# BUDGET & TAX POLICY INITIATIVE

**SPECIAL REPORT**

**June 2010**


# PASSING THE BUCK

## FY 2011 STATE BUDGET JEOPARDIZES KEY PROGRAMS FOR CHILDREN AND FAMILIES


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In January 2009, Illinois was facing a $12 billion General Funds (GF) budget deficit for FY 2009 and FY 2010 combined.[1] In mid-July, the General Assembly enacted a budget for FY 2010 that relied on federal fiscal assistance under the American Recovery and Reinvestment Act (ARRA), authorized borrowing to cover state pension contributions, and provided lump-sum appropriations for most state agencies and additional lump sums to be allocated by the Governor. The budget ignored a backlog of more than $3 billion in unpaid bills from FY 2009.

By January of this year, the state was confronting an intensified fiscal firestorm. The recession continued to batter state revenues, which had plummeted by $2 billion in FY 2009 and were expected to fall another $1.9 billion by the end of FY 2010. The cumulative deficit for FY 2011 was estimated to be about $13 billion. In the last week of May, the General Assembly passed an appropriations bill that would again give most state agencies lump-sum funding rather than line-item appropriations. Similarly, $3.46 billion would be appropriated to the Governor's Office to allocate among agencies. Related legislation would give the Governor sweeping "emergency budget" powers to control spending and make changes in state programs. This legislative package would do nothing to address the state's structural deficit or reduce the $5 billion backlog of unpaid bills. For the second consecutive year, the Illinois General Assembly has confronted the state fiscal crisis by "passing the buck."

Legislators from both political parties have wanted to avoid responsibility for either a major tax increase or substantial spending cuts in an election year. The final FY 2011 budget and its impact on particular programs and services will be determined by the allocation of lump-sum funding by state agencies and the Governor's Office, as well as by the Governor's use of various emergency budget powers. Still unresolved is the matter of pension contributions for the coming fiscal year. In FY 2010, the lump-sum appropriations allocated by the Governor — $3.46 billion — were specifically tied to the issuance of five-year pension obligation notes in the same amount. The FY 2011 budget has also appropriated $3.46 billion to the Governor's Office, but the General Assembly has not provided any source of funding. In the absence of new sources of sustainable revenue, deep spending cuts and further erosion of vital public services are inevitable. The abdication of fiscal and social responsibility will have devastating effects on children, families, and communities throughout Illinois.

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[1] The General Funds — which include the General Revenue Fund, the Common School Fund, and the Education Assistance Fund — support the regular operating and program expenses of most state agencies.

## FISCAL YEAR 2011 APPROPRIATIONS

Under House Bill 859, the main appropriations legislation approved by the General Assembly, most state agencies receive a lump-sum appropriation for operations and another for awards and grants in FY 2011. The State Board of Education and the Department of Healthcare and Family Services have line-item appropriations for parts of their GF budgets. The largest gaps between FY 2011 appropriations and FY 2010 funding are those in human service agencies — especially Human Services (37%), Children and Family Services (33%), Aging (52%), and Public Health (32%). Most other agencies are slated for level funding or relatively small cuts (5% or less). Some portion of these shortfalls will be offset by the $3.46 billion in lump-sum appropriations to be allocated by the Governor, although the Governor is not required to distribute the entire amount (see Table 1).

**Table 1: Appropriations for Selected State Agencies, FY 2010 and FY 2011 (in $ millions)**

| | FY 2010 Revised budget | FY 2011 HB 859 approp. | Change from FY10 | Pct. change |
|---|---|---|---|---|
| State Board of Education* | 7,307.9 | 6,715.0 | -592.9 | -8.1% |
| Higher education agencies | 2,207.4 | 2,180.0 | -27.4 | -1.2% |
| | | | | |
| Department of Healthcare and Family Services | 7,808.7 | 6,970.6 | -838.1 | -10.7% |
| Department of Human Services | 4,036.9 | 2,543.7 | -1,493.2 | -37.0% |
| Department of Children and Family Services | 865.0 | 579.0 | -286.0 | -33.1% |
| Department on Aging | 656.2 | 313.9 | -342.3 | -52.2% |
| Department of Public Health | 143.2 | 97.4 | -45.8 | -32.0% |
| Department of Juvenile Justice | 115.2 | 109.4 | -5.8 | -5.0% |
| Department of Veterans' Affairs | 60.4 | 63.2 | 2.8 | 4.7% |
| Comprehensive Health Insurance Plan | 29.3 | 14.6 | -14.6 | -50.0% |
| Illinois Guardianship and Advocacy Commission | 8.9 | 8.4 | -0.5 | -5.3% |
| Illinois Violence Prevention Authority | 2.9 | 1.7 | -1.2 | -41.8% |
| | | | | |
| Department of Corrections | 1,151.3 | 1,114.9 | -36.4 | -3.2% |
| Judicial agencies | 364.2 | 327.4 | -36.8 | -10.1% |
| Department of State Police | 287.4 | 273.3 | -14.1 | -4.9% |
| Office of the Secretary of State | 260.3 | 260.3 | 0.0 | 0.0% |
| Department of Revenue | 142.5 | 136.6 | -5.9 | -4.2% |
| Department of Central Management Services | 90.0 | 86.0 | -4.0 | -4.5% |
| | | | | |
| All other agencies | 649.4 | 486.9 | -163.2 | -25.1% |
| | | | | |
| Lump sums to be allocated by Governor's Office | ------- | 3,466.0 | ------- | ------- |
| | | | | |
| Total | 26,187.6 | 25,748.3 | -456.4 | -1.7% |

* FY 2011 appropriations include $17.1 million from HB2270.

Sources: Governor’s Office of Management and Budget; House Bill 859.

### State Board of Education

Under ARRA, Illinois was eligible to receive more than $2 billion from the State Fiscal Stabilization Fund, administered by the U.S. Department of Education. The Governor's Office has used all of the state's allocation to maintain funding for public school districts and for higher education. The State Board of Education (ISBE) received $1.96 billion for FY 2009 and FY 2010. Most of these funds were used for General State Aid (GSA) to local school districts. According to the ARRA statute, the "first use" of the State Fiscal Stabilization Fund was to be the restoration of state formula aid to public schools to the FY 2008 or FY 2009 level, whichever was greater.

General State Aid accounts for more than 60 percent of the ISBE budget. Under HB 859, appropriations for GSA would be at the same level as FY 2010 (see Table 2). The FY 2011 Budget Implementation Act (SB 3662) specifies that the foundation level — the minimum level of per-pupil funding from state and local sources — will remain at $6,119. SB 3662 also repeals a provision of the Illinois School Code that had given priority to regular GSA over supplemental GSA or "poverty grants," which provide additional funding to school districts based on their concentration of students from low-income households. In the event of an insufficient appropriation in a given fiscal year, this provision required that each school district receive the full amount of regular GSA, after which poverty grants would be prorated. Repeal of that provision means that both regular GSA and poverty grants could be prorated in FY 2011.

The second largest portion (about one-fourth) of the ISBE budget consists of mandated categorical grants, most of which support special education programs that serve students with specific learning disabilities, speech and language impairments, mental impairments, and other disabilities. FY 2011 appropriations for mandated categorical grants would be cut by $310 million — 16 percent below FY 2010 levels (see Table 2).

Most of the remainder of the ISBE budget would receive a lump-sum appropriation of $371 million, which would represent a 43 percent reduction in aggregate funding (see Table 2). The largest program in this group is the Early Childhood Block Grant (ECBG), which supports preschool programs for children ages 3-to-5, as well as developmental services for even younger children. FY 2010 funding for ECBG was $342 million. This funding level, which was 10 percent lower than the previous year, included $131 million in federal ARRA funds.

Many other smaller programs would also have to be funded through ISBE's inadequate lump-sum appropriation or additional resources allocated by Governor. These include bilingual education, the Reading Improvement Block Grant, the Summer Bridges program for struggling students who attend low-performing schools, the Philip J. Rock Center and School for children who are deaf and blind, and the ISBE component of the Children's Mental Health Partnership, which provides funding to participating school districts to improve social/emotional learning and student support services.

### Higher Education Agencies

From FY 2004 to FY 2009, GF expenditures for higher education (excluding the State Universities Retirement System) grew at an average annual rate of only 1 percent — substantially below the rate of inflation. In the FY 2010 budget, state funding increased by 2 percent to $2.2 billion, including $93.9 million in federal ARRA funds. HB 859 would maintain GF appropriations at FY 2010 levels for state universities, as well as for the Illinois Student Assistance Commission. Funding for the Illinois Community College Board, however, would be cut by 7.5 percent (see Table 3).

**Table 2: State Board of Education, General Funds Appropriations (in $ millions)**

| | FY 2010 Revised budget | FY 2011 HB 859 approp. | Change from FY 2010 | Pct. change |
|---|---|---|---|---|
| Operations | 58.7 | 60.1 | 1.4 | 2.4% |
| General State Aid | 4,616.0 | 4,616.0 | 0.0 | 0.0% |
| Mandated categorical grants* | 1,926.9 | 1,616.3 | -310.6 | -16.1% |
| Special education* | 1,536.5 | 1,307.0 | -229.5 | -14.9% |
| Transportation - regular/vocational | 351.1 | 270.0 | -81.1 | -23.1% |
| Other | 39.3 | 39.3 | 0.0 | 0.0% |
| Textbook loans (re-appropriation) | 42.8 | 42.8 | 0.0 | 0.0% |
| Regional superintendents and assistants | 9.1 | 9.1 | 0.0 | 0.0% |
| All other grants** | 654.4 | 370.7 | -283.7 | -43.4% |
| Early Childhood Block Grant | 342.2 | ------- | ------- | ------- |
| Reading Improvement Block Grant | 68.5 | ------- | ------- | ------- |
| Bilingual education | 68.1 | ------- | ------- | ------- |
| Career and technical education | 38.6 | ------- | ------- | ------- |
| Summer Bridges Program | 20.7 | ------- | ------- | ------- |
| ADA Block Grant | 18.7 | ------- | ------- | ------- |
| Truant Alternative & Optional Education | 18.1 | ------- | ------- | ------- |
| Regional Safe Schools | 16.7 | ------- | ------- | ------- |
| After School Matters | 5.0 | ------- | ------- | ------- |
| Philip J. Rock Center and School | 3.6 | ------- | ------- | ------- |
| Children's Mental Health Partnership | 2.7 | ------- | ------- | ------- |
| Arts and foreign language education | 2.2 | ------- | ------- | ------- |
| Other | 49.3 | ------- | ------- | ------- |
| Total* | 7,307.9 | 6,715.0 | -592.9 | -8.1% |

* FY 2011 appropriations include $17.1 million in “hold harmless” funding from HB2270.

** Lump-sum appropriation for FY 2011

Sources: Governor’s Office of Management and Budget; House Bill 859.

**Table 3: Higher Education Agencies, General Funds Appropriations (in $ millions)**

| | FY 2010 Revised budget | FY 2011 HB 859 approp. | Change from FY 2010 | Pct. change |
|---|---|---|---|---|
| State universities | 1,394.4 | 1,393.8 | -0.6 | 0.0% |
| Illinois Community College Board | 358.7 | 331.9 | -26.8 | -7.5% |
| Illinois Student Assistance Commission | 425.0 | 425.0 | 0.0 | 0.0% |
| Illinois Math and Science Academy | 18.2 | 18.2 | 0.0 | 0.0% |
| Board of Higher Education | 9.8 | 9.8 | 0.0 | 0.0% |
| State universities civil service system | 1.3 | 1.3 | 0.0 | 0.0% |
| Total | 2,207.4 | 2,180.0 | -27.4 | -1.2% |

Sources: Governor’s Office of Management and Budget; House Bill 859.

## Department of Healthcare and Family Services

In order to protect and maintain state Medicaid programs during the recession, ARRA instituted a temporary increase in federal matching funds. For Illinois, the federal share of Medicaid costs was raised from 50 percent to more than 60 percent, retroactive to October 2008. In order to qualify for the enhanced federal match, states could not make eligibility standards or enrollment procedures more restrictive, and they had to assure prompt payments to hospitals, nursing homes, and medical practitioners (in most cases, within 30 days). This latter requirement compelled Illinois to reduce its backlog of unpaid Medicaid bills, which stood at $2 billion at the end of FY 2008, to about $750 million in June 2010. By the end of FY 2010, Illinois will have received more than $2 billion in enhanced federal matching funds, including $1.4 billion for the General Funds. The ARRA Medicaid provisions are scheduled to expire at the end of December 2010, which means that the General Funds will get about $450 million from ARRA in FY 2011.

Under HB 859, GRF appropriations for medical assistance programs in the Department of Healthcare and Family Services are 3.2 percent higher than the FY 2010 level (see Table 4). Line-item appropriations are provided for hospital services, long-term care services, and practitioners at the same levels as recommended in the Governor's FY 2011 budget, outlined in March. All other GRF appropriations for medical assistance — including prescription drugs, community health centers, managed care, Medicare premiums, and other services — would be in a lump sum that is $46 million above FY 2010 funding but $302 million below the Governor's proposal.

**Table 4: Department of HealthCare and Family Services, General Funds Appropriations (in $ millions)**

| | FY 2010 Revised budget | FY 2011 HB 859 approp. | Change from FY 2010 | Pct. change |
|---|---|---|---|---|
| Operations* | 153.9 | 100.4 | -53.5 | -34.8% |
| Medical Assistance | | | | |
| Hospital services | 2,531.3 | 2,822.5 | 291.2 | 11.5% |
| Long-term care | | | | |
| Skilled and intermediate long-term care | 787.9 | 552.3 | -235.6 | -29.9% |
| Institutions for mental disease | 145.3 | 132.9 | -12.4 | -8.5% |
| Supportive living facilities | 128.7 | 119.5 | -9.2 | -7.1% |
| Practitioners | | | | |
| Physicians | 865.8 | 943.4 | 77.6 | 9.0% |
| Dentists | 224.7 | 262.1 | 37.4 | 16.6% |
| Optometrists | 30.5 | 49.0 | 18.6 | 60.9% |
| Podiatrists | 5.7 | 7.4 | 1.7 | 30.8% |
| Chiropractors | 1.4 | 1.3 | -0.1 | -6.8% |
| Subtotal: line items | 4,721.2 | 4,890.4 | 169.2 | 3.6% |
| All other* | 1,933.5 | 1,979.8 | 46.3 | 2.4% |
| Subtotal: Medical Assistance | 6,654.7 | 6,870.2 | 215.5 | 3.2% |
| Employee Group Insurance | 1,000.0 | 0.0 | -1,000.0 | -100.0% |
| Total | 7,808.6 | 6,970.6 | -838.0 | -10.7% |

* Lump-sum appropriation for FY 2011

Sources: Governor's Office of Management and Budget; House Bill 859.

The General Assembly did not provide any appropriation for state employee group insurance, which is also part of the DHFS budget, in either FY 2010 or FY 2011. In FY 2010, $1 billion from the $3.5 billion lump-sum appropriation to the Governor's office was used for employee group insurance. The Governor will presumably have to allocate a comparable amount of funding for this purpose in FY 2011.

### Department of Human Services

The Department of Human Services (DHS) has responsibility for a wide range of program areas. Lump-sum appropriations for DHS are 37 percent below the FY 2010 budget (see Table 5). The total shortfall of nearly $1.5 billion is the largest of any state agency. In the Governor's allocation of "discretionary" appropriations, funding for nearly all DHS programs is uncertain, but some parts of the budget will be partially protected by federal funding and related federal mandates. The most significant source of federal funding in DHS is Medicaid:

- The Division of Developmental Disabilities is the largest part of the DHS budget. More than 80 percent of GF spending for developmental disability grants, as well as more than 90 percent of spending for state developmental centers, is covered by Medicaid.

- The DHS Home Services program offers a wide range of services for individuals under age 60 with physical disabilities so they can remain in their homes and be as independent as possible. More than 60 percent of Home Services spending is funded through Medicaid or the federal Social Services Block Grant (SSBG).

- The Early Intervention program provides developmental assessments and a wide range of services for children under age three who are experiencing developmental delays. About two-thirds of spending from the Early Intervention Services Revolving Fund is covered by Medicaid, SSBG, or federal funding for special education.

- Family Case Management and Targeted Intensive Prenatal Case Management are designed to help women have healthy babies and to reduce the rates of infant mortality and very low birth-weight. Both programs receive Medicaid matching funds as well as other federal grants.

In federal FY 2009, about $680 million in GRF spending in DHS came from the Temporary Assistance for Needy Families (TANF) block grant or related state maintenance-of-effort (MOE) funding.[2] Only $60 million represented cash income assistance, while the largest amount of spending ($254 million) went to child care. About one-third of GRF spending for DHS child care services comes from federal funds, primarily the TANF block grant and the Child Care and Development Fund (CCDF). Most of the state share represents the required match for CCDF and MOE spending for CCDF and TANF (see Table 6).

Another constraint on budget cuts for child care services comes from federal ARRA funds. Illinois was allocated $74 million in ARRA child care funding, although the state had drawn down only $21 million as of June 4, 2010. These funds, which are available through September 2010, cannot be used to supplant state funds for child care assistance to low-income families.[3]

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[2] Combined TANF and MOE funding in Illinois is about $1 billion. TANF and MOE expenditures are also found in various other state agencies, most notably the Department of Children and Family Services, which received $254 million from the TANF block grant in FFY 2009.

[3] Center for Law and Social Policy, "Tracking American Recovery and Reinvestment Act Funds: Child Care and Development Block Grant Outlays" (June 2010).

**Table 5: Department of Human Services, General Funds Appropriations (in $ millions)**

| | FY 2010 Revised budget | FY 2011 HB 859 approp. | Change from FY 2010 | Pct. change |
|---|---|---|---|---|
| Operations* | 966.4 | 946.4 | -20.0 | -2.1% |
| Developmental Disabilities | 299.5 | ------- | ------- | ------- |
| Human Capital Development | 225.1 | ------- | ------- | ------- |
| Mental Health | 215.2 | ------- | ------- | ------- |
| All other | 226.6 | ------- | ------- | ------- |
| Awards and grants* | 3,070.5 | 1,596.9 | -1,473.6 | -48.0% |
| Developmental Disabilities | 1,010.8 | ------- | ------- | ------- |
| Child Care Services | 642.3 | ------- | ------- | ------- |
| Home Services | 531.2 | ------- | ------- | ------- |
| Mental Health | 299.7 | ------- | ------- | ------- |
| Community Health and Prevention | 222.3 | ------- | ------- | ------- |
| Addiction Treatment Services | 146.3 | ------- | ------- | ------- |
| Income Assistance and Related Services | 93.3 | ------- | ------- | ------- |
| All other | 124.6 | ------- | ------- | ------- |
| Total | 4,036.9 | 2,543.7 | -1,493.2 | -37.0% |

* Lump-sum appropriation for FY 2011

Sources: Illinois Department of Human Services; House Bill 859.

**Table 6: Department of Human Services, Estimated General Funds Spending for Child Care, FY 2009**

| | $ millions | Pct. distribution |
|---|---|---|
| Federal | 202.2 | 31.4% |
| TANF Block Grant | 139.0 | 21.6% |
| Child Care and Development Fund (CCDF)* | 62.0 | 9.6% |
| Social Services Block Grant | 1.2 | 0.2% |
| State | 442.5 | 68.6% |
| TANF Maintenance-of-Effort | 296.3 | 46.0% |
| CCDF Maintenance-of-Effort | 56.9 | 8.8% |
| CCDF State Matching Funds | 71.7 | 11.1% |
| Other state funds** | 17.6 | 2.7% |
| Total | 644.7 | 100.0% |

* An additional $138.5 million from CCDF was spent outside the General Funds.

** Includes FY09 Budget Relief Fund.

Sources: Illinois Office of the Comptroller; Illinois Department of Human Services.

In addition to providing funding for income assistance and child care services, the TANF block grant and state MOE funds have been used to support several smaller DHS programs, including Healthy Families Illinois, Parents Too Soon, Teen REACH, Teen Parent Services, and Domestic Violence Shelters and Services (see Table 7). All of these programs had their funding cut in FY 2010 — in some cases, below the reported amount of TANF and MOE funds used for the programs in federal FY 2009. This would require shifting some TANF and MOE funds to other programs.

Federal health care reform legislation includes new funding for home visiting programs such as Healthy Families and Parents Too Soon. Illinois is eligible for about $50 million over the next five years, but the state must meet certain MOE requirements, which also apply to some expenditures from the Early Childhood Block Grant in the ISBE budget.

**Table 7: Department of Human Services, Selected Programs Receiving TANF/MOE Funds, Federal FY 2009 (in $1,000s)**

| | FFY 2009 TANF | FFY 2009 MOE | FFY 2009 Total | SFY 2009 GRF/BRF expend. | SFY 2010 Revised budget |
|---|---|---|---|---|---|
| Domestic Violence Shelters & Services | 17,339 | 0 | 17,339 | 21,580 | 19,432 |
| After School Youth Support (Teen REACH) | 16,306 | 0 | 16,306 | 18,055 | 15,714 |
| Healthy Families | 8,393 | 0 | 8,393 | 11,126 | 10,123 |
| Parents Too Soon | 7,464 | 0 | 7,464 | 7,707 | 6,940 |
| Teen Parent Services | 948 | 8,756 | 9,704 | 6,682 | 5,996 |

Sources: Illinois Department of Human Services; Governor's Office of Management and Budget

Federal funding does not guarantee immunity from budget cuts, but federal MOE and matching requirements could limit the damage. DHS programs and services that are funded primarily with state revenue are likely to be in much greater jeopardy. For example, the role of Medicaid in financing mental health services is substantially smaller than for developmental disability services. GRF appropriations for community mental health services were cut by 17 percent in FY 2010 and were slated for another reduction of 23 percent in the Governor's recommended budget for FY 2011. The FY 2011 proposal reflected reductions in capacity grants for community providers and the elimination of non-Medicaid mental health services.

Another especially vulnerable part of the DHS budget is youth services, including Comprehensive Community-Based Youth Services, Community Youth Services, Homeless Youth Services, Juvenile Justice Reform, Unified Delinquency Intervention Services, and Delinquency Prevention. GF appropriations for most of these programs, which do not receive federal funding, were cut by more than 20 percent between FY 2008 and FY 2010 and were designated for additional cuts in the Governor's FY 2011 budget proposal.

## Department of Children and Family Services

The lump-sum appropriations for the Department of Children and Family Services (DCFS) would reduce its state funding by one-third. Because of federal mandates, however, most of this shortfall ($286 million) is likely to be restored by the Governor. DCFS operates under various consent decrees arising from class action lawsuits — most notably, *B.H. v. McDonald*, which mandated that Illinois maintain an acceptable level of child protection and foster care services. Last year, when the General Assembly was considering a "doomsday budget" for FY 2010, a federal court order prohibited the state from implementing DCFS budget cuts that would violate the B.H. decree. The court order required the state to maintain existing payments to foster parents and relative caregivers, adoption subsidies, caseload ratios for caseworkers, and clinical and social assessments for children, as well as medical, psychiatric, counseling, and other services.

### Department on Aging

Lump-sum appropriations for the Department on Aging (DOA) would be 52 percent below FY 2010 funding levels. More than 90 percent of the GF budget for DOA goes to the Community Care Program (CCP), which provides in-home and community-based services to seniors who might otherwise need nursing home care. Since 1984, CCP has operated under a consent decree (*Benson v. Blaser*), which eliminated a long waiting list for services and mandated timely eligibility determination and enrollment. About two-thirds of current CCP participants are covered by Medicaid.

## EMERGENCY BUDGET POWERS

The final FY 2011 budget will be determined not only by the Governor's allocation of lump-sum appropriations, but also by provisions of the "Emergency Budget Act of Fiscal Year 2011" (SB 3660), which gives the Governor broad authority to institute changes in state programs and control state spending. Emergency budget powers through January 9, 2011 (the last day of Governor Quinn's current term in office) include the following:

> *Contingency reserves*: The Governor is authorized to set aside "contingency reserves" from FY 2011 appropriations from the General Funds or special state funds. Most state agencies — except for other constitutional officers, the legislative and judicial branches, the Executive Inspector General, and the Executive Ethics Commission — could be affected. The total amount of contingency reserves is limited to one-third of the amount of unpaid vouchers and outstanding statutory transfers at the beginning of FY 2011. This means that the Governor could hold back appropriations of about $2 billion.
>
> *Expenditures subject to appropriation*: All expenditures for state programs, including expenditures that are generally regarded as mandatory, will be subject to available FY 2011 appropriations.
>
> *Emergency rule-making*: State agencies are given authority to adopt emergency rules to implement the FY 2011 budget. The normal process, as outlined in the Illinois Administrative Procedure Act, requires a 45-day public notice period, a public hearing if requested by certain parties, and review by the legislature's Joint Committee on Administrative Rules. An emergency rule becomes effective immediately or within days after filing and may remain effective for up to 150 days.

## THE REVENUE SIDE

On the revenue side of the budget, the General Assembly has again failed to go beyond stop-gap measures. Governor Quinn's proposal for a 1 percent income tax surcharge earmarked for education garnered virtually no support. Another revenue measure — House Bill 174 — would raise the state income tax to 5 percent, increase the standard exemption, triple the state earned income tax credit, and double the residential property tax credit, as well as expand the base of the state sales tax to cover more consumer services. This legislation was passed by the State Senate in May of last year and was still a legislative option, but it was never brought up for a vote in the House of Representatives.[4]

The General Assembly did pass a tax amnesty plan that would produce an estimated $250 million. Senate Bill 377 creates a new tax amnesty period from October 1 to November 8, 2010. The legislation eliminates any interest or penalties applicable for those who still owe taxes for the period between June 30, 2002 and July 1, 2009 — but only if the back taxes are paid in full during the amnesty period.

A substantial portion of anticipated revenue from the tax amnesty plan will be lost as a result of a back-to-school sales tax holiday (SB 3658). From August 6 to August 15, 2010, clothing, sports equipment, school supplies, textbooks, selected computer accessories, and other similar items will be exempt from the 5 percent state sales tax. The sales tax holiday will cost the state about $50 million.

### Tobacco Settlement Revenue

In November 1998, Illinois was one of 46 states to sign the Master Tobacco Settlement Agreement with major tobacco companies. (Four other states had previously reached separate agreements.) The various state lawsuits were based largely on compensation for Medicaid and other health care costs arising from treatment of smoking-related illnesses. Illinois began to receive its share of payments in December 1999. These funds can be used for almost any purpose. In FY 2009, the state received $340 million for the Tobacco Settlement Recovery Fund, most of which was used to leverage federal Medicaid matching funds for prescription drug coverage (see Table 8).

**Table 8: Tobacco Settlement Recovery Fund, Revenue and Expenditures (in $ millions)**

| | FY 2008 | FY 2009 | FY 2010 (est.) |
|---|---|---|---|
| Revenue | | | |
| Tobacco settlement payments | 310.0 | 340.2 | 315.0 |
| Balance from previous year | 12.8 | 16.1 | 11.9 |
| Investment income | 2.0 | 0.8 | 0.3 |
| Federal Medicaid matching funds | 229.2 | 452.5 | 460.7 |
| Total | 554.0 | 809.5 | 787.9 |
| Expenditures | | | |
| Department of Healthcare and Family Services | 511.6 | 766.6 | 733.5 |
| Department of Public Health | 15.3 | 16.9 | 17.9 |
| Department on Aging | 8.0 | 8.0 | 8.1 |
| Department of Human Services | 2.4 | 2.4 | 2.4 |
| Other | 1.0 | 3.8 | 1.1 |
| Total | 538.3 | 797.7 | 762.9 |

Sources: Illinois Office of the Comptroller; Governor's Office of Management and Budget

The Emergency Budget Act authorizes the state transfer of some of its expected tobacco settlement revenues in exchange for up-front payments (a process known as “securitization”). The Governor would appoint a three-member “Railsplitter Tobacco Settlement Authority,” including the director of the Governor’s Office of Management and Budget. The Authority would issue bonds — in an

[4] Even a modest increase in cigarette taxes, which was passed by the Senate last April (SB 44), did not gain approval in the House.

amount no greater than $1.75 billion — backed by the revenue stream from the tobacco settlement. The revenue bonds would mature not more than 19 years after the date of issuance. Because bond buyers would assume the risk of declining tobacco settlement revenue, the bonds would be sold at a "discount." Based on the experiences of other states, Illinois would receive up-front payments that are significantly lower than the expected revenue over time.[5] The net proceeds from the issuance of tobacco settlement bonds has been estimated at about $1.2 billion.

### Interfund Borrowing

In every fiscal year since FY 2003, the state has made transfers from special state funds to the General Funds as a tool for reducing budget deficits. These special fund transfers have taken various forms, including "fund sweeps" and "administrative charge-backs." In FY 2009, fund sweeps went into a "Budget Relief Fund" to restore cuts in appropriations for specific agencies and programs. In FY 2010, fund sweeps into the General Revenue Fund totaled $352 million.

The General Assembly did not approve any fund sweeps for FY 2011, but the Emergency Budget Act authorizes interfund borrowing. The Governor can make transfers to the General Revenue Fund or Common School Fund from special state funds — to the extent allowed by federal law. The originating funds must be reimbursed (with interest) within 18 months (i.e., during FY 2012). The amount of interfund borrowing is estimated to be $1 billion, but the state is not likely to have an extra $1 billion in the FY 2012 budget.

## PENSION CONTRIBUTIONS

In April, the Governor signed pension legislation (Senate Bill 1946) that will raise the retirement age and reduce benefits for new employees hired after January 1, 2011. According to the Commission on Government Forecasting and Accountability (CGFA), the total mandated pension contribution for FY 2011 under prior law was $4.57 million. As a result of SB 1946, the required contribution was reduced to $3.52 billion (about 90% from the General Funds). The long-term savings through FY 2045 would be more than $75 billion.

Nonetheless, the issue of required FY 2011 contributions to the state retirement systems remains unresolved. The House of Representatives has narrowly approved legislation (SB 3514) that authorizes additional borrowing to cover scheduled contributions for next year, but the votes needed for the required three-fifths majority have not been found on the Senate side. The Senate, but not the House, passed legislation (HB543) that would suspend continuing appropriations for state pension contributions until the Governor certifies that adequate funds are available.

The reluctance to engage in more borrowing is understandable, but skipping state contributions would be even more fiscally irresponsible. CGFA estimates that a "pension holiday" in FY 2011 would cost the state an additional $12.4 billion between FY 2012 and FY 2045.[6]

## CONCLUSION

The General Assembly's inability to enact a responsible budget will exacerbate the state's burgeoning fiscal firestorm. Legislators from both parties have chosen maneuvering for short-term political

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[5] See, e.g., House Research Organization, Texas House of Representatives, "Securitizing Texas' Tobacco-Settlement Receipts," *Interim News*, February 4, 2002; Wisconsin Legislative Fiscal Bureau, "Tobacco Settlement and Securitization" (January 2009).

[6] Dan Hankiewicz, "Fiscal Impact of a FY 2011 Pension Holiday," *Monthly Briefing* (Commission on Government Forecasting and Accountability, May 2010).

advantage over policymaking for the long-term common good. And too many public opinion leaders have failed to make a constructive contribution to the debate over the state fiscal crisis.

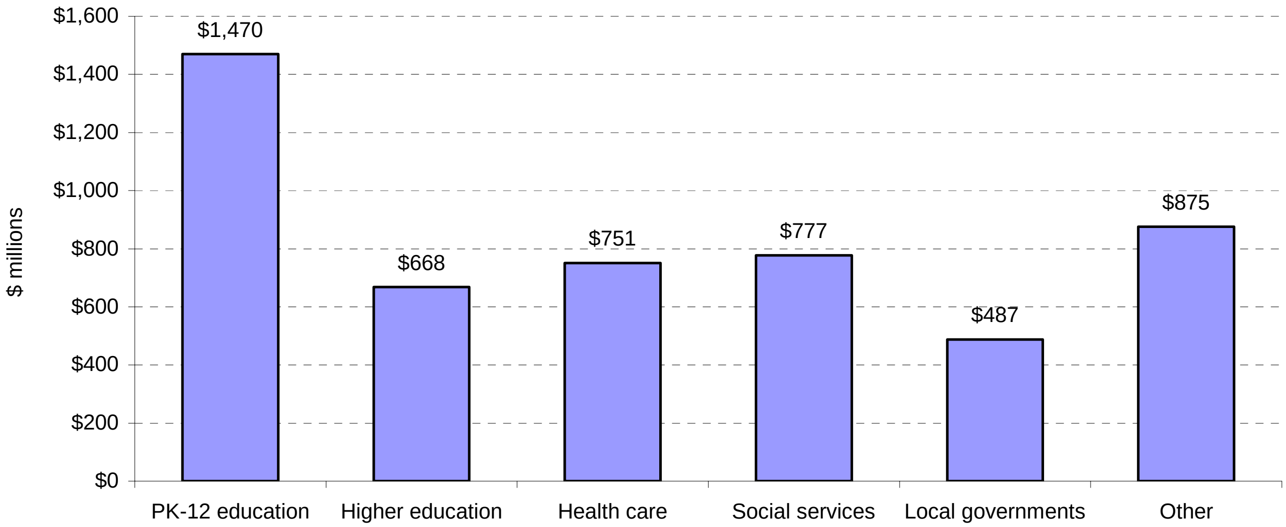
Before legislative changes were enacted during the spring session, the cumulative GF deficit for FY 2011 was about $13.6 billion, including a projected operating deficit of $7.6 billion and a carryover deficit of $6 billion. The various changes in required pension contributions, state agency appropriations, and expected revenue from income taxes and sales taxes, together with the authorization of tobacco settlement revenue bonds and interfund borrowing, still leave a one-year operating deficit of $3.8 billion and a cumulative deficit of $9.8 billion (see Table 9). If the state were to avoid pension contributions through additional borrowing or outright deferral, the FY 2011 operating deficit would be reduced to $620 million and the cumulative deficit to about $6.6 billion. Under either scenario, the backlog of unpaid bills will grow, and the disintegration of public services will continue. Moreover, some of the stop-gap revenue measures for FY 2011 will exacerbate budget problems in the future fiscal years.

**Table 9: Revised Estimate of General Funds Budget Deficit for FY 2011 (in $ millions)**

| | |
|---|---|
| Cumulative deficit before legislative changes | $13,640 |
| FY 2011 operating deficit before legislative changes | 7,620 |
| Reduction in state agency appropriations (HB 859 and SB 3660) | -440 |
| Pension changes (SB 1946) | -960 |
| Income tax amnesty (SB 377) | -250 |
| Sales tax holiday (SB 3658) | +50 |
| Tobacco settlement bonds (SB 3660) | -1,200 |
| Interfund borrowing (SB 3660) | -1,000 |
| Revised operating deficit | 3,820 |
| Carryover deficit from FY 2009 and FY 2010 | 6,020 |
| Cumulative deficit | 9,820 |
| Deficit without FY 2011 pension contributions | |
| Revised operating deficit | 3,820 |
| Pension borrowing or “pension holiday” | -3,200 |
| Operating deficit without pension contributions | 620 |
| Carryover deficit from FY 2009 and FY 2010 | 6,020 |
| Cumulative deficit | 6,640 |

The FY 2011 budget passes the buck to the Governor to make decisions about allocating lump-sum appropriations, ordering contingency reserves, and instituting emergency rules — decisions that will entail painful budget cuts. By ignoring the huge backlog of unpaid bills, lawmakers have also passed the buck to educators, service providers, and local communities. The backlog now exceeds $5 billion, including $1.47 billion in delayed payments to public school districts (see Figure 1). Required payments for General State Aid have been made twice a month, but the state is far behind in quarterly payments for mandated categorical grants. The state also owes hundreds of millions of dollars to higher education agencies, health care providers, social service agencies, and local governments (see Figure 1). These "de facto" budget cuts have already caused staff lay-offs, service reductions, and elimination of state-funded programs in many communities. In FY 2011, the situation will only get worse.

**Figure 1: State of Illinois, Backlog of Unpaid Bills as of June 14, 2010 (in $ millions)**




Total: $5,027 million

Source: Illinois Office of the Comptroller

One immediate result of the enacted FY 2011 budget is that the state's rating for general obligation bonds has been downgraded. A report from Moody's Investors Service cites the state's failure to find a long-term solution to its financial problems: "This failure underscores a chronic lack of political will that indicates further erosion of an already weak financial position." The report warns about the dangers of continuing to avoid difficult decisions: "The longer the solution to the state's challenges are deferred, the more difficult they will become."[7]

Policymakers have missed another window of opportunity to fashion a responsible and balanced solution to the state budget crisis. The key elements of such a solution must include a significant amount of new revenue, appropriate spending restraints, and meaningful fiscal reforms. Illinois must decide what kind of state it wants to be: one that meets its fiscal and social responsibilities or one that undermines its own future by allowing the erosion of essential programs and services for children, families, and communities.

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[7] Doug Finke, "Moody's Downgrades State Bond, Revenues Continue Slide," *State Journal-Register*, June 7, 2010. Illinois was also downgraded by Fitch Ratings. See Dave McKinney, "State Credit Rating Downgraded," *Chicago Sun-Times*, June 15, 2010.

## About Voices for Illinois Children

Voices for Illinois Children works across issue areas to improve the lives of children of all ages throughout our state so they grow up healthy, nurtured, safe, and well-educated. For more than 20 years, Voices has been helping opinion leaders and policymakers understand the issues facing children and families. The Voices network weaves through the state, engaging community leaders and people who care passionately about children.

## About the Budget & Tax Policy Initiative

The Budget & Tax Policy Initiative (BTPI) provides information and analysis to advocates and policymakers on a wide range of spending and revenue topics that affect the lives of children and families in Illinois. BTPI is part of the State Fiscal Analysis Initiative, a network of organizations coordinated by the Center on Budget and Policy Priorities in Washington, D.C.

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