid, approximately $0.34 goes to aspects of the budget the Governor and General Assembly have little to no discretion over—like pensions and debt service on bonds—while the remaining $0.66 is spent on current year services. Out of that $0.66, $0.21 is spent on PreK and K-12 Education, $0.19 is spent on Healthcare, $0.16 on Human Services, $0.05 on Public Safety and Higher Education, and only $0.03 will be spent on items like other government services, including the State's Constitutional offices. Meanwhile, $0.14 will go towards paying down the pension debt.

### 4.2 The FY2018 Enacted General Fund Budget Broken Down Between Hard Costs and Current Service Expenditures

FY2018 General Fund appropriations are detailed by major service category in Figure 8. To allow for historic comparisons, CTBA has grouped the budget into major service categories in a manner consistent with past reporting practices.

**Figure 8**
**FY2018 Enacted General Fund Appropriations ($ Millions)**

| Category | Appropriation |
|---|---|
| **General Fund Appropriations** | |
| **1. Total Hard Costs** | **$12,099** |
| Debt Service (Pension & Capital Bonds) | $3,215 |
| Statutory Transfers Out | $339 |
| Pension Contributions | $6,687 |
| Group Health Insurance | $1,858 |
| **2. Current Services Appropriations** | **$26,044** |
| Healthcare (including Medicaid) | $7,229 |
| Early Childhood Education | $444 |
| K-12 Education | $7,760 |
| Higher Education | $1,733 |
| Human Services | $5,834 |
| Public Safety | $1,869 |
| Other | $1,175 |
| Unspent Appropriations and Adjustments —5% Across the Board Cuts | -$1,070 |
| **Net General Fund Service Appropriations** | **$37,073** |

Sources: CTBA analysis of P.A. 100-0021, COGFA, *State of Illinois Budget Summary: Fiscal Year 2018*

Statutory Transfers Out, Debt Service, Pension Contributions, and Group Health are the Hard Costs payable in FY2018, which collectively will total $12.099 billion. These expenditures are categorized as "Hard Costs", because they are required to be paid by current law and thus, neither the General Assembly nor the Governor has the discretion to reduce or eliminate them. Since the Hard Costs must be paid, the revenue left available to fund core services—like Education, Healthcare, and Human Services—is reduced. It also means that, to the extent the state has an accumulated deficit in its General Fund, that full deficit impacts solely the appropriations made for Current Services, over which the General Assembly (and Governor) have some discretion. However, in FY2018, the General Assembly passed major legislative changes that impacted the General Fund Budget line items for Pension Contributions and Statutory Transfers Out. These legislative changes to Hard Costs will, in the short term, allow the General Assembly to put more money towards core services, but in turn create long-term costs that will reduce revenue available for funding future service expenditures.

As the name implies, "Statutory Transfers Out" covers expenditures that, pursuant to state legislation, must be paid from the General Fund to local governments and other state funds. The most significant items included under the Statutory Transfers Out category include the:

- Local Government Distributive Fund (**LGDF**) ($1.273 billion budgeted for FY2018);[29] and
- Repayment of loans extended to the General Fund by other, special state funds like the Budget Stabilization Fund.

In FY2018, the General Assembly changed the process in which transfers to the LGDF are made. Previously, taxes were collected and put into the General Revenue Fund. From there, the General Assembly (and Governor) then appropriated the required amount of funds from the General Revenue Fund to the LGDF. However in FY2018, the General Assembly overrode Governor Rauner's veto of SB 42 (now Public Act 100-0023), the BIMP, and changed this process. Now, the LGDF will receive income tax revenues directly from the State Treasurer,[30] bypassing the General Fund all together. This decreases the amount of revenue that goes into the General Fund, but simultaneously reduces the Hard Cost appropriation for the LGDF. In FY2018, the LGDF was prorated at 90 percent.[31] Bottom line, in FY2018, General Fund Revenue and LGDF appropriations will both appear to be lower by $1.146 billion, than if all funding for the LGDF was run through the General Fund as was done in the past. While at first glance this appears to be simply a change in state accounting, it is troubling because the new process is not as transparent as the prior budget practice.[32]

Prior to 2011, the LGDF received 10 percent of net personal and corporate income taxes.[33] However, since 2011, despite the income tax increase under TABSA, local governments continued to receive only the 10 percent of the amount of revenue that would have been generated under the lower rates that were in effect prior to TABSA. This continues to apply today, even after the income tax increases in July of 2017. [34] In other words, even though income tax rates increased both in 2011 and again in the summer of 2017, local governments did not receive additional revenue from the state. And, as previously stated, in FY2018, the LGDF was prorated at 90 percent. Hence, not only will local governments not share in the new revenue being generated by the recent increase in the state's income tax rates, they'll actually receive less in FY2018 than what their historic share has been.[35]

The second item of Hard Costs is "Debt Service." Debt service payments are payments made on general obligation bonds. Proceeds from the sale of general obligation bonds are used to finance capital projects, and have been used in the past to meet the state's required pension contribution. In the FY2018 budget, $3.215 billion will be spent on debt service. This figure includes CTBA's estimates of the cost in FY2018 of the $6 billion bond sale the state completed in October 2017—to start to pay down the $16.8 billion backlog of bills left over from the FY2016 and FY2017 budget impasse.

The Hard Cost line for pension contributions in Figure 8 includes the vast majority of payments to the five state funded pension systems: the Teachers' Retirement System (**TRS**), State University Retirement System (**SURS**), State Employees Retirement System (**SERS**), the General Assembly Retirement System (**GARS**), and the Judicial Retirement System (**JRS**).[36] Of the $6.687 billion total shown in Figure 8, $4.627 billion is debt service payments on the unfunded liability while only $2.06 billion is for the employer "normal cost" needed to cover benefits being earned by current employees who are members of the state pension systems.[37] Another $114 million goes to healthcare benefits for retirees who were employed by a non-Chicago public school.[38]

"Group Health Insurance" or "Group Health" covers the state's health insurance program provided to current employees and retirees. Given that Group Health accounts for approximately 5 percent of the General Fund service budget, it is listed separately from other service costs. CTBA has categorized Group Health as a Hard Cost in FY2018, and it will continue to do so in the years to come, because the state has the legal obligation to pay its Group Health bills whether or not appropriated in the General Fund Budget. This is important, given that state lawmakers failed to appropriate any funds to Group Health during the budget impasse, but Illinois still accumulated over $3.5 billion in Group Health bills and liabilities during this period.[39]

## 4.3 Discretionary Spending Priorities

After accounting for Hard Costs and allocating some FY2018 revenue to pay past due obligations, the FY2018 enacted budget covers spending for service delivery over the fiscal year. Appropriations for Education are broken down into three subcategories: "Early Childhood Education," "K-12 Education," and "Higher Education." The agency responsible for providing Early Childhood Education and K-12 Education is the Illinois State Board of Education (**ISBE**). The Higher Education category includes appropriations made to the Board of Higher Education, the Illinois Community College Board, the Illinois Mathematics and Science Academy, the Illinois Student Assistance Commission, State Universities Civil Service System, and Illinois' nine public universities.

The "Human Services" category in Figure 8 includes all appropriations to the three agencies primarily responsible for delivering those services, the Department on Aging (**DOA**), Department of Children and Family Services (**DCFS**), and the Department of Human Services (**DHS**). Several other agencies that receive small amounts of General Fund appropriations are also grouped into the Human Services category.[40] The "Public Safety" category includes appropriations for the Department of Corrections (**DOC**), Department of Juvenile Justice (**DJJ**), the Illinois State Police, and several smaller agencies.[41]

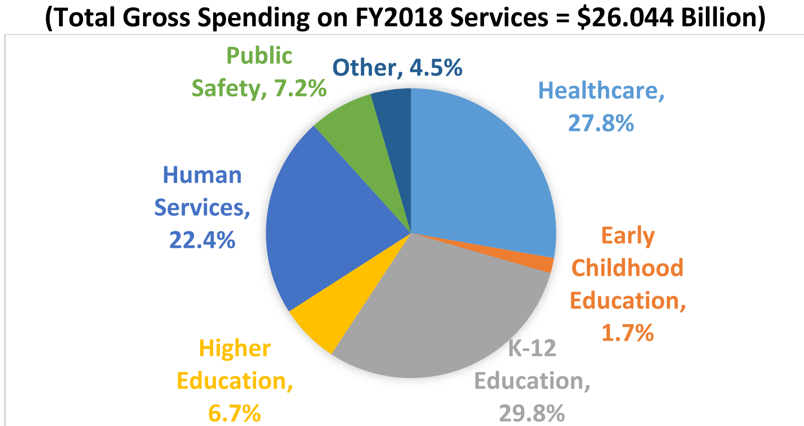
The "Healthcare" category includes $7.229 billion in appropriations for the Department of Health and Family Services (**DHFS**) and $133 million in appropriations for the Department of Public Health.[42] Note that the vast majority of funding for DHFS is the over $7 billion in appropriations for Medicaid.[43]

The category of "Other" includes: appropriations for legislative agencies such as the General Assembly and COGFA; smaller state agencies such as the Department of Central Management Services (**CMS**), Department of Commerce and Economic Opportunity, and Department of Revenue; all environmental protection expenditures, and various boards, commissions, and authorities such as the Capital Development Board and East St. Louis Financial Advisory Authority.

Since Hard Costs are mandatory expenditures required by law, they do not provide much insight into current legislative or gubernatorial policy priorities. Discretionary spending, on the other hand, does.

As shown in Figure 9, the FY2018 Enacted General Fund Budget for Current Services continues to prioritize the same core services of Education (38.2 percent), Healthcare (27.8 percent), Human Services (22.4 percent), and Public Safety (7.2 percent) the state has historically devoted its General Fund to providing. Combined, these core service areas account for over $9 out of every $10 in the enacted FY2018 General Fund Budget for Current Services.

**Figure 9**
**Enacted FY2018 General Fund Current Services Budget**
**(Total Gross Spending on FY2018 Services = $26.044 Billion)**




Source: CTBA analysis of PA 100-0021.

Although Figure 9 shows the breakdown of the $26.044 billion in spending on Current Services that is the maximum authorized for FY2018, actual spending on Current Services in FY2018 will be less due to spending reductions authorized by: the $908 million in "unspent appropriations" line; and the $261 million in negative adjustments. Hence, net spending on Current Services in FY2018 could be as low as $24.974 billion, however, at this point there is no detail available to allocate those cuts to specific service categories.

### 4.4 Illinois' $6 Billion Bond Sale Will Help Pay Down Some of the State's Backlog of Bills, But Comes At a Future Cost to General Fund Services

The backlog of bills, which totaled over $16.7 billion in November of 2017 according to Comptroller Susana Mendoza, was mostly accumulated during the FY2016 and FY2017 budget impasse.[44] This backlog put pressure on thousands of organizations that provide vital Healthcare and Human Services to millions of citizens in Illinois, which had to meet their respective payrolls and cover costs like utilities and rent despite the state's failure to pay them on a timely basis. This not only hurt providers but also dented the pockets of taxpayers, since by law the state must pay interest on late payments.[45] The interest rate the state must pay on past-due bills varies from 9 to 12 percent annually.[46] By bonding out some of this $16 billion plus in unpaid bills, Illinois was be able to pay some late bills sooner than its fiscal system would otherwise permit. Because the average interest rate on these bonds was 3.5 percent, this saves the state—and taxpayers—some interest cost. In fact, according to State Comptroller Mendoza, the use of $6 billion in bonds to pay past due bills will save taxpayers around $2 million a day, or $730 million annually—because Illinois will pay a much lower interest rate on the bond debt (3.5 percent) than it was on the past due bills.[47] This savings is a good thing, since Illinois racked up $1.14 billion in interest costs on its backlog of bills over the FY2016 and FY2017 sequence.[48] The state's $6 billion of borrowing to pay back roughly 40 percent of its backlog of bills will have to be repaid over the next 12 years, with the amount, maturity of the bonds, and interest rates varying.[49]

The majority of the proceeds from the state's $6 billion bond issuance will go towards paying old Group Health bills (about $3.5 billion), and the remaining $2.5 billion will be directed towards late payments owed to Medicaid providers, which has the added benefit of generating federal matching dollars.[50]

### 4.5 Nominal Dollar (without adjusting for inflation) Comparison of FY2018 Budget to FY2015

Figure 10 shows how appropriations for public services in the enacted FY2018 General Fund Budget compare to FY2015 in nominal dollars. Why FY2015 instead of FY2017? As previously explained, in both FY2016 and FY2017 there was not a complete General Fund Budget passed by the General Assembly and signed into law by the Governor. Thus, a majority of spending authorizations were done via court order and consent decrees and actual expenditures were finalized in a non-transparent manner. Hence, FY2015 gives the best "apples-to-apples" comparison to FY2018, because it compares the last two fully enacted budgets.

As shown in Figure 10, in FY2018 Early Childhood Education, K-12 Education, Human Services, and Public Safety are authorized to realize nominal dollar increases in appropriations from FY2015 levels. In contrast, Healthcare (-1.0 percent) and Higher Education (-10.9 percent) are scheduled to be cut in nominal dollars. In total, gross General Fund appropriations authorized for Current Services in FY2018 are $1.762 billion or 7.3 percent more than in the enacted FY2015 budget. However, as indicated previously, that gross appropriation authorization for FY2018 is subject to be cut by $1.07 billion, leaving net spending for the year at $24.974 billion—which is only $692 million or 2.8 percent greater in nominal, non-inflation adjusted dollars than FY2015.

**Figure 10**
**FY2018 General Fund Appropriations Compared to FY2015 Final – Nominal Dollars ($ Millions)**

| Category | FY2015 | FY2018 | $ Difference (nominal) | % Change |
|---|---|---|---|---|
| Healthcare | $7,303 | $7,229 | -$74 | -1.0% |
| Early Childhood Education | $300 | $444 | $144 | 48.0% |
| K-12 Education | $6,454 | $7,760 | $1,306 | 20.2% |
| Higher Education | $1,946 | $1,733 | -$213 | -10.9% |
| Human Services | $5,336 | $5,834 | $498 | 9.3% |
| Public Safety | $1,704 | $1,869 | $165 | 9.7% |
| Other | $1,239 | $1,175 | -$64 | -5.2% |
| **Net General Fund Service Appropriations** | **$24,282** | **$26,044** | **$1,762** | **7.3%** |

Source: CTBA analysis P.A. 100-0021, COGFA, *State of Illinois Budget Summary: Fiscal Year 2018*. CTBA, *It Is All About the Revenue: Why Both Current FY2016 General Fund Budget Proposals Fall Short*. Note: Numbers may not all add due to rounding.

## 4.6 In Real Terms, Funding for Most Core Services in the FY2018 Enacted General Fund Budget is less than in FY2000

Of course, a nominal dollar comparison does not provide an accurate barometer of whether spending on services is actually growing, staying flat, or declining. That is because nominal dollar comparisons do not adjust for either inflation or population change, both of which make it more expensive to provide the same level of services from one fiscal year into the next.

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

The second major inflation metric is the Employment Cost Index (**ECI**). As the name implies, the ECI covers a narrower number of items than the CPI and focuses on changes in the cost of paying compensation to workers over time. Public services are very labor intensive, and the vast majority of public sector expenditures on services made through the Illinois General Fund—75 to 85 percent annually—cover the compensation paid to the healthcare workers, teachers, correctional officers, social workers and other civil servants who provide the public services consumed in communities across the state. Hence, the ECI is the more accurate metric for analyzing the inflationary cost increases that impact public sector expenditures on services.

Calculating inflation adjustments over time is relatively simple. Say expenditures on Public Safety were $100 in year one, and the inflation rate for that year was four percent. In year two, the appropriation for Public Safety would have to be $104 to purchase the same level of services provided in year one, in what is referred to as “real”—i.e. inflation-adjusted—terms. If in year two Public Safety received an appropriation of $102, then despite the $2 increase in nominal appropriations, in real, inflation-adjusted terms, spending was actually cut by $2.

Figure 11 shows how authorized spending on Current Services under the enacted FY2018 General Fund Budget compares to the final FY2015 General Fund Budget, in real, inflation-adjusted dollars. When adjusted for inflation and population growth, Early Childhood Education, K-12 Education, Human Services, and Public Safety are all slated to gain real increases in funding over FY2015 levels. Please note that, Figure 11 compares FY2018 *authorized* spending on Current Services for FY2018, to actual spending in FY2015. Final, actual spending in FY2018 will be less than what is authorized by $1.07 billion, after netting out the unspent appropriations line item for the year. This of course means that Figure 11 overstates what FY2018 expenditures on Current Services will be—however, because the distribution of spending cuts authorized under the unspent appropriations line item among the various Current Service categories has not been finalized as of yet, the gross, authorized appropriations amounts therefore had to be used for this comparison.

That said, even the gross appropriations authorized for Healthcare and Higher Education in FY2018 are scheduled to be less in real terms than FY2015 levels—and those cuts will be worse once the unspent appropriations for FY2018 are applied.

**Figure 11**
**Illinois General Fund Spending: Gross Enacted FY2018 Compared to FY2015 Final, Adjusted for Inflation and Population Growth ($ Millions)**

| Category | FY2015 (Nominal) | FY2015 (Adj Inflation & Population) | FY2018 | $ Difference (Adj Inflation & Population) | % Change |
|---|---|---|---|---|---|
| Healthcare | $7,303 | $7,844 | $7,229 | -$615 | -7.8% |
| Early Childhood Education | $300 | $318 | $444 | $126 | 39.6% |
| K-12 Education | $6,454 | $6,844 | $7,760 | $916 | 13.4% |
| Higher Education | $1,946 | $2,064 | $1,733 | -$331 | -16.0% |
| Human Services | $5,336 | $5,659 | $5,834 | $175 | 3.1% |
| Public Safety | $1,704 | $1,807 | $1,869 | $62 | 3.4% |
| Other | $1,239 | $1,314 | $1,175 | -$139 | -10.6% |
| **General Fund Service Appropriations** | **$24,282** | **$25,850** | **$26,044** | **$194** | **0.8%** |

Sources: CTBA analysis P.A. 100-0021, COGFA, *State of Illinois Budget Summary: Fiscal Year 2018*. CTBA, *It Is All About the Revenue: Why Both Current FY2016 General Fund Budget Proposals Fall Short*. Inflation for healthcare inflated by Midwest Medical Care CPI; all other appropriations adjusted using ECI-C and CPI from the BLS as of September 2017, and population growth from the Census Bureau as of July 2017.

Even more eye-opening however, is what the data reveal about the state's long-term disinvestment in core service expenditures. As shown in Figure 12, the maximum appropriations authorized for all Current Services in the FY2018 enacted General Fund Budget are less in real, inflation adjusted terms in total—and in every individual service category except Pre-K—than in FY2000, regardless of the inflation metric used, CPI or ECI.

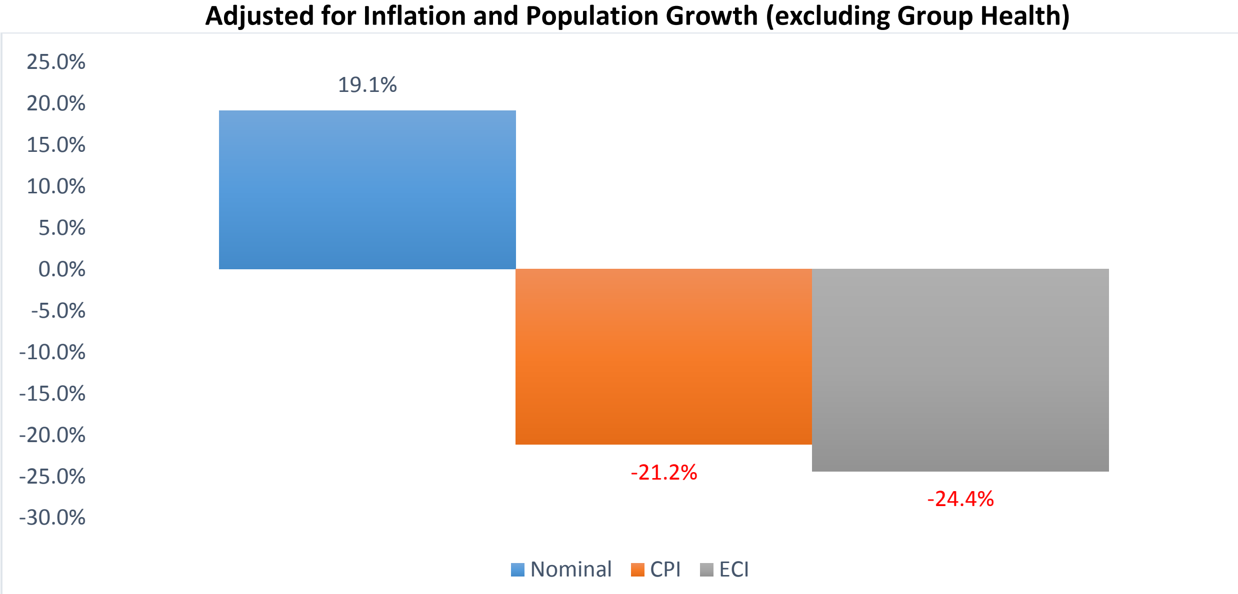
**Figure 12**
**Illinois General Fund Spending On Core Services FY2018 Compared to FY2000 Enacted, And FY2000 Adjusted for Inflation and Population Growth ($ Millions)**

| Category | FY2000 (Nominal) | FY2000 (Adj for Inflation (ECI) & Pop Growth to FY2018) | FY2018 Enacted (Gross before Unspent Approps) | $ Difference (Adj for Inflation (ECI) & Pop Growth | % Change |
|---|---|---|---|---|---|
| Early Childhood Education | $170 | $287 | $444 | $157 | 54.7% |
| K-12 Education | $4,674 | $7,892 | $7,760 | -$132 | -1.7% |
| Higher Education | $2,152 | $3,633 | $1,733 | -$1,900 | -52.3% |
| Healthcare | $5,022 | $10,028 | $7,229 | -$2,799 | -27.9% |
| Human Services | $4,599 | $7,765 | $5,834 | -$1,931 | -24.9% |
| Public Safety | $1,350 | $2,279 | $1,869 | -$410 | -18.0% |
| **General Fund Appropriations for Core Services** | **$17,967** | **$31,869** | **$24,869** | **-$7,015** | **-20.1%** |

Sources: FY2000 unadjusted appropriations from Governor's final budget summary for FY2000; and FY2018 CTBA analysis of P.A. 100-0021. Inflation for healthcare inflated by Midwest Medical Care CPI; all other appropriations adjusted using ECI-C and CPI from the BLS as of September 2017, and population growth from the Census Bureau as of July 2017.

Specifically, Higher Education will be cut in real terms by at least 50 percent when compared to FY2000, while Human Services will experience a reduction in real appropriations of at least 24.9 percent. In all, General Fund spending on Current Services in FY2018 will be at least 20 percent, or $7.015 billion less in real, inflation-adjusted dollars, than in FY2000.

**Figure 13**
**FY2018 General Fund Services Appropriations Relative to FY2000, in Nominal Dollars and Adjusted for Inflation and Population Growth (excluding Group Health)**




Sources: FY2000 unadjusted appropriations from Governor's final budget summary for FY2000; and FY2018 CTBA analysis of P.A. 100-0021. Inflation for healthcare inflated by Midwest Medical Care CPI; all other appropriations adjusted using ECI-C and CPI from the BLS as of September 2017, and population growth from the Census Bureau as of July 2017.

Illinois' continued policy of resolving fiscal problems primarily through service spending cuts is difficult to justify given the state's status as low spending nationally. Consider that, in calendar year 2016—the last year for which there is comprehensive data for all 50 states—Illinois had the fifth highest state GDP overall, the 12th highest state GDP per capita, and fifth largest population of any state (Illinois' population has since declined to sixth largest).[51] However, Illinois ranked just 31st in total General Fund spending per capita in FY2016.[52] Illinois also ranked 49th out of all 50 states in number of state workers per 1,000 residents in 2016.[53]

While the state's per capita spending is illustrative of Illinois' status as a low spending state, it is not the best metric to use. Spending as a percentage of state GDP is more informative, given that it takes into account a state's total wealth, and hence measures effort. As of FY2016, Illinois ranked just 39th out of all 50 states in General Fund spending as a percentage of state GDP.[54] The bottom line is by any metric chosen, Illinois is low spending when compared to other states.

### 4.7 The General Fund Will End FY2018 with an Accumulated Deficit of Roughly $9.6 Billion

As shown in Figure 14, the minimum, accumulated General Fund deficit by the end of FY2018 is projected to be $9.754 billion. This projected General Fund deficit is significant, but $7.118 billion lower than what it was at the end of FY2017. Unfortunately, the reason for this reduction in the accumulated deficit wasn't fiscal reform—but rather the $6 billion bond sale the state made in the second quarter of FY2018 to pay some of its past due bills. The bond sale enabled the state to pay old Medicaid bills, which are reimbursable, thus, the state received $1.206 billion from Federal sources.[55] The state's General Fund deficit, without taking the bond proceeds and additional Medicaid matching funds then generated into account, would be upwards of $16.96 billion.

**Figure 14**
**FY2018 Estimated Accumulated Deficit ($ Millions)**[56]

| Step | Revenue | $ Millions | Spending | $ Millions | Remaining Revenue (Revenue – Spending) |
|---|---|---|---|---|---|
| (i) | FY2018 Revenue | $36,985[57] | FY2018 Hard Costs | $12,099 | $24,886 |
| (ii) | Revenue After Hard Costs | $24,886 | Accumulated Deficit Carry Forward from FY2017 | ($16,872) | $8,014 |
| (iii) | Projected Net FY2018 General Fund Revenue Available for Services | $8,014 | Projected Net General Fund Service Appropriations after Unspent Appropriations | $24,974 | ($16,960) |
| (iv) | Sale of Bonds (to pay down bills from the FY2016 and FY2017 budget impasse) | $6,000 | Accumulated Deficit Carry Forward from FY2017 after Bond Sale | ($10,960) | ($10,960) |
| (v) | Federal Sources Due to Medicaid Backlog Payments | $1,206 | Accumulated Deficit Carry Forward from FY2017 after Federal Sources Matching | ($9,754) | ($9,754) |
| **Projected Accumulated FY2018 General Fund Deficit** | | **($9,754)** | | | |
| **Projected Deficit as a Percentage of General Fund Service Appropriations** | | **-39.1%** | | | |

Source: CTBA analysis P.A. 100-0021, P.A. 100-0022, P.A. 100-0023, COGFA *State of Illinois Budget Summary: Fiscal Year 2018,* COGFA *FY 2019 Economic Forecast and Revenue Estimate and FY 2018 Revenue Update*.

By incurring debt in the form of bonds to pay some past due bills, Illinois made its accumulated deficit appear artificially smaller, while creating a new $6 billion Hard Cost, the payment of which will limit the amount of funding the state can appropriate for Current Services in the General Fund in the years to come. This is troublesome, given that despite gaining just over $5 billion in new, annual revenue from the increase in the state's income tax rates that passed in 2017, there remains no fiscal or policy plan to pay down the remaining $9.754 billion bill backlog.

# 5. FY2019 GENERAL FUND BUDGET PROPOSAL IS NOT BALANCED

## 5.1 Piercing the Illusion of Balance

Governor Rauner has repeatedly insisted his FY2019 General Fund Budget proposal is balanced, despite his projection of $37.964 billion in revenue for the year—which is $521 million LESS than his proposed $38.485 billion in expenditures. The Governor gets around this problem with some adjustments, primarily for unspent appropriations and projected savings from his proposed pension reforms, as shown in Figure 15.

**Figure 15**
**Governor Rauner's Projections FY2019 Proposed General Fund Surplus/(Deficit)**

| $ in Millions | FY2019 Projected |
|---|---|
| Revenue | $37,964 |
| Expenditures | $38,485 |
| Unspent Appropriations | -$872 |
| Pension Reform: Consideration Model | $900 |
| Lowering of Income Tax | -$917 |
| **Surplus/(Deficit)** | **$334** |

Sources: CTBA analysis of Governor Bruce Rauner's Fiscal Year 2019 Proposed Budget

The Governor's FY2019 budget proposal includes lowering the state's personal income tax rate from 4.95 percent to 4.7 percent, which is projected to cause a $917 million decrease in revenue from FY2018 levels.[58] To offset this loss in revenue, the Governor is relying on "savings" from his proposed "pension reform," based on a consideration model. Unfortunately, Governor Rauner's FY2019 budget proposal does not provide details on the design of his "consideration model" of pension reform. The Governor does, however, refer to elements of such a model that have "bipartisan support." This may mean the Governor is proposing something similar to the consideration model that was previously introduced by Senate President John Cullerton,[59] that would allow state workers to trade off lower pension benefits for some other benefit. Unfortunately, Governor Rauner's "pension reform" is so short on details it cannot be evaluated, and hence his claim that it will reduce the required FY2019 pension contribution by $900 million lacks credibility. Without these illusory savings, he cannot afford his proposal to reduce the income tax rate, and lose $917 million in annual revenue.

Taking both his proposed tax cut and pension reform out of his FY2019 General Fund Budget proposal, leaves a budget surplus of $351 million for the year, which appears to verify Governor Rauner's claim that his proposal is balanced. However, digging deeper into his FY2019 budget proposal reveals that it relies on significant new revenue sources and/or savings—which collectively total $2.03 billion—that are unlikely to be realized for various reasons, including setting unrealistic time tables for sales of major state assets, or because they require legislative changes that are either poor public policy and hence unlikely to pass the General Assembly, or unconstitutional and hence cannot become law. All of these issues are outlined in Figure 16.

**Figure 16**
**Assumptions Made in the FY2019 Proposed Budget**

| Budget Assumption | Assumed Value in New Revenue or Savings |
|---|---|
| Sale of Thompson Center | $240 |
| Continued Proration of the LGDF | $125 |
| Savings on Group Health Insurance | $470 |
| Pension Cost Shift - TRS | $387 |
| Pension Cost Shift - CPS | $228 |
| Pension Cost Shift - SURS | $105 |
| Medicaid Reimbursement - 4% Reduction of Rates for Providers | $175 |
| Step Increases for State Employees | $300 |
| **Total** | **$2,030** |

Source: CTBA analysis of Fiscal Year Governor Bruce Rauner's 2019 Proposed Budget and Illinois General Obligation Bonds Statements.

For instance, Governor Rauner's FY2019 proposed budget includes $240 million in new, one-time revenue from the sale of the James R. Thompson Center.[60] This is now the third consecutive fiscal year in which the Governor has used "revenue" from a proposed "sale" of the Thompson Center to cover expenditures in his proposed budget. As with the first two attempts, there is no buyer for the Thompson Center, there is no authorization to sell the Thompson Center, and there is neither a credible way to assess how much revenue such a sale would generate, nor much realistic likelihood of it happening prior to the end of the fiscal year. Hence, the $240 million in revenue he claims from the sale is not credible.

In FY2018, the General Assembly short-changed local governments by only transferring to them 90 percent of what was statutorily required to be distributed to them under the LGDF. Governor Rauner's FY2019 proposed budget relies on again prorating what is statutorily required to be distributed to local governments under the LGDF at 90 percent.[61] If the General Assembly does not pass legislation authorizing this proration of the LGDF, it will create another revenue shortfall in the Governor's FY2019 budget proposal of $125 million.

Next, the Governor proposes changing the state's Group Health Insurance program to save $408 million. These savings would come primarily from his proposal to remove insurance benefits from collective bargaining allowing the Governor to impose reduced levels of health benefits on workers, which in turn generate some premium savings for the state.[62] Those savings allowed the Governor to budget only $1.45 billion for Group Health in FY2019, a year-to-year decrease of $408 million from FY2018. That decrease in appropriations, however, is highly questionable, given that it is unlikely the General Assembly will pass legislation that eliminates the right of public sector unions to bargain collectively over insurance benefits. Moreover, some of the Governor's Group Health cost savings are attributable to cutting retiree healthcare benefits, which the Illinois Supreme Court in its recent Kanerva Decision ruled unconstitutional.[63]

Given: it is highly unlikely the Governor will get the legislative authority to cut Group Health benefits as proposed; the unconstitutional nature of his proposed cuts to retiree healthcare benefits; historic cost-growth trends in the Group Health program; and based on acknowledgements the Rauner Administration made in the recent bond issuance concerning how uncertain it is the state will realize the proposed Group Health savings; it appears that the appropriation for Group Health in the Governor's FY2019 General Fund Budget proposal falls $470 million short of what the actual costs will be for the year. [64] Since Group Health liabilities are Hard Costs Illinois is contractually obligated to pay, this under-appropriation creates a $470 million hole in the Governor's FY2019 budget proposal.

The third major hole in the Governor's FY2019 budget proposal is the $615 million in projected savings he hopes to generate by shifting the responsibility to pay normal costs associated with pensions and retiree health care for teachers from the state to local school districts. Under the Governor's proposal, this cost shift would be implemented over a four-year period beginning in FY2019 for all school districts that are members in the Teachers Retirement System, at the rate of 25 percent of such costs per year. The Governor estimates this will result in $262 million of pension and $125 million of retiree healthcare costs being shifted from the state to local school districts in FY2019.[65] He also proposes to shift 100% of the normal pension costs associated with the Chicago Teachers Pension Fund the state paid in FY2018—estimated to be some $228 million in FY2019—to the Chicago Public Schools (**CPS**) in FY2019 and thereafter.[66] Of course, if such a shift were to happen, the "savings" would be for the state only—taxpayers will still have to pay those costs, in the form of local property taxes.

This cost shift proposal by the Governor is troubling for two key reasons. First, forcing an increase in property taxes to pay expenses the state has traditionally covered is a pretty bad idea in Illinois, given the state's over-reliance on property taxes as a revenue source when compared to other states. Second, it is a particularly bad idea to shift any costs incurred for public education from the state to local schools, since Illinois already ranks 50th among states in the portion of K-12 funding covered by state-based resources, and first in reliance on local property taxes to fund schools in FY2015, the most recent data available.[67] Indeed, given how reliant Illinois already is on local property tax revenue to fund education, any such shift of costs would result in either the diversion of property taxes from covering the cost of educating students to instead cover the shifted pension/retiree healthcare costs—or additional property taxes being levied against taxpayers. Neither of those outcomes is desirable.

Which is why it's highly unlikely the General Assembly will go along with the Governor's proposal and pass the legislation required to authorize these cost shifts—a fact that apparently isn't lost on the Rauner Administration. Indeed, in one of its recent bond issuances, Illinois state government acknowledged that it "provides no assurances as to how, when or in what form a cost shift proposal may be adopted."[68] And when these cost shifts don't materialize, they collectively increase costs for FY2019 by $615 million over the Governor's budget proposal, throwing it seriously out of balance.

Similarly, the Governor is also proposing to shift to universities and community colleges, the obligation for paying the normal costs associated with pensions and retiree healthcare for employees under the State Universities Retirement System that the state currently pays. The Governor projects that this will reduce FY2019 expenditures by $105 million from FY2018 levels.[69] This is also a questionable proposition from a good policy standpoint, because Illinois has been disinvesting significantly in Higher Education for almost two decades. In fact, after adjusting for inflation, General Fund appropriations for Higher Education were 52 percent less in FY2018, than they were in FY2000.[70] This disinvestment has put significant pressure on public universities and community colleges to hike tuition to cover lost state funding. Against that backdrop, it is not likely the General Assembly will pass the legislation required to shift pension and retiree healthcare costs to institutions of higher learning—and that in turn puts the Governor's FY2019 budget proposal another $105 million out of balance.

The Governor's proposed budget also reduces FY2019 expenses by $175 million from FY2018 levels, based on reducing the reimbursement rates the state pays to Medicaid providers by 4 percent.[71] Prescriptions and community health centers would be excluded. The goal, according to Governor Rauner, is to help control Medicaid costs. However, these rate cuts not only require legislative action by the state's General Assembly, but also, in some circumstances, federal approval. If, as is likely, the Medicaid reimbursement rate remains unchanged, the Governor's FY2019 budget proposal would be understating expenditures for the year by said $175 million.

Finally, the Governor's proposed FY2019 General Fund Budget failed to account for, what was at the time, a pending legal decision concerning back-pay owed by the state to workers represented by the American Federation of State, County and Municipal Employees (**AFSCME**). Since the Governor's budget proposal was released, the Illinois Supreme Court ruled that the state will have to pay retroactive step increases dating back to the start of FY2016, and continue to do so until a collective bargaining agreement can be reached between the state and AFSCME (step increases are annual raises given to employees based upon their years of service with the state).[72] This decision will cost the state at least $300 million in FY2019 for which the Governor's proposal fails to account.

As shown in Figure 16, the Governor's FY2019 budget proposal is built on a combined $2 billion in anticipated savings and/or new revenue which are not likely to materialize. When that $2 billion is removed from the Governor's FY2019 budget proposal, it results in his proposal generating a net, on-budget deficit of $1.679 billion (as shown in Figure 17), as opposed to the $334 million on-budget surplus the Governor claims for the year.

**Figure 17**
**FY2019 Proposed General Fund Surplus/(Deficit),**
**After Governor Rauner's Assumptions are Removed**

| $ in Millions | FY2019 Projected |
|---|---|
| Revenue | $37,599 |
| Expenditures | $40,150 |
| Unspent Appropriations | -$872 |
| **Surplus/(Deficit)** | **-$1,679** |

Sources: CTBA analysis of Fiscal Year 2019 Proposed Budget and Illinois General Obligation Bonds Statements.

## 5.2 Governor Rauner's FY2019 Proposed General Fund Appropriations

Governor Rauner has proposed appropriating $37.613 billion to the General Fund for FY2019, as detailed by type and major service category in Figure 18.

**Figure 18**
**FY2019 Proposed General Fund Appropriations ($ Millions)**

| Category | Appropriation |
|---|---|
| **Total General Fund Appropriation for Capped Items (Net)** | |
| **A. Total Hard Costs** | **$11,844** |
| Debt Service (Pension & Capital Bonds) | $2,787 |
| Statutory Transfers Out | $396 |
| Pension Contributions | $7,211 |
| Group Health Insurance | $1,450 |
| **B. General Fund Service Appropriations (Gross)** | **$26,641** |
| Healthcare (including Medicaid) | $7,875 |
| Early Childhood Education | $454 |
| K-12 Education | $7,859 |
| Higher Education | $1,959 |
| Human Services | $5,781 |
| Public Safety | $1,729 |
| Other | $984 |
| Lapsed Appropriations | -$872 |
| **Net General Fund Service Appropriations** | **$37,613** |

Sources: CTBA analysis of Fiscal Year 2019 Proposed Budget.

Statutory Transfers Out, Debt Service, Pension Contributions, and Group Health are the Hard Costs payable in FY2019 which, using the Governor's questionable savings estimates detailed in Section 5.1 of this Report, total only $11.844 billion, or $255 million less than FY2018. The Governor's FY2019 proposed budget targets $2.787 billion for debt service, which includes the first repayments of the $6 billion bond Illinois issued in FY2018 to address some of the state's then 16.8 billion backlog of bills. The Pension Contribution of $7.211 billion the Governor proposes for FY2019 is $526 million less than scheduled for the year under the Pension Ramp—based on the highly questionable cost shifts the Governor proposed that are delineated in Section 5.1 above.

## 5.3 Nominal Dollar (without adjusting for inflation) Comparison of FY2019 Proposed Budget to FY2018 Enacted Budget

Figure 19 shows how appropriations for public services in the Governor's FY2019 proposed budget compare to the FY2018 enacted budget in nominal dollars. Year-to-year, Early Childhood Education, K-12 Education, and Healthcare are projected to realize increases in funding. In contrast, Human Services (-5.0 percent) and Public Safety (-1.9 percent) are proposed to be cut in nominal dollars. In total, the Governor proposes gross General Fund Current Services expenditures for FY2019 that are $715 million (2.7 percent) more than in the FY2018 enacted budget.

**Figure 19**
**FY2019 Proposed General Fund Appropriations Compared to FY2018 Enacted Nominal Dollars ($ Millions)**

| Category | FY2018 Enacted | FY2019 Proposed | Difference | % Difference |
|---|---|---|---|---|
| **Healthcare (including Medicaid)** | $7,229 | $7,987 | $758 | 10.5% |
| **Early Childhood Education** | $444 | $454 | $10 | 2.3% |
| **K-12 Education** | $7,760 | $7,858 | $98 | 1.3% |
| **Higher Education** | $1,733 | $1,959 | $226 | 13.0% |
| **Human Services** | $5,834 | $5,542 | -$292 | -5.0% |
| **Public Safety** | $1,869 | $1,834 | -$35 | -1.9% |
| **Other** | $1,175 | $1,125 | -$50 | -4.3% |
| **Gross General Fund Service Appropriations** | $26,044 | $26,759 | $715 | 2.7% |

Source: CTBA analysis P.A. 100-0021, COGFA, *State of Illinois Budget Summary: Fiscal Year 2018*. CTBA, Fiscal Year 2019 Proposed Budget Note: Numbers may not all add due to rounding.

A word of caution—the comparisons in Figure 19 are of maximum authorized spending—not what would actually be spent. That's because of the utilization of an $872 million "unspent appropriations" line item in the FY2019 proposed budget. This means under the Governor's proposal, net expenditures for FY2017 would actually be $25.887 billion, rather than the $26.759 billion gross amount shown in Figure 19. There will also be a total of $1.07 billion in unspent appropriations for FY2018, bringing net spending down to $24.968 billion for that year. Unfortunately, how spending will be reduced by program area is not final yet for FY2018, and not projected for FY2019. Hence, comparisons by program have to be done on a gross authorized appropriation basis until those spending cuts are finalized.

### 5.4 Under the Governor's FY2019 Budget Proposal, the General Fund Will End the Fiscal Year with an Accumulated Deficit of Roughly $11.188 Billion—an Increase of $1.434 billion from FY2018

As shown in Figure 20, the state is projected to have a minimum, accumulated General Fund deficit of $11.188 billion in FY2019 under Governor Rauner's proposed budget for the year.

**Figure 20**
**FY2019 Estimated Accumulated Deficit ($ Millions)[73]**

| Step | Revenue | $ Millions | Spending | $ Millions | Remaining Revenue (Revenue – Spending) |
|---|---|---|---|---|---|
| (i) | FY2019 Revenue | $37,599 | FY2019 Hard Costs | $12,964 | $24,635 |
| (ii) | Revenue After Hard Costs | $24,635 | Accumulated Deficit Carry Forward from FY2018 | ($9,754) | $14,881 |
| (iii) | Projected Net FY2019 General Fund Revenue Available for Services | $14,881 | Projected Net General Fund Service Appropriations after Unspent Appropriations | $25,769 | ($10,888) |
| (iv) | Step Increases | $300 | Surplus/Deficit Remaining after General Fund Services | ($11,188) | ($11,188) |
| **Projected Accumulated FY2019 General Fund Deficit** | | **($11,188)** | | | |
| **Projected Deficit as a Percentage of General Fund Service Appropriations** | | **-43.4%** | | | |

Source: CTBA analysis of 2019 Proposed Budget; COGFA, *State of Illinois Budget Summary: Fiscal Year 2018*.

The projected General Fund deficit for FY2019 under Governor Rauner's proposed budget of $11.188 billion is an increase of $1.434 million from the projected deficit for FY2018.

The projected increase in the state's deficit from FY2018 to FY2019 is a cause for concern because it follows a fiscal year in which Illinois both increased taxes and borrowed $6 billion to pay past due bills. Governor Rauner's FY2019 proposed General Fund Budget fails to include any fiscal policy proposals to resolve the state's (still) growing backlog of bills. As highlighted previously, this lack of a coherent fiscal policy diminishes the state's capacity to fund the core services of Education, Healthcare, Human Services, and Public Safety over time—given that those areas account for over 90 percent of General Fund Current Service expenditures annually.

# 6. ILLINOIS STRUCTURAL DEFICIT

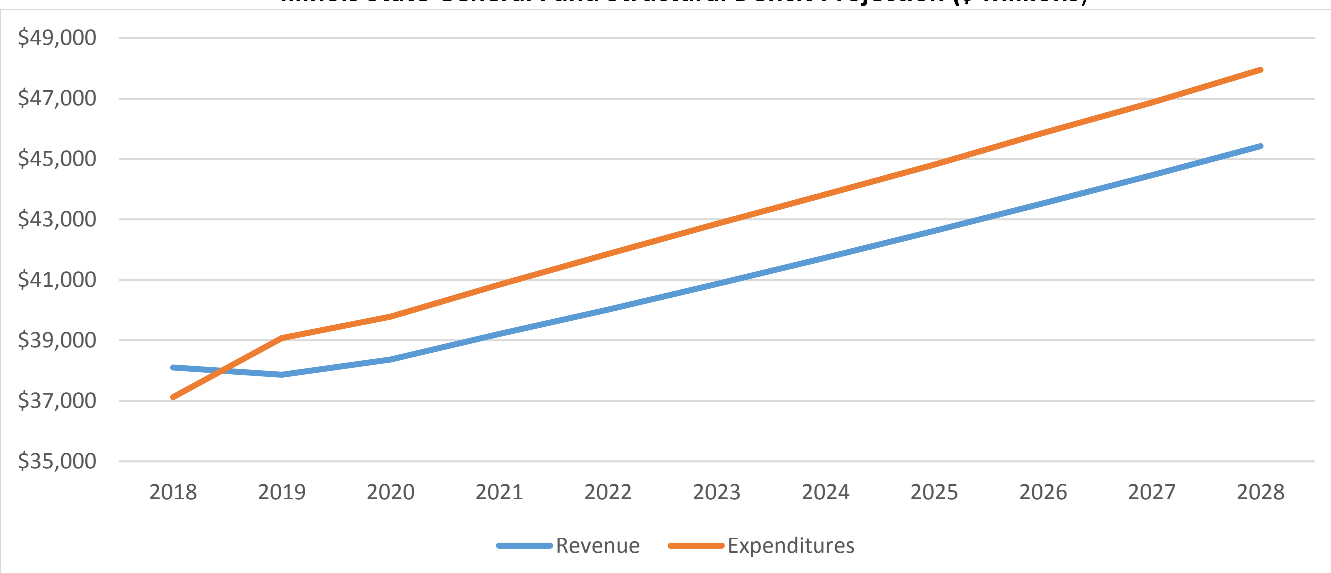
## 6.1 Spending on Services Has Not Driven Illinois' Ongoing Deficit Problem

Illinois' accumulated General Fund deficit—which would get worse under Governor Rauner's FY2019 budget proposal—is nothing new. According to the Illinois Comptroller's Office, Illinois has had a deficit in its General Fund every fiscal year since at least 1991 (the records do not cover years prior to that date).[74] This long-term fiscal struggle has led many to conclude that overspending on services in Illinois has been one of the primary causes of the state's significant, ongoing deficits. The data, however, clearly indicate that Illinois' deficits have not been driven by its service spending. Indeed, as shown in Figures 12 and 13 above, after adjusting for inflation and population growth, real General Fund spending on Current Services for FY2018 will be over 20 percent less than it was in FY2000.

### 6.2 Poor Revenue Policy is One of Two Main Drivers of Illinois' Deficits

So if it's not profligate spending on services, what is causing the state's deficits to grow so considerably over time? Here, the data make it clear two culprits are to blame. First and foremost, the Illinois tax system consistently does not generate enough General Fund revenue to maintain delivery of the same level of public services from year-to-year after adjusting for inflation—a fact CTBA has demonstrated for over 15 years. Even after the income tax increase that passed in the summer of 2017, this remains the case. This ongoing mismatch in the state's General Fund between the lower rates of growth for revenue than the pace of increase in the cost of maintaining service levels is commonly called a "structural deficit." Figure 21 is a graphic depiction of the structural deficit in the Illinois General Fund.

**Figure 21**
**Illinois State General Fund Structural Deficit Projection ($ Millions)**




The structural deficit depicted in Figure 21 assumes that: (i) FY2018 revenue projections are accurate; (ii) the state funds the Evidence Based Formula (**EBF**) for K-12 Education as drafted through FY2028; (iii) spending on all other services remains constant in real terms, meaning that no programs are expanded or added; and (iv) revenue will grow at historic annual rates.[75] The FY2018 revenue figure does not include the state's $6 billion in bond proceeds, however, it does include the $1.2 billion in Federal matching funds the state received due to paying down the backlog of bills. Note, this structural deficit model assumes the state only puts $4 billion into the EBF through 2028, which is the current statutory minimum. However, preliminary model runs by the Illinois State Board of Education found that, as of the end of FY2017, an additional $7.2 billion was needed in order for all schools in Illinois to be adequately funded. So while the $4 billion investment over the next decade appears imposing, it will still not be enough to fund our state's schools to the level which the evidence shows is necessary for the K-12 system to provide every child the education he or she needs to succeed academically.

### 6.3 Pension Debt is the Second Main Driver of Illinois Ongoing Deficits

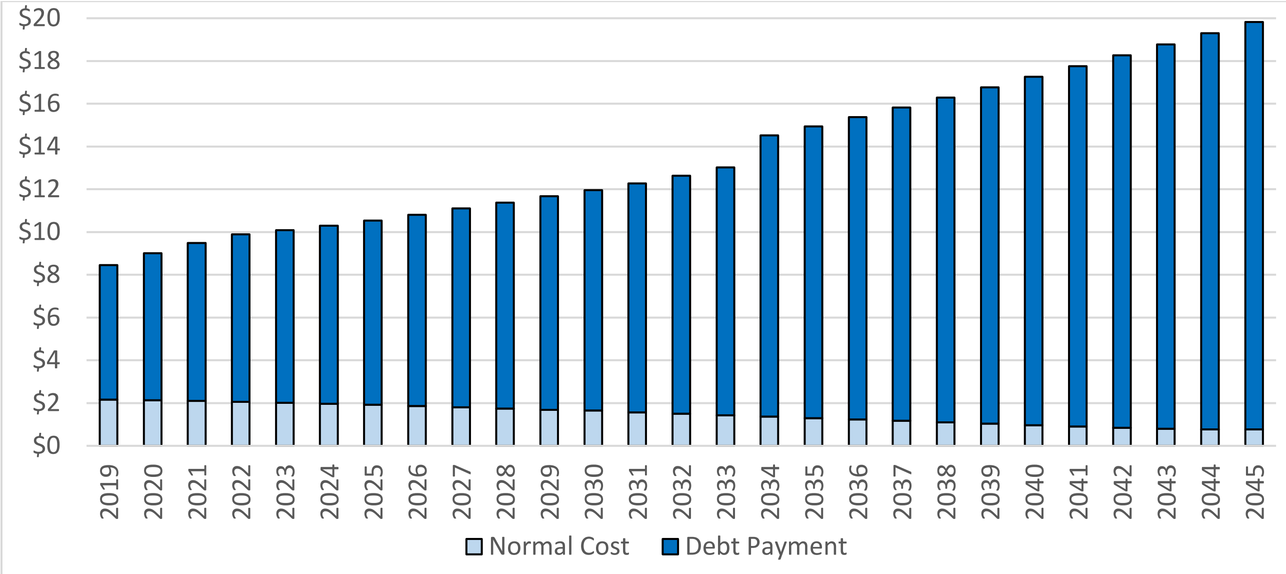
A structural deficit, like that depicted in Figure 21, has impacted Illinois' fiscal system since at least the late 1970s. Over time, elected officials in both parties chose not to resolve the state's structural deficit by either raising taxes to the level needed to support expenditures or permanently cutting expenditures down to revenue levels. Instead, they chose to borrow against the annual contribution the state was required to make to its five pension systems, and use that borrowed funding to paper over a portion of the structural deficit, and thereby subsidize the cost of funding Current Services. Effectively, this amounted to a decades-long practice of borrowing to spend, which is not only irresponsible, but also unsustainable. Hence, the consistent borrowing against the pension contribution to fund services was initially a consequence of the structural deficit caused by Illinois' poor revenue policy. Now the statutory plan for repaying that pension debt embodied in P.A. 88-593 and known as the "Pension Ramp", which initially passed under the Edgar Administration in 1995, is the second main driver of the structural deficit going forward.[76]

At this point, it is important to distinguish this long-term pension debt from the costs of funding pension benefits themselves. The actual cost of funding future pension benefits being earned by current workers in a given year is called the "Normal Cost." Both the state and public workers make contributions to the Normal Cost, which is calculated according to actuarial expectations such as investment returns, retirement dates, life expectancies, and so on.

Public workers' contributions to the Normal Cost are a fixed portion of their wages, with the state expected to make up the rest. When the state either fails to make an adequate payment, or actuarial assumptions turn out to be erroneous—for example, if investment returns are lower than anticipated—this creates "pension debt," or "unfunded liabilities." Of the $110.15 billion in pension debt that the state has generated since the Pension Ramp went into effect in FY1996, $47.86 billion, or nearly 43 percent, is the result of the state borrowing from the pension systems to pay for Current Services.[77] Another $31 billion, or 28 percent, is because of changes in actuarial assumptions; $16.15 billion, or about 15 percent, is because of demographic changes; and $14.05 billion, or 13 percent, is because of underperforming investment returns. Just $1.08 billion of the increase in pension debt since FY1996, or less than 1 percent, is the combined cost of salary and benefit increases over that sequence.[78]

Looking ahead, the Normal Cost of Illinois' five state pension systems is projected to decline. Despite that, as shown in Figure 22, the total cost of the state's contributions to the pension systems, will continue to grow substantially under the Pension Ramp because the ramp is structured to backload the repayment of Illinois' pension debt. Compounding the problems, each year that the pension systems are under-funded, those systems not only receive inadequate contributions from the state, but also lose out on the investment returns full contributions would have earned.

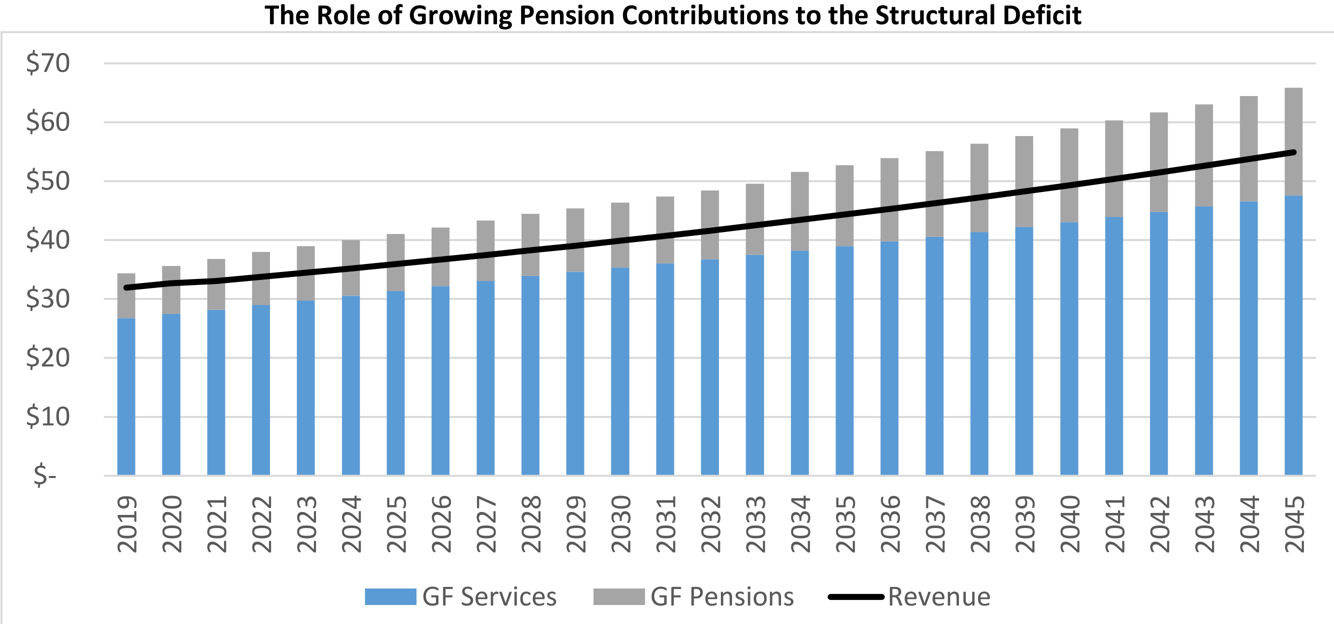
**Figure 22**
**Projected State Contributions to the State Pension Systems by Normal Cost and Debt Payment**




Source: COGFA and state pension systems' actuarial reports.

It is these escalating payments under the Pension Ramp—made up entirely of debt owed to the pension systems, rather than the Normal Cost of providing pension benefits—that are now helping drive Illinois' structural deficit. Figure 23 depicts the General Fund structural deficit with expenditures for Current Services distinguished from pension contributions.

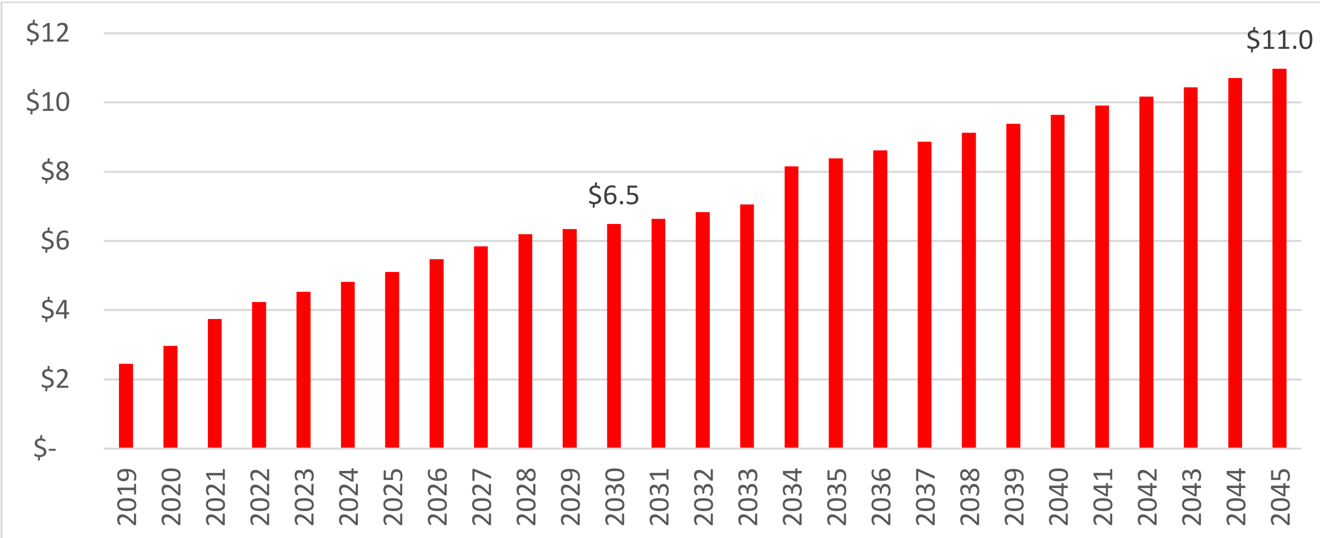
**Figure 23**
**The Role of Growing Pension Contributions to the Structural Deficit**




Source: CTBA analysis of COGFA data.

If the payment structure for pension debt set forth in the Pension Ramp is not changed, that repayment plan will make it fiscally impossible for Illinois to continue funding core services such as Education, Healthcare, Human Services, and Public Safety. In fact, as depicted in Figure 24, by FY2045, Illinois would have to cut $11 billion in annual General Fund Current Services spending, or raise an equivalent amount of new tax revenue, simply to keep up with growing pension debt costs under the 1995 Pension Ramp.

**Figure 24**
**Cuts to General Fund Current Services Required to Make State Pension Contribution**

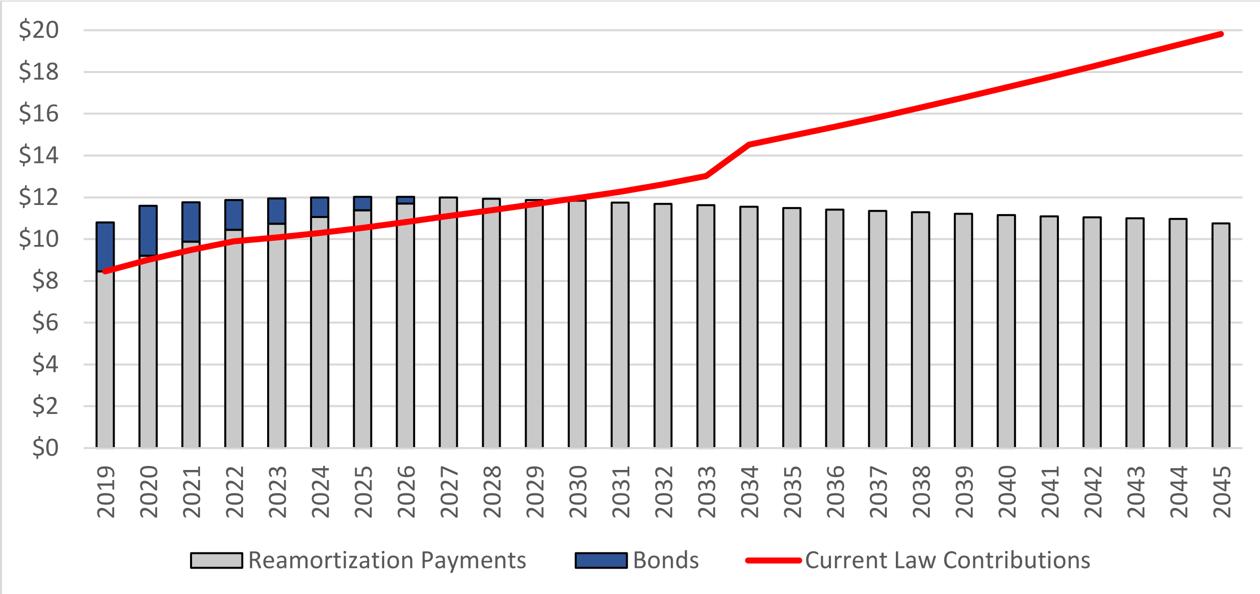



Source: CTBA analysis of COGFA data.

To date, legislative and gubernatorial proposals to reduce pension funding costs have focused on cutting benefits for workers. This is a loser proposition for two reasons. First, as shown in Figure 22 above, the cost of benefits is not driving the fiscal stress created by the pension systems—the backloaded repayment of debt under the Pension Ramp is. Second, it is not constitutional to cut pension benefits in Illinois.

Indeed, the Illinois Constitution clearly states that pension benefits are a contractual obligation of the state which cannot be "diminished or impaired," and the Illinois Supreme Court has consistently struck down attempts to do so.[79] Illinois can, however, reduce its total debt payments over time by reamortizing its pension debt, moving away from the current backloaded "Pension Ramp" to a level-dollar schedule. An example of how this can be accomplished is identified in Figure 25.

**Figure 25**
**CTBA Level-Dollar Reamortization Compared to Current Law Payment Schedule ($ Billions)**




Source: CTBA analysis of data from COGFA and state pension funds actuarial reports.

To work, this level-dollar reamortization requires greater contributions to the systems on the front end than under the current Pension Ramp, but over time the compounding of interest on these slightly greater up-front payments leads to significant savings. The second element of reamortization is to move from a target of a 90 percent funded ratio in FY2045 to a target of between 70 and 80 percent. According to the Congressional Budget Office, an 80 percent funded ratio is a baseline for a healthy pension system. Since the five state pension systems are only around 39 percent funded today, this proposed reamortization puts them on a clear path to full health. The funded ratio could continue to grow after FY2045 to a higher target.

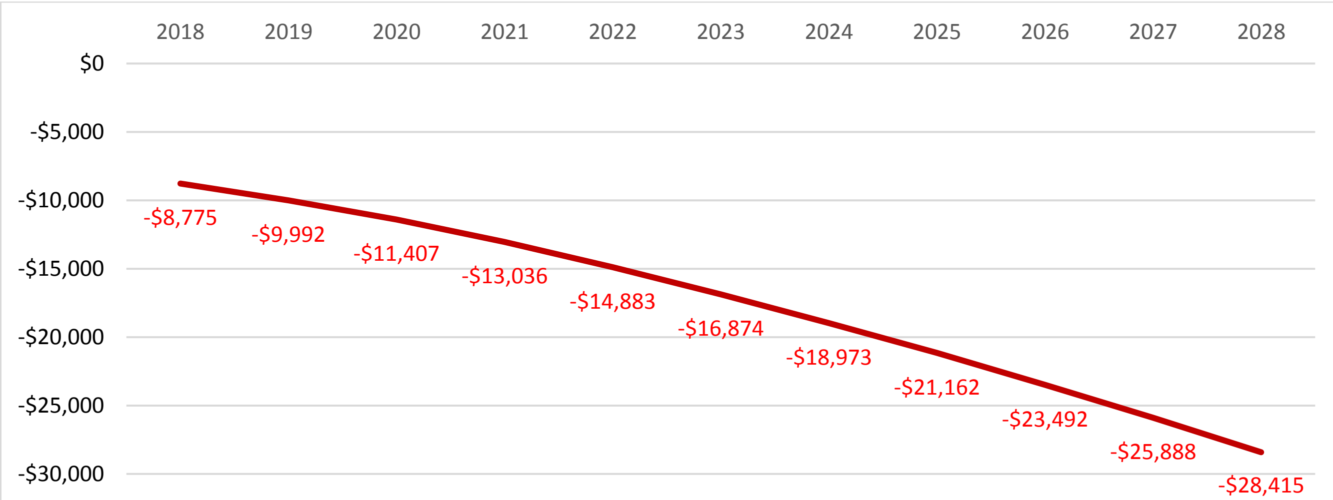
Given the state's current troubled fiscal condition, generating the additional up-front payments required by the reamortization will be difficult. Hence, to facilitate making those up-front payments without requiring cuts to Current Services or raising taxes, CTBA proposes issuing a series of annual pension obligation bonds to cover the difference between the contributions called for under the reamortization plan and those called for under the current Pension Ramp. With a funding target of 70 percent in FY2045, these bonds would total $11.2 billion over eight years. Even taking into account the interest cost of these bonds (and assuming an extremely conservative estimate of 6.5 percent interest rates), Illinois would save some $67 billion from what it is required to pay under the current Pension Ramp through FY2045.

### 6.4 The Potential Long-Term Consequences of Illinois' Structural Deficit

The state's structural deficit depicted in Figure 21, raises a number of concerns about the state's capacity to continue funding core services into the future. Figure 26 assumes that the state maintains constant spending on services in real terms through FY2028, meaning that no new programs are added and no existing programs are expanded. Instead, public spending on core services is adjusted over this period solely to account for historic rates of inflation and population growth. On the revenue side, Figure 26 assumes: (i) state own-source revenue will grow in line with historic rates; and (ii) federal revenue will be flat.

As shown in Figure 26, despite the very large nominal and real cuts in state spending that have occurred over the last several years, and assuming no real increases in spending on any core service under current law, the state's estimated operating deficit will grow by at least another $19.6 billion through FY2028.

**Figure 26**
**Projected Growth in Illinois State General Fund Annual Operating Budget Caused by the Structural Deficit ($ Millions)**




Note that Figure 26 only shows the estimated growth in the state's annual operating deficit in its General Fund going forward. When the state's current, accumulated deficit is factored in, the projected General Fund deficit by FY2028 is projected to be over $28 billion.

# 7. ENDNOTES

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[6] CTBA analysis of FY2017 CTBA analysis of data obtained from the Comptroller's office.

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[10] Center for Tax and Budget Accountability, *Illinois General Fund Spending in FY2016: How Elected Officials Cut Billions in Core Service Expenditures While Worsening the Deficit—All Without Casting a Vote*, (Chicago, IL: October 27, 2016), 2.

[11] Center for Tax and Budget Accountability, *Illinois General Fund Spending in FY2016: How Elected Officials Cut Billions in Core Service Expenditures While Worsening the Deficit—All Without Casting a Vote*, (Chicago, IL: October 27, 2016), 2.

[12] FY2016 figures from: Center for Tax and Budget Accountability, *Illinois General Fund Spending in FY2016: How Elected Officials Cut Billions in Core Services Expenditures While Worsening the Deficit—All Without Casting a Vote*, (Chicago, IL: October 27, 2016), 1. FY2017 figures for debt service are from GOMB, *FY2017 Budget Book* (Springfield, IL: March 18, 2016), 75. Figure for pensions are from CTBA's analysis of GOMB, "Fiscal Year 2017 Operating Budget Detail," February 2016 and PA 99-542. Transfers out are from GOMB, *FY2017 General Fund Transfers Out by Fund (https://www.illinois.gov/gov/budget/Documents/Budget%20Book/FY%202017%20Budget%20Book/GeneralFundsTransfersOutDetail.pdf)*—CTBA adjusted GOMB's reported transfer out figure to include the General Fund transfer to the Healthcare Provider Relief Fund, which has historically been categorized as a statutory transfer.

[13] CTBA analysis of FY2017 CTBA analysis of data obtained from the Comptroller's office.

[14] Center for Tax and Budget Accountability, *Illinois General Fund Spending in FY2016: How Elected Officials Cut Billions in Core Service Expenditures While Worsening the Deficit—All Without Casting a Vote*, (Chicago, IL: October 27, 2016), 11.

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[19] P.A. 100-0022, (35 ILCS 5/201).

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[21] P.A. 100-0022.

[22] P.A. 100-0022.

[23] P.A. 100-0022.

[24] Illinois Department of Revenue, *Summary of Illinois Income Tax and Sales Tax Changes from P.A. 100.0022*, July 2017. http://tax.illinois.gov/Publications/Bulletins/2018/FY-2018-01.pdf

[25] CTBA analysis of Commission on Government Forecasting & Accountability, *State of Illinois Budget Summary Fiscal Year 2018*, (Springfield, IL: September 5, 2017), 26.

[26] Commission on Government Forecasting & Accountability, *State of Illinois Budget Summary Fiscal Year 2018*, (Springfield, IL: September 5, 2017), 26.

[27] Commission on Government Forecasting & Accountability, Monthly Briefing For the Month Ended: November 2017, (Springfield, IL: December 2017), 1. http://cgfa.ilga.gov/Upload/1117revenue_special_pension_briefing.pdf

[28] Figure is based on gross appropriations, meaning the $500 million estimated unspent appropriations is not netted out.

[29] Commission on Government Forecasting & Accountability, *State of Illinois Budget Summary Fiscal Year 2018*, (Springfield, IL: September 5, 2017), 24.

[30] P.A. 100-0023.

[31] P.A. 100-0023, 35 ILCS 5/901.

[32] P.A. 100-0023, 35 ILCS 5/901.

[33] P.A. 100-0023.

[34] P.A. 100-0023.

[35] Illinois Department of Revenue, “Local Government; Income Tax”, accessed May 24, 2018. http://www.revenue.state.il.us/localgovernment/Overview/HowDisbursed/income.htm

[36] A small portion of the state’s annual required pension contribution is made via state agencies, and these contributions have been kept in the General Fund service budget to allow for historical comparisons. Another small portion is also paid from non-General Fund sources.

[37] Figure reached by taking the proportion of all required state contributions that are for Normal Cost, per state pension fund actuarial reports, and multiplying it by total authorized General Fund contributions.

[38] Members of the Teachers’ Retirement System are eligible to participate in the Teachers Retirement Insurance Program (TRIP) and individuals employed by a public community college are eligible for the College Insurance Program (CIP). The retiree health insurance program for members of GARS, SERS, JRS and non-community college retirees in SURS is the State Employees’ Group Insurance Program (“Group Health”). Line item appropriations for CIP and TRIP are reported in GOMB’s Operating Budget (http://www2.illinois.gov/gov/budget/Pages/BudgetBooks.aspx) as appropriations to SURS and TRS, and as such, these appropriations have been categorized as hard costs in this report. Line item appropriations for Group Health are reported by GOMB as an appropriation to the Department of Central Management and appropriations for retirees are not easily distinguished from appropriations made for current workers health insurance, as such, this report categorizes these appropriations as part of the General Fund Service budget.

[39] Center for Tax and Budget Accountability, *Illinois General Fund Spending in FY2016: How Elected Officials Cut Billions in Core Service Expenditures While Worsening the Deficit—All Without Casting a Vote*, (Chicago, IL: October 27, 2016), 8.

Commission on Government Forecasting and Accountability, *FY 2018 Liabilities of The State Employee' Group Health Insurance Program*, (Springfield, IL: March 2017), 1-2. http://cgfa.ilga.gov/Upload/FY2018GroupInsuranceReport.pdf

[40] Human Services category also includes the following agencies: Department of Human Rights, Department of Veterans' Affairs, Human Rights Commission, and the Illinois Guardianship and Advocacy Commission.

[41] Other agencies included in the Public Safety category are: Department of Military Affairs, Illinois Criminal Justice Information Authority, Illinois Emergency Management Agency, Illinois State Police Merit Board, and the Prisoner Review Board.

[42] The Healthcare category also includes the Comprehensive Health Insurance Plan (CHIP).

[43] Commission on Government Forecasting & Accountability, *State of Illinois Budget Summary Fiscal Year 2018*, (Springfield, IL: September 5, 2017), 29.

[44] Illinois Office of the Comptroller, Backlog Voucher Report. https://ledger.illinoiscomptroller.gov/financial-data/backlog-voucher-report-bvr/

[45] Amanda Kass, "Why Illinois's Non-Budget Is Actually the Worst Budget Ever", *Chicago Magazine*, May 30, 2017. http://www.chicagomag.com/city-life/May-2017/IL-Budget-Debt-Finance/

[46] Amanda Kass, "Why Illinois's Non-Budget Is Actually the Worst Budget Ever", *Chicago Magazine*, May 30, 2017. http://www.chicagomag.com/city-life/May-2017/IL-Budget-Debt-Finance/

[47] Office of the Comptroller, "Comptroller Mendoza's Statement on Wednesday's Bond Sale", October 25, 2017. https://ledger.illinoiscomptroller.gov/ledger/includes/themes/TheLedger/display_objects/custom/fiscal-condition/COMPTROLLER%20MENDOZAS%20STATEMENT%20ON%20WEDNESDAYS%20BOND%20SALE_.pdf

[48] John O'Connor, "Illinois' late fees skyrocket over past 3 years", The State Journal-Register, The Associated Press, (April 23, 2018). http://www.sj-r.com/news/20180423/illinois-late-fees-skyrocket-over-past-3-years

[49] Elizabeth Campbell and Danielle Moran, "Bond Market's Dip Didn't Hit $4.5 Billion Illinois Sale" Bloomberg, October 25, 2017. https://www.bloomberg.com/news/articles/2017-10-25/bond-market-dip-bypassing-illinois-in-state-s-4-5-billion-sale
The 3.77 percent interest rate was for $4.5 billion in bonds sold in October of 2017. The state also sold $500 million in bond at 3.78 percent with a 12 year maturity date, $500 million with a 2 year maturity date, and $500 million with a 1 year maturity date earlier in the month. Yvette Shields, "First chunk of $6 billion in Illinois paper goes down easy", *Bond Buyer*, October 17, 2017.

[50] Office of the Comptroller, "Comptroller Mendoza Uses Bond Proceeds to Begin Paying Down Backlog of Unpaid Bills", November 8, 2017. https://illinoiscomptroller.gov/news-portal/comptroller-mendoza-uses-bond-proceeds-to-begin-paying-down-backlog-of-unpaid-bills/#.WiDi1kqnGUk

[51] Sources: CTBA analysis using (i) US Census Bureau. "Annual Estimates of the Resident Population: April 1, 2010 to July 1, 2016: July 2016 totals." Last updated December 2016. http://factfinder2.census.gov/faces/nav/jsf/pages/index.xhtml; and (ii) US Bureau of Economic Analysis. "2016 State GDP." Last modified November 21, 2017. http://www.bea.gov/.

[52] CTBA analysis of: (i) National Association of State Budget Officers, Fall 2016: Fiscal Survey of the States (Washington, DC: 2016); (ii) General Fund budgets from all 50 states; and, US Census Bureau. "Annual Estimates of the Resident Population: April 1, 2010 to July 1, 2016: July 2016 totals." Last updated December 2016. http://factfinder2.census.gov/faces/nav/jsf/pages/index.xhtml.

[53] Sources: CTBA analysis using (i) US Census Bureau. "Annual Estimates of the Resident Population: April 1, 2010 to July 1, 2016: July 2016 totals." Last updated December 2016. http://factfinder2.census.gov/faces/nav/jsf/pages/index.xhtml; and (ii) State and Local Government Employment and Payroll Data: March 2016." Last modified October 19, 2017. https://factfinder.census.gov/bkmk/table/1.0/en/GEP/2016/00A4

[54] CTBA analysis of: (i) National Association of State Budget Officers, *Fall 2016: Fiscal Survey of the States* (Washington, DC: 2016); (ii) General Fund budgets from all 50 states; and, (iii) US Bureau of Economic Analysis. "2016 State GDP." Last modified June 6, 2013.

[55] COGFA, *FY 2019 Economic Forecast and Revenue Estimate and FY 2018 Revenue Update*, (Springfield, IL: February 27, 2018), 20. http://cgfa.ilga.gov/Upload/02272018econforecastrevest2018-2019.pdf

[56] Note numbers may not perfectly add due to rounding.

[57] The FY2018 Revenue figure is updated to reflect updates that COGFA has made during FY2018. COGFA, *FY 2019 Economic Forecast and Revenue Estimate and FY 2018 Revenue Update*, (Springfield, IL: February 27, 2018), 20. http://cgfa.ilga.gov/Upload/02272018econforecastrevest2018-2019.pdf

[58] *Illinois State Budget: Fiscal Year 2019, Governor Bruce Rauner*, (Springfield, IL: February 14, 2018), 31. https://www2.illinois.gov/sites/budget/Documents/Budget%20Book/FY%202019/Fiscal-Year-2019-Operating-Budget-Book.pdf

[59] *Illinois State Budget: Fiscal Year 2019, Governor Bruce Rauner*, (Springfield, IL: February 14, 2018), 30. https://www2.illinois.gov/sites/budget/Documents/Budget%20Book/FY%202019/Fiscal-Year-2019-Operating-Budget-Book.pdf

[60] *Illinois State Budget: Fiscal Year 2019, Governor Bruce Rauner*, (Springfield, IL: February 14, 2018), 49. https://www2.illinois.gov/sites/budget/Documents/Budget%20Book/FY%202019/Fiscal-Year-2019-Operating-Budget-Book.pdf

[61] *Illinois State Budget: Fiscal Year 2019, Governor Bruce Rauner*, (Springfield, IL: February 14, 2018), 60. https://www2.illinois.gov/sites/budget/Documents/Budget%20Book/FY%202019/Fiscal-Year-2019-Operating-Budget-Book.pdf

[62] *Illinois State Budget: Fiscal Year 2019, Governor Bruce Rauner*, (Springfield, IL: February 14, 2018), 48. https://www2.illinois.gov/sites/budget/Documents/Budget%20Book/FY%202019/Fiscal-Year-2019-Operating-Budget-Book.pdf

[63] Kanerva v. Weems, 2014 IL 115811. http://www.illinoiscourts.gov/Opinions/SupremeCourt/2014/115811.pdf

[64] State of Illinois, *General Obligation Bonds, Series of May 2018, Preliminary Official Statement*, (Springfield, IL: April 13, 2018), 31. https://www2.illinois.gov/sites/capitalmarkets/RecentBondSales/State%20of%20Illinois,%20General%20Obligation%20Bonds,%20Series%20of%20May%202018%20-%20Preliminary%20Official%20Statement.pdf

[65] *Illinois State Budget: Fiscal Year 2019, Governor Bruce Rauner*, (Springfield, IL: February 14, 2018), 46. https://www2.illinois.gov/sites/budget/Documents/Budget%20Book/FY%202019/Fiscal-Year-2019-Operating-Budget-Book.pdf

[66] State of Illinois, *General Obligation Bonds, Series of May 2018, Preliminary Official Statement*, (Springfield, IL: April 13, 2018), 31. https://www2.illinois.gov/sites/capitalmarkets/RecentBondSales/State%20of%20Illinois,%20General%20Obligation%20Bonds,%20Series%20of%20May%202018%20-%20Preliminary%20Official%20Statement.pdf

[67] CTBA analysis of Stephen Q. Cornman, Lei Zhou, Malia R. Howell, Jumaane Young, *Revenues and Expenditures for Public Elementary and Secondary Education: School Year 2014–15 (Fiscal Year 2015) First Look*, U.S. Department of Education, National Center for Education Statistics, (Washington, DC: January 2018), 4-5. https://nces.ed.gov/pubs2018/2018301.pdf

[68] State of Illinois, *General Obligation Bonds, Series of May 2018, Preliminary Official Statement*, (Springfield, IL: April 13, 2018), 10. https://www2.illinois.gov/sites/capitalmarkets/RecentBondSales/State%20of%20Illinois,%20General%20Obligation%20Bonds,%20Series%20of%20May%202018%20-%20Preliminary%20Official%20Statement.pdf

[69] State of Illinois, *General Obligation Bonds, Series of May 2018, Preliminary Official Statement*, (Springfield, IL: April 13, 2018), 31. https://www2.illinois.gov/sites/capitalmarkets/RecentBondSales/State%20of%20Illinois,%20General%20Obligation%20Bonds,%20Series%20of%20May%202018%20-%20Preliminary%20Official%20Statement.pdf

[70] FY2000 unadjusted appropriations from Governor's final budget summary for FY2000; and FY2018 CTBA analysis of P.A. 100-0021. Inflation for healthcare inflated by Midwest Medical Care CPI; all other appropriations adjusted using ECI-C and CPI from the BLS as of September 2017, and population growth from the Census Bureau as of July 2017.

[71] *Illinois State Budget: Fiscal Year 2019, Governor Bruce Rauner*, (Springfield, IL: February 14, 2018), 44. https://www2.illinois.gov/sites/budget/Documents/Budget%20Book/FY%202019/Fiscal-Year-2019-Operating-Budget-Book.pdf

[72] State of Illinois, *General Obligation Bonds, Series of May 2018, Preliminary Official Statement*, (Springfield, IL: April 13, 2018), 32. https://www2.illinois.gov/sites/capitalmarkets/RecentBondSales/State%20of%20Illinois,%20General%20Obligation%20Bonds,%20Series%20of%20May%202018%20-%20Preliminary%20Official%20Statement.pdf

[73] Note numbers may not perfectly add due to rounding.

[74] State of Illinois Comptroller, GAAP Fund Balance, http://www.ioc.state.il.us/index.cfm/fiscal-condition/gaap-fund-balance

[75] Public spending on the core services is based on these assumptions: (i) projecting spending on core services using the Congressional Budget Office's projection on employment growth and population growth using the Illinois Department of Commerce and Economic Opportunity's population projections; (ii) pension contributions based on the funding plan put in place by Public Act 88-593; (iii) statutory transfers are projected based on historic CPI-U growth and population growth using the Illinois Department of Commerce and Economic Opportunity's population projections; and (iv) bond debt service is the General Revenue Fund schedule reported by the Comptroller in FY2011 Bond Indebtedness and Long Term Obligations.

[76] P.A. 88-0593.

[77] Commission on Government Forecasting and Accountability, *Illinois State Retirement Systems: Report on the Financial Condition of the State Retirement Systems FY 2017*, March 2018.

[78] Commission on Government Forecasting and Accountability, *Illinois State Retirement Systems: Report on the Financial Condition of the State Retirement Systems FY 2017*, March 2018.

[79] Rick Pearson, and Kim Geiger, "Illinois Supreme Court rules landmark pension law unconstitutional", *Chicago Tribune*, May 8, 2015.