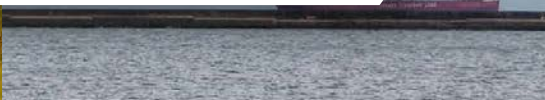




RESTORE ILLINOIS:

A FOUNDATION FOR GROWTH

February 2019



Civic Committee
COMMERCIAL CLUB OF CHICAGO





Civic Committee

COMMERCIAL CLUB OF CHICAGO

The Civic Committee of the Commercial Club of Chicago

The Civic Committee is composed of the senior leaders of the Chicago region's leading employers. Its mission is to improve the Chicago region as a place to live, work, and conduct business.

We have a strong history of taking on broad, systemic issues that impact the Chicago region and Illinois and call for a sustained effort. These projects change over time and currently include efforts to:

- ★ Restore the State of Illinois to fiscal stability;
- ★ Improve the educational system in Chicago for all who live here;
- ★ Solidify Chicago's position as a global transportation hub;
- ★ Grow Chicago's position as a top-tier technology ecosystem that promotes inclusive economic growth;
- ★ Help organizations become veteran-friendly employers.

We also work closely with the organizations we have helped create over our history:

- ★ The Civic Consulting Alliance builds pro bono teams of business experts, government leaders, and its own professional staff to work on transformative public sector challenges, such as reducing crime, increasing the availability of high-quality healthcare, improving the educational system, and promoting economic growth.
- ★ Kids First Chicago is dedicated to ensuring Chicago's public school system provides high-quality, accessible options for all Chicago families.

Tax Policy Task Force

The Civic Committee formed the Tax Policy Task Force in the summer of 2015 to examine the fiscal challenges facing the State of Illinois and to propose solutions. The Task Force issued its previous report, *Bringing Illinois Back: A Framework for our Future*, in May 2017.

This report, *Restore Illinois: A Foundation for Growth*, is an update and expansion of *Bringing Illinois Back* and presents the ongoing work of the Task Force to address the State's financial situation.

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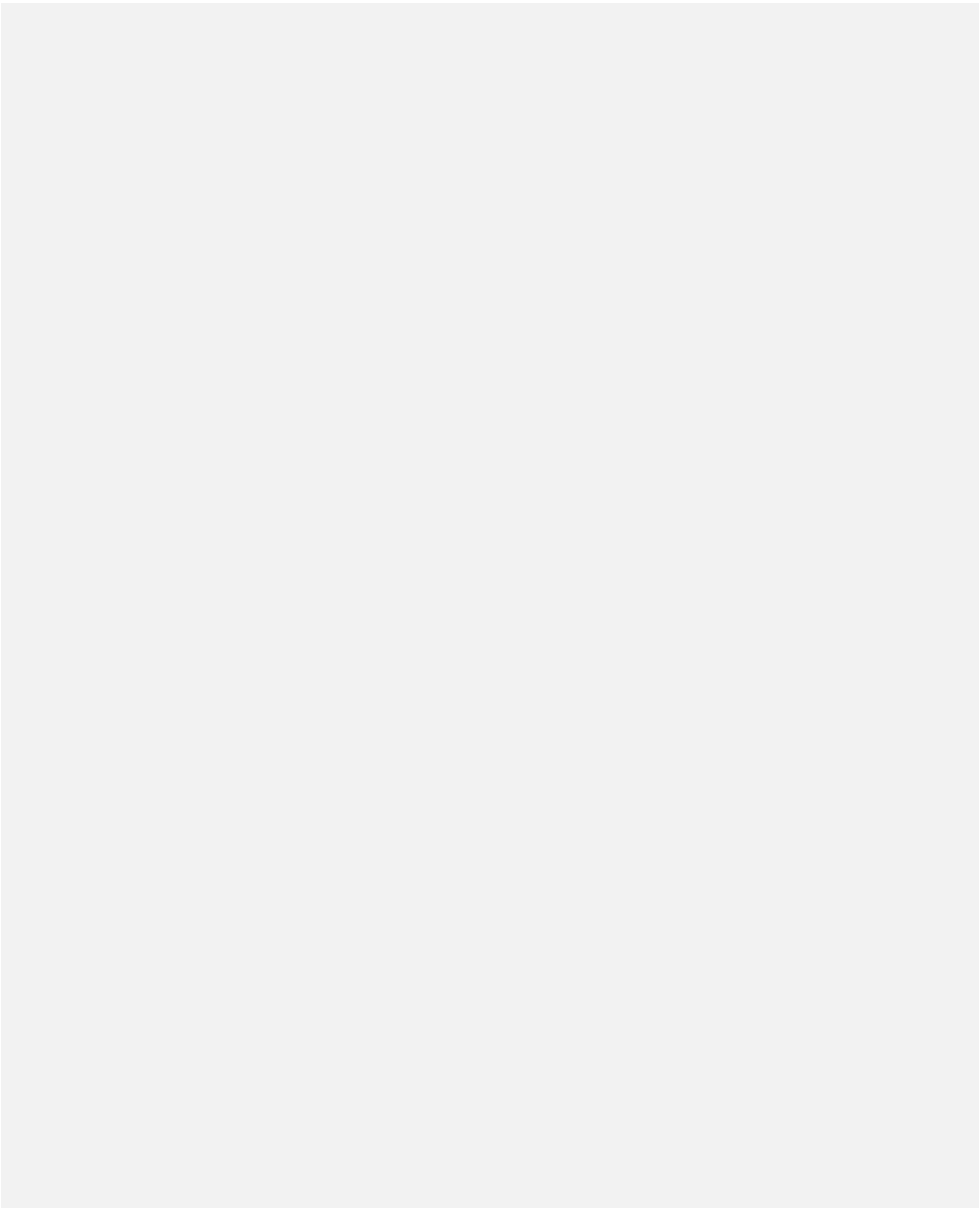
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Restore Illinois:

A Foundation for Growth

Executive Summary



Illinois is a world-class place to live, work, and do business.

The State's economy is one of the largest in the world and represents a diverse mix of industries.¹ The City of Chicago, the economic engine of the Midwest, has been the top city in the United States for direct foreign investment for the last six years² and was the top location for corporate relocations and expansions in 2017.³ The State's workforce is skilled and well-educated, with approximately one-third of the State's workforce holding at least a bachelor's degree.⁴ In addition, Illinois' central location and diversified transportation network have solidified the State as an essential transportation hub for the entire country.

Despite Illinois' many competitive advantages, it faces significant challenges. The State's fiscal uncertainty and instability hurt our economy and cause many families and businesses to leave Illinois and others not to come here. Illinois' population has declined each year from 2014-2018, and population loss as a percentage of the State's population for 2017-2018 was second highest in the nation behind West Virginia. These challenges have been abundantly covered by local, national, and global media and shape a negative narrative of Illinois.

Given this context, Civic Committee leadership has grown increasingly concerned about the deterioration of the State's finances and its effect on the jobs climate. As a result, in 2015 Civic Committee leadership created a Tax Policy Task Force ("Task Force") to analyze the State's financial challenges and identify tax and budget policies to address them. The Task Force met with a variety of tax policy and state finance experts and developed a financial framework ("Framework") for the State of Illinois that if implemented fully would put the State government back on the path to fiscal solvency and help restore confidence in the State's fiscal future.

In 2017, the Task Force released *Bringing Illinois Back: A Framework for our Future*. This report addressed the key issues facing the State and included the Task Force's Financial Framework, as well as several additional reforms to improve the jobs climate.

The State has made progress on many fronts, but there is still a long way to go to ensure stability and certainty in the State's jobs climate going forward. In addition, having a new Governor and General Assembly presents an opportunity to pursue the bold

action necessary to stabilize Illinois' finances and lay a foundation for economic growth. As a result, the Task Force has produced an updated and expanded report, *Restore Illinois: A Foundation for Growth*, to evaluate the progress that has been made since 2017 and to identify actions that still need to be taken by State government to improve its financial standing and jobs climate.

The Task Force selected a five-year time frame for full implementation of our recommendations, reflecting our belief that swift and comprehensive action is required to improve Illinois' fiscal health and combat the narrative that the State is a questionable choice to live, work, and do business.

Although we recognize that not every recommendation may be adopted on the schedule we have prescribed, some policy prescriptions should be a higher priority, such as eliminating the structural budget deficit and increasing contributions to the State's pension funds up front to stop the growth in the State's pension debt faster than under the current schedule. The key is instituting a plan that will achieve our recommendations in a defined time frame rather than deferring action on critical issues to the future.

While this report focuses primarily on State finances, we recognize that the impact of solutions to the State's problems will not occur in a vacuum and that Illinois taxpayers are already burdened by high taxes, particularly property taxes. Our

recommendations focus on the areas in which the State has room to make changes without increasing its negative outlier status in order to mitigate the overall impact on the State's jobs climate and Illinois taxpayers wherever possible.

This report represents a comprehensive set of recommendations that can be enacted immediately. These recommendations do not require constitutional amendments, which at the earliest would take several years to go into effect because *it is critical that the State move forward with implementing fiscal reforms now to ensure Illinois is on a viable path to fiscal health and stability*. If the State enacts these reforms, Illinois will have addressed its financial challenges and given people and businesses certainty about the State's future, which is a critical element in promoting job growth in Illinois. Without a growing economy, the State will not be able to move forward to provide vital services to all Illinoisans and focus on other future growth initiatives.

Although there have been several policy changes enacted since we published *Bringing Illinois Back*, the legislature has not yet implemented many of the recommendations of the Framework. We continue to believe that the State should adopt the Financial Framework created by the Task Force and pursue policy solutions consistent with it. Part 1 of this report provides an overview of the components of the Financial Framework.

It is critical that the State move forward with implementing fiscal reforms now to ensure Illinois is on a viable path to fiscal health and stability.

Part 1:

Civic Committee Financial Framework

The Financial Framework consists of five elements:

- ★ Implement long-term financial planning and increase fiscal transparency;
- ★ Eliminate the structural budget deficit and unpaid bills, establish a reserve fund, and implement a new funding plan to pay down the approximately \$130 billion in unfunded liabilities of the State's pension funds;
- ★ Scrutinize the entire State budget for spending reductions;
- ★ Reform the tax system to reduce Illinois' negative outlier status and raise revenues, as needed, in a way that minimizes the negative impact on Illinois' competitiveness; and
- ★ Establish goals and metrics to measure the State's progress.

The issues facing the State are interconnected, and the elements of the Financial Framework represent a balanced, comprehensive plan that reflects that interconnectedness. The State should adopt all elements of the Framework to maximize the effectiveness of reform efforts; piecemeal implementation may do more harm than good.

We believe that it will require \$8 billion a year in expenditure cuts and revenue increases over the next five years to put Illinois back on the path to financial stability.

Identifying \$8 billion a year will allow the State to fully eliminate the structural budget deficit, pay down the remaining bill backlog, establish an appropriate reserve fund, and properly address the State's unfunded pension liabilities.

Pursuing these policies, in turn, will lay the groundwork for an upgrade in the State's credit rating to AA. This is a goal of the Task Force not only because it will reduce the cost of borrowing for the State, but, more fundamentally, because the rating is a measure recognized throughout the world of the State's fiscal health and stability.

The Financial Framework does not specifically address a capital budget. Nevertheless, the Task Force recognizes that the State has significant capital needs that should be addressed in the near term. For example, the Regional Transportation Authority (RTA) estimates it will need \$38 billion over 10 years to bring the mass transit system in the Chicago metropolitan region into a state of good repair.⁵ In addition, the Illinois Department of Transportation estimates that it will require \$1.7 billion each year to maintain existing highway and transit infrastructure.⁶

We believe that the State should adopt a long-term, transparent capital investment plan that relies on recurring revenue sources and performance-based project funding so that future capital investments are strategic, well thought out, and sustainable. Developing such a plan will bolster Illinois' position as a key transportation hub and promote economic and job growth.

In addition to the Financial Framework described above, the Task Force has identified several additional reforms to improve the jobs climate which are detailed in Part 2:

- ★ Local Government Consolidation;
- ★ P-12 School Funding Reform; and
- ★ Workers' Compensation Reform.

Illinois' Current Performance

Illinois has many strengths and enjoys many competitive advantages over other states. Despite the State's numerous advantages, Illinois' economic growth has lagged its peers in recent years and compares unfavorably to other states in several significant ways:

- ★ In a March 2018 poll conducted by the Paul Simon Public Policy Institute at Southern Illinois University, 84% of respondents said that the State was headed in the wrong direction;⁷
- ★ Illinois' credit ratings, which serve as a useful proxy for a state's fiscal health, are the worst in the nation. Illinois' S&P credit rating (BBB-) sits one notch above a junk bond rating;⁸ and
- ★ Illinois ranks poorly compared to other states on key economic metrics. For example, Illinois is:
 - 41st out of the 50 states for year-over-year Gross State Product (GSP) growth (for 2016-2017); and
 - 36th out of the 50 states for year-over-year employment growth (for December 2017-December 2018).

The State needs to make significant changes in order to right its fiscal ship and reduce uncertainty for job creators. The elements of the Civic Committee's Financial Framework identify the changes Illinois needs to make and are based on best practices of successful states.

It is important to note that the policy options described throughout the report assume the current state of affairs; that is, they do not require constitutional changes to implement. We do not rely on policy changes that would require a constitutional amendment – such as

implementing a graduated income tax or adjusting pension benefits for current plan participants – since passing any amendment would be a challenging, multi-year process, and delays will only make the State's fiscal challenges greater.

I. Implement long-term financial planning and increase fiscal transparency

Compared to other states, Illinois' financial planning processes are incomplete and opaque. Budget documents tend to focus on the General Funds budget, which includes only about half of the State's spending. Revenue and expenditure forecasts vary depending on which source they come from (the Governor's Office of Management and Budget or the Commission on Government Forecasting and Accountability) and rarely include projections beyond three years. In addition, the State frequently uses short-sighted budgetary practices – such as one-time revenues, interfund borrowing, and borrowing to fund current operations – to “balance” the State's budget.

To identify best practices of other States, we have used the Volcker Alliance's *Truth and Integrity in State Budgeting* report (issued in 2017) as a starting point. The report focuses on five key areas (budget forecasting, budget maneuvers, legacy costs, reserve funds, and transparency) and grades states based on their specific policy practices.

The Civic Committee's recommendations for improving Illinois' financial planning processes and transparency are consistent with the best practices outlined in the Volcker Alliance report. Our recommendations include:

- ★ Establishing clear financial objectives and articulating metrics that will illustrate progress towards those goals in both the short and long terms;

- ★ Focusing on long-term (at least five-year) financial projections for revenues and expenditures;
- ★ Scrutinizing all funds under the control of the State during budget negotiations (including General Funds and Other State Funds, as well as revenue-sharing with local governments);
- ★ Ensuring that expense forecasts accurately and completely reflect the full expected costs of programs;
- ★ Creating consensus revenue forecasts that do not rely on one-time revenues to balance the budget and focus on sustained revenue sources;
- ★ Producing timely financial statements that report revenues and expenses (as well as assets and liabilities) that are updated at key points of the budget cycle;
- ★ Including baseline budgets in budget documents that show projected revenues and expenditures absent major policy changes; and
- ★ Publishing the aggregate State pension contribution (from General Funds and Other State Funds) as well as standard pension contribution benchmarks (e.g.,

the Normal Cost plus Interest payment) so stakeholders can evaluate the adequacy of the State's pension contribution and see how current funding compares to that benchmark and how it impacts the total amount of pension liabilities.

II. Eliminate the budget deficit and unpaid bills, establish a reserve fund, and implement a new funding plan to pay down the State's \$130 billion unfunded pension liability

In order to reach financial stability over the next five years, the State needs to right-size its budget and eliminate the structural budget deficit, pay down the remaining bill backlog, establish a reserve fund, and implement a new pension funding plan.

Since the increase in personal and corporate income taxes at the beginning of FY18, the structural deficit is much smaller than it was when we published *Bringing Illinois Back*. Nevertheless, it has not been completely eliminated. As shown in Table 1 below, the State's annual structural deficit is projected to be as much as \$3.4 billion from FY19-24.

Table 1: Baseline General Funds Budget (\$ Millions)

FISCAL YEAR	ESTIMATED 2019	PROJECTED 2020	PROJECTED 2021	PROJECTED 2022	PROJECTED 2023	PROJECTED 2024
Total General Funds Revenue	\$37,985	\$37,874	\$38,451	\$39,409	\$40,501	\$41,496
Total General Funds Expenditures	\$39,029	\$40,637	\$41,885	\$42,685	\$43,700	\$44,771
Surplus/(Deficit)	(\$1,044)	(\$2,763)	(\$3,434)	(\$3,276)	(\$3,199)	(\$3,275)

Source: Governor's Office of Management and Budget, "General Funds Financial Walk Down FY19-FY24."

As a result of past budget deficits and the two-year budget impasse, the State still has unpaid bills that will have to be paid down, which will total approximately \$7.8 billion by the end of FY19.¹⁰

In addition, the State should implement a new pension funding plan that will speed up the time frame for getting to a point where contributions are sufficient to keep the unfunded liabilities from growing (“tread water”), is budget sustainable (will not significantly worsen crowding out of all other budget spending imperatives), and will amortize the remaining unfunded liability after the plans reach 90% funded. As described in the “Pension Reform” section, implementing our “2+2” Plan will require the State to contribute an additional \$2 billion a year beginning with the FY20 contribution.

Finally, the State should follow best practices of other states and establish a reserve fund to cushion against future budgetary shocks, including the potential impact of economic

downturns. Depending on the size of the State’s budget over the next five years (reserve fund requirements are frequently determined as a percentage of revenues or expenditures), a healthy reserve fund would be approximately \$4-5 billion.¹¹

Once the State eliminates the bill backlog and establishes an appropriate reserve fund, it should consider rolling back the recommended tax increases as well as evaluate its top fiscal priorities and allocate these resources as necessary to ensure a balanced budget, adequate spending on education, sufficient pension contributions, and appropriate levels of State services.

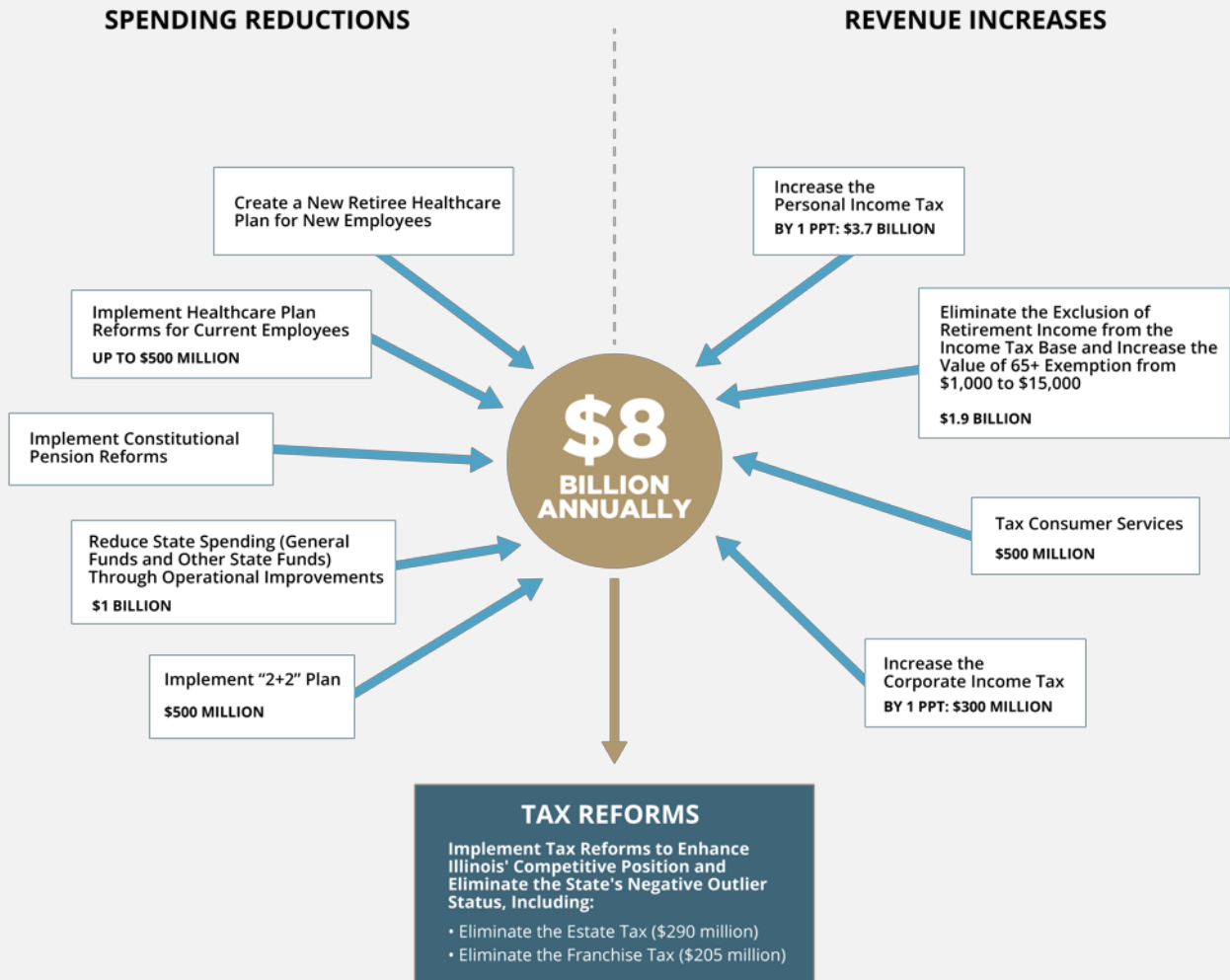
To achieve the goal of eliminating the budget deficit and unpaid bills, establishing a reserve fund, and implementing a new pension funding plan, the State will need to identify approximately **\$8 billion a year** in spending cuts and/or revenue increases from FY20-FY24, as summarized in Table 2 below.

Table 2: Summary of the Gap (\$ Millions)

FISCAL YEAR	PROJECTED 2020	PROJECTED 2021	PROJECTED 2022	PROJECTED 2023	PROJECTED 2024
Annual Deficit	\$2,763	\$3,434	\$3,276	\$3,199	\$3,275
Pay Down the Bill Backlog	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500
Establish a Reserve Fund	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000
Incremental Pension Funding	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000
TOTAL GAP	\$7,263	\$7,934	\$7,776	\$7,699	\$7,775

Figure A below shows several policy options that could be implemented to reach this goal.

Figure A: Elements of a Solution



Pension Reform

The challenges facing Illinois' public pension systems – massive unfunded liabilities, extremely low funded ratios, and annual contributions that are crowding out other State spending – are significant and well known. Across all five pension systems, unfunded liabilities total roughly \$130 billion, and the funded ratio is only 40%.¹² In addition, pension contributions currently account for nearly 20% of the General Funds budget,¹³ a share that will likely increase as the State's statutorily required pension contributions continue to grow over the next 26 years.

When the State adopted its current pension contribution schedule, it was designed in a way that shifted costs to the future. The schedule has been in place for 24 years, but to date, *the State's pension contributions have not reached a level sufficient to keep the unfunded liabilities from growing*. Instead, it relies on higher contributions in the final years of the schedule to amortize the unfunded liabilities; pension contributions will grow at a 3.3% compound annual growth rate until they reach approximately \$19.5 billion in FY45 (approximately \$10 billion in 2018 dollars).¹⁴ Unless the State's budget growth keeps pace with or exceeds the pension contribution growth, it will become increasingly difficult to make the statutorily required pension contributions without severely cutting services, raising taxes to unreasonable levels, or some combination of both.

The status quo is not sustainable, and the State needs to reform its public pensions. However, options to reduce the unfunded liability are limited due to constitutional constraints and the recent Illinois Supreme Court decision that overturned benefit reforms. Future reforms should expand their focus to include creating a credible plan for paying down the unfunded liabilities of Illinois' pension systems, while also mitigating the negative impact of pension contributions on the provision of important government services.

Any new funding plan the State pursues should meet the following criteria:

- ★ Structure contributions in a budget sustainable manner that will not significantly worsen crowding out with extremely high, back-end loaded contributions;
- ★ Increase pension contributions up front so that contributions reach the point at which contributions are sufficient to keep the unfunded liability from growing faster than under the current schedule; and
- ★ Provide a plan to amortize the remaining unfunded liability after the funds reach 90% funded.

"2+2" Plan

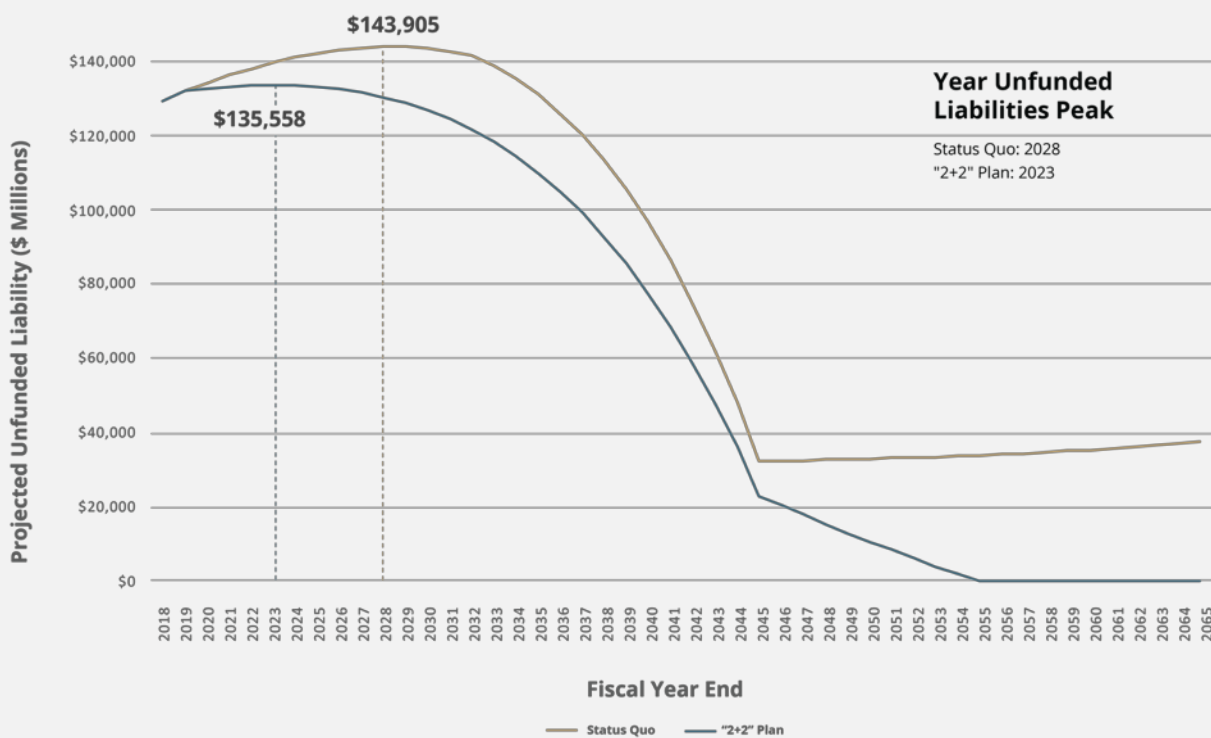
The Civic Committee recommends the "2+2" Plan, which meets the above requirements. The "2+2" Plan would restructure the pension contribution schedule so that the State's baseline contributions would grow at 2% a year (which translates to a roughly \$500 million reduction in the projected FY20 contribution under the current schedule) and the State would provide an additional \$2 billion in supplemental contributions until the plans are 90% funded. Then, this plan would amortize the remaining unfunded liability over 10 years. Under the "2+2" Plan, the State's pension plans are projected to reach 93% funded by FY45. The "2+2" Plan also produces total financial benefits of approximately \$46 billion. The State's contributions over time (FY20-FY65) would be about \$8.6 billion less in real dollars than

under the current status quo contribution schedule. And the "2+2" Plan would eliminate the State's unfunded pension liability, which under current policy is projected to be \$37.7 billion in FY65.

Another benefit (as shown in the graph below) is that not only are the State's pension funds projected to reach the "tread water" level faster, but under the "2+2" Plan, the unfunded liability is projected to peak at a lower level than under the Status Quo pension schedule. It would remain lower than the projected unfunded liability for the Status Quo pension schedule for all years.

Additionally, the State should consider making changes to pension fund governance to ensure that funds are held to high standards (which may, in turn, lead to higher returns and/or funding levels).¹⁵

Figure B: Unfunded Liability Comparison, Status Quo Contribution Schedule vs. "2+2" Plan



III. Scrutinize the entire State budget for spending reductions

The State should intensify its focus on identifying opportunities for savings in the State budget. These savings should be generated through improving the efficiency of service provision and ensuring that resources are directed to the State's highest-priority programs.

General Funds Savings: Group Health Insurance for Active Employees

The State Employees' Group Insurance Program (SEGIP) provides medical, dental, vision, and life insurance coverage to the following (and their dependents): active State employees, elected State officials, and State university employees. It also provides retiree healthcare benefits for members of the State's five pension plans (and their dependents) except for retirees eligible for coverage through the Teachers' Retirement Insurance Program (TRIP) or College Insurance Program (CIP). Total costs for SEGIP in FY18 (excluding interest costs) totaled approximately \$2.8 billion, with medical care coverage accounting for approximately 85% of the total.¹⁶

As part of recent contract negotiations, reforms were proposed that would require employees to pay a larger share of their healthcare costs in order to reduce the medical care coverage costs to the State for active employees. These reforms would establish a multi-tiered system that offered plans with different combinations of monthly premiums and plan benefits (including out-of-pocket costs such as deductibles and co-pays) that employees could choose from. The tiers range from "bronze" plans that would require no employee premium contribution but would have higher out-of-pocket costs than

current plans to "platinum" plans that would require significantly higher employee premium contributions to maintain current plan benefits. This proposal was projected to save the State approximately \$470 million for FY19;¹⁷ however, contract negotiations were at a stalemate and the subject of litigation, so the proposal was not enacted. We support the State reforming and re-designing employee healthcare plans to retain solid benefits for State employees, but make them more consistent with the benefits received by private sector employees.

General Funds Savings: Create a New Retiree Healthcare Plan for New Employees

Retiree healthcare under SEGIP provides another avenue of potential savings. Currently, retirees receive a 5% premium subsidy for every year of creditable service (i.e., retirees with 20 years of creditable service receive a 100% premium subsidy). As a result, they tend to pay a very small portion of their healthcare costs. (For FY19, retired SEGIP enrollees are projected to pay only 6.3% of their healthcare costs.)

The State has attempted to change the premium subsidy in the past, but the *Kanerva v. Weems* case held that the State's subsidies toward the cost of retiree healthcare coverage are constitutionally protected and cannot be diminished or impaired. However, the ruling does not apply to new employees, and the State could create a separate retiree healthcare plan for new employees with a reduced premium subsidy structure that would be applied going forward. It is unclear how much the State could save from reducing the premium subsidy for new employees, but the State should pursue the implementation of a separate retiree healthcare plan for new employees.

Other Expenditure Reduction Opportunities

The State also should expand the frame of the budget beyond the General Funds to include Other State Funds. Currently, budget negotiations focus on the General Funds, which ignores nearly half of total State spending. This narrow view of the State budget can be misleading when analyzing total programmatic spending, since several key State programs receive funding from a combination of General Funds, Other State Funds, and federal funds. Looking only at the General Funds portion of spending will give an incomplete picture of programmatic spending. The State should adopt an All Funds budget model that aggregates General Funds and Other State Funds into a smaller number of revenue and spending categories.

Local government revenue sharing also should be scrutinized. Illinois has nearly 7,000 units of local government, by far the most of any state, and many of these governments receive significant funding from the State each year (such as through the Local Government Distributive Fund). The lack of transparency into most local government finances makes it nearly impossible to thoroughly review their revenues and expenditures, which suggests that there are opportunities to improve efficiency and reduce the need for revenue through measures like shared services, joint purchasing, and consolidation. Local government consolidation will have the largest savings impact on local revenue sources (e.g., property taxes), but consolidation could eventually produce savings for the State.

IV. Reform the tax system to reduce Illinois' negative outlier status and raise revenues, as needed

A state's tax climate is an important consideration for businesses deciding where to expand or locate and for individuals deciding where to live. It is important that Illinois' tax structure is carefully designed so that it raises sufficient revenues to pay for critical programs without making the State an outlier.

Despite the many changes to the tax system that occurred when the FY18 budget was enacted, there are still several ways in which Illinois is an outlier compared to other states:

- ★ Other states levy taxes that Illinois does not;
- ★ Illinois imposes some taxes that other states do not; and
- ★ Illinois has burdensome administrative procedures.

The Task Force's policy recommendations reflect the need to make Illinois less of an outlier compared to other states while raising sufficient revenues to pay for critical State services. Our recommended policy options to reform the tax system and raise sufficient revenues include:

- ★ Increasing the personal income tax to 5.95% would bring in an additional \$3.7 billion;¹⁸
- ★ Increasing the corporate income tax base rate to 8% would raise an additional \$300 million;¹⁹

- ★ Ending the exclusion of retirement income from the personal income tax and increasing the value of the 65 and over exemption from \$1,000 to \$15,000 to protect senior citizens with low and moderate incomes would raise \$1.9 billion;²⁰
- ★ Applying the sales tax to a set of consumer services would raise an additional \$500 million;
- ★ Repealing the capital-based tax portion of the Franchise Tax. Repealing all parts of the Franchise Tax would cost the State \$205 million, but keeping the fee-based portion would reduce revenue loss to the State;²¹
- ★ Eliminating the Estate Tax would cost the State \$290 million;²²
- ★ Amending the Illinois False Claims Act to exclude all tax laws; and
- ★ Amending the Uniform Penalty and Interest Act to better align Illinois' tax penalty structure with other states.

V. Establish financial goals and metrics to measure the State's progress

The overarching goal of the Task Force is to take a comprehensive approach to improving the State's finances and business climate. Our Framework provides a blueprint for the policy changes necessary to bring Illinois back to financial solvency as reflected in an AA credit rating. Together, our recommendations provide a comprehensive plan that will reduce uncertainty and change the narrative about Illinois' fiscal health and lead to improvement in Illinois' economic and jobs performance.

To measure the State's progress, the Task Force has identified several short- and long-term goals. The timeline for achieving short-term goals is within the first fiscal year after full implementation of the Framework; long-term goals are to be achieved within five years of full implementation of the Framework.

Short-Term Goals

- ★ Implementation of a long-term financial planning process that is transparent, implements best practices, and includes the entire State budget;
- ★ Approval of a structurally balanced annual budget and beginning to amortize the State's unpaid bills;
- ★ Increasing pension funding levels immediately to accelerate the time frame to stop the growth in the State's unfunded liabilities;
- ★ Implementing meaningful expense reductions based on a comprehensive review of spending across the entire State budget; and
- ★ Reforming tax provisions and practices that make Illinois an outlier compared to other states.

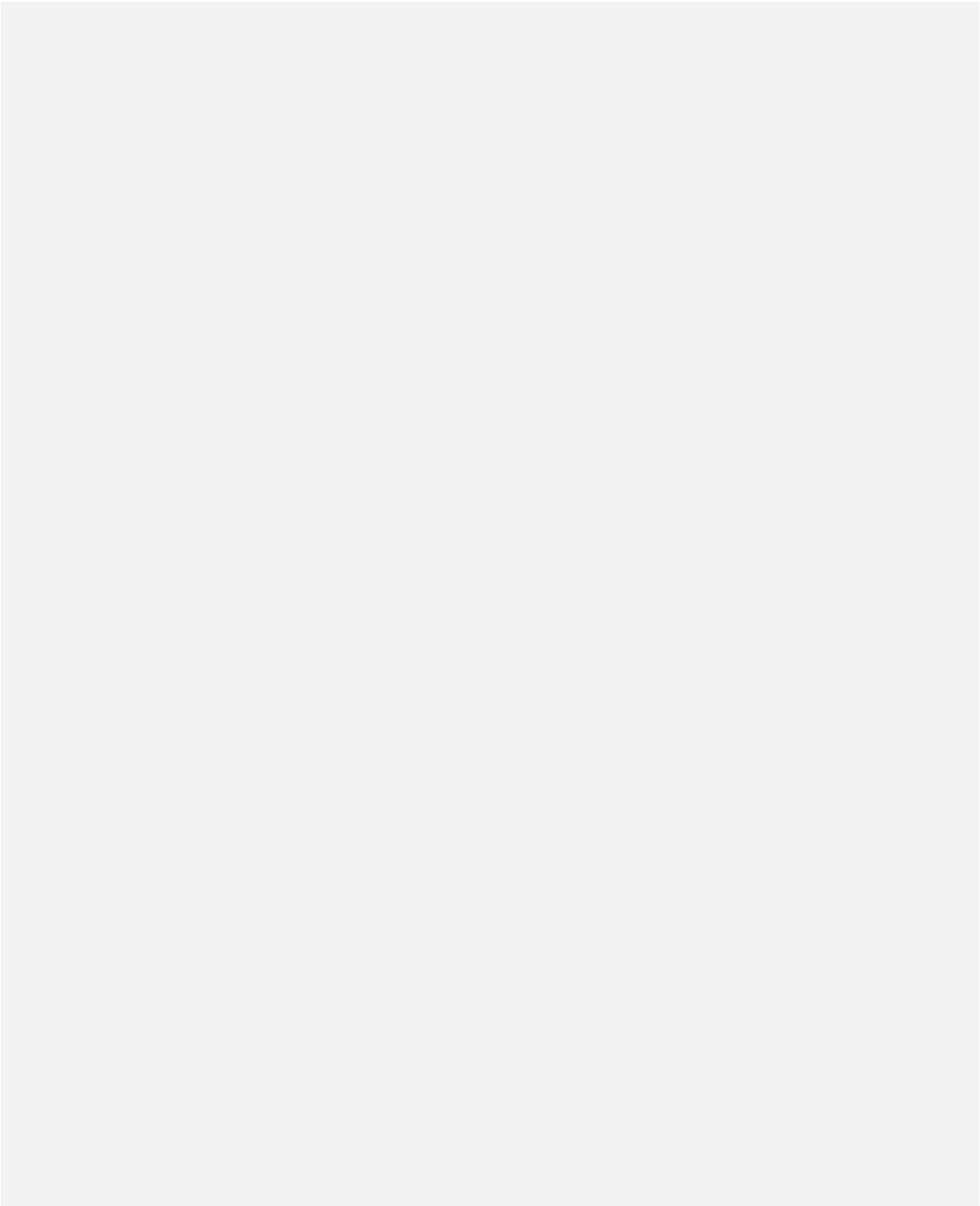
Long-Term Goals

- ★ Sustained achievement of the median level of performance among the 50 states for employment growth, GSP growth, and unemployment rate;
- ★ Achievement of “Top 10” performance among all 50 states for per capita income;
- ★ Elimination of the State’s unpaid bills; and
- ★ Establishment of a reserve fund that equals more than 8% of revenues/expenditures.²³

It is also a goal of the Task Force to achieve an upgrade in the S&P credit rating to AA because it serves as a useful proxy for financial health.

The S&P credit rating incorporates several different metrics into one aggregate score, and includes:

- ★ Debt and liability metrics (including pension liabilities);
- ★ Budgetary performance metrics (including the level of reserves);
- ★ Economic indicators (including Gross State Product and income per capita);
- ★ Government framework measures (including whether there is a balanced budget amendment); and
- ★ Financial management measures (including measures around budget forecasting).



Part 2: Additional Reforms to Improve the Jobs Climate

Part 2 of this report provides an overview of key jobs climate-related issues and updates on policy changes that have been enacted since our 2017 report was published. These policy issues include:

- ★ Local Government Consolidation;
- ★ P-12 School Funding; and
- ★ Workers' Compensation Reforms.

Local Government Consolidation

Illinois has the largest number of local governments of any state in the nation. This, combined with inconsistent and incomplete financial reporting, makes it nearly impossible to provide effective oversight and a lack of transparency severely hampers efforts to identify opportunities for efficiency and savings.

With nearly \$30 billion²⁴ in revenue, the money going to the 7,000 units of local government is substantial and should receive closer scrutiny. If local governments consolidated, achieved operating efficiencies, and reduced costs, the State could benefit financially in addition to the likely savings to local taxpayers. However, a key impediment to consolidation is the often poor quality of local government data. Reporting

requirements vary depending on the type and size of government, and there are no consistent accounting standards for these reports. We reiterate the data-related recommendations we made in *Bringing Illinois Back*:

- ★ Require all local governments to report full and accurate financial data to a single State repository;
- ★ Require all local governments to report information in a standardized, consistent format; and
- ★ Provide tools, training, and other supports to local officials to meet these new requirements.

In addition, we recommend that the State take action to remove statutory roadblocks to consolidation and enact the recommendations included in the final report of the 2015 Local Government Consolidation and Unfunded Mandate Task Force, including:

- ★ Empowering Illinois citizens to consolidate or dissolve local governments via referendum;
- ★ Expanding DuPage County's consolidation program to all 102 counties;
- ★ Allowing all townships in the State to consolidate with coterminous municipalities via referendum;
- ★ Protecting the Intergovernmental Cooperation Act to preserve the ability of local governments to coordinate; and
- ★ Empowering State agencies to incentivize local government consolidation and cooperation.

P-12 School Funding

Since we released *Bringing Illinois Back* in 2017, the General Assembly passed Senate Bill 1947 (the “Evidence-Based Funding for Student Success Act”) based on evidence-based funding principles, including the calculation of a unique Adequacy Target for each school district based on student demographics, accounting for local resources and differentiating what each district is expected to contribute, and the creation of a distribution system that ensures State money goes to the neediest districts first. It fundamentally changes the way the State provides education funding to local school districts. Key components of the law include:

- ★ An evidence-based school funding formula that prioritizes school districts with the greatest need and least property wealth;
- ★ A \$350 million year-over-year increase in education funding (contingent on annual appropriations) that is distributed through the new formula;
- ★ Pension parity for Chicago Public Schools (CPS) by providing State funding for the normal cost of pensions and retiree healthcare costs through new provisions in the State’s pension code; and
- ★ Recognition of CPS’s payments to amortize its unfunded pension liabilities in the school funding formula.

This law represents an historic step forward in establishing a school funding system that is fair and equitable for all students. However, there are a few areas the State needs to monitor going forward to ensure that the law works as intended, including:

- ★ Provisions that would adjust for pension costs in the formula if non-CPS districts ever became responsible for paying their pensions;
- ★ The Property Tax Relief Pool;
- ★ Ensuring that the State fully meets the \$350 million funding target each year; and
- ★ The funding formula’s interaction with federal education funding.

Workers’ Compensation Reforms

Companies often consider the cost of workers’ compensation insurance in a given state when deciding where to locate, making it an important component of a state’s jobs climate. Illinois historically has been a higher-cost state for workers’ compensation premiums and despite improvement stemming from significant reforms enacted in 2011, the State continues to have higher costs than the majority of states. Illinois’ workers’ compensation premium rates are the 22nd highest in the country.²⁵

Workers’ compensation premiums reflect the overall cost of providing workers’ compensation benefits in a given state, which can vary significantly depending on the rules and regulations in place. Broadly, there are three major determinants of workers’ compensation costs: causation, medical care costs, and indemnity benefits.

Compared to other states, Illinois has a relatively broad causation standard, requiring only that the injury stemming from

employment is a cause of the injury (e.g., any pre-existing conditions are not taken into account). Once the injury is determined to be work-related, it is fully compensable under workers' compensation.

Illinois' medical care costs for claims in the workers' compensation system tend to be higher than other states. Illinois' medical costs for claims with more than seven days of lost time are 24% higher than the median for comparison states.²⁶ This is due to the fact that Illinois is on the high end of both the prices paid for medical treatment and utilization rates (visits per claim and services per visit). Other states control these costs by tying their medical fee schedules to Medicare and implementing utilization limits; by contrast, Illinois' fee schedule is not tied to Medicare, and the State does not have any utilization limits in place.

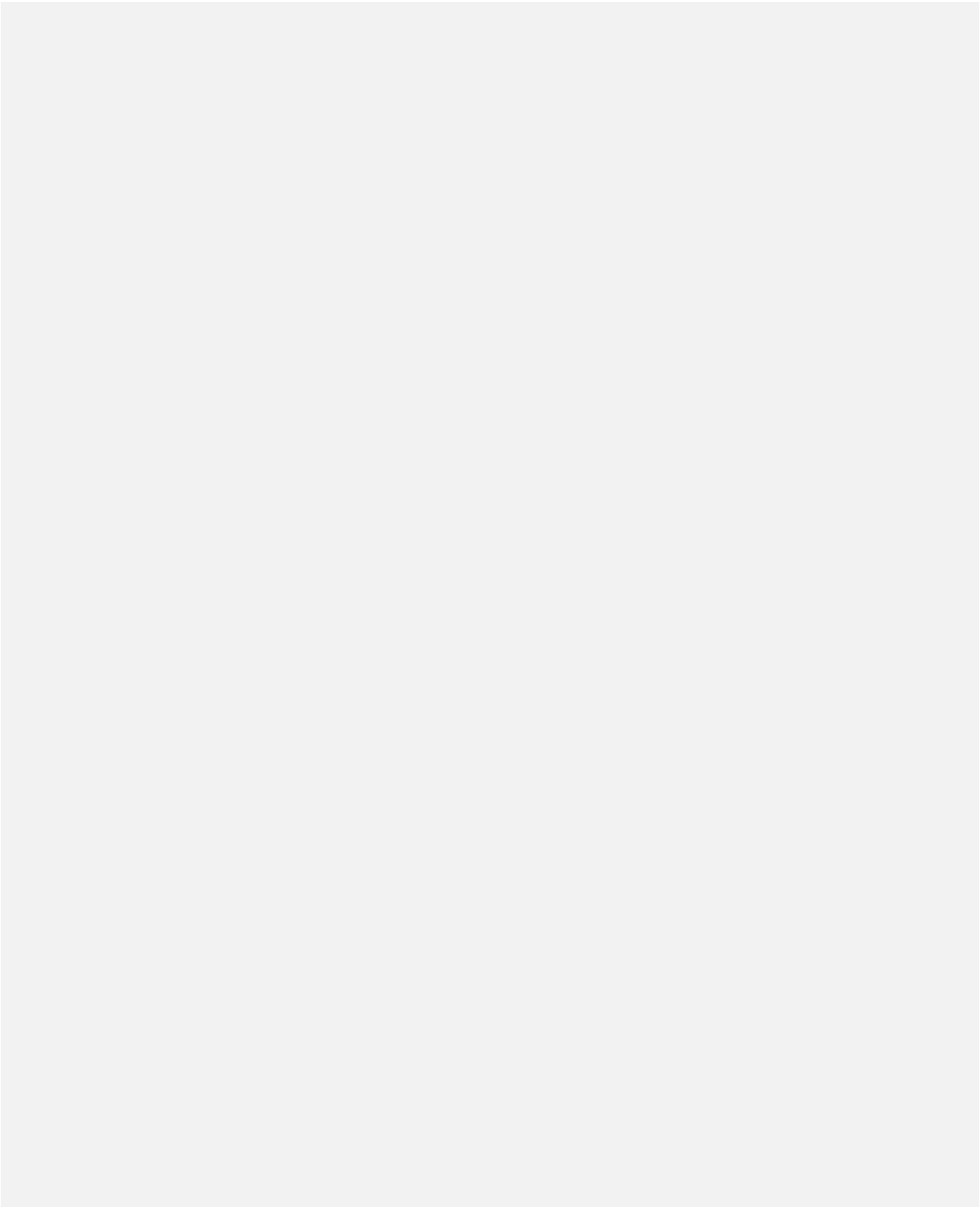
In addition, indemnity benefits per claim in Illinois tend to be higher than most other states (\$22,911 compared to the median state's cost of \$17,815).²⁷ Broadly, this is due to three factors: weekly benefit amounts for temporary disability, the duration of temporary benefits, and the benefit structure for permanent disabilities.

The State enacted workers' compensation reforms in 2011, which reduced workers' compensation costs overall. However, there are additional cost reduction measures the State should adopt to align more closely with best practices:

- ★ Defining traveling employees in statute (e.g., codifying the factors that determine whether or not an employee is required to travel for work);
- ★ Following best practices of other states and tying medical fee schedules to Medicare rates;
- ★ Adopting limits on utilization of certain medical services;
- ★ Implementing best practices for reducing the average length of temporary disability; and
- ★ Adjusting the use of American Medical Association (AMA) guides for determining impairment so that AMA guides have more weight but are not mandatory.

Conclusion

The challenges facing Illinois are considerable, yet they are surmountable if the State acts urgently to stabilize its finances and make key reforms to improve Illinois' business climate. The recommended reforms to improve the jobs climate offer an opportunity to help turn around the State's reputation and will make Illinois an even more attractive place to live, work, and do business. The Financial Framework developed by the Tax Policy Task Force should be implemented immediately and will put the State back on the path to fiscal solvency. Most importantly, adopting the recommendations in the report will provide businesses and individuals confidence and certainty about the direction of the State so that Illinois can achieve its potential as a great place to live, work, and do business.



Summary of Recommendations

Financial Planning and Transparency (pp. 31-35)

- ★ Implement reforms to the State's financial planning processes to focus on the long term and increase fiscal transparency.

Eliminate the Budget Deficit and Unpaid Bills, Establish a Reserve Fund, and Address Unfunded Pension Liabilities (pp. 37-41)

- ★ Eliminate the structural budget deficit;
- ★ Pay down the approximately \$7.8 billion bill backlog;
- ★ Establish a \$4-5 billion reserve fund; and
- ★ Provide an additional \$2 billion in pension contributions to implement a new pension funding plan.

Pension Reform (pp. 42-54)

- ★ Adopt a new pension funding plan that is budget sustainable, reaches the tread water contribution level faster than the current schedule, and creates a plan to amortize the remaining unfunded liability after the pension plans reach 90% funded; and
- ★ Examine governance of State and local pension funds.

Expenditure Reductions (pp. 55-61)

- ★ Reform healthcare plans for current State employees (estimated savings: up to \$500 million);
- ★ Implement a new retiree healthcare plan;
- ★ Reduce State spending through operational improvements (estimated savings: \$1 billion);
- ★ Implement "2+2" Plan (estimated savings: \$500 million); and
- ★ Scrutinize Other State Funds for savings.

Tax System Changes (pp. 63-70)

- ★ Increase the personal income tax rate to 5.95% (estimated revenue: \$3.7 billion);
- ★ Increase the corporate income tax base rate to 8% (estimated revenue: \$300 million);
- ★ Eliminate the retirement income exclusion; increase the 65 and over exemption to \$15,000 (estimated revenue: \$1.9 billion);
- ★ Expand the sales tax base to include a set of consumer services (estimated revenue: \$500 million);
- ★ Eliminate the Franchise Tax (estimated revenue loss: \$205 million);
- ★ Eliminate the Estate Tax (estimated revenue loss: \$290 million); and
- ★ Reform administrative practices to make them less burdensome.

Establish Goals and Metrics to Measure Progress (pp. 71-74)

- ★ Implement a set of long- and short-term goals and metrics to measure the State's progress.

Local Government Consolidation (pp. 76-83)

- ★ Pursue reforms to improve local government financial data; and
- ★ Remove statutory barriers to local government consolidation.

P-12 School Funding Reform (pp. 85-89)

- ★ Monitor key components of the new funding formula to ensure they work as intended.

Workers' Compensation Reforms (pp.91-96)

- ★ Implement additional reforms to reduce costs and align with best practices of other states.



Restore Illinois:

A Foundation for Growth

Full Report

Introduction

With its large, diversified economy, educated workforce, abundant natural resources, and prime location, Illinois is the economic engine of the Midwest, with Chicago as its cultural, business, educational, and financial center.

One of the State's greatest assets is its diverse and skilled workforce. Approximately one-third of the State's workforce holds at least a bachelor's degree, ranking higher than any neighboring state.²⁸ In the City of Chicago, the share of adults with at least a bachelor's degree is even higher, at approximately 37%.²⁹ Chicago is second only to Boston in its number of universities, and the State is home to more than 200 institutions of higher education.³⁰ The University of Chicago, Northwestern University, and the University of Illinois consistently rank in the top of their categories.

Additionally, the fundamentals of the State's economy are strong. The Illinois economy is fifth largest in the country and 17th largest in the world.³¹ Thirty-six Fortune 500 companies are headquartered in Illinois, and approximately 1.2 million small businesses are based in the State.³² Chicago has been the top city for direct foreign investments for the last six years³³ and was the top location in 2017 for corporate relocations and expansions.³⁴ The companies located here represent a wide breadth of industries, as the State ranks highest in the country for industry diversity, with no single industry employing more than 12% of the workforce.³⁵ In addition, Chicago has a vibrant start-up culture, ranking 8th globally in the number of annual start-ups and 8th nationally in total start-up funding.³⁶

Illinois has also grown as a technology hub, with Chicago ranking 7th among U.S. cities in terms of percentages of job postings that are in disruptive technology roles.³⁷ In addition, Illinois ranks highly in producing STEM (science, technology, engineering, and math) graduates, ranking 6th for graduating bachelor's degrees in STEM, 4th in master's degrees, and 7th in PhDs. Furthermore, the State's growth in STEM degrees outpaces the rest of the nation.³⁸

Lastly, Illinois' location in the center of the country has made it an essential transportation hub. Chicago is the nation's premier freight hub with 25% of freight trains and 50% of all intermodal trains passing through the City.³⁹ Illinois is at the heart of the nation's interstate system, with the third highest total of interstate routes and mileage.⁴⁰ O'Hare is the 6th busiest airport in the world, and it will soon have even greater capacity with the completion of the runway modernization and a planned \$8.7 billion capital improvement plan of the airport facilities.⁴¹ The State's robust transportation network is rounded out with its access to shipping on Lake Michigan and the Mississippi River.

Yet, despite the myriad strengths of Illinois, the State faces considerable challenges.

In fact, uncertainty and deep fiscal problems in Illinois are hurting our economy and future prospects, as residents and companies alike are choosing other locations. There are, of course, Illinois' well-publicized losses of Amazon's HQ2 and the Foxconn facility. In 2018, a Mazda-Toyota joint venture took 4,000 jobs and \$1.6 billion in investment to Alabama⁴² rather than central Illinois. General Mills, Mondelez, and Butterball all have closed operations in Illinois in recent years.⁴³ Moreover, Illinois' population has declined by approximately 157,000 since 2014, some of which is due to the outmigration of residents.⁴⁴

The national media regularly describes the financial crisis in Illinois, and credit rating agencies' negative outlooks on the state have become common reading, with the State teetering one notch above junk status. Media coverage focuses on the State's structural budget deficit, unpaid bills, lack of budget reserve, unfunded pension liabilities, and the political dysfunction that caused the State to operate without a budget for over two years. These constant reminders in the press have reinforced a narrative about Illinois as a questionable choice to live, work, and locate businesses.

To turn around the negative jobs climate in Illinois, we should implement policies and reforms that create long-term certainty and stability for Illinois businesses or for those businesses considering locating in Illinois. The State needs to adopt a balanced budget, address its bill backlog, create a reasonable reserve fund, and adequately fund its pensions in a way that does not crowd out other critical spending on services for the State. Illinois also should adopt solutions that align it better with the best practices of other States to make it less of a negative outlier, particularly with respect to tax policy. To the

extent that the State successfully creates a sense of financial reliability and predictability, Illinois' business climate will improve, and we will see the State grow and prosper.

The Task Force's aggressive time frame for full implementation of our recommendations reflects our belief that it is imperative to act quickly to restore Illinois' finances and reputation. However, certain policy recommendations should be given top priority, including eliminating the annual budget deficit and increasing pension contributions up front in order to stop the growth of the State's unfunded liability faster than under the current schedule. The key is instituting a plan that would achieve our recommendations in a defined time frame, rather than deferring action on critical issues to the future.

The fiscal challenges facing the State are considerable, but we believe that adopting the Civic Committee's Financial Framework and making the Additional Reforms to Improve the Jobs Climate will put the State back on the path to financial stability, reduce uncertainty, and foster economic and job growth. The recommendations included in this report will require sacrifice from all Illinoisans, but together they form a clear and balanced approach to improving the finances of the State and making the State a more attractive place to live, work, and do business.

With a new Governor and General Assembly, we have an opportunity to pursue the bold policies necessary to stabilize Illinois' finances and lay a foundation for economic growth. We urge State leadership to focus on doing what's best for the long-term health of our State and to address these difficult issues immediately.

A photograph of a person in a workshop, wearing a blue long-sleeved shirt and a yellow hard hat. They are using a chainsaw to cut through a piece of wood. The workshop is filled with various tools and equipment, including a drill, a saw, and a workbench. The image is partially obscured by a dark, semi-transparent overlay on the right side.

Part 1:

The Financial Framework

I. Implement Long-Term Financial Planning and Increase Fiscal Transparency

The first elements of the Financial Framework are implementing long-term financial planning and increasing fiscal transparency. As in 2017, the Tax Policy Task Force calls for the State to adopt measures that would align its financial planning policies with the best practices of other states.

The State continues to employ irresponsible budget practices and has not made significant progress on making its finances more transparent. The State should also make State finances more transparent so that important financial information is easy to find and understand for all interested parties.

Best Practices of Other States

A useful starting point for identifying the best practices that other states employ is the Volcker Alliance's *Truth and Integrity in State Budgeting* report (issued in 2017). The report evaluates states' budgeting and transparency practices and focuses on five key elements.⁴⁵

- ★ Budget Forecasting;
- ★ Budget Maneuvers;
- ★ Legacy Costs;
- ★ Reserve Funds; and
- ★ Transparency.

States are assigned a letter grade (A to D-) based on the scores they receive on subcategory questions (e.g., for budget forecasting, a subcategory question is "Does the state utilize a consensus revenue estimate for the forthcoming fiscal year or biennium in budget and planning documents?"). Illinois' grades were generally poor, indicating that the State does not typically follow budget and transparency best practices.

ILLINOIS GRADES	
Budget Forecasting:	D-
Budget Maneuvers:	D-
Legacy Costs:	D-
Reserve Funds:	C
Transparency:	B

Best Practices: Budget Forecasting

Many of the budgeting procedures identified as best practices by the Volcker Alliance focus on ensuring that budgets paint an accurate picture of a state's finances and do so well into the future so that states can plan in advance for changes in revenues and expenditures that will have a major impact on state finances. States are evaluated on whether or not they utilize consensus revenue estimates, if they provide reasonable (and detailed) rationales for their revenue projections, if their budget and planning documents use multi-year revenue and expenditure forecasts, and whether or not the state had to make a material mid-year budget adjustment. Illinois performs poorly in the budget forecasting category and received a D-.

Florida performed well on the budget forecasting category because it uses consensus revenue forecasting and makes multi-year projections. Florida uses a six-year revenue forecast that is the product of the Revenue Estimating Conference, which includes representatives of the Governor, Senate, House, and the Office of Economic and Demographic Research. This office provides six-year expenditure forecasts as well.⁴⁶

Illinois, by contrast, does not utilize consensus revenue estimates and tends to rely on estimates from two different bodies: the Governor's Office of Management and Budget (GOMB) and the Commission on Government Forecasting and Accountability (COGFA). Estimates from both bodies are generally close, but there have been instances in the past where they have been far apart (by as much as \$800 million).⁴⁷

In addition, the State has not consistently used multi-year revenue and expenditure forecasts in its budgeting documents. The GOMB issues one document each year with multi-year projections, but the projections are often obsolete by the time the Governor issues a proposed budget only a few months later. For example, in October 2017, the GOMB released five-year projections that showed projected total resources of \$36.2 billion for FY19.⁴⁸ By the time the Governor released his proposed budget the following February, the projected total resources for FY19 were \$38 billion.⁴⁹ Since there was a significant change in projected resources, the resource projections for FY20-FY23 made in October were no longer accurate. Despite the significant change, the State did not publish updated projections for the out years.

Best Practices: Budget Maneuvers

The next category that the Volcker Alliance grades states on is budget maneuvers. A basic tenet of responsible budgeting is to use one-time revenues for one-time expenses only rather than using one-time measures to cover recurring expenses to "balance" the budget. States are graded based on whether they avoided budget maneuvers, such as borrowing to pay for recurring expenses, using "scoop and toss" financing,⁵⁰ and using proceeds from material, non-recurring asset sales to fund recurring costs. Most states (22) earned an A because they successfully avoided budget maneuvers during the three-year period the report covers; another 15 earned a B because they only had limited reliance on budget maneuvers. Illinois, on the other hand, was rated poorly and earned a D-.

Illinois frequently utilizes the types of budget maneuvers that best practice dictates should be avoided. The FY19 enacted budget provides many examples, including relying on \$800 million of interfund borrowing and \$300 million of anticipated proceeds from the sale of the Thompson Center to balance the budget.⁵¹ (Although the Thompson Center has yet to be sold, the proceeds from the sale have been counted as revenues in enacted budgets for several fiscal years including 2018 and 2019). In addition, although the State has made progress on paying down its unpaid bills, the remaining bill backlog is the legacy of deferring recurring expenditures to the future.

Best Practices: Legacy Costs

The third area of analysis is how a state handles its legacy costs, including pension and Other Post-Employment Benefit (OPEB) liabilities. When states weigh the need to fully fund their retirement costs against the need to maintain government services, states sometimes short-change their pension funds in order to achieve a balanced budget, rather than make tough decisions to increase revenues or cut other expenditures. As such, they push retirement costs (plus interest) onto future generations. The Volcker Alliance grades states based on whether they contribute an actuarially determined amount to their pension funds and to public employee OPEB liabilities. Generally, states have mixed records on how they handle legacy costs (only eight states earned an A), but Illinois earned a D- on how it handles its legacy costs.

Illinois' pension problems are well known: the State has an extremely low funded ratio with unfunded liabilities totaling approximately \$130 billion. The State has a pension payment schedule that was set in statute in 1995, but 24 years into the schedule, the State's contribution is still not sufficient to keep the unfunded liability from growing.⁵² Indeed, the State's low contributions are responsible for roughly \$48 billion in increased unfunded liabilities from FY96-FY17.⁵³ Eventually, pursuant to the statutory schedule, the contributions will increase to levels high enough to amortize the unfunded liability, but that will not occur for many more years. And when the contribution levels are higher, they increasingly crowd out other needs for government revenues. The State is accruing more and more unfunded liability that must be paid off in the future.

The "Pension Reform" section goes into more detail about solutions for Illinois' pension problem, but it is clear that the State needs to enact a credible plan to pay down its unfunded liabilities and better address its legacy costs.

Best Practices: Reserve Funds

The next area evaluated by the Volcker Alliance report is reserve (or "rainy day") funds. Reserve funds are important from a budgeting standpoint because they help states weather the ups and downs of the economy and any associated budgetary shocks. These funds make it less likely that states will have to drastically cut services or increase taxes to deal with fiscal downturns. The reserve fund criteria that are evaluated include whether there are formal policies in place governing use and replenishment of a rainy day fund, if its balance is tied to historical trends in volatility (i.e., whether it is large enough to help a state if there is an economic downturn), and whether or not there is money in the fund. Illinois earned a C for its reserve fund, primarily because of its formal policies governing the fund (this grade does not indicate how well it is funded).

Texas serves as a good example for how states should approach reserve funds. Its Economic Stabilization Fund is the largest in the country with \$9.7 billion in assets as of June 30, 2016 and is supported by natural resource taxes.

Illinois, on the other hand, has never had a functional rainy day fund. A law was enacted in 2004 to build up a rainy day fund using the existing Budget Stabilization Fund, and the goal was to set aside 5% of General Fund revenues. Deposits were to be made into the fund when revenues grew more than 4% over the prior year and any withdrawals were meant to reduce the need for tax increases or short-term borrowing, maintain the credit rating, and address budgetary shortfalls.⁵⁴

Likely due to the high threshold for requiring deposits into the fund, the balance of the Budget Stabilization Fund has never come close to 5% of General Fund revenues, although there was a balance of approximately \$275 million at the end of FY15 (which is far short of the 5% goal). In addition, the entire balance of the fund was used to cover regular operating expenses in FY17.⁵⁵ As such, even though the State follows some of the best practices of other states by having a rainy day fund and clearly defining the process for funding and making withdrawals, these processes are not strict enough to ensure that the State has a robust fund.

Best Practices: Transparency

The last area of evaluation is transparency, which is key to ensuring that policymakers and citizens can easily access and understand important information about their state's budget. The Volcker Alliance rates states on whether they have a consolidated website (or set of websites) that provide budgetary data, whether the state makes tables listing outstanding debt and debt service available, whether the state provides a tax expenditure budget, and whether it includes the estimated cost of deferred infrastructure maintenance liability for its capital assets in budget and planning documents. Illinois scored relatively well on this category (earning a B), but other states serve as aspirational examples for transparency in budgeting.

Minnesota and Colorado provide excellent consolidated budget websites that make financial information accessible to citizens, including budget processes, current and previous budgets, budget and economic forecasts, etc.⁵⁶ Utah's website also provides visual representations of budget information, including tax incentives/exceptions and the yearly budget.⁵⁷ California and Alaska also serve as positive examples because they disclose infrastructure replacement costs, which most states do not do.⁵⁸

Illinois scores fairly well on transparency, mostly because it has a consolidated website with budget information, and it discloses debt and debt service tables. However, simply making these sorts of documents available does not necessarily make them particularly useful to the public. For example, one way to make finances more transparent would be for budget documents to include a baseline budget, then describe how planned policy changes affected the baseline.⁵⁹ New York provides such a comparison in its Detailed General Fund Gap-Closing Plan, which begins by showing the baseline budget gap that exists prior to any changes, then lists the spending and revenue changes the Governor plans to enact to address that gap.⁶⁰

Recommendations for Financial Planning and Increasing Fiscal Transparency

The Civic Committee's recommendations for improving Illinois' financial planning processes and transparency are consistent with the best practices outlined in the Volcker Alliance report. Our recommendations include:

- ★ Establishing clear financial objectives and articulating metrics that will illustrate progress towards those goals in both the short and long terms;
- ★ Focusing on long-term (at least five-year) financial projections for revenues and expenditures;
- ★ Reviewing all funds under the control of the State during budget negotiations (including General Funds, Other State Funds, as well as revenue-sharing with local governments);
- ★ Ensuring that expense forecasts accurately and completely reflect the full expected costs of programs;
- ★ Creating consensus revenue forecasts that do not rely on one-time revenues to balance the budget and focus on sustained revenue sources;
- ★ Producing timely financial statements that report revenues and spending (as well as assets and liabilities) that are updated at key points of the budget cycle;
- ★ Including baseline budgets in budget documents that show projected revenues and expenditures absent major policy changes; and
- ★ Publishing the aggregate State pension contribution (from General Funds and Other State Funds) as well as pension contribution benchmarks (e.g., the Normal Cost plus Interest payment) so that stakeholders can evaluate the adequacy of the State's pension contribution (and how underfunding compared to that benchmark will impact pension liabilities).

II. Eliminate the State's Structural Budget Deficit and Unpaid Bills, Establish a Reserve Fund, and Implement a New Funding Plan to Pay Down the Approximately \$130 Billion in Unfunded Liabilities of the State's Pension Funds

The second element of the Financial Framework is to stabilize State finances. This includes not only eliminating the structural deficit and unpaid bills, but also establishing a reserve fund and making progress on reducing the State's unfunded pension liabilities.

In our 2017 report, the Task Force adopted a five-year timeframe for eliminating the structural deficit and unpaid bills, as well as establishing a reserve fund of \$4-5 billion, which was estimated to require \$10 billion a year in spending cuts and/or revenue increases to achieve.

Since that time, the State has taken action to address some of the most immediate financial problems (e.g., enacting an income tax increase and passing a budget with a reduced structural deficit), but there is still much more to be done in order for the State to reach financial stability. The structural deficit is much smaller than it was, but it has not been eliminated. The State's bill backlog has only been partially addressed (through issuing bonds), and Illinois still does not have an appropriate reserve fund. In addition, the State needs to create a long-term plan for addressing pension liabilities in a sustainable way.

In order to address all of these components, **the State will now need to identify \$8 billion a year in spending cuts or revenue increases.**

At the end of five years, some of the goals outlined in this Framework will have been achieved, including eliminating the bill backlog and establishing a reasonable reserve fund. At

that time, the State should consider rolling back the recommended tax increases or evaluate its top fiscal priorities and allocate these resources to the most pressing needs. In particular, the State should ensure that it has a balanced budget incorporating all funds, education is adequately funded, pension contributions are sufficient, and state services are at an appropriate level.

It should be noted that the Financial Framework does not specifically address the State's capital needs and budget because funding for capital comes primarily from funding sources that are not included in the General Funds budget. However, the Civic Committee recognizes that infrastructure will require significant investment in the coming years and that ongoing capital investment is critical to maintaining the State's infrastructure and preserving Illinois' position as a key transportation hub.

The Illinois Department of Transportation estimates that additional revenues of \$1.7 billion each year are needed simply to maintain existing highway and transit infrastructure.⁶¹ In addition, the Regional Transportation Authority (RTA) estimates it will need \$38 billion over 10 years to bring the mass transit system in the Chicago metropolitan region into a state of good repair.⁶² However, the State's history of

episodic capital plans and reliance on unsustainable revenues (such as gaming, liquor taxes, etc.) has not been adequate to support the ongoing capital and infrastructure needs of the State.

The State of Illinois needs to make new investments to maintain and improve our transportation network and spur economic growth. Any revenues identified for transportation should be sustainable, user-fee based, able to support all modes of transportation, and, importantly, invested transparently and efficiently based on data.

Eliminate the Structural Budget Deficit and Unpaid Bills

Despite a balanced budget amendment, the State has passed budgets with significant structural deficits for many years. At the time *Bringing Illinois Back* was published, baseline budget projections (that is, what the State's budget was projected to be absent any major policy changes) showed structural deficits of roughly \$7 billion a year from FY18-FY22.⁶³

The structural deficit was significantly reduced when the legislature passed the FY18 budget and enacted rate increases for the personal and corporate income tax. These increases brought in roughly \$4.7 billion in additional revenue in FY18,⁶⁴ but it was not enough to balance the FY18 budget. Two other measures provided significant one-time revenues to the general funds: proceeds from bonds that were sold to pay down the bill backlog (approximately \$2.5 billion) and an increase in federal match revenues from using those bond proceeds to pay prior year Medicaid bills (\$1.2 billion).⁶⁵

The enacted FY19 budget was "balanced" through the use of one-time revenue sources, pre-booking savings that have not yet materialized, and under-appropriating costs that are likely to occur during the fiscal year.⁶⁶ However, as noted in State bond disclosure documents and the recently released five-year projections from the GOMB, the structural deficit for FY19 is more than \$1 billion.⁶⁷

As indicated in the chart below, the GOMB projects structural deficits as much as \$3.4 billion over the next five years.

Table 1: Baseline General Funds Budget (\$ Millions)⁶⁸

FISCAL YEAR	ESTIMATED 2019	PROJECTED 2020	PROJECTED 2021	PROJECTED 2022	PROJECTED 2023	PROJECTED 2024
Total General Funds Revenue	\$37,985	\$37,874	\$38,451	\$39,409	\$40,501	\$41,496
Total General Funds Expenditures	\$39,029	\$40,637	\$41,885	\$42,685	\$43,700	\$44,771
Surplus/(Deficit)	(\$1,044)	(\$2,763)	(\$3,434)	(\$3,276)	(\$3,199)	(\$3,275)

Source: Governor's Office of Management and Budget, "General Funds Financial Walk Down FY19-FY24."

The projected structural deficits are higher than the GOMB previously predicted (the five-year projections released in October 2017 estimated deficits peaking at roughly \$1.5 billion)⁶⁹ for a few key reasons. First, the new projections build the probability of a recession into their revenue estimates. As described in the Illinois Economic and Fiscal Policy Report accompanying the General Funds projections, the GOMB selected a pessimistic economic scenario to underlie revenue projections due to their view that a recession is likely to occur in the next few years. As a result, key State source revenues such as the personal income tax are expected to grow slowly in the near term (FY20 and FY21) and grow more quickly thereafter.⁷⁰

Second, the new projections include a more complete and realistic accounting of General Funds expenditures and revenues. For example, the new projections remove proceeds from the sale of the Thompson Center from the FY19 revenue estimate and reduce the amount of interfund borrowing from \$800 million to \$400 million. In addition, costs that were not included in the enacted FY19 budget that will surface in FY19 and beyond (e.g., debt service for bonds used to finance the pension buyout programs and American Federation of State, County and Municipal Employees (AFSCME) step increases that the State will be required to pay) are reflected in the five-year projections.⁷¹

Given these revenue projections, the State will have to identify as much as \$3.4 billion in spending cuts or revenue increases each year over the next five years just to cover the structural deficit.

However, as noted above, eliminating the structural budget deficit is not the only financial pressure facing the State. After years of running budget deficits (and two years of not having a budget in place), the State accumulated a bill backlog totaling \$16.7 billion.⁷² After the State sold bonds and used the proceeds to pay down some of these overdue bills, the backlog was substantially reduced. The GOMB estimates that by the end of the fiscal year it will stand at roughly \$7.8 billion.⁷³

If the remaining unpaid bills are amortized over the next five years, the State will need to identify an additional \$1.5 billion each year.

Establish a Reserve Fund

Another key step for the State to take in order to stabilize its finances is to establish a reserve fund. Having a reasonable reserve fund would cushion against future budgetary shocks or fluctuations and make it easier for the State to weather economic downturns. It is a best practice for states to have a reserve fund, and credit rating agencies take them into account when assessing a state's credit worthiness.

For the State to create a \$4-5 billion reserve fund (large enough to cover 8% of State revenues), the State would need an additional \$1 billion a year over the next five years in either spending cuts or revenue increases.

Address the State's Unfunded Pension Liabilities

The last major step the State needs to take to get back on the path to fiscal stability is to address its unfunded pension liabilities. The Civic Committee recommends adopting a new pension funding plan that meet the following criteria:

- ★ Structure contributions in a budget sustainable manner (e.g., will not significantly worsen crowding out);

- ★ Increase pension contributions up front so that contributions reach the “tread water” level faster than under the current schedule; and
- ★ Provide a plan to amortize the remaining unfunded liability after the funds reach 90% funded.

The plan is discussed in greater detail in the “Pension Reform” section, and it will require an additional \$2 billion a year until the pension systems are 90% funded.

Summary of the Gap

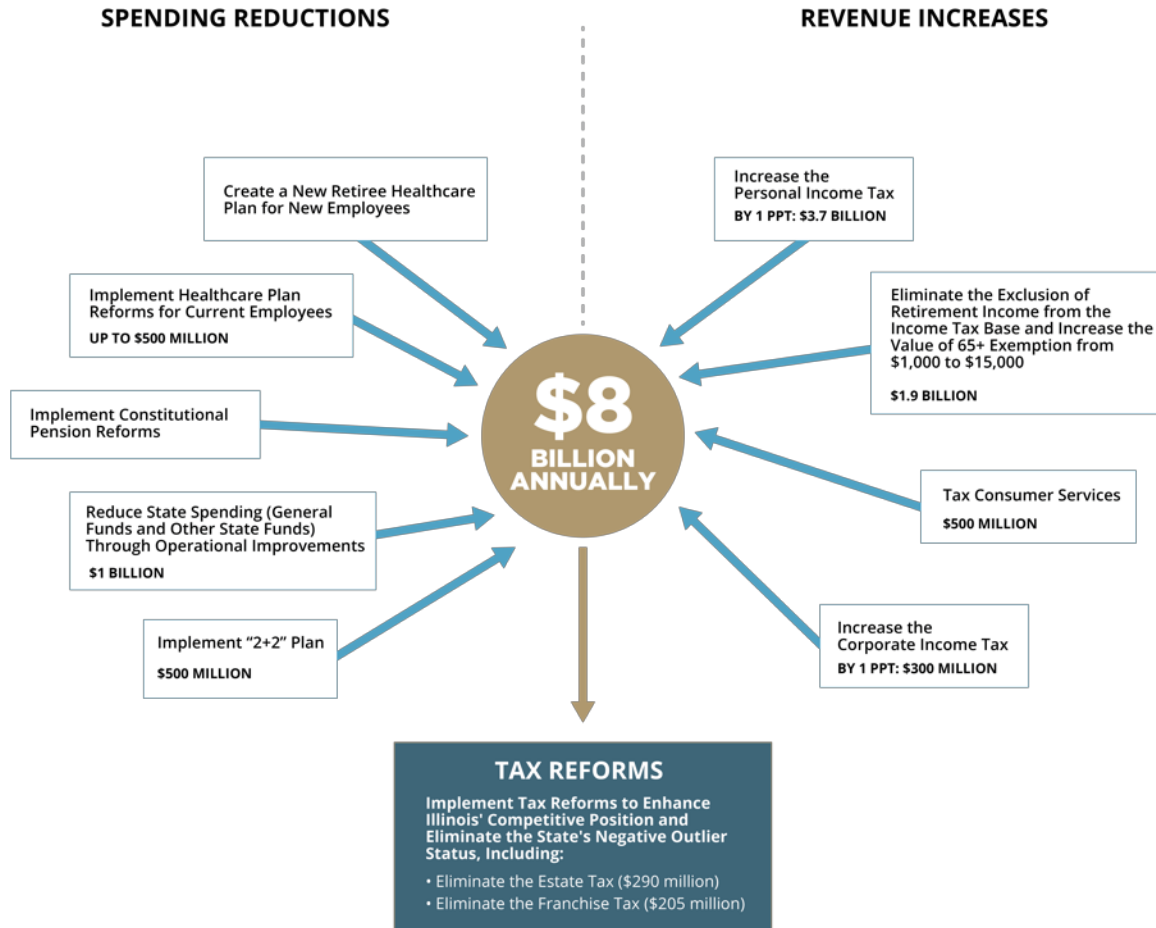
In order for the State to eliminate the structural deficit and unpaid bills, establish a reserve fund, and implement the new pension funding plan, it will require approximately **\$8 billion a year** of additional operating profit for the State over the next five years.

Table 2: Summary of the Gap (\$ Millions)

FISCAL YEAR	PROJECTED 2020	PROJECTED 2021	PROJECTED 2022	PROJECTED 2023	PROJECTED 2024
Annual Deficit	\$2,763	\$3,434	\$3,276	\$3,199	\$3,275
Pay Down the Bill Backlog	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500
Establish a Reserve Fund	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000
Incremental Pension Funding	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000
TOTAL GAP	\$7,263	\$7,934	\$7,776	\$7,699	\$7,775

Figure A below shows several policy options that could be implemented to reach this goal.

Figure A: Elements of a Solution



Pension Reform

The challenges facing Illinois' public pension systems – massive unfunded liabilities, extremely low funded ratios, and annual contributions that are crowding out other State spending – are significant and well known. Across all five pension systems, unfunded liabilities total roughly \$130 billion, and the funded ratio is only 40%. In addition, pension contributions currently account for nearly 20% of the General Funds budget, a share that will almost certainly increase as the State's statutorily required pension contributions continue to grow over the next 26 years.

It is clear that the State needs to make changes to its public pensions, but options to reduce the unfunded liability are limited due to the Illinois Supreme Court's 2015 decision on pension reform. Accordingly, future reforms should focus on creating a credible plan for paying down the unfunded liabilities of Illinois' pension systems, while also mitigating the negative impact of pension contributions on the provision of government services.

This analysis will describe several options for addressing the State's pensions, including reforms to reduce the unfunded liabilities, options to pay down the existing unfunded liabilities, and the evaluation and implementation of possible changes to pension governance. Given the current level of unfunded liabilities and the level to which pension payments are crowding out critical services in the State budget, policymakers should implement a responsible, long-term solution that begins to pay down the unfunded liability faster than the current contribution schedule and structures payments in a more sustainable manner.

Illinois' Statutory Pension Contribution Schedule

The State makes pension contributions according to a schedule enacted in 1995. After an initial 15 year phase-in period that has since ended, the law required that the State's pension contributions be made at a level percent of payroll until 90% funding is achieved in 2045. The structure of the contribution schedule is such that contributions started out lower and will increase each year until 2045, effectively deferring amortization of the unfunded liability to the future. Since the schedule delays amortization of the unfunded liability, contributions are currently too low to keep the unfunded liability from growing (the unfunded liability is projected to increase at the end of FY19; it is expected to grow until it peaks at approximately \$144 billion at the end of FY28).

In order to keep unfunded liabilities from growing, contributions would need to equal the "Normal Cost plus Interest," or the cost of benefits earned in a given year plus the "interest" on any unfunded liabilities (the plan's discount rate times the unfunded liability).⁷⁴ If the State does not cover the "Normal Cost plus Interest" with its annual contribution, the unpaid interest is then added to the total unfunded liability. Since the statutory contribution schedule was enacted in 1995, over 20 years ago, the State's pension payments have not been sufficient to keep unfunded liabilities from growing and are responsible for roughly \$48 billion of the total increase in unfunded liabilities from FY96-FY17.⁷⁵

However, the State needs to do more than just keep the unfunded liability from growing; it needs to make payments to amortize the approximately \$130 billion in unfunded

liabilities. There are accounting standards for disclosing the contribution necessary to cover normal costs plus a payment to amortize unfunded liabilities over a certain time frame (the “Actuarially Determined Contribution” or ADC),⁷⁶ but Illinois’ statutory contributions are much lower than the ADCs calculated by the State’s pension systems. If the State’s contributions equaled the ADC (as calculated and reported by each of the pension systems), it would have required an additional \$4 billion contribution from the State for FY19.⁷⁷

Since the State’s contributions have been actuarially insufficient to date, pension contributions in the final years of the contribution schedule will be much higher as a result. Back-loading pension contributions in this manner will make it increasingly difficult for the State to make its required contributions and still provide necessary government services, as it increases the likelihood of pension contributions growing at a faster rate than the State budget. Even the current contribution level (\$7.5 billion from the General Funds in FY19)⁷⁸ is crowding out State spending, accounting for nearly 20% of all General Funds expenditures.⁷⁹

Under the current schedule, required pension contributions are projected to grow at a compound annual growth rate of approximately 3.3% a year until 2045⁸⁰ (with the final contribution projected to peak at \$19.5 billion), which is faster than the likely growth of the rest of the State budget over that same time frame. As such, pension contributions will become a larger percentage of the State budget, crowding out will worsen, and it will be increasingly difficult for the State to make its required pension contributions and still maintain essential services.

Yet, despite the astronomical contributions scheduled for the end of the pension schedule, the State’s existing plan will never fully amortize the unfunded liabilities of the pension systems. The pension funding schedule aims for 90% funding rather than 100%, and while 90% funded is considered healthy for a pension system, there will still be unfunded liabilities the State must eventually pay. The longer the State delays in paying off the remaining unfunded liabilities, the more expensive it will be to do so as the interest on the unfunded liabilities grows. The State should amortize all of its unfunded liabilities so that it will only have to pay the normal cost of pensions going forward.

Previous Pension Reform Efforts

In May 2015, the Illinois Supreme Court ruled that the pension reform bill passed in 2013 to address the State’s pension problems (Public Act 98-0599) was unconstitutional. The provisions of the bill included capping the 3% automatic compounded benefit increases, increasing retirement ages, and limiting the final average pay used to calculate pension benefits. The Illinois Supreme Court ruled unanimously that the law violated the pension protection clause of the Illinois Constitution, which states that pension benefits cannot be “diminished or impaired.” In addition, the court stated that benefits that are promised to employees on their first day of work cannot later be reduced during the term of their employment, only increased. This decision severely limits potential reforms to pension benefits and suggests that only reforms to benefits for new employees or reforms that allow for voluntary changes will pass constitutional muster.

The State already has enacted new employee benefit reforms with the establishment of the Tier 2 pension system, which requires a higher retirement age, a change in the calculation of final average salary, a cap on pensionable earnings, and a reduction in the automatic cost of living adjustment.

The State also authorized an optional Tier 3 plan in its FY18 budget, which would allow new employees to opt-in to a hybrid pension plan with a defined benefit and defined contribution component (similar to a 401(k) plan). After the new Tier 3 plan is enacted, the responsibility for paying the cost of pensions going forward will fall on local employers rather than the State (except for existing Tier 1 and Tier 2 employees).⁸¹ The State would see some savings eventually from the Tier 3 plan requiring local employers to pay the cost of pensions, but it is unclear how much money it will save or when those savings will materialize (estimates are further complicated due to the pension-related provisions in the new Evidence-Based School Funding Formula). It is estimated that the pension plans will not be able to enact Tier 3 until FY20 at the earliest.⁸²

There have also been a number of smaller scale pension reforms that have been enacted. Most recently in the FY19 Budget Implementation Act (BIMP), the State authorized buyout programs that could save the State approximately \$400 million (although no actuarial analysis of either program was released prior to the savings being taken in the FY19 budget). The buyout programs consist of two pieces:

- ★ Tier 1 buyout for vested, inactive members⁸³
 - The State would offer inactive members with vested benefits 60% of the net present value of their pensions.

★ 3% Automatic Annual Increase buyout

- Retiring Tier 1 members could choose to keep their automatic increases at 3% a year, or they could accept a lower 1.5% annual increase in exchange for a lump sum payment of 70% of the difference between what they would have gotten with 3% increases and what they will now get with 1.5% increases.

However, since the savings from the buyout programs rely on people opting in, the ultimate projected savings is not clear. In addition, projections do not take into account the cost of issuing bonds to pay for the buyout programs, so the savings would be reduced. Recent projections from the GOMB show that the cost of debt service for issuing bonds to pay for the buyout will cost the State nearly \$100 million a year from FY20-FY24.⁸⁴

Opportunities for Future Reforms

With the Illinois Supreme Court ruling that benefits cannot be changed for current employees and the less expensive Tier 2 system already in place for all new employees, there are not many options left for pension reform that would produce significant savings (particularly because 70% of liabilities are attributable to current retirees).⁸⁵ The potential reform options described below will first focus on reform options to reduce the unfunded liability, then on creating a credible plan to pay down the unfunded liability. In addition, we will discuss reform options for pension plan governance, as well as options for addressing the unfunded liabilities of local pension plans.

Reforms to Reduce the Unfunded Liability

One reform that is often discussed is the “consideration model” proposed by Senate President Cullerton. This model would ask Tier 1 employees to choose between having their future pay increases included in the calculation of their pension benefits or maintaining the automatic 3% compounded cost of living adjustment. However, as many have noted, there is no guarantee that this plan would survive a constitutional challenge since it may be interpreted as asking Tier 1 employees to choose between two forms of benefit diminishment. Proponents argue that this model will survive a constitutional challenge since future pay increases are not guaranteed.

Some also have proposed a type of pension reform that has been successfully implemented in the private sector, a “hard freeze.” A hard freeze would end benefit accruals for active employees in the pension plans, which would eliminate future normal costs and reduce the current liability for active employees (this is the equivalent of terminating all workers and workers would only get what is earned to date). The reduction in current liability would be the result of eliminating future pay increases from the calculation of accrued pension benefits; pension benefits would instead be based on current pay. However, since the majority of the State’s pension liabilities (70%) are attributable to members who are already retired, a hard freeze would only reduce the unfunded liability by an estimated \$9 billion.⁸⁶ It is also likely that a hard freeze would be challenged pursuant to the Illinois Constitution’s pension protection clause.

Finally, another potential reform is a constitutional amendment to the pension protection clause. Passing a constitutional

amendment is frequently brought up as the solution that will solve the State’s pension problems since it would allow the State to reduce the benefits it is obligated to pay out. However, passing a constitutional amendment is a difficult process: the amendment must pass with a three-fifths majority in both the House and Senate before it is voted on by residents in the next general election, where either three-fifths of those voting on the amendment or a majority of those voting in the general election must vote to approve it.⁸⁷

Depending on what form the amendment took, the State could be empowered to make benefit changes for Tier 1 members, including current employees and retirees. The majority of the current liability for the State’s pension plans is attributable to current retirees (\$148 billion of \$212 billion or 70%, of total liabilities for the three largest plans).⁸⁸

Options for Paying Down Pension Liabilities

Given the limited options for reducing the unfunded liability without a constitutional amendment and the time it would take to pass an amendment and implement it should it pass, the State should immediately focus on instituting a credible plan for paying down the unfunded liability. Several options for how the State might address its pension liabilities and their pros and cons are listed below.

It should be noted that projections for all scenarios only include the “big three” plans (TRS, SERS, and SURS). They presume future experience will match assumptions embedded in these projections, including meeting the assumed asset returns (7.00% for TRS and SERS, 7.25% for SURS). Real dollar contributions are discounted using a growth rate of 2.5% per year. Contribution estimates

are for the *entire* State contribution, not just the portion paid out of the General Funds.

Status Quo: Following the Statutory Pension Schedule

The first option is to continue to follow the statutory pension contribution schedule. One positive aspect of the statutory schedule is that it clearly lays out a plan for reaching 90% funding by 2045. If the State makes contributions as scheduled (and all other assumptions are met), the State will meet this goal.

However, in our view, the Status Quo funding schedule does not represent a credible plan for paying down the State's unfunded liabilities. The current pension contribution schedule was set up in a way that shifted costs to the future and despite contributions already consuming a significant amount of the general funds budget (roughly 20% for FY19), the statutorily required contribution will be more than double its current level in nominal dollars by the final year of the schedule (\$19.5 billion or approximately \$10 billion in 2018 dollars). Unless the State's budget (specifically revenue) grows at the same rate or more, it will become increasingly difficult to make the statutorily required pension contributions without severely cutting services, significantly raising taxes, or some combination of both.

In addition, through the first 24 years of the statutory contribution schedule (i.e., FY96-FY19), contributions have not been sufficient to keep the unfunded liability from growing. As such, the State has essentially dug itself deeper throughout the life of the pension payment schedule and due to its structure, will continue to do so for another 10 years.⁸⁹ The State's "plan" for paying down the unfunded liabilities of the pension funds actually makes the problem worse while

pushing off an even heavier future price. It also contributes to Illinois having one of the worst-funded pension systems in the country, behind only Kentucky and New Jersey.⁹⁰

Addressing the State's Pensions Through Supplemental Contributions

The second option the State could pursue to fund its pensions is to make supplemental pension contributions on top of what is required by statute. Putting additional money towards pensions immediately would speed up the timeline for reaching key funding benchmarks – including the "tread water" level and the State's own goal of 90% funded – thereby removing a key roadblock to fiscal stability sooner. In addition, putting more money towards pensions now would likely reduce the total amount of interest the State would have to pay on the unfunded liability in the long run.⁹¹

It is important to note that in order for these payments to accelerate the timeline for reaching 90%, they would need to be kept in a separate fund. Due to the structure of the current funding schedule, making additional contributions to the pension funds directly would lead to a decrease in required contributions in future years.⁹² Alternatively, the State could take a potentially simpler approach and amend the funding law so that any supplemental contributions would not change the rest of the contribution schedule.

The main argument in favor of making supplemental pension contributions is that it helps get the State to a "tread water" level much faster than under the current pension schedule (contributions are not currently projected to reach "tread water" levels for approximately 10 years), and it significantly accelerates the timeline for reaching 90% funded.

A Civic Committee analysis of the three major pension systems (TRS, SERS, SURS)⁹³ suggests that an additional \$2 billion a year made as a supplemental contribution would get the State's contributions above the level necessary to tread water quickly (unfunded liabilities would peak at the end of FY20). It would also reduce the projected time it takes to reach 90% funded by six years. If the State made \$4 billion supplemental contributions, it would exceed the tread water payment level immediately and would reduce the projected timeline for reaching 90% funded by 11 years. With supplemental pension contributions of \$2 billion a year, the pension funds are projected to reach 90% funded by 2039; with \$4 billion supplemental contributions, the funds are projected to reach 90% by 2034.⁹⁴

When discussing potential changes to the State's pension schedule, it is useful to compare how much money the State will have to put towards pension contributions under each scenario (the "total contribution"). Since the funding scenarios discussed throughout this analysis have different funding targets (e.g., 90% vs. 100%) and different target years to reach those funding goals, we define the total contribution as the sum of State pension contributions from FY20 until FY65.

If the State's goal is to reach 90% funded, there will still be an unfunded liability that the State must pay interest on going forward; any State contributions after reaching 90% funded must equal the Normal Cost plus Interest to remain at 90%. By contrast, if the State changed its funding target to 100%, any contributions after reaching 100% would not include interest since there would no longer be any unfunded liability. The difference in post-funding target contributions can be significant, and therefore, should be taken into account when evaluating the total costs borne by the State under each scenario.

The potential reduction in the State's total pension contributions from making supplemental payments until it gets to 90% funded is enormous. If the State follows its current pension schedule, its projected contributions in inflation-adjusted dollars will total roughly \$263 billion; with \$4 billion in supplemental contributions, the State's total contribution will be *approximately \$40 billion less*, totaling approximately \$224 billion. Supplemental contributions of \$2 billion would reduce the State's total contribution by approximately \$25 billion to approximately \$238 billion.⁹⁵

The challenge with making supplemental contributions, of course, is finding the money to pay for them, especially since required contributions will be increasing steadily over the life of the pension payment schedule. Crowding out is already an issue at the current contribution level; it would be difficult to make supplemental contributions without additional sacrifice, whether through cutting services, raising taxes, or both.

Extend the Pension Contribution Schedule

The third option for addressing pension funding is to extend the current pension schedule beyond 2045 while keeping the underlying funding mechanism in place. Extending the pension schedule would give the State more time to pay down the unfunded liabilities, allowing it to reduce yearly contribution levels and alleviate further crowding out in the near term. However, extending the schedule and taking more time to reach 90% funding significantly increases the State's total pension contribution in the long run, exposes the funds to greater risk during market downturns, and would make it so the State's unfunded liability is higher in all years than it would be under the current schedule.

Analysis of the three largest pension systems shows that if the State extended its pension schedule by 10 years to 2055 (keeping the 90% funded target), the total pension contribution for FY20 would decrease by roughly \$1.3 billion. Extending the schedule by 20 years to 2065 and keeping the 90% target would reduce the required FY20 contribution by roughly \$2 billion. In the near term, the State would benefit from the reduction in required contributions, as it would free up some money in the short term to spend on government services rather than on legacy debt.

However, the reductions in required contributions do not represent “savings” in any way – the unfunded liability would increase as a result of lower contributions, and the interest that accrues on those liabilities eventually must be paid off. Delaying the timeline for amortizing the unfunded liability significantly increases the total contributions the State must make until it reaches 90% funded. Extending the schedule to 2055 (while also targeting 90%) would increase the State’s total contributions by approximately \$42 billion to \$305 billion (in 2018 dollars); extending the schedule to 2065 (while also targeting 90%) would increase the State’s total contribution by \$91 billion to \$354 billion (in 2018 dollars).⁹⁶

Restructure the Pension Contribution Schedule

A final option for the State is to restructure the statutory pension contribution schedule. However, given the State’s history of underfunding its pensions, any plan that only extends the time frame for reaching its funding target (e.g., keeping the same funding mechanism but giving the State more time to meet the funding target) is likely to be met with criticism from bond rating agencies, investors, and the general public. Given that

the State’s bond rating is the lowest in the nation and one level above junk, any new plan should be credible, achievable, and demonstrate that the State is making progress on funding its pensions. As such, we have identified criteria which we believe should be met by any new pension funding plan. It should:

- ★ Structure contributions in a budget sustainable manner (i.e., will not significantly worsen crowding out);
- ★ Increase pension contributions up front so that contributions reach the “tread water” level faster than under the current schedule; and
- ★ Provide a plan to amortize the remaining unfunded liability after the funds reach 90% funded.

“2+2” Plan

We have identified a funding plan that meets these criteria by blending attributes from the different funding options described thus far. Broadly, this funding scenario would set a new yearly contribution schedule (the “baseline contributions”) with a lower growth rate so that contributions are more budget sustainable than the current schedule. In addition, it would require fixed supplemental \$2 billion contributions (“supplemental contributions”) each year (in nominal dollars) until the pension funds reach 90% funding, which puts more money into the funds up front and gets the State to a “tread water” level faster than the current contribution schedule. Lastly, this plan provides a path to full funding – targeting a 100% funded ratio by amortizing the remaining unfunded liability over 10 additional years (i.e., after the plans reach 90% funded, which the current contribution schedule does not do).

Similar to the supplemental contribution options described earlier (the \$2 billion or \$4 billion on top of the current contribution schedule), the main challenge with this scenario is identifying the additional \$2 billion to contribute to the pension plans each year. However, the baseline contribution for FY20 under the “2+2” Plan will be roughly \$500 million less than the projected FY20 contribution under the Status Quo. Therefore, an additional \$2 billion a year in nominal dollars should be more manageable. Several policy options that could produce the required \$2 billion a year are described throughout this report.

This proposal would restructure the contribution schedule so that the State’s

baseline contributions would grow at 2% each year (compared to an average 3.3% each year under the current schedule). In this schedule, the FY20 payment would be set to be 2% higher than the FY19 payment, which would continue until the plans are 90% funded. In addition to this regular payment, the State would make supplemental \$2 billion contributions each year until the pension funds reached 90% funded. Once the pension plans reach the 90% funded target, the “2+2” Plan provides for the amortization of the remaining unfunded liabilities. The remaining liability would be paid down over 10 years, and the pension plans would reach 100% funded by 2055.

Figure B: Yearly Pension Contribution Comparison: Status Quo Contribution Schedule vs. the “2+2” Plan

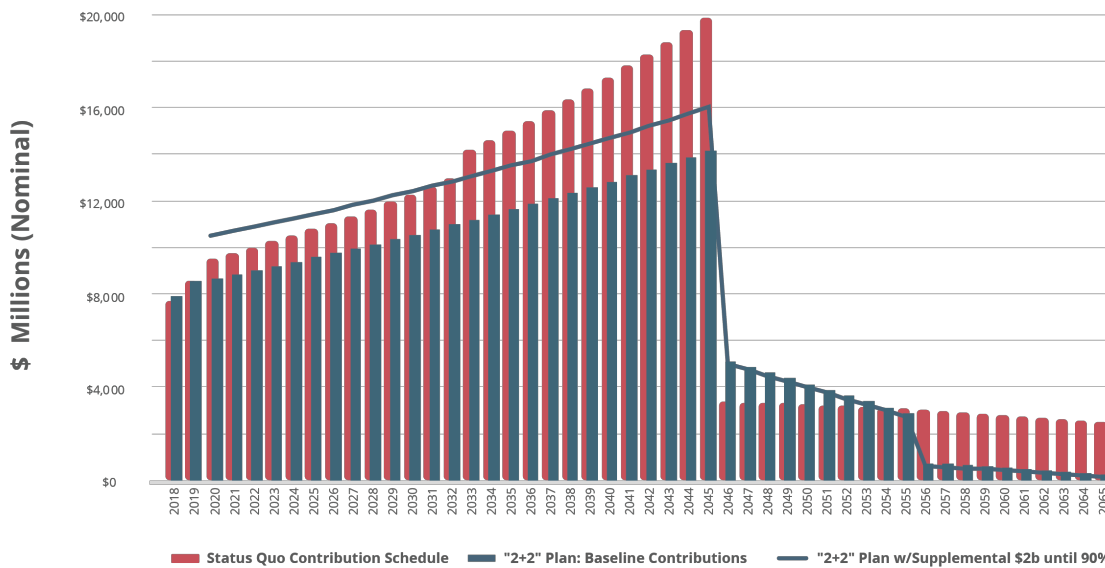


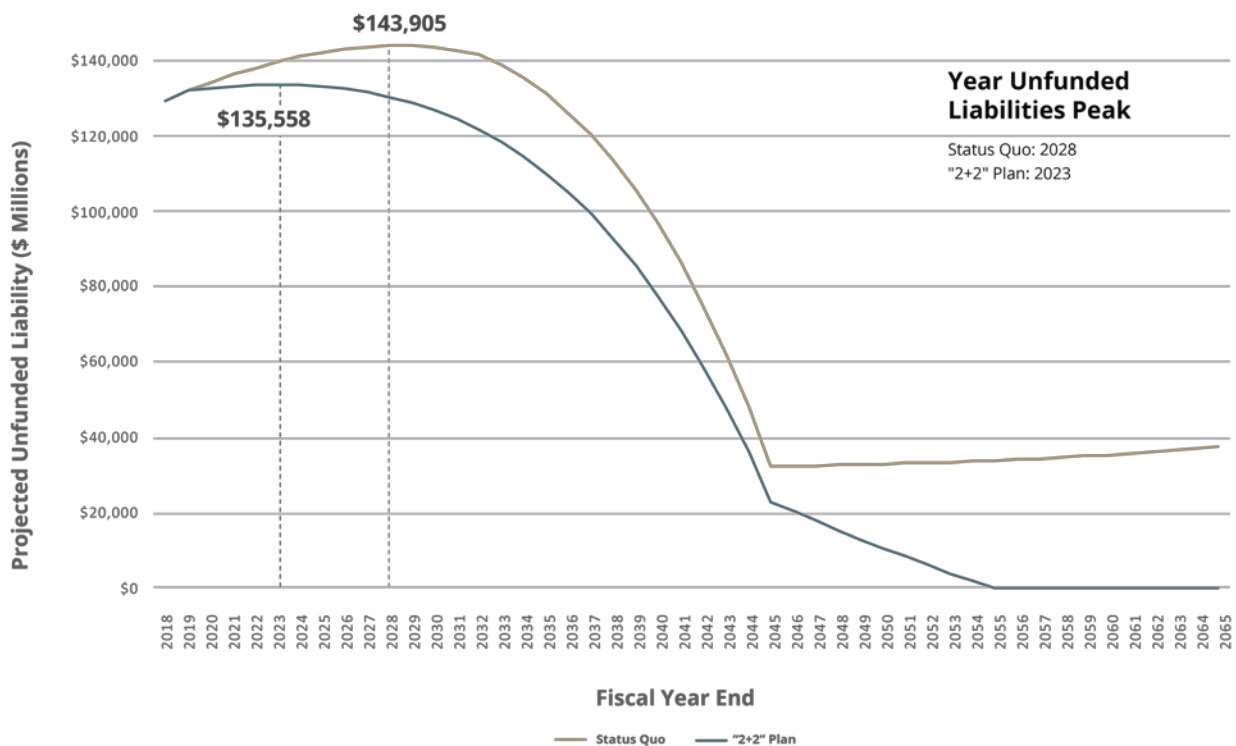
Figure B shows a comparison of pension contributions in nominal dollars under the status quo (current pension schedule) and the “2+2” Plan. (The bars for the “2+2” Plan represent the baseline contribution levels; the line for the “2+2” Plan represents the yearly baseline contribution level plus the supplemental \$2 billion contribution.)

As shown in Figure B, yearly pension contributions for the “2+2” Plan are initially higher than the yearly contributions under the Status Quo. As such, the State’s contribution is projected to reach the level necessary to tread water a full five years sooner under the “2+2” Plan than under the Status Quo contribution schedule (FY23 vs. FY28). In addition, the fact

that yearly contributions under the “2+2” Plan are lower than the Status Quo in FY33 and beyond make the “2+2” Plan a more budget-sustainable option in the long term.

The benefits of increasing contributions up front are shown in Figure C below. Not only are the State’s pension funds projected to reach the “tread water” level faster, but under the “2+2” Plan, the unfunded liability is projected to peak at a lower level than under the Status Quo pension schedule. It would remain lower than the projected unfunded liability for the Status Quo pension schedule for all years.

Figure C: Unfunded Liability Comparison, Status Quo Contribution Schedule vs. “2+2” Plan



In addition to comparing the cost of the State's yearly pension contributions and unfunded liabilities, it is important to analyze how altering yearly contributions will affect the total cost of the State's pension contributions over time. Table 3 below shows a comparison of the total cost of the State's pension contributions for three time frames: FY20-FY45 (when both scenarios are projected

to reach approximately 90% funded), FY46-FY55 (when the Status Quo scenario maintains 90% funded and the "2+2" Plan amortizes the remaining unfunded liability), and FY56-FY65 (when the Status Quo is still maintaining 90% and the "2+2" Plan has no remaining unfunded liability).

Table 3: Comparison of Total State Contributions and Unfunded Liability, Status Quo vs. the "2+2" Plan (\$ Billions).

	STATUS QUO CONTRIBUTION SCHEDULE			"2+2" PLAN		
	Funded Ratio (at FY End)	Total Contribution (Real Dollars)	Remaining Unfunded Liability	Funded Ratio (at FY End)	Total Contribution (Real Dollars)	Remaining Unfunded Liability
FY20-FY45	90%	\$241.9	\$32.4	93%	\$236.0	\$23
FY46-FY55	90%	\$13.0	\$34.0	100%	\$17.6	\$0
FY56-FY65	90%	\$8.6	\$37.7	100%	\$1.4	\$0
Total (FY20-FY65)	90%	\$263.5	\$37.7	100%	\$254.9	\$0

Note: Forecasts presume all assumptions as of June 30, 2017 will be realized, including asset return assumptions of 7.00% (TRS and SERS) or 7.25% (SURS). Real dollar totals are based on a 2.5% inflation assumption.

As Table 3 illustrates, there are benefits to restructuring the contribution schedule so that the full unfunded liability is amortized, and more money goes into the pension systems up front:

- ★ The “2+2” Plan would get the State to better than 90% funded by 2045 (the target under the Status Quo) for approximately \$6 billion less in total State contributions.
- ★ While amortizing the remaining unfunded liability (“2+2” Plan) would cost the State more than maintaining a 90% funded ratio from FY46-FY55 (Status Quo), the projected savings compared to the Status Quo after the “2+2” Plan has eliminated all unfunded liability (FY56-FY65) is approximately \$7 billion.
- ★ The total financial benefit to the State would be approximately \$46 billion: total contributions from FY20-FY65 would be approximately \$8.6 billion less compared to the Status Quo, as well as the *elimination of the \$37.7 billion in projected unfunded liability* in FY65 under the Status Quo.

The “2+2” Plan meets the three criteria we have identified as necessary for any new pension plan: contributions are structured in a more budget sustainable manner, payments are increased up front so that the State gets to tread water faster than the current schedule, and the proposal provides a plan to amortize the full unfunded liability. In addition to meeting these criteria, the “2+2” Plan also provides a likely reduction in the total State contribution to the pension systems over the next 46 years, saving a projected \$8.6 billion.

Adjusting some of the levers of this plan, particularly the growth rate for baseline contributions, could give the State more options for a pension funding plan that would still meet the three criteria we have outlined. For example, if the baseline contribution growth rate were 1% instead of 2%:

- ★ Contributions would be lower than under the Status Quo (and the “2+2” Plan), making them more budget sustainable;
- ★ The State would reach the contribution level necessary to tread water one year faster than under the Status Quo (FY27 vs. FY28); and
- ★ The unfunded liability would be fully amortized, with the pension plans reaching 100% funded in FY62.

However, making adjustments such as slowing the growth rate for baseline contributions changes the projected timeline and cost for reaching key funding goals compared to the “2+2” Plan. For example, slowing the baseline contribution growth rate to 1% instead of 2% would delay the time frame for reaching 90% funded by approximately eight years (the “2+2” Plan would reach 93% funded by FY2045, vs. 90% funded by FY2053 with 1% baseline contribution growth) and would add approximately \$24 billion to the total cost of State contributions from FY20-FY65 (total contributions under the “2+2” Plan would total approximately \$255 billion compared to approximately \$279 billion if baseline contributions grew at 1% a year).

The State could also consider pension contribution schedules that flatten out yearly contributions so they don’t go above a certain level or would gradually phase contributions down to avoid a “cliff” where payments drop substantially after a funding target is met. No matter how the State decides to restructure its pension ramp, it is critical that the State focuses on options that put more money in up front (in order to begin reducing unfunded liabilities sooner than the Status Quo schedule) and adhere to the other key principles (budget sustainability and fully amortizing the unfunded liability) we have identified.

Governance of Pension Funds

A third area of reform that the State should pursue is evaluating the governance of State and local pension funds and making improvements to governance where evidence indicates it is necessary.

State and local pension funds are not subject to the strict requirements of the Employee Retirement Income Security Act (ERISA) to which private pensions must adhere, and research shows that most pension funds do not voluntarily follow many best practices in pension fund governance. There is some evidence that pension plans that do employ best practices in transparency (reporting financial, actuarial, statistical, and investment information) are shown to be more likely to have higher investment returns.⁹⁷

Conversely, poor governance produces lower investment results and lower levels of plan funding. For example, one study demonstrated that the presence of plan participants, either active or retired, on a pension fund board is correlated with lower levels of pension plan funding.⁹⁸ Furthermore, many plans have significant leeway to employ practices that intuitively suggest lower investment returns and funding ratios will result. For example, plans are allowed to choose investments that offer “collateral benefits” (e.g., promoting local economic activity or avoiding undesirable investments like tobacco, firearms, etc.) regardless of whether they are sound investments on their other merits. Some plans are also not required to use reasonable actuarial factors in critical plan calculations.⁹⁹

The Center for Municipal Finance at the University of Chicago has identified the relationship between pension fund governance and investment returns and funding ratios as an important topic ripe for academic research and plans to study the issue further. We support ongoing efforts to ascertain the link between good governance and strong pension results and to implement changes accordingly.

Local Government Pension Liabilities

Illinois’ pension troubles are not limited to the State pension funds as local government pension funds (e.g., local police and fire pensions) face significant challenges as well. One high-profile example is the City of Harvey, which had State funds withheld and diverted to its pension funds by the Comptroller earlier this year due to its failure to make required pension payments. Yet, Harvey is not alone in its pension challenges. An analysis of the more than 600 police and fire pension funds across the State show that most police and fire pension funds are underfunded, with an average 60% funded ratio. However, approximately 29% of these funds had a funded ratio *less than* 50%, and only 9% of the funds had a funded ratio above 80%.¹⁰⁰

Some argue that local governments do not have the capacity to deal with underfunded pensions on their own since property taxes in some jurisdictions are high and already going mostly toward pensions. (For example, approximately 69% of property tax revenues in the City of Galesburg are projected to go towards pensions in FY19.¹⁰¹) Rather than leave local funds to fend for themselves, some have called for the State to take on the responsibility for the unfunded liabilities and

governance of the local pension funds. If the State took on the unfunded liabilities of all the pension funds in the State (e.g. the local police and fire plans, the City of Chicago plans, the Cook County plan, and the Illinois Municipal Retirement System) it would increase the unfunded liabilities by approximately \$60 billion,¹⁰² bringing the unfunded liability to approximately \$190 billion.

However, taking on the unfunded liabilities for all local pension funds has complexities that should be considered. First, there is an issue of fairness – should taxpayers statewide have to pay to fund pensions in other localities whose underfunding may be due to financial mismanagement? Second, if the State assumed local pension liabilities, it would preclude the possibility of those liabilities being restructured or discharged if the

municipality declared bankruptcy. (Note: while municipalities are currently prohibited from declaring bankruptcy under Illinois law, the State could change the law to authorize municipal bankruptcy. States, however, are not permitted to declare bankruptcy.)

The issue of the State potentially assuming unfunded liabilities for local pension funds is complex and merits further study. Before any decision is made on absorbing the unfunded liabilities of local pension funds, a comprehensive actuarial analysis should be performed, and a thorough study of governance changes that would be needed at the state and local levels should be undertaken.

III. Scrutinize the Entire State Budget for Spending Reductions

In order to achieve the required additional \$8 billion each year to get the State back on sound financial footing, there will need to be expenditure reductions in addition to new revenues.

A closer evaluation of the General Funds budget suggests that additional savings opportunities may be limited. Many of the savings proposed by the Governor's Office and/or the General Assembly in the past are based on very optimistic assumptions and often do not materialize as expected. It is clear that there needs to be a comprehensive assessment of all State expenditures (including the General Funds and Other State Funds) to identify areas where additional savings can be achieved, either through cuts or reorganizing.

Savings in the Enacted FY19 Budget

The enacted FY19 budget appears balanced at first glance, but it relies on one-time revenues (including \$800 million from interfund borrowing and \$300 million from the sale of the Thompson Center) and counts savings that have not yet materialized. Proposed pension reforms are an area in which the State frequently assumes savings in the budget before those savings have actually materialized. Higher education is one area of the budget where there have been significant cuts in recent years, including in the FY19 budget.

Pension Reforms

The FY19 budget assumed roughly \$400 million in savings from pension reforms. Provisions include:¹⁰³

- ★ Tier 1 buyout for vested, inactive members:
 - The State would offer inactive members with vested benefits 60% of the net present value of their pensions
 - Estimated savings are roughly \$40 million
- ★ 3% Automatic Annual Increase buyout:
 - Retiring Tier 1 members could choose to keep their automatic increases at 3% a year, or they could accept a lower 1.5% annual increase in exchange for a lump sum payment of 70% of the difference between what they would have gotten with 3% increases and what they will now get with 1.5% increases
 - Estimated savings are \$382 million
- ★ Reduction of the "spiking cap" from 6% to 3%:
 - Requires local employers to pick up the increased cost of pensions if they are due to a salary increase of more than 3% at the end of an employee's career
 - Estimated savings are \$22 million

There are several reasons the State should not count savings from these pension reforms immediately.

First, regarding the buyout provisions, although it is reasonable to assume that some members of the pension systems will find this option attractive and will choose to participate, the fact remains that savings hinge entirely on how many people opt in. The State assumed participation based on a similar program in Missouri and projected Illinois' savings using the same 22% take-up rate Missouri initially saw.¹⁰⁴ It is likely that the State will achieve some savings if and when the programs are implemented, but the State cannot guarantee that they will be to the level of what is assumed in the enacted FY19 budget.¹⁰⁵

An additional concern with counting pension buyout savings now is that the timing of implementation is such that a significant portion of savings will not occur immediately. First, the State will need to issue bonds to pay for the buyout, the timing of which has not been determined. Additionally, as described in the FY19 Budget Implementation Act ("BIMP"), which authorized the pension buyout programs, members may opt into the buyout programs until June 30, 2021. Given the nearly three-year window of time over which the buyout program could take place, it does not make sense to count all of the savings from the programs upfront.

Lastly, even if all assumptions are met and the timing works such that these reforms produce savings in FY19, there will be costs associated with these buyout programs that are not included. Future debt service on the bonds used to pay for the buyouts (and the costs associated with issuing those bonds) will reduce the net savings to the State.

Potential Areas of Future Savings

After years of budget issues, it appears that the State has utilized many sources of General Funds savings; however, our analysis indicates that the State Employee Group Insurance Program (SEGIP) is one area for significant General Funds savings. We also continue to believe that the State should conduct a comprehensive analysis of both General Funds and Other State Funds to determine what savings might exist in funds that typically are not scrutinized during the budget process. Additionally, the State should continue to pursue local government consolidation measures in order to reduce the cost of government and achieve savings through more efficient governance, which could in turn reduce the yearly cost of State transfers to local governments and would benefit State taxpayers by reducing their local tax burden.

General Funds Savings: State Employees' Group Insurance Program (SEGIP)

The State Employees' Group Insurance Program (SEGIP) provides medical, dental, vision, and life insurance coverage to the following (and their dependents):

- ★ Active State employees;
- ★ Elected State officials (legislators and judges); and
- ★ State university employees.

SEGIP also provides retiree healthcare benefits for members of the State's five pension plans (and their dependents) EXCEPT:

- ★ Teachers who receive benefits through the Teachers' Retirement Insurance Program (TRIP); and
- ★ Community college workers who receive benefits through the College Insurance Program (CIP).

SEGIP participants have their choice of medical plans, including HMOs, Open Access Plans (OAPs), and the State's self-insured plan (QCHP). Medicare-eligible retirees and their Medicare-eligible dependents must enroll in Medicare Advantage HMO and PPO plans.

In FY18, costs associated with SEGIP totaled approximately \$3.1 billion, including \$335 million in interest payments from overdue FY16/FY17 bills that were paid in FY18. Excluding interest payments, total SEGIP costs were close to \$2.8 billion, with medical care coverage accounting for about 85% of the total (\$2.4 billion).¹⁰⁶

SEGIP and the Previously Proposed FY19 Budget

A package of reforms to the existing medical plans offered to SEGIP enrollees (excluding the Medicare Advantage plans) have been proposed to create a multi-tier system of "metal" plans – Platinum, Gold, Silver, and Bronze – for the QCHP, HMO, and OAP plans. The tiers would be defined by a balance between increased premiums and/or increased out-of-pocket costs (co-payments, deductibles, etc.):

- ★ Platinum plans would require significant increases to the current employee premium contribution;
- ★ Silver plans would keep the employee premium contribution at the current level but have higher out-of-pocket costs;
- ★ Gold plans would split the difference between the Platinum and Silver plans; and
- ★ Bronze plans would have no employee premium contribution but much higher out-of-pocket costs.

Each of these plans would increase employee contributions toward their own healthcare

costs, whether by higher premiums or higher out-of-pocket costs.

Successful implementation of the reforms, which was assumed in the former Governor's FY19 Proposed Budget, was expected to reduce FY19 General Funds expenditures on group health insurance by about \$470 million. These reform provisions were included in contract negotiations with the American Federation of State, County and Municipal Employees (AFSCME) union; however, those negotiations were at a stalemate and the subject of litigation. (The Governor also requested that the General Assembly change the statute that requires negotiating health benefits for public workers through collective bargaining but was unsuccessful). In addition, the FY19 Proposed Budget included a shift of \$105 million in group health insurance costs for State university workers to the universities that employ them.¹⁰⁷ That proposed cost shift was rejected by the General Assembly.

As a result, the FY19 Enacted Budget does not include either the "metal" tier reforms or the cost shift and appropriates \$2 billion in General Funds for group health insurance¹⁰⁸ – the FY19 Proposed Budget appropriated only \$1.45 billion.¹⁰⁹ We believe healthcare plan reforms that align the State's plans better with what is offered in the private sector should be pursued.

Retiree Healthcare under SEGIP

As described above, the State requires Medicare-eligible retirees and their Medicare-eligible dependents to enroll in Medicare Advantage plans which are offered by private companies that contract with the federal government to provide Medicare benefits.

This requirement went into effect in FY14; prior to that, Medicare-eligible retirees were offered the same plans as other SEGIP enrollees.

Retiree healthcare benefits are similar to pension benefits in that future benefits are earned through current service (i.e., the 5% retiree healthcare premium subsidy that is earned for each year of service). Therefore, similar to the treatment of pension benefits, the State is required to report the present value of future employer-provided retiree healthcare benefits that are attributable to previous service – the accrued Other Post-Employment Benefits (OPEB) liability. The State does not pre-fund its OPEB liability in the same way that it pre-funds its pension liability; retiree healthcare benefits are funded on a pay-as-you-go basis. As a result, the unfunded OPEB liability is equal to the accrued OPEB liability.

The Governmental Accounting Standards Board requires that OPEB liabilities be reported and that OPEB programs funded on a pay-as-you go basis (like Illinois) use a discount rate that is consistent with an index of high-quality 20-year general obligation bonds. The discount rate used for the State's accrued OPEB liability as of June 30, 2016 was 2.85%, and the accrued OPEB liability was reported as \$42 billion.¹¹⁰

Retiree Healthcare Reforms and the Kanerva Decision

Opportunities for reducing the cost of retiree healthcare fall into two broad categories – changes to the medical plan(s) offered to retirees and changes to the State's subsidy of retiree healthcare premiums. The successful shift of Medicare-eligible retirees into Medicare Advantage plans falls into the former category while the *Kanerva* decision,

described below, relates to the latter cost category.

SEGIP enrollees who retired after January 1, 1998 are subject to a statutory provision that the State provide a 5% healthcare premium subsidy for each year of creditable service (i.e., retirees with 20 years of creditable service receive a 100% premium subsidy). SEGIP members who retired before January 1, 1998 are eligible for single coverage at no cost to the member.¹¹¹

In June of 2012, during the Quinn administration, the State enacted Public Act 97-695, which *eliminated* the statutory provisions regarding State subsidies of retiree healthcare premiums. Public Act 97-695 gave the Illinois Department of Central Management Services (CMS) the authority to determine how much retirees would contribute toward their premiums.

During the subsequent collective bargaining negotiations, the State negotiated new retiree healthcare provisions with its largest union, AFSCME, which took effect in FY14.¹¹²

- ★ The contract included the requirement that, in FY14, Medicare-eligible retirees contribute 1% of their pension benefit toward their healthcare premium; non Medicare-eligible retirees were required to contribute 2% of their pension benefit toward their healthcare premium;
- ★ In FY15, those amounts increased to 2% and 4%; and
- ★ The contract also included the agreement to move Medicare-eligible retirees into Medicare Advantage plans.

Governor Quinn's administration estimated that, over the course of the two-year contract, increasing retiree premiums would generate \$128 million in savings, and the switch to Medicare Advantage would generate savings

of \$232 million. State retirees challenged the law in four separate lawsuits that were consolidated and became known as the *Kanerva* litigation after Roger Kanerva, the lead plaintiff in one of the cases.¹¹³

In July 2014, the Illinois Supreme Court held that the State's subsidies toward the cost of retiree healthcare coverage are subject to constitutional protection, which the legislature may not diminish or impair. As a result of that ruling, the required increased contributions from retirees toward their healthcare premiums imposed by the Quinn administration no longer applied after September 2014.

For FY19, retired SEGIP enrollees are projected to pay only 6.3% of their healthcare costs.¹¹⁴

However, the Supreme Court decision did not impact the shift of Medicare-eligible retirees and their Medicare-eligible dependents into Medicare Advantage plans. Currently, SEGIP enrollees who become eligible for Medicare (and whose covered dependents are also Medicare-eligible) must enroll in a Medicare Advantage plan if they wish to remain in SEGIP; they are not given the option of remaining in one of the other SEGIP plans.

Potential Cost Savings: Implement a New Retiree Healthcare Plan

The *Kanerva* decision does not apply to new employees. There is no prohibition against establishing a new retiree healthcare plan that would change the retiree healthcare premium subsidy for future hires. Such a change would not affect the State's current OPEB liability (because the OPEB liability is based on previous service), but would limit its growth in the future.

Under the current system, the State is taking on approximately \$70,000 in promised retirement healthcare benefits for each new hire, on

average.¹¹⁵ (As an average, this figure factors in employees who will not be owed benefits in retirement, as well as those who will be owed benefits, so the value of promised benefits owed to each person covered by SEGIP at retirement is higher than the \$70,000 average.)

These costs are driven in part by the structure of the premium subsidy and the fact that the State assumes payment for 5% of a retiree's healthcare premium for every year of service. Recent analysis by the Pew Charitable Trusts demonstrates that the primary driver for variation in OPEB liabilities between states is how they structure their contribution toward retiree healthcare benefits:¹¹⁶

- ★ States that provide a monthly contribution equal to a flat percentage of the premium report the largest liabilities and costs that automatically increase as plan premiums increase. Illinois is one of these states;
- ★ States with fixed-dollar premium subsidies provide a smaller benefit and report lower liabilities. Their exposure to healthcare cost inflation is also lower because a fixed-dollar subsidy does not rise with the plan premiums; and
- ★ States that only provide access to a retiree healthcare plan, with no subsidy, have the lowest liabilities as a percentage of personal income. Although these plans do not make an explicit monthly premium contribution to retirees, many offer retirees a reduced premium through a group rate, which is an implicit subsidy.

In order to limit the future growth in its OPEB liability (and reduce the average \$70,000 in promised SEGIP retirement benefits associated with each new hire), Illinois should implement a new retiree healthcare plan for future hires as soon as possible. The plan should move away from a fixed percent of premium subsidy and provide either a fixed-dollar premium subsidy or

no subsidy but allow continued access to a group medical plan.

Potential Cost Savings: Remaining Avenues for Healthcare Benefit Reform in the Context of Kanerva¹¹⁷

Although the *Kanerva* case provides clear protection of the **premium subsidy** for current retirees, it leaves room for the State to change the **healthcare plans** that the premium subsidy supports. The State may also be able to make prospective changes to the premium subsidy for current employees, but doing so would be difficult to reconcile with other decisions interpreting the pension protection clause.

The State Employees Group Insurance Act gives the State the power to determine and modify the healthcare plans it offers its employees and retirees. It does not, however, spell out the level of benefits that must be included in employee healthcare plans. This is in contrast to the premium subsidy, which is a benefit promised in statute. Accordingly, even though the State cannot change the premium subsidy for current annuitants, the State has the power to make changes to plan design without it being considered a “diminishment or impairment” of benefits under the pension protection clause. Savings could be achieved through changes to healthcare plan design for both current employees and retirees (subject to collective bargaining agreements).

In addition to the creation of a new retiree healthcare plan that would change the premium subsidy for new employees, the State should explore the possibility of making changes to the premium subsidy that current employees earn. Other cases involving the pension protection clause have held that an employee’s rights are governed by the provisions in effect when they entered the system, but statements in the *Kanerva* case emphasized that previous changes

had been made in 1997 and 1998 to the premium subsidy for current employees who had not yet retired. In addition, the inherent ambiguity of healthcare compared to pension costs (e.g., pension costs are based on a formula and healthcare benefits are frequently negotiated) suggests that prospective changes to the premium subsidy would not be a diminishment of benefits. Such a change might also generate significant savings for the State.

Scrutiny of Other State Funds

One of the major impediments to identifying savings in the State budget is that only about half of the budget is part of budget negotiations and scrutinized closely each year.¹¹⁸ Typically, budget discussions and negotiations focus on the General Funds; Other State Funds receive little scrutiny by comparison.

The narrow focus on the General Funds budget can be misleading when analyzing total programmatic spending. Key programs, such as Medicaid, receive funding from several sources, including General Funds, federal funds, and Other State Funds. Therefore, looking only at the General Funds portion of Medicaid funding will give an incomplete picture of actual programmatic spending; a reduction in General Funds Medicaid spending could represent an actual cut to the program, or it could merely be a shift in where funding comes from.

In addition, ignoring Other State Funds in budget debates and negotiations allows some significant budgetary choices to be made with little scrutiny. Some important programmatic areas, such as transportation, get the bulk of their funding from sources outside the General Funds. If the State increased the scope of the budget to include All Funds, there would be increased discussion and

scrutiny of spending priorities in these types of programs.

The Fiscal Futures Project at the University of Illinois' Institute for Government and Public Affairs has created an All Funds budget model that aggregates General Funds and Other State Funds into a smaller number of revenue and spending categories. The Fiscal Futures Project's model groups revenue and spending by State function using "fundamental, time-consistent criteria,"¹¹⁹ allowing for comparison of actual revenues and spending over time.

When the Fiscal Futures Project first conceived the All Funds Budget, the process for aggregating spending and revenue data was manual and time-intensive. More recently, however, the process has become fairly automated. They receive data automatically from the Comptroller's office, which is then run through a computer program to group spending and revenue into programmatic categories. If the State decided to require that the budget process include All Funds, there would be a relatively inexpensive and straightforward implementation process. We urge State leadership to take action to improve budget transparency and require budget documents to include the Fiscal Futures Project's All Funds Budget and undertake a comprehensive review of the State budget.

Consolidation of Local Governments

According to the 2012 Census of Governments, Illinois is home to nearly 7,000 units of local government. Revenues for these local governments are nearly as much as the State's General Fund revenues and totaled approximately \$30 billion in FY16.¹²⁰ (General Fund revenues are projected to be approximately \$38.5 billion for FY19.)¹²¹

For many of these local units of government, public oversight is difficult due to the sheer number of governments in a given area (e.g., there are 536 local governments in Cook County),¹²² as well as outdated and inconsistent financial reporting processes. As a result, it is difficult to ensure that government services are being provided efficiently and at the lowest possible cost to taxpayers.

Reducing the number of local governments in Illinois would have an indirect impact on State finances since most local government revenue comes from locally-imposed property taxes. However, local governments are recipients of revenues from some State-imposed taxes, including income taxes¹²³ and sales taxes.¹²⁴ Reducing the cost of local governments through consolidation could reduce the need for revenue, leading to reduced property tax levies or reductions in transfers to local governments from the State.

The Local Government Consolidation section in Part 2 of this report provides details about the cost of local government in Illinois, as well as opportunities for achieving efficiency through consolidation. Although it is difficult to quantify precisely how much taxpayers could save by consolidating governments, the magnitude of potential savings is significant: a 10% reduction in the cost of local government would save Illinois taxpayers \$3 billion. We continue to support consolidation efforts (including enabling legislation) and encourage shared services between units of government.

IV. Reform the Tax System to Reduce Illinois' Negative Outlier Status and Raise Revenues, as Needed

One of the key components of the Financial Framework is reforming the tax system to reduce Illinois' negative outlier status and raise revenues, as needed. A state's tax system is an important consideration for job creators deciding where to locate or expand their businesses; as such, it is critical that Illinois' tax system is carefully designed so that it raises sufficient revenue to provide necessary services without making the State an outlier.

The Tax Policy Task Force conducted a thorough review of Illinois' tax system, consulting with tax policy experts and reviewing the findings of a proprietary Business Tax Outlier study (prepared for the Civic Committee in 2015), which compared Illinois' tax provisions to other states. A key finding of this review was that Illinois' combined state and local *revenues* as a percentage of its Gross State Product (GSP) was relatively low, but its combined state and local *taxes* as a percentage of GSP was relatively high.¹²⁵

This is due to the fact that Illinois cannot access some streams of revenue that other states have access to (including higher levels of federal funding,¹²⁶ as well as other own-source revenues from state enterprises such as public hospital systems), so the State relies more heavily on taxes for revenue. Recognizing that the State has limited options for non-tax own-source revenues and already relies heavily on taxes, the Task Force emphasized that any tax increases must be carefully considered and thoughtfully targeted.

In *Bringing Illinois Back*, the Tax Policy Task Force presented several tax policy options

that would raise needed revenues for the State without contributing to Illinois' negative outlier status. These options included:

- ★ Increasing the personal income tax rate;
- ★ Increasing the corporate income tax rate;
- ★ Including consumer services in the sales tax base;
- ★ Ending the exclusion of retirement income from the personal income tax base; and
- ★ Means-testing tax exemptions by phasing them out at higher income levels.

In addition to providing options for raising additional revenue, the Civic Committee identified reforms that would enhance Illinois' competitive position and reduce the State's negative outlier status, including:

- ★ Eliminating the Estate Tax;
- ★ Eliminating the Corporate Franchise Tax;
- ★ Lowering the LLC fee; and
- ★ Reforming burdensome administrative practices and business tax provisions.

Changes to Illinois' Tax System

Since *Bringing Illinois Back* was published, there have been several changes to the State's tax system. These changes include:

- ★ Increasing the personal income tax rate from 3.75% to 4.95%;
- ★ Increasing the corporate income tax base rate from 5.25% to 7%;
- ★ Increasing the Earned Income Credit for low-income taxpayers from 10% to 14% of the value of the federal EITC;
- ★ Phasing out personal exemptions and some tax credits for high-income taxpayers;
- ★ Reducing LLC fees;
- ★ Reinstating the Research and Development Tax Credit;
- ★ Adding the Graphic Arts Sales Tax Exemption to the Manufacturing Machinery and Equipment Exemption;
- ★ Increasing the value of the K-12 Education Expense Credit;
- ★ Adding an Instructional Materials and Supplies Credit; and
- ★ Decoupling from the federal Domestic Production Activities Deduction.

Many of these changes were recommended as options by the Task Force and had a positive impact on State finances. However, the State has not fully resolved most of its financial issues: Illinois is still running annual deficits, the bill backlog is projected to be approximately \$7.8 billion at the end of FY19, and the State has not established an appropriate reserve fund.

While there is room for spending reductions in the General Funds budget and in Other State Funds (as detailed in the "Scrutinize the Entire State Budget for Spending Reductions" section), the State will need additional

revenue to address its financial challenges. Some of the additional revenue need can be met by aligning Illinois' tax system with tax policies in other states (such as ending the exclusion of retirement income from the income tax base and taxing consumer services), but the State's financial challenges are such that the State must consider other revenue options as well.

Illinois is a high-tax state: analysis from the Taxpayers' Federation of Illinois estimates that Illinois' state and local taxes rank 11th highest out of all states when adjusting for today's higher income tax rates.¹²⁷ The State must remain mindful about which revenue options it pursues so it does not excessively increase Illinois' negative outlier status and damage the State's economy.

Our analysis indicates that the personal income tax may offer the best opportunity for raising additional revenues while inflicting the least damage possible on the State's tax climate. According to the Tax Foundation's *2019 State Business Tax Climate Index*, Illinois ranks favorably compared to other states on its personal income tax. With the current 4.95% tax rate in place, Illinois' personal income tax ranked 13th out of all states. By contrast, the State ranked much lower on other tax types: 39th for the corporate income tax, 36th for sales taxes, 45th for property taxes, and 42nd for unemployment insurance taxes.¹²⁸ It is likely that a personal income tax increase would not substantially change Illinois' ranking relative to other states.¹²⁹ The estimated revenue impact of increasing the personal income tax is substantial. A full percentage point increase, which would raise the tax rate to 5.95%, would bring in an additional \$3.7 billion a year.

However, recognizing the impact of an increase in the personal income tax rate, the State should also consider measures to provide tax relief to low-income families. For example, one way to achieve this goal would be to increase the value of the State's Earned Income Tax Credit.

With an increase in the personal income tax, the State would also need to consider an increase in the corporate income tax. The State has historically maintained a ratio between the personal income tax rate and the corporate income tax base rate (in recent years, this ratio has been 7:5),¹³⁰ but due to the State's combined corporate income tax rate¹³¹ being relatively high compared to other states, the State should consider a smaller increase. The estimated revenue impact of increasing the corporate income tax base rate by one percentage point to 8% would be approximately \$300 million.

In addition to ensuring that revenues (combined with spending reductions) are sufficient to fund necessary State services, the Civic Committee urges State leadership to adopt tax policies that will reduce Illinois' negative outlier status. Several policy recommendations that fall under this category are described below.

Reforms to Reduce Illinois' Outlier Status

Despite the recent changes made to the State's tax system, there are still a number of ways in which Illinois is an outlier compared to other states:

- ★ Other states levy taxes that Illinois does not;
- ★ Illinois imposes some taxes that other states do not; and

- ★ Illinois has burdensome administrative procedures.

Taxes Other States Levy that Illinois Does Not

Illinois is an outlier because it does not levy some taxes that other states do, including applying the personal income tax to retirement income and extending the sales tax to consumer services.

Extending the Personal Income Tax to Retirement Income

Illinois is one of only three states that has a personal income tax and completely excludes retirement income from taxation. The structure of this exclusion is broad and inefficient; all retirement income (including pensions, IRAs, 401(k)s, Social Security, etc.) is excluded from taxation regardless of the age or income of the taxpayer.¹³²

The retirement income exclusion is one of the State's largest tax expenditures and costs the State billions in foregone revenue each year. Additionally, the portion of income exempt from taxation under the retirement income exclusion is growing much faster than taxable income in Illinois: the value of excluded income grew by 51% from 2007-2015, compared to 18% growth in the value of taxable income during the same time period.¹³³

This exclusion is often discussed as a measure to protect low-income seniors, but in 2015, only about 13% of the value of the retirement income exclusion was associated with seniors with incomes of \$50,000 or less. The remaining 87% benefited taxpayers who were younger, richer, or both.¹³⁴ Additionally, the retirement income exclusion does not protect low-income seniors who have to work, since their wage income is fully taxable.

Traditional analysis of taxing retirement income in Illinois generally assumes any tax break for seniors will be attached to retirement income specifically (e.g., there would still be an unlimited retirement income exclusion but only for those with Adjusted Gross Income less than \$100,000). However, after thorough analysis of other states' retirement income tax provisions, there are other approaches that Illinois could consider that would cost less than the current retirement income exclusion and would more precisely target tax relief to low-income seniors than today's unlimited exclusion.

Broadly, these approaches can be separated into three categories:

- ★ Provisions that limit the *type* of retirement income that is excluded from taxation;
- ★ Provisions that limit the *amount* of retirement income that is excluded from taxation; and
- ★ Provisions that do not provide tax relief based on the type of income, but instead provide tax breaks based on *age and/or income requirements*.

The Civic Committee recommends a policy approach in line with the third category above: eliminating the blanket exclusion for retirement income and providing tax relief to seniors by increasing the value of the 65 and over exemption. Providing tax relief through the 65 and over exemption provides the following advantages:

- ★ **Tax relief would be tied to age.** The current retirement income exclusion has no age requirement, so a younger person who inherits an IRA, for example, can take distributions from it without paying taxes.

- ★ **It reduces the inequity between working seniors and retired seniors.** As described above, seniors who work to supplement their retirement income currently must pay full taxes on their wages. Structuring tax relief so that it applies to all types of income would allow seniors to exempt wage income from taxation as well.
- ★ **Implementation would be simple.** The 65 and over exemption already exists; the legislature would only need to increase the value.

If the State were to eliminate the retirement income exclusion and increase the 65 and over exemption to \$15,000, it would bring in as much as **\$1.9 billion a year** at a 5.95% tax rate.¹³⁵ (This estimate is based on 2015 tax data and is therefore likely to be conservative; when evaluated using today's larger tax base, the revenue impact is likely to be significantly greater.)

There are several different variations of this policy proposal that that would affect the revenue estimate above, namely the State could increase or decrease the value of the 65 and over exemption. For example, increasing the value of the 65 and over exemption to \$20,000 would decrease projected revenues to \$1.6 billion.

The State should extend the personal income tax to retirement income by eliminating its retirement income exclusion and increasing the value of its 65 and over exemption. Doing so would reduce Illinois' status as an outlier, raise much-needed revenue, and provide more targeted tax relief to seniors.

Taxes on Consumer Services

Illinois' state and local sales tax¹³⁶ rates are frequently cited as some of the highest in the nation. According to recent analysis by the Tax Foundation, Illinois' combined State¹³⁷ and average local rate is 8.7%, making it the 7th highest in the country.¹³⁸ However, Illinois' sales tax revenues as a percentage of GSP are relatively low compared to other states with a sales tax; by that metric, Illinois' sales tax revenues ranked 34th lowest among all states in FY16.¹³⁹ It is important to note that in addition to general sales taxes, Illinois levies excise taxes on certain goods and services, including on tobacco products, hotels, and various utilities.¹⁴⁰ If excise taxes are accounted for in the ranking of state and local sales taxes as a percentage of GSP, Illinois' ranking climbs to 25th.

The fact that Illinois has relatively low state and local sales tax revenues despite relatively high tax rates is likely due to a few different factors that narrow the State's sales tax base. The first factor is Illinois' use of excise taxes on goods and services that may fall under a general sales tax in another state; the second factor is that Illinois taxes fewer services than most other states.

States with a sales tax tend to include most goods but few services in their sales tax base, despite the shift to a more service-based economy. Very few states could be described as having a broad-based sales tax on services, but Illinois stands out because it taxes even fewer services than most. According to a 2017 survey of states by the Federation of Tax Administrators, Illinois taxed 29 out of 176 services they track; the number of services taxed by the median state is 60.¹⁴¹ By taxing fewer services than most states, Illinois' tax base is much narrower, making it an outlier.

To bring its sales tax system more in line with other states, Illinois should extend the sales tax to include more services, focusing on consumer services to avoid taxing business-to-business transactions.¹⁴² In 2017, the Commission on Government Forecasting and Accountability (COGFA) produced estimates for how much revenue the State could expect if it taxed services like neighboring states. The revenue estimates at full compliance¹⁴³ range from \$179 million (taxing six additional services currently taxed by Kentucky) to \$1.2 billion (taxing 81 additional services that are currently taxed by Iowa).¹⁴⁴

Recognizing that the mix of services taxed in other states may or may not make sense for Illinois, the Task Force recommends identifying a set of services to tax that would bring in an additional \$500 million in revenue.

Taxes Illinois Imposes That Other States Do Not Impose

Two examples of taxes that Illinois imposes that most other states do not are the Franchise Tax and the Estate Tax.

Capital-Based Portion of the Franchise Tax

Illinois' Franchise Tax is levied on corporations doing business in the State. Broadly, there are two components: registration/filing fees on corporations, as well as a capital-based tax.¹⁴⁵

The fee portion includes the fees that corporations pay when they initially form or register, their annual report fee, and reinstatement fees. All states require corporations to file and pay an annual fee for the privilege of doing business.

The tax portion is made up of three components: the initial franchise tax (imposed when a corporation begins doing business in Illinois), the annual franchise tax (an annual

tax of 0.1% on paid-in capital),¹⁴⁶ and an additional franchise tax (imposed whenever events trigger an increase in the corporation's paid-in capital).¹⁴⁷ According to the Tax Foundation, only 16 states have a capital-based tax, and two of those states are in the process of phasing it out.¹⁴⁸

The fact that Illinois has a Franchise Tax makes it a negative outlier, but there are business-related concerns about the Franchise Tax that the State should consider as well. For example, the method for calculating the Franchise Tax in Illinois is complicated and burdensome and can lead to tax pyramiding. Tax pyramiding, in turn, can negatively impact business formation, expansion, and investment.¹⁴⁹

The Franchise Tax (including both the tax and fee portion) is expected to bring in approximately \$205 million for FY19.¹⁵⁰

Since it discourages business formation and investment and makes Illinois an outlier, the capital-based tax portion of the Franchise Tax should be repealed by the State. However, the State should continue to charge corporations filing and registration fees (since that is standard practice for other states) and should set these fees at a level that is competitive with other states. This would lessen the budget impact of repealing the Franchise Tax entirely and would not make Illinois an outlier.

Estate Tax

There are two types of taxes triggered by a person's death: an estate tax, which is imposed on the net value of an estate before it is distributed to inheritors, and an inheritance tax, which is paid by heirs or beneficiaries upon receipt of a bequest.

Illinois is one of only 13 states that has an estate tax (six others have an inheritance tax),

making it an outlier. It applies to estates valued at more than \$4,000,000 and taxes assets at graduated rates ranging from 0% to 16% (only the state of Washington has a higher top marginal rate on its estate tax at 20%).¹⁵¹ The Estate Tax is projected to bring in roughly \$290 million for FY19.¹⁵²

The federal government has had an estate tax in place since 1916,¹⁵³ enacted against the backdrop of rising concentration of wealth, and progressives advocating for estate and inheritance taxes as tools to address income inequality.¹⁵⁴ At that time, many states also had estate or inheritance taxes, but more states enacted them after a federal tax credit for state estate taxes was created (1924) and later increased (1926). Initially, the credit was capped at 25% of federal estate tax liability; Congress later increased the credit to 80% of the federal estate tax liability.¹⁵⁵

States that already had estate and inheritance taxes responded by modifying them to take better advantage of the credit. States frequently designed their estate taxes as "pick-up taxes," where the amount of state tax liability was equal to the maximum value of the federal credit.¹⁵⁶ These pick-up taxes captured tax revenue that, absent a state level estate tax, simply would have gone to the federal government. As a result, they did not increase a taxpayer's overall tax liabilities. Instead, they merely shifted tax revenue from the federal government to state governments.

This changed when the federal tax credit for state estate taxes was phased out with the passage of the Economic Growth Tax Relief Reconciliation Act (EGTRRA) in 2001; the tax credit was completely eliminated by 2005. After the credit's elimination, state estate and inheritance taxes imposed an additional tax burden on estates. As a result, many states repealed their estate taxes or had their estate

taxes effectively zeroed out if their statute was directly tied to the federal credit.¹⁵⁷

The fact that Illinois has an estate tax after most other states repealed them makes it an outlier. While it may make policy sense for a **federal** estate tax to exist as a tool to raise revenues in a progressive way, the lack of estate taxes in most states has created a competitive tax environment in which states that still have an estate tax are at a disadvantage. The existence of Illinois' estate tax provides an incentive for the State's wealthiest residents to move to another state (and stop paying other taxes and otherwise contribute to the State's economy) or shift their assets and investments to other states so that they will not be subject to the Illinois estate tax.

A working paper from the National Bureau of Economic Research supports this concern about Illinois' competitiveness. The study looked at federal estate tax returns across all states over an 18-year period and showed that there is a relationship between a state's effective estate and inheritance tax rates and the number of federal estate tax returns filed in that state.¹⁵⁸ For every one percentage point increase in the effective estate and inheritance tax rate for a state, the number of federal estate tax returns filed in the state declined by 1.4% to 2.7% (depending on the model used). The number of returns for the highest wealth estates (\$5 million or more) were even more sensitive to estate and inheritance effective tax rates: for a one percentage point increase in a state's effective estate and inheritance tax rate, the number of returns in this wealth category declined by nearly 4%.¹⁵⁹

It is unclear if the reduction in federal estate tax returns filed in a given state is due to high wealth individuals actually moving out of state

or merely changing their reported state of residence.¹⁶⁰ Regardless of whether or not these changes are due to actual migration, this study provides evidence of behavioral responses to state tax policy by high-wealth individuals.

The migration of high-wealth individuals to other states may have negative effects on philanthropy. A study of migration to and from New Jersey from 1999-2008 showed how changes in the migration patterns of high-wealth households can impact a state's capacity for charitable giving. From 1999-2003, the net effect of migration into New Jersey resulted in a substantial increase in household wealth and charitable capacity. From 2004-2008, the migration flow was reversed: fewer high-wealth households migrated to New Jersey, and there was a moderate uptick in the number of high-wealth households leaving the state. (Note: the study does not address reasons why this migration flow was reversed). The resulting change in estimated charitable giving capacity (based on the wealth of migrating households) was a reduction of approximately \$2 billion.¹⁶¹

Since most other states no longer have an estate or inheritance tax, the existence of an estate tax in Illinois creates an incentive for high-wealth residents to move out of state or otherwise modify their behavior to avoid the tax. The potential negative consequences of Illinois' wealthiest residents leaving the State outweigh the benefits of having an estate tax in place. Illinois should repeal its estate tax so that it removes the additional incentive for high-wealth individuals to move out of state and aligns its tax policy more closely with other states.

Burdensome Administrative Practices

Illinois has a history of burdensome administrative practices that made it an outlier compared to other states. Many of the issues we raised in *Bringing Illinois Back* have improved, including how the State provides advice to business taxpayers and its implementation of corporate tax credits.

However, there are still some issues that remain a concern, including the Illinois False Claims Act. Under this law, private parties are allowed to assert a tax liability against business taxpayers. Most other states have excluded all tax laws from their False Claims Acts, and Illinois is an outlier because it does not have such an exclusion.

Illinois' tax penalty structure also makes it an outlier. Penalties are imposed to incentivize compliance and timely payment, and Illinois' financial penalties are higher than many of its peers. In addition, according to the 2015 *Business Tax Outlier Study*, Illinois' tax penalty structure may discourage voluntary compliance due to the fact that penalties are imposed even when taxpayers self-identify errors on previous returns. Taxpayers also face increased penalties if they disagree with the Illinois Department of Revenue and exercise their right to contest an assessment of additional tax liability, unlike most other states.¹⁶²

To make Illinois' administrative practices less burdensome, the General Assembly should amend the False Claims Act to exclude tax laws. In addition, it should reduce the penalties listed in the Uniform Penalty and Interest Act to align them more with the tax penalty structures in other states. Addressing these administrative issues would not be costly to the State but would go a long way toward improving the tax and business climate.

V. Establish Goals and Metrics to Measure the State's Progress

The final element of the Financial Framework is to establish goals and metrics to measure the State's progress. The original goals and metrics have largely remained unchanged; it is still a goal to achieve an S&P credit rating of AA, as well as achieve several additional short- and long-term goals.

The goal of the Tax Policy Task Force is to take a holistic approach to improving the State's finances and business climate. Our Framework provides a blueprint for the policy changes necessary to bring Illinois back to financial solvency; together, our recommendations provide a comprehensive plan that will improve Illinois' economic performance, reduce uncertainty, and move the State towards a AA credit rating.

Short-Term Goals

In the near term (in the next fiscal year after full implementation of the Framework), the State should focus on making changes that will lay the groundwork for improving Illinois' financial standing and eventually achieving an increase in the State's credit rating.

These goals include:

- ★ Implementation of a long-term financial planning process that is transparent, implements best practices, and includes the entire State budget;
- ★ A structurally balanced annual budget and the amortization of the State's unpaid bills;

- ★ Immediate increases to pension funding to accelerate the time frame for reaching the "tread water" level and stopping the growth in the State's unfunded pension liabilities;
- ★ Meaningful expense reductions based on a comprehensive review of spending across the entire State budget; and
- ★ Reform of tax provisions and practices that make Illinois an outlier compared to other states.

Since 2017, there has been very limited progress on achieving the short-term goals outlined in the Framework. The State has reduced the structural budget deficit, but it has not been fully eliminated, nor has it fully addressed amortization of the unpaid bills. The State also reformed some tax practices that made Illinois an outlier compared to other states, but there are several reforms that remain unaddressed. The State has not made progress on implementing transparent long-term financial planning processes, making contributions to the State's pension systems that are sufficient to keep the unfunded liability from growing, or making meaningful expense reductions across the entire State budget.

Long-Term Goals

We have identified several long-term goals (to be achieved within five years of full implementation of the Framework), which set targets for economic performance. These goals include:

- ★ Sustained achievement of the median level of performance among the 50 states for employment growth, GSP growth, and unemployment rate;
- ★ Achievement of “Top 10” performance among all 50 states for per capita income;
- ★ Elimination of the State’s unpaid bills; and
- ★ Establishment of a reserve fund that equals more than 8% of revenues/expenditures.

Although it has only been a year and a half since *Bringing Illinois Back* was published (and, therefore, it is too soon to judge how Illinois is doing with respect to long-term goals), we can look at Illinois’ recent performance to see if the State is on track to meet its long-term goals. The State has improved its position relative to other states on its unemployment rate and remained in the same position for per capita personal income, but its position has declined relative to other states on employment growth and GSP growth.¹⁶³ For example, Illinois is:

- ★ 34th out of the 50 states for unemployment rate (previously 43rd).
- ★ 36th out of the 50 states for employment growth (previously 37th).
- ★ 41st out of the 50 states for GSP growth (previously 18th); and
- ★ 15th out of the 50 states for per capita personal income (previously 15th).

In addition, the State has not fully eliminated the bill backlog, established a reserve fund, or reduced outstanding debt.

S&P Credit Rating

An additional long-term goal identified by the Task Force is to achieve an upgrade in the State’s S&P credit rating to AA. The credit rating was selected as a metric not only because it affects the State’s costs in issuing bonds, but, more fundamentally, because it encompasses many of the economic indicators and measures of government management that the Task Force identified as important to improving Illinois’ overall financial status.

Some of the metrics built into the S&P credit rating include:

- ★ Debt and liability metrics (including pension liabilities);
- ★ Budgetary performance metrics (including the level of reserves);
- ★ Economic indicators (including Gross State Product and income per capita);
- ★ Government framework measures (including whether the state has a balanced budget amendment); and
- ★ Financial management measures (including measures around budget forecasting).

The five elements of the Financial Framework represent a comprehensive set of actions that will improve Illinois’ standing on many of these metrics and will advance the goal of reaching a AA credit rating. As specific policy proposals are made to address the State’s financial issues, the Task Force will evaluate them together as part of a comprehensive plan to determine whether that set of actions will move the State toward AA.

Issues the State Must Address to Improve the Credit Rating

There are four areas that are continually mentioned as negatives by credit rating

agencies when they review Illinois' credit: the lack of a structurally balanced budget, the bill backlog, pension liabilities, and the lack of a rainy day fund.

Lack of a Structurally Balanced Budget

Despite the State's balanced budget amendment, Illinois has had significant structural deficits for years. When *Bringing Illinois Back* was originally released, the projected structural deficit (assuming no major policy changes) was approximately \$7 billion a year. Since the personal income tax and corporate income tax rates were increased, the structural deficit has been significantly reduced. As such, the gap between revenues and expenditures for FY19 was small enough that a combination of premature savings assumptions, one-time revenues, and interfund borrowing were enough to "balance" the enacted FY19 budget and show a small surplus. However, recent projections from the GOMB show that the deficit is actually more than \$1 billion.¹⁶⁴

Bill Backlog

The bill backlog is another factor that has a negative impact on the State's credit rating, primarily because the State does not have a plan in place to eliminate it. After issuing bonds last year to pay down part of the backlog, the State has not taken steps to address the remaining unpaid bills, which are expected to total \$7.8 billion at the end of FY19. Amortizing the remaining unpaid bills over the next five years will put additional strain on the State budget. The State needs to enact a plan to eliminate the bill backlog and then budget for the additional funding needed.

Pension Liabilities

The State's pension liabilities are another drag on its credit rating. Although there is a statutory contribution schedule in place, it is not seen as a credible funding plan because it does not aim for 100% funding and it increases contributions in the later years of the schedule to a degree that makes it unlikely the State could ever pay them. Additionally, the State's current pension contributions are not sufficient to keep the unfunded liability from growing. In order to demonstrate that the State is serious about addressing its pension problems, it needs to re-evaluate the contribution schedule (whether through making supplemental contributions, changing the payment schedule, etc.) so that it represents a credible plan to pay down its unfunded pension liabilities.

Lack of a Rainy Day Fund

Lastly, Illinois needs to establish a robust reserve fund in order to provide sufficient funds to operate State government should there be an economic downturn or some other budgetary shock. A healthy reserve fund (as determined by S&P) should be at least 8% of general revenues; as such, Illinois should aim to have a reserve fund of \$4-5 billion. This could be achieved in five years if the State budgeted \$1 billion a year; in the meantime, making significant contributions to the rainy day fund would demonstrate to the rating agencies that Illinois is taking steps to improve its financial management practices.

Illinois has a long road ahead to improve its financial situation enough to achieve an upgrade in its credit rating to AA. As specific policy proposals are made to address Illinois' finances, the State should ensure that it evaluates them as part of a set of actions that would advance the goal of a credit rating upgrade. Any plan the State advances should lay the groundwork for financial solvency, improving Illinois' overall financial status and, as a result, put the State's credit rating on an upward trajectory.

Financial Impact of Improving the Credit Rating

Achieving AA status is important for Illinois because the rating encompasses a number of meaningful financial fundamentals that the State must achieve. The rating serves as a single, objectively evaluated measure of Illinois' progress towards achieving sound financial footing.

Additionally, an upgrade in the State's credit rating is important because Illinois' near-junk ratings increase the costs of borrowing to levels far higher than peer states. Illinois' bonds are riskier, so the State has to pay much higher interest rates than it would if its credit rating were better. In addition, the State's low rating impacts all bond-issuing entities (such as local governments, universities, and school districts) in the State.

In April of 2018, State of Illinois General Obligation (GO) Bonds were trading at approximately 215 basis points over the AAA Municipal Market Data (MMD) Curve, which is a benchmark yield curve for AAA-rated GO bonds. More recently, that spread has narrowed to about 185 basis points. Nonetheless, the State of Wisconsin's GO bonds (rated Aa1/AA/AA+ by Moody's, S&P, and Fitch, respectively) are currently trading at about 10 basis points over the AAA MMD. If Illinois takes the steps necessary to improve its finances and return to its previous AA status, its bonds may trade as much as 175 basis points lower than currently. On a hypothetical \$500 million serial issue with equal principal amortization over a 25-year period, that could amount to more than \$113 million in debt service savings over the life of the bond issue.¹⁶⁵

The image shows the Illinois State Capitol building, a large, ornate structure with a prominent dome. The building is partially obscured by a large, blue, right-pointing arrow graphic that serves as a background for the text. The sky is clear and blue.

Part 2:

Additional Reforms to Improve the Jobs Climate

Local Government Consolidation

According to the U.S. Census Bureau, Illinois has the largest number of local governments of any state in the nation, with nearly 7,000 individual local units of government. (The state with the second most governments, Texas, has roughly 2,000 fewer units of government.)¹⁶⁶ One of the reasons for the high number of governments is that in addition to a large number of multi-purpose governments (e.g., county, city, village, and township governments), Illinois also has special purpose governments that provide a single service, such as fire protection, parks, and mosquito abatement. The multiplicity of local governments makes it difficult for taxpayers to understand which services are provided by which government, where their tax dollars are going, how wisely the money is being spent, and who is accountable.

The review of local government consolidation in our 2017 report discussed the consequences of having so many local governments in the State, including the costs borne by local taxpayers, the loss of effective oversight, and lack of transparency. While the focus of the Tax Policy Task Force and *Bringing Illinois Back* was State finances, it became clear through the Task Force's work that local governments and State finances are intertwined issues and that significant reforms are necessary to improve budgetary and financial processes across all units of government. Consolidation and increased reporting requirements will help to provide citizens with critical information for decision making and to eliminate unnecessary spending.

The patchwork of local governments in Illinois makes it nearly impossible for policymakers and the public to provide effective oversight or identify opportunities for efficiency and savings. At a minimum, the State should work to promote and facilitate local government consolidation, specifically through passing legislation to allow all local governments to consolidate and working to improve financial reporting and local government data. If necessary, the State also should consider alternative methods for achieving consolidation, including an incentive system or a consolidation mandate.

Funding of Local Governments

In FY16, local government revenues for general and special purpose governments totaled nearly \$29.5 billion from a combination of local, state, and intergovernmental sources. The majority of revenue (53.5%) came from local taxes.¹⁶⁷ However, some local governments rely more heavily on local revenues than others; for example, library districts, fire protection districts, and townships all receive the vast majority of their funding from local sources (93%, 83%, and 78%, respectively).¹⁶⁸

Local revenues consist of property taxes, locally-imposed sales taxes, utility taxes, and other local taxes. Property taxes make up the lion's share of local government funding (33.4%), but there are some differences between governments in how much they rely on property taxes. For example, counties and municipalities receive only 31.2% of their combined total revenue from property taxes since they receive funding from many different sources, including local sales taxes

and transfers from State government. By contrast, library and fire protection districts (which rely most heavily on local sources as described above) get more than 80% of their combined total revenue from property taxes.¹⁶⁹

The other three major local revenue sources – local sales taxes, utility taxes, and “other local taxes” – make up roughly 20% of all local government funding. However, like with property taxes, there are differing levels of reliance on these taxes because not every governmental body is allowed to levy them. Municipalities, which can levy all three, receive approximately 17% of their funding from these local sources. Counties, which can only levy two of these three additional local sources of revenue (they cannot levy utility taxes), receive only 5.9% of their funding from these sources.

The heavy reliance on local tax revenues for funding local governments and the multiplicity of local governments is one of the reasons Illinois’ sales and property taxes are so high compared to other states. Recent analysis by the Taxpayers’ Federation of Illinois shows that Illinois’ effective property tax rate (2.03%) is 2nd highest of all states, behind only New Jersey.¹⁷⁰ In addition, recent analysis by the Tax Foundation shows that

Illinois’ average local sales tax rate was 2.45%, making it the 13th highest average local rate of all states and bringing Illinois’ combined state and local sales tax rate to 8.7%.¹⁷¹

In addition to locally imposed taxes, the State provides additional sources of funding for local governments:

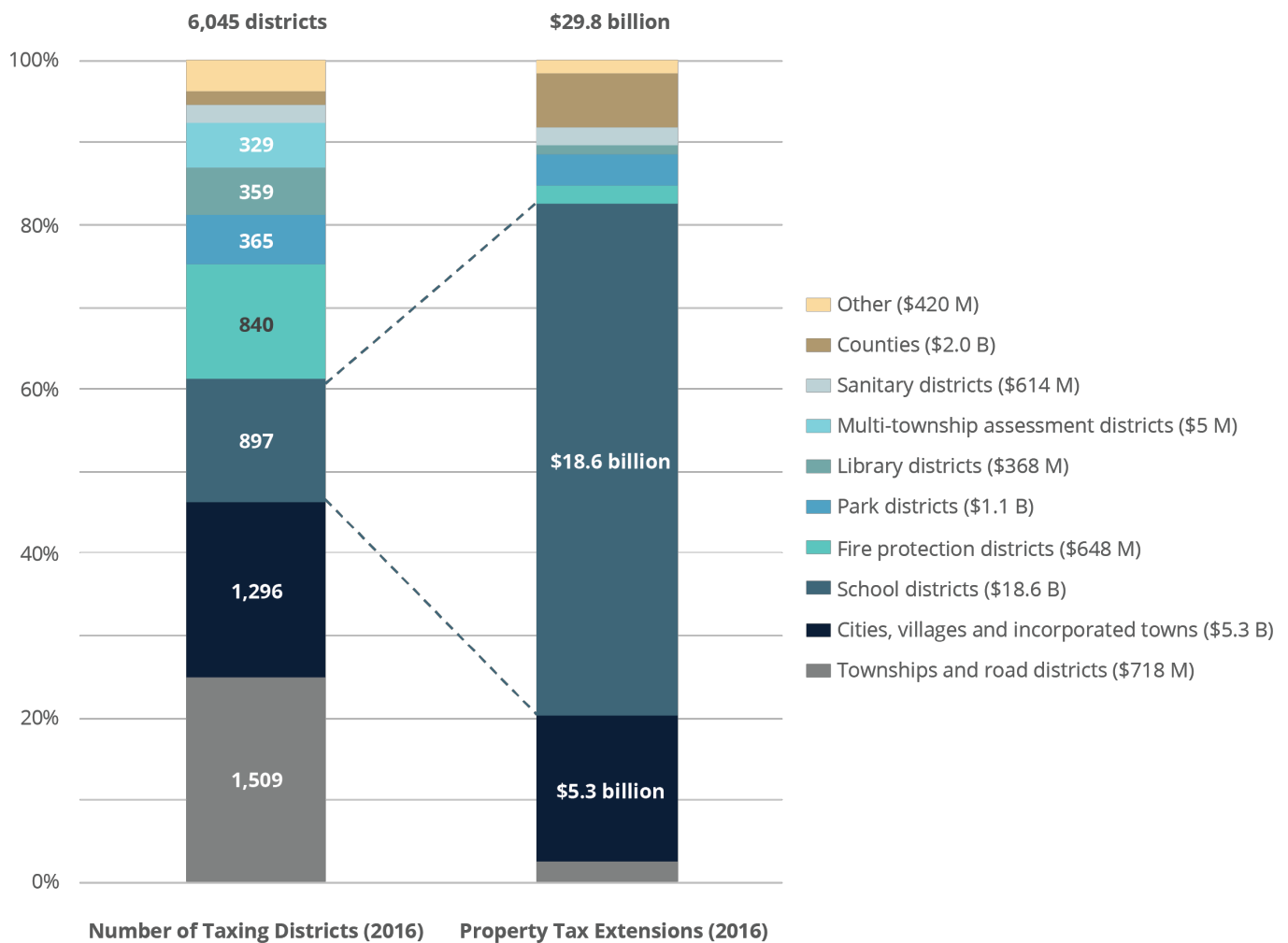
- ★ The state-imposed Personal Property Replacement Tax is distributed to local governments based on their share of personal property tax collections in the late 1970s. The Personal Property Replacement Tax totaled \$1.7 billion in FY17;¹⁷² and
- ★ The State also transfers to local governments a portion of personal and corporate income taxes through the Local Government Distributive Fund (LGDF). For FY19, counties and municipalities will receive approximately \$1.25 billion from the LGDF.¹⁷³

With nearly \$30 billion in revenues, the amount of funding local governments receive from State and local sources is significant. As such, it is critical that policymakers and citizens review local government operations and finances and look for opportunities to become more efficient in the provision of services.

School Districts

It is valuable to look separately at school districts, since they are an important driver of the large number of local government units and receive a disproportionate share of local property taxes. In 2016, Illinois had 897 school districts, which represented 15% of the 6,045 units of local government with the authority to levy property taxes. However, school districts received 62% of the total property tax revenues.¹⁷⁴

Figure 4: Property Tax Extensions by Type of District



Note: School districts include community college districts in this analysis. Source: Illinois Department of Revenue website; Property Tax Statistics: Tables 3 and 4.

Consolidation of these 897 school districts could result in significant cost savings, which in turn could translate to lower property tax costs for taxpayers.

However, school district consolidation may be beneficial for non-financial reasons as well. Small school districts are often unable to provide robust educational offerings to their students; if those smaller districts consolidated and formed larger school districts, they may be able to improve their educational offerings. For example, a national study by the University of New Hampshire's Carsey School of Public Policy found that remote rural districts with small populations are nearly 10 times less likely to offer access to AP courses than are larger rural districts closer to urbanized areas.¹⁷⁵ Similarly, in neighboring Indiana, a Ball State University study found that only 55% of the smallest districts offer an introductory physics class compared with 83% of districts with between 2,000-2,999 students. Likewise, the likelihood of offering high school calculus classes increased with the size of the school district.¹⁷⁶

Potential Cost Savings

It is difficult to precisely quantify the benefits of consolidating local governments. The lack of transparency, inadequate reporting, and the sheer number of individual units of government impede efforts to measure the impact. However, in addition to increasing efficiency and eliminating redundancies, direct financial benefits will result from reducing the number of local government units.

Several examples underscore this reality. One example described in *Bringing Illinois Back* is the DuPage County ACT Initiative. The multifaceted initiative involving county

government departments and many independently administered agencies implemented a variety of reforms, including creating a portal to increase public access to related information, implementing standardized procurement and ethics policies, creating shared services and cooperative purchasing agreements, and dissolving or consolidating local governments. Together the efforts have saved more than \$100 million.¹⁷⁷

In another study, the Center for American Progress analyzed the additional costs of small, non-remote school districts across the country. They identified 382 non-remote school districts in Illinois with fewer than 1,000 students and estimated that those districts create an additional cost of \$91 million. This places Illinois 3rd highest in the country for states with high costs due to small, non-remote school districts, behind only New Jersey and New York.¹⁷⁸

In addition, the Lieutenant Governor issued the second edition of the *Journal of Local Government Shared Service Best Practices* in July 2018,¹⁷⁹ which outlined several reforms to make local government more efficient, effective, and streamlined. It described 20 projects that illustrate the type of progress and savings local governments have seen as a result of sharing services:

- ★ The Fieldcrest and El Paso-Gridley districts consolidated some of their bus services saving 33% (\$6,000) and 40% (\$4,000), respectively.
- ★ Two school districts both located in LaGrange now share a communications director, saving \$25,000 per year.

- ★ New Holland-Middletown and Midwest Central school districts found a variety of ways to share transportation services saving more than \$120,000 in the first year with potential for additional savings in future years.

While some of these projects involve low absolute dollar amounts, the savings are significant in these small budgets and, if they are replicated across Illinois' nearly 7,000 units of government, the cumulative reductions can be meaningful.

Consolidation Challenge: Quality of Financial Reporting

Because of the State's high local taxes (property taxes in particular), examining the finances of local governments and determining where there are opportunities for achieving efficiencies (e.g., consolidation, shared services, etc.) is frequently discussed as a solution for reducing the cost of local government. However, the lack of quality financial data on local governments is a serious impediment to conducting any sort of meaningful analysis.

There are disparate financial reporting requirements for local governments depending on a number of factors, including the type of government, total appropriations, and whether the district has bonded debt. The most stringent financial reporting is required for: counties with a population between 10,000 and 50,000; municipalities that have bonded debt, a population over 800, or that own and operate a public utility; special purpose governments that have total revenues over \$850,000; and townships with total revenues over \$850,000. These governments must file an audit each year. All other governments with more than \$7,367 in appropriations (as of 2017) must file an

Annual Financial Report; governments appropriating less than that amount must only submit a Verification of Appropriation form.¹⁸⁰

The Comptroller's Office compiles a Fiscal Responsibility Report Card based on the financial reports submitted by local governments, which provides the high-level revenue and expenditure data used in the analysis above. In addition, there are financial reports and Individual Data Summaries for governments on the Comptroller's website that provide basic financial information on general and special funds, equity, net assets, etc. However, the ability to use the data in a meaningful way is hindered by a number of factors.

First, the financial reports are often inaccurate or missing information. Information is self-reported and, although the Comptroller's Office attempts to reconcile issues like mathematical errors or misclassified data, there are no guarantees that data is correct.¹⁸¹ In addition, governments are not required to use the same accounting methods (e.g., some use cash basis, some use a modified accrual basis) so comparisons between governments may not be strictly apples-to-apples. Lastly, the information that is publicly available is not in a usable format – the Fiscal Responsibility Report Card data and metrics are viewable on the website itself or as a PDF, but there is no option for downloading the data into an Excel spreadsheet or other usable format.

Consolidation Challenge: Statutory Limitations

Another impediment is statutory barriers to local government consolidation. As was

described by the 2015 Task Force on Local Government Consolidation and Unfunded Mandates, there are two legal issues that make it more difficult for governments to consolidate:

- ★ Existing consolidation-related laws are narrowly crafted and often only apply to a single government unit, not the whole State; and
- ★ There is no statutory process for citizens to initiate government consolidation in many instances and for situations in which consolidation processes exist requirements are burdensome and significantly hamper efforts.

As such, government consolidation efforts to date have largely been incremental.

Local Government Consolidation Success Stories

There has been some progress in addressing local government consolidation, primarily in the form of legislation that enables local governments to consolidate. In 2017, the General Assembly passed bills related to streamlining, reducing costs, or increasing transparency of local governments that were signed into law. This legislation includes:¹⁸²

- ★ **Senate Bill 2299:** Prohibits people in elected township roles from being employed by the township;
- ★ **Senate Bill 2459:** Allows for the dissolution of some districts in Lake County, including the Seavey Drainage District and the Lakes Region Sanitary District, and transfer of the powers, assets, and responsibilities from the districts to the Lake County Board;
- ★ **Senate Bill 2543:** Provides a mechanism for mosquito abatement districts to consolidate with neighboring entities;

- ★ **Senate Bill 3236:** Requires that School Report Cards include data on school districts' administrative costs;
- ★ **House Bill 5123:** Authorizes the DuPage County Board, by ordinance or resolution, to dissolve the County Election Commission and to fold its duties into the Office of the County Clerk; and
- ★ **House Bill 5777:** Streamlines the dissolution process of a defined group of county appointed agencies. (Originally the Act only included DuPage County and was expanded to all counties in the State.)

These measures add to previous successes in local government consolidation. We will continue to support consolidation efforts by local governments, as well as legislation that enables governments to consolidate and/or provides incentives (or even mandates) to do so.

Opportunities for Improvement

In addition to the legislature passing new legislation to enable and promote government consolidation, there are significant opportunities to improve local government data and use that data to make local units more efficient.

The Transform Illinois coalition, which is composed of local elected officials, civic organizations, and research institutions, is currently working on a project to improve data reported by local governments. The goal of the project is to better align the Annual Financial Reports that most local governments are required to file with the type of information required in government Comprehensive Annual Financial Reports. In addition, the project aims to increase the efficiency of reporting, make reporting more reliable and useful, and create fiscal health indicators so that comparisons may be made across government entities. The Civic

Committee strongly supports the efforts of Transform Illinois to improve the data on local government finances.

However, the existence of better data is not a panacea; rather, governments must use the data to analyze and compare their performance to other similar governments. North Carolina's Local Government Performance Measurement Project serves as a valuable example of transparency and the power of data to transform practice.

Beginning in 1995, governments in North Carolina undertook a comprehensive review and reporting of extensive city-level data on the services offered in 15 municipalities, including the top three largest in the state. The goals of the project were to expand the use of performance measurement in local government, to produce reliable performance and cost data for comparison, and to facilitate the use of performance and cost data for service improvement.

Data included not only financial data, but also data related to the services provided by the government (e.g., for Fire Services, service data includes things like the number of fire stations, the number of fire department responses, and fire code violations that had been reported that year). Since that time, the report has been produced annually, although the number of participating municipalities and services evaluated has not remained constant. It currently includes data on 13 services, including refuse collection, recycling, police, water, parks, and more.¹⁸³

Using this data to compare their performance against other municipalities, city leaders can identify high-performing peers and areas for improvement. Winston-Salem, one of the participating cities in the North Carolina project, provides a good example of using the

results to improve its delivery of services. For FY02-FY03, the Benchmarking Project's report showed that Winston-Salem's residential refuse collection service was the most expensive per ton of all comparison municipalities. The city used those results to make changes to its refuse collection service and reduced its operating costs.¹⁸⁴

Efforts to make local government more efficient and effective in Illinois would benefit greatly from access to data similar to what is available in North Carolina. However, the State has a long way to go before it has the capacity to produce quality data that could be used to improve efficiencies; the necessary first step will be clearly reported local government data. We reiterate the data-related recommendations we made in *Bringing Illinois Back*:

- ★ Require all local governments to report full and accurate financial data to a single State repository;
- ★ Require all local governments to report information in a standardized, consistent format; and
- ★ Provide tools, training, and other supports to local officials to meet these new requirements.

We also continue to support measures to enable and promote local government consolidation that were recommended by the State's Task Force on Local Government Consolidation and Underfunded Mandates, including:

- ★ Empowering Illinois citizens to consolidate or dissolve local governments via referendum;
- ★ Expanding DuPage County's consolidation program to all 102 counties;
- ★ Allowing all townships in the State to consolidate with coterminous municipalities via referendum;
- ★ Protecting the Intergovernmental Cooperation Act to preserve the ability of local governments to coordinate; and
- ★ Empowering State agencies to incentivize local government consolidation and cooperation.

P-12 School Funding Reform

When the Civic Committee released *Bringing Illinois Back* in May 2017, we recommended adopting a new school funding formula to reduce funding disparities between high- and low-income districts and ensure fair and equitable treatment for all Illinois students. We supported the framework developed by the Illinois School Funding Reform Commission, which identified reform elements that were critical for any new school funding model.

Soon after the conclusion of the Commission, the General Assembly considered competing bills. Both were based on the Evidence-Based Model (EBM), an approach whose underlying principles – calculation of a unique Adequacy Target for each school district based on student demographics, accounting for local resources and differentiating what each district is expected to contribute, and the creation of a distribution system that ensures State money goes to the neediest districts first – complied with the Commission’s framework.

The compromise bill that eventually emerged, Senate Bill 1947 (the “Evidence-Based Funding for Student Success Act”) was signed into law on August 31, 2017.

Key Provisions of the New School Funding Law¹⁸⁵

The Evidence-Based Funding for Student Success Act fundamentally changes the way the State provides education funding to local school districts. The law’s general components include:

- ★ An evidence-based school funding formula that prioritizes school districts with the greatest need and least property wealth;

- ★ A hold-harmless provision to ensure that no district receives less State funding than it received the prior year;
- ★ A \$350 million year-over-year increase in education funding (contingent on annual appropriations) that is distributed through the new formula. Up to \$50 million of that money can be used for property tax relief grants for high-tax, low-wealth districts;
- ★ A narrower range of funding that districts must provide to charter schools, changing the range from 75-125% of the per capita tuition charge (PCTC) to between 97% and 103% of the PCTC;
- ★ Relief for school districts regarding driver’s education and physical education mandates; and
- ★ A program providing a 75% tax credit (up to \$1 million) for contributions to organizations that provide scholarships for low-income students to attend non-public schools.

The new law also includes Chicago-specific provisions, including:

- ★ Pension parity for Chicago Public Schools (CPS) by providing State funding for the normal cost of pensions and retiree healthcare costs through new provisions in the State’s pension code;
- ★ Recognition in the funding formula of CPS’s payments to amortize its unfunded pension liabilities;
- ★ The elimination of CPS’s block grants (while keeping that funding as part of the hold-harmless provision that ensures no district receives less State funding than it received the prior year); and
- ★ An increase in the dedicated property tax that CPS may levy for teacher pensions, from .383% to .567%.

Evidence-Based Funding Model Impact on State Finances

The primary impact of the new school funding law on the State's finances is the provision calling for an increased financial contribution from the State each year.

First, the law calls for an additional \$350 million in State funding *each year* until school districts reach their Adequacy Targets. Beginning in FY19, part of the \$350 million target can be used for property tax relief – all new education money up to \$300 million will be run through the formula, and anything above that amount will be directed to the Property Tax Relief Pool Fund until it has a balance of \$50 million.¹⁸⁶ All funding increases are subject to yearly appropriations by the legislature.

Second, the State assumed the normal cost of teacher pensions and retiree healthcare for CPS which will be provided through a continuing appropriation (which does not require yearly legislative approval). The costs are variable but amount to roughly \$240 million for FY19.¹⁸⁷

Third, the State will begin indirectly picking up the cost of unfunded liabilities for Chicago teacher pensions. The new formula contains a provision that allows for the reduction of CPS's local contribution by the amount of its annual payment to amortize unfunded pension liabilities (currently more than \$570 million).¹⁸⁸ By allowing this reduction, CPS's Adequacy Gap (the difference between what CPS contributes locally and the district's Adequacy Target, the amount the State is expected to cover over time) is increased. Since funding from the State is incremental, it will take many years at current funding levels for the full value of this provision to be realized, but the annual payments to amortize

CPS's unfunded liabilities will eventually be covered by State funding.

Lastly, the new scholarship donation tax credit will cost the State as much as \$75 million a year (until it sunsets on January 1, 2024).¹⁸⁹ The actual cost to the State will depend on how many taxpayers claim the credit and what the value of each credit is.

Key Areas to Monitor in the Future

The new school funding formula is an important step forward in establishing a school funding system that is fair and equitable for all students. However, there are a few areas the State needs to monitor going forward to ensure that the law works as intended.

Pension Provisions

One of the major issues that came up during the School Funding Commission and debates around school funding proposals was the issue of pension parity. Historically, the State's annual pension contributions for teachers (including the normal cost and payments to amortize unfunded pension liabilities) have covered costs for all school districts *except* CPS. Since Chicago was the only district in the State that was required to pay the employer share of its teacher pension costs, Chicago taxpayers were on the hook for the costs of their own teacher pensions (through local property taxes) *as well as* the cost of every other school district's pensions (through State-imposed taxes).

To address this inequity, the compromise bill included some provisions to ease CPS's pension burden:

- ★ The State pension code was amended to provide a continuing appropriation for CPS's normal costs; and
- ★ Recognition of CPS's payments to amortize its unfunded pension liabilities in the formula.

The continuing appropriation for CPS's normal costs and the recognition of its payments to amortize its unfunded liabilities are an important step towards pension parity between CPS and all other school districts.

In addition, the new law addresses how other school districts' pension costs would be treated if the State shifted responsibility for pension contributions to local school districts.¹⁹⁰ If local school districts became responsible for the normal cost of their pensions, districts would be allowed to count that cost as part of their Adequacy Target (the amount of funding a district needs each year).¹⁹¹ Since the formula determines the percentage of funding the district is supposed to contribute locally (taking into account the property wealth and ability to pay in the district) and the State is supposed to fill the gap between that amount and the Adequacy Target, *the State will still end up paying a portion of the normal cost of pensions for every district.* The share of the normal cost that the State would end up paying is highest for low-wealth districts and lowest for high-wealth districts. This is more equitable than current law where the State pays a higher amount for pensions for wealthier districts than for low-wealth districts.

Additionally, if there were a normal cost shift and non-CPS districts ever accumulated unfunded pension liabilities, those districts would receive a reduction in their Local Capacity Targets like CPS does currently, meaning that they would be expected to contribute fewer local dollars than they otherwise would have been expected to contribute.¹⁹² Reducing the amount that districts are expected to contribute increases the funding gap that the State is supposed to cover, so the State would end up paying for a portion of unfunded pension liabilities.

These provisions are currently working as they should to remedy the pension parity issue between CPS and the rest of the State. However, if the State wanted to shift pension costs down to local school districts (as was proposed in Governor Rauner's FY19 budget proposal), which would increase local accountability for pension costs they incur, policymakers should be aware that the way the formula is structured currently would make it so that the State would still be responsible for paying at least part of districts' pension costs.

Property Tax Relief Pool

The funding increases called for by the new school funding formula are incremental – the law calls for \$350 million increases in State funding each year until all districts reach adequacy. However, there is one provision of the funding formula, the Property Tax Relief Pool Fund, which could divert as much as \$50 million a year away from the formula, potentially delaying the projected timeframe (10 years) for all districts to reach adequacy.

Illinois' reliance on local property taxes to fund education has led to major disparities in how well school districts are funded. Districts with more property wealth can tax themselves at lower rates and still have sufficient funding, but districts with low property wealth have had to increase their tax rates to try to make up for the shortfall between the resources they have locally, the funding they receive from the State, and their total funding need.

The Property Tax Relief Pool Fund aims to decrease the tax burden for low-wealth, high-tax districts. School districts can apply to reduce their Unit Equivalent Tax Rate (UETR)¹⁹³ by up to one percentage point, and the State Board of Education will provide a grant to the district that covers part of the lost property tax revenue. The grants are not a dollar-for-dollar swap; the amount of grant funding a district would receive depends on the amount of tax reduction, as well as the district's local capacity percentage (the share of funding the district is expected to contribute locally). Districts with the highest property taxes will get priority, and any unused portion of the fund will go through the EBF formula.

However, it is unclear how the grant process will play out or how much interest there will be from local school districts. Since the grants do not provide a total offset of lost tax revenue, school districts will have to weigh their ability and willingness to give up some funding. It is possible that districts that are far from their adequacy targets will decide it is not in their interest to trade much-needed funding for a slight tax decrease. As such, the low-wealth, high-tax districts for whom the grants are intended may not apply, and

districts that are not as needy but are willing to forgo some revenues may benefit. FY19 is the first year of the Property Tax Relief Pool Fund, which the State should monitor closely to ensure it is working as intended.

Consistent Funding

Unfortunately, given the State's history of underfunding education and prorating General State Aid (that is, appropriating less funding than the General State Aid formula required and allocating partial payments to districts that had been cut on an across-the-board percentage basis),¹⁹⁴ it is not certain that the State will fulfill its commitment to increase funding by \$350 million each year. However, the State must ensure that all districts are properly funded so that students have greater opportunity to succeed.

Historically, Illinois has contributed far less to education funding at the State level than most other states. According to data from The Education Trust, only 40% of school funding comes from the State (rather than local sources), and only four states contribute smaller shares at the State level.¹⁹⁵ This sort of funding inadequacy has contributed to a 27% achievement gap between low-income and non-low-income students, meaning that across all grade levels and subjects, the share of low-income students whose scores are deemed "proficient" is 27 percentage points lower than non-low-income students.¹⁹⁶ It is critical that the State keep its commitment to increase funding every year so that low-wealth districts have the resources they need to improve outcomes for their students.

The Every Student Succeeds Act

The Every Student Succeeds Act (ESSA) is a federal law with several different components, one of which is to provide School Improvement Grants to schools that require additional support. The grants are funded by the federal government and are intended to provide supplemental funding to provide additional support to struggling schools.

Because of the State's history of inadequate funding (particularly during the years of proration), schools that received these grants were essentially receiving money from the federal government through the front door while losing State money out the back door. With the new school funding formula focusing State money on the neediest schools, the School Improvement Grants provided through ESSA may finally be truly supplemental as they were intended, allowing schools to make long-term, sustainable changes. Again, it is critical that the State fund the formula fully so that schools receiving additional federal support have the opportunity to make sustainable improvements.

Workers' Compensation Reforms

Workers' compensation reform is needed to improve the jobs climate in Illinois. Each state has its own unique rules and regulations, but in general workers' compensation insurance covers the cost of medical care and rehabilitation for employees injured on the job and compensates them for lost wages. In return, employees give up the right to sue the employer for injuries caused by the employers' negligence or on the job.

Companies often consider the cost of workers' compensation insurance in a given state when deciding where to locate, making it an important component of a state's jobs climate. Historically, Illinois has been a higher-cost state for workers' compensation premiums and, despite recent cost reductions resulting from reforms enacted in 2011, the State continues to have several components of its workers' compensation laws that make it an outlier. The State should enact additional reforms that would bring Illinois' workers' compensation structure more in line with other states and continue to reduce workers' compensation costs to employers, while maintaining appropriate coverage and compensation for employees injured on the job.

Workers' Compensation Overview

Broadly, there are three determinants of workers' compensation costs: causation, medical care costs, and indemnity benefits.

Causation

Causation standards determine whether an injury is compensable; that is, whether it will be covered by workers' compensation insurance or the employee's regular health insurance. The injury must have occurred

within the "course and scope" of employment to fall under workers' compensation, but the standards for what constitutes the "course and scope" of employment vary significantly by state (e.g., some states specifically mention that travel to or from work does not fall under this definition). In addition, some states require additional causation standards that address the issue of pre-existing conditions and the extent to which they contributed to the workplace injury:

- ★ *Causation threshold:* If a pre-existing condition contributed to the work-related injury, is there a causation threshold that must be met for the claim to be covered under workers' compensation (e.g., must the work-related incident account for 50% or more of the injury)?
- ★ *Apportionment:* If a pre-existing condition contributed to the work-related injury, are there provisions that apportion workers' compensation benefits based on the portion due to the new injury?

Illinois has a relatively broad causation standard, requiring only that the injury stemming from employment is a cause of the injury. Once that standard has been met, no further causation threshold or apportionment is applied; the injury is compensable under workers' compensation.

Florida, by contrast, requires that work-related injuries must be the "major contributing cause" of the injury for it to be compensable. That is, an injury is only compensable under Florida's workers' compensation system if the work-related injury "remains more than 50 percent responsible for the injury as compared to all the other causes combined."¹⁹⁷ If an injury meets the high causation threshold, it is fully compensable under Florida's workers' compensation system.

Many states take a more middle of the road approach than Illinois or Florida. States such as Indiana and Connecticut will deem an injury compensable under workers' compensation if it is related to work and the scope of employment. However, they also take into account the degree to which the workplace incident contributed to the overall condition and apportion benefits accordingly (e.g., if an employee had a pre-existing knee condition and that same knee was injured further at work, the employer's workers' compensation insurance is only responsible for the portion of the injury that occurred in the workplace).

Medical Care Costs

Medical care costs are another contributing factor to Illinois' high workers' compensation costs. According to the Workers' Compensation Research Institute (WCRI), Illinois' medical costs for claims with more than seven days of lost time are 24% higher than the median for comparison states.¹⁹⁸ This is driven by two factors:

- ★ *Medical prices:* the maximum allowable fees for workers' compensation claims. Most states regulate prices through medical fee schedules; and
- ★ *Utilization:* the amount of provider visits and/or services provided for each workers' compensation claim. The more visits or services used per claim, the higher the cost of that claim.

Illinois has a medical fee schedule, but unlike many other states, it is not linked to Medicare rates. Overall, Illinois' medical fee schedule rates are 74% higher than Medicare rates, but there is quite a bit of difference between types of services. Illinois' fee schedule rate for major surgery is 296% higher than the Medicare rate; the rate for evaluation and management services is only 3% higher than the Medicare rate.¹⁹⁹

Illinois' utilization, both in terms of number of visits per claim and the number of services per visit, is also a factor in its high medical costs. Many states limit utilization of services like chiropractic care, physical therapy, and occupational therapy, but Illinois does not. According to the WCRI, Illinois continues to have one of the highest utilization rates among study states.²⁰⁰

Indemnity Benefits

Indemnity benefits are intended to compensate workers for lost wages when they are unable to work due to injury. They include temporary disability benefits for workers who are recovering from injuries, as well as permanent disability benefits for those whose injuries cause permanent impairment.

Illinois' indemnity benefits per claim were \$22,911 compared to the median state's cost of \$17,815 (these figures are adjusted for injury/industry mix and wages).²⁰¹ Three factors that contribute to Illinois' higher indemnity costs include:

- ★ Weekly benefit amounts;
- ★ Duration of benefits; and
- ★ Benefits for permanent disabilities.

Temporary Disability Benefits

Injured workers are paid temporary total disability (TTD) benefits when they are unable to return to work (or they are allowed to do light duty work, but their employer cannot accommodate them). Benefits are set at 66 2/3% of the worker's average weekly wage, subject to minimum and maximum limits. There is no statutory limit on how long an employee may receive temporary disability benefits.

TTD benefits are paid until the injured worker recovers completely or achieves maximum

medical improvement (MMI). MMI is the point at which the injured worker's condition has stabilized and no other improvement is expected, even with additional medical treatment. Once a worker reaches MMI, an assessment can be made as to whether permanent impairment exists.

Temporary disability benefits tend to be high in Illinois, contributing to the State's high indemnity costs. TTD benefit costs tend to be higher because of higher weekly benefit amounts, as well as a longer duration of TTD benefits.

Illinois' weekly TTD benefits tend to be high because Illinois has a higher statutory maximum for these benefits, even after adjusting for wage differences. Most states tie their TTD benefit amounts to the wages a worker was earning prior to their injury (as noted above, it is 66 2/3% in Illinois), subject to a maximum amount that is tied to the Statewide Average Weekly Wage (SAWW). Illinois' maximum is set to 133 1/3% of the SAWW, while most comparison states set their maximum at 100% of the SAWW.²⁰²

Workers' compensation claims in Illinois also tend to have a longer duration of temporary disability benefits compared to study states. On average, Illinois workers are out of work for 20 weeks, compared to 14 weeks in the average comparison state.²⁰³ This is likely due to a combination of factors: 1) there is no statutory limit on how long someone can receive TTD benefits (many states have limits), and 2) workers receive significantly higher maximum TTD benefits compared to what they would receive for Permanent Partial Disability. This gap in benefits may create an incentive to delay the transition from temporary to permanent disability benefits.²⁰⁴

Permanent Disability Benefits

If a work-related injury results in permanent physical loss, a worker will receive permanent disability benefits, either Permanent Total Disability (PTD) or Permanent Partial Disability (PPD).

If the injury results in permanent total disability,²⁰⁵ the worker will receive a benefit equal to two-thirds of their average weekly wage before they sustained the injury (subject to minimums and maximums) for life.

If the injury results in permanent partial disability (e.g., permanent loss of function of a body part), they are eligible for PPD benefits. PPD benefits cover four main areas:

- ★ *Wage differential benefits* – if the employee obtains a new job that pays less than their pre-injury wage, they may be entitled to a wage differential award.
- ★ *Schedule injuries* – State law includes a schedule of injuries that sets a value on certain body parts (expressed as a number of weeks of compensation).²⁰⁶ The value of an injury is determined by multiplying the percentage of loss of the injured body part by the weeks of compensation, then multiplying the resulting number of weeks by 60% of the employee's average weekly wage.
 - *For example*, the loss of a thumb is worth 76 weeks of compensation according to the schedule – if an employee was earning \$500 a week, they would be entitled to 60% of that wage times 76 weeks, or \$22,800.
- ★ *Non-schedule injuries* – if an injury is not included on the schedule of injuries, the employee may be entitled to benefits for loss of "the person of the whole." The

calculation for determining compensation is similar to scheduled injuries, with a maximum value of 500 weeks of compensation.

- ★ *Disfigurement* – an employee who suffers a serious and permanent disfigurement may be entitled to benefits based on the value of the disfigurement. Calculating the value is similar to scheduled injuries, with a maximum of 162 weeks.

A determinant of PPD benefits is the degree to which use of a body part is lost due to the injury. In some states, PPD benefits are based on medical impairment only; in Illinois, they may be based on up to five factors (one factor may not be the sole determinant of PPD benefits):

- ★ Medical impairment reports (based on the American Medical Association's "Guide for the Evaluation of Permanent Impairment");
- ★ Occupation of the injured employee;
- ★ Age at the time of injury;
- ★ Future earning capacity; and
- ★ Evidence of disability corroborated by the treating medical records.

According to the WCRI, PPD benefits in Illinois are typically viewed as a settlement after a worker gets to maximum medical improvement and tend to be paid out in lump sums (rather than weekly PPD benefits).²⁰⁷ Forty percent of injured workers in Illinois received lump-sum settlements for claims with more than seven days of lost time, which is higher than most other PPD benefit states. In addition, PPD benefit settlements tend to be higher than other states. For 2014/17 claims, Illinois' average lump-sum payment per claim was \$29,844, compared to \$24,376 for the median state.²⁰⁸

Workers' Compensation Premiums

Workers' compensation premiums are the costs faced by employers to provide insurance for work-related injuries to their employees. The premiums reflect the costs (both medical care and indemnity benefits) an insurer is likely to face if there is a workers' compensation claim. The premiums can vary significantly from state to state depending on each state's workers' compensation laws, as well as across industries.

Premiums are based on the "pure premium" (the amount of premium necessary to pay for workers' compensation claims) and the "expense load factor" (the amount necessary to cover the insurer's expenses, taxes, and profit) for different occupational classes. These two factors represent the total costs that workers' compensation insurers face, and together represent a "manual rate," which provides a recommended rate for insurers to charge. In most states, including Illinois, the manual rate is determined by the National Council on Compensation Insurance (NCCI).²⁰⁹

However, insurers may modify the manual rates based on other factors, such as premium discounts for quantity purchases, experience modification factors, and premium discounts for policies carrying deductible features. As a result, even when a state experiences reductions in its workers' compensation costs (as Illinois did after reforms were enacted in 2011), the rates insurers charge may not fully reflect those cost reductions.

Past Reform Efforts

In an effort to reduce workers' compensation costs, the General Assembly passed a package of reforms in 2011. The 2011 reforms made the following significant changes to Illinois' workers compensation system:

- ★ Reduced medical fee schedule rates by 30%;
- ★ Created a preferred provider program limiting workers' choice of medical providers;
- ★ Set utilization review standards;
- ★ Allowed the use of the American Medical Association's "Guide for the Evaluation of Permanent Impairment" as one of the factors in determining permanent disability benefits;²¹⁰
- ★ Set limits on carpal tunnel permanency; and
- ★ Established a cap on wage differential benefits.

Immediately following the reforms, workers' compensation costs decreased. Prior to the 2011 reforms, Illinois' total cost per claim with more than seven days lost time was 37% higher than the median state; afterwards, it was 19% higher than the median state.²¹¹

However, despite the initial reduction in costs due to the 2011 reforms, Illinois continues to have the highest total costs for all claims paid among study states: for all paid claims for 2014/17, Illinois' total costs per claim were \$16,025, compared with \$10,632 for the median state.²¹² In addition, Illinois' indemnity benefit costs remain comparatively high at \$22,911 per claim compared with the median state's cost of \$17,815 per claim.²¹³

The cost savings have also been reflected in lower workers' compensation premiums for businesses in Illinois. In 2010, before the reforms, Illinois' workers' compensation premiums were 49% above the median U.S. state; in 2016, Illinois' premiums were 21% higher than the median state. Premium rates in Illinois have continued to decrease and were 6% higher than the median in 2018.

Illinois now has the 22nd highest workers' compensation premiums in the country, compared with the 8th highest in 2016.²¹⁴

Since premiums had remained high for employers despite the 2011 reforms, the Illinois General Assembly has frequently considered additional workers' compensation legislation. Most recently, in 2017, the General Assembly passed two bills that primarily address workers' compensation premiums, but not the underlying costs of workers' compensation claims.

HB2525, sponsored by Senator Raoul and Representative Hoffman, focused on the concern that insurance companies have not passed on savings to employers in the form of lower premiums. Its main provisions included "prior approval" of rates for insurers and rating agencies, a repeal of provisions regarding the presumption that a competitive market prevents excessive profit, and clarification of workers' compensation for injuries related to employee travel.²¹⁵ HB2622, introduced by Representative Fine and Senator Biss, would have established the Illinois Employer Mutual Insurance Company, which aimed to reduce premiums through increased competition in the market.²¹⁶

The two bills passed both chambers, but Governor Rauner vetoed them, noting that they did not adequately address the structural flaws of Illinois' workers' compensation system or represent "real reform."²¹⁷ (When the Senate was debating the components of the so-called "Grand Bargain" in 2017, the Governor pushed for workers' compensation reforms such as much stricter causation standards, but the parties did not come to an agreement.)

Recommended Reforms

Although the State has made progress in reducing workers' compensation costs, there are still significant opportunities for improvement. The State should make additional reforms to become less of an outlier and align itself with the best practices of other states by:

- ★ Defining traveling employees in statute (i.e., codifying the factors that determine whether or not an employee is required to travel for work);
- ★ Following best practices of other states and tying its medical fee schedules to Medicare rates;
- ★ Adopting limits on utilization of certain medical services;
- ★ Implementing best practices for reducing the average length of temporary disability; and
- ★ Adjusting the use of AMA guides for determining impairment so that AMA guides have more weight but are not mandatory.

Endnotes

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⁴⁵ The best practices (and therefore, categories and subcategories the Volcker Alliance grades states on) are based on academic research and the Volcker Alliance's State Budget Crisis Task Force project. Source: The Volcker Alliance, "Truth and Integrity in State Budgeting: What is the Reality?" 2017.

⁴⁶ Ibid, pp. 12-13.

⁴⁷ The Civic Federation, "Forecasting Revenue for the State of Illinois," April 20, 2018.

⁴⁸ State of Illinois Governor's Office of Management and Budget, "General Funds Financial Walk Down, FY18-FY23." October 2017.

⁴⁹ Governor's Office of Management and Budget, "Illinois State Budget: Fiscal Year 2019," February 14, 2018, p. 31.

⁵⁰ "Scoop and toss" refers to the practice of repaying maturing bonds by selling new long-term debt (thereby extending the time the state has to pay off the obligation).

⁵¹ State of Illinois, "Official Statement: General Obligation Refunding Bonds, Series of September 2018," August 22, 2018, pp. 31-32.

⁵² The State's contributions are currently lower than the normal cost plus interest or the contribution level that would prevent the unfunded liabilities from growing. An "actuarially determined" or "actuarially required" contribution would include this amount, plus a payment to amortize some of the unfunded liability.

⁵³ Commission on Government Forecasting and Accountability, "Illinois State Retirement Systems: Financial Condition as of June 30, 2017," March 2018, p. 34.

⁵⁴ The Civic Federation, "State of Illinois FY2019 Budget Roadmap: State of Illinois Budget Overview, Projections and Recommendations for the Governor and the Illinois General Assembly," February 9, 2018, p. 41.

⁵⁵ Ibid, p. 41.

⁵⁶ “Truth and Integrity in State Budgeting,” pp. 9, 39.

⁵⁷ Utah State Legislature. <https://budget.utah.gov>.

⁵⁸ “Truth and Integrity in State Budgeting,” p. 40.

⁵⁹ The baseline budget shows the trajectory of expected revenues and expenditures absent any major policy changes.

⁶⁰ State of New York, “FY2019 Enacted Budget Financial Plan,” May 2018, p. 28.

⁶¹ The Civic Federation, “How Will Illinois Fund its Infrastructure Needs?” January 26, 2018.

⁶² Regional Transportation Authority, “2018-2023 Regional Transit Strategic Plan,” p.14.

⁶³ The Civic Committee of the Commercial Club of Chicago, *Bringing Illinois Back: A Framework for our Future*, May 2017.

⁶⁴ State of Illinois, “Official Statement: General Obligation Refunding Bonds, Series of September 2018,” August 22, 2018, p. 28.

⁶⁵ *Ibid*, pp. 28-30.

⁶⁶ A recent court ruling in requires the State to pay retroactive step increases to State employees, which will cost approximately \$400 million for FY19. The enacted budget does not appropriate for any of these costs. *Ibid*, pp. 31-33.

⁶⁷ *Ibid*, p. 11.

⁶⁸ State of Illinois Governor’s Office of Management and Budget, “General Funds Financial Walk Down, FY19-FY24.” November 2018.

⁶⁹ “General Funds Financial Walk Down, FY18-FY23.” October 2017.

⁷⁰ State of Illinois Governor’s Office of Management and Budget, “Illinois Economic and Fiscal Policy Report,” November 15, 2018.

⁷¹ *Ibid*.

⁷² The backlog peak occurred in November 2017. State of Illinois Comptroller’s Office, “Backlog Voucher Report,” August 22, 2018.

⁷³ GOMB, “General Funds Financial Walk Down, FY19-FY24.”

⁷⁴ The State uses a discount rate (equal to the expected annual investment returns on pension assets) to calculate the present value of all future pension liabilities. This determines what the State needs to contribute to its pension funds each year to keep the unfunded liability from growing. If the State does not meet the Normal Cost plus Interest amount, the difference between the State’s contribution and the Normal Cost plus Interest amount is added to its unfunded liabilities. Source: R. Eden Martin and Kirsten Carroll, “Illinois’ Pension Crisis and Recommendations for Reform,” Taxpayers’ Federation of Illinois, *Tax Facts*, October 2009. pp. 2-3.

⁷⁵ The total increase in unfunded liabilities was \$110.1 billion from FY96-FY17. Other factors resulting in higher unfunded liabilities include assumption changes and demographics. Source: Commission on Government Forecasting and Accountability, “Illinois State Retirement Systems: Financial Condition as of June 30, 2017,” March 2018, p. 34.

⁷⁶ The Governmental Accounting Standards Board (GASB) requires reporting the Actuarially Determined Contribution (ADC) instead of the old standard, the Annual Required Contribution (ARC). The ARC and ADC are similar in function—they are ways to calculate a contribution in compliance with actuarial practices and methods. Pension plans have a fair amount of latitude in terms of acceptable amortization methods; the ADCs described in this report are those calculated by the plans themselves according to their own standards.

⁷⁷ Civic Committee calculations. Original data: Teachers’ Retirement System of the State of Illinois, “Actuarial Valuation and Review of Pension Benefits as of June 30, 2017,” p. 4; State Employees’ Retirement System of Illinois, “Annual Actuarial Valuation as of June 30, 2017,” p.3; General Assembly Retirement System of Illinois, “Annual Actuarial Valuation as of June 30, 2017,” p. 14; Judges’ Retirement System of Illinois, “Annual Actuarial Valuation as of June 30, 2017,” p. 12; State Universities Retirement System of Illinois, “Actuarial Valuation Report as of June 30, 2017,” p. 33.

⁷⁸ Calculated as the Estimated FY19 General Funds contribution (not including savings from the pension buyout plans that were assumed in the enacted FY19 budget) divided by General Funds expenditures from the enacted FY19 budget. Sources: “Illinois State Retirement Systems: Financial Condition as of June 30, 2017,” p. iii; Commission on Government Forecasting and Accountability, “State of Illinois Budget Summary: Fiscal Year 2019,” August 1, 2018, p. 26.

⁷⁹ A portion of the State’s pension contribution comes from non-General Funds sources; the total pension contribution across all funds is projected to be approximately \$8.5 billion for FY19. Source: Illinois State Retirement Systems: Financial Condition as of June 30, 2017,” p. iii.

⁸⁰ This growth rate is the CAGR for projected contributions from 2020-2045.

⁸¹ The shift to local employers will cover TRS and SURS. Source: Governor’s Office of Management and Budget, “FY2018 Operating Budget Book,” February 15, 2017, pp. 176-177.

⁸² The Civic Federation, “State of Illinois FY2019 Recommended Operating and Capital Budgets: Analysis and Recommendations,” May 9, 2018, p. 17.

⁸³ In order to be eligible as a “vested, inactive member,” three criteria must be met: the member has terminated service, they have accrued sufficient service credit to be eligible for a retirement annuity, and they have not yet

received any retirement annuity. Source: State of Illinois, "Official Statement: General Obligation Refunding Bonds, Series of September 2018," August 22, 2018, p. E-32.

⁸⁴ State of Illinois Governor's Office of Management and Budget, "General Funds Financial Walk Down, FY19-FY24," November 2018.

⁸⁵ "Assessing Illinois Pensions: An Examination of Illinois TRS, SERS, SURS," Presentation to the Civic Committee on May 9, 2018. Brian Septon, FSA, Principal, The Terry Group.

⁸⁶ Ibid.

⁸⁷ Constitution of the State of Illinois, Article XIV: Constitutional Revision, Section 2.

⁸⁸ Ibid.

⁸⁹ The unfunded liabilities of the five pension systems peak in 2028 at approximately \$146 billion. Source: "Illinois State Retirement Systems: Financial Condition as of June 30, 2017," p. 105.

⁹⁰ Katherine Loughhead, "How Well-Funded are Pension Plans in Your State?" The Tax Foundation, May 17, 2018. <https://taxfoundation.org/state-pensions-funding-2018/>. Accessed December 5, 2018.

⁹¹ The interest the State needs to pay each year to keep the unfunded liability from growing is the discount rate times the unfunded liability. If that amount isn't met, it is added to the unfunded liability. By increasing contributions to a level that reduces the unfunded liability, the total amount of interest will be reduced.

⁹² Contributions are set at a level percent of payroll from 2011-2045. If more funding is added to the pension funds upfront, required contributions for the remaining years of the payment schedule will decrease to keep them at a level percent of payroll (since the goal of 90% funded by 2045 remains the same).

⁹³ Before any policy decisions are made with respect to pension funding, analysis should be verified by the actuaries of the pension plans and be analyzed using an enterprise-wide stress testing. All projections are for policy analysis purposes only.

⁹⁴ Because the supplemental contributions are outside the pension funds and do not cause payments to be adjusted to fit the 90% goal (as the statutory payment schedule would if additional money were deposited directly into the funds), funding would be projected to reach 93.4% by 2039 for an additional \$2 billion a year and 89.6% by 2034 for an additional \$4 billion a year. This analysis assumes the first supplemental payment would be made mid-year in FY2020.

⁹⁵ Contribution amounts are in 2018 dollars (assuming 2.5% inflation). "Total state contribution" is calculated as the sum of all pension contributions (including supplemental contributions) from FY2020 until FY2065. From 2045 to 2065, contributions will only be the normal cost plus interest amount required to maintain 90% funding. This

analysis assumes the same return assumptions for the supplemental contributions as the State's required contribution.

⁹⁶ Total contributions represent the sum of all contributions until the funds reach 90% funded, plus contributions made to maintain 90% thereafter until 2075.

⁹⁷ Tongxuan (Stella) Yang and Olivia S. Mitchell, "Public Pension Governance, Funding, and Performance: A Longitudinal Appraisal," Pension Research Council at the Wharton School of the University of Pennsylvania, PRC Working Paper 2005-02, p. 21, 2005.

⁹⁸ Ibid, p. 18.

⁹⁹ Thomas J. Fitzpatrick IV and Amy B. Monahan, "Who's Afraid of Good Governance? State Fiscal Crises, Public Pension Underfunding, and the Resistance to Governance Reform," Federal Reserve Bank of Cleveland, Working Paper no. 12-23, p. 30, 2012.

¹⁰⁰ Amanda Kass, "The Illinois Comptroller is Withholding Funds from a Chicago Suburb, and Other Towns Could Follow," April 15, 2018. <https://amandakass.blog/2018/04/15/the-illinois-comptroller-is-withholding-funds-from-a-chicago-suburb-and-other-towns-could-follow/>. Accessed December 5, 2018.

¹⁰¹ Rebecca Susmarski, "Pensions Account for 67 percent of City Property Tax Revenue," The Register-Mail, August 26, 2018. <https://www.galesburg.com/news/20180826/pensions-account-for-67-percent-of-city-property-tax-revenue>. Accessed December 5, 2018.

¹⁰² Civic Committee Calculations. Source: Illinois Department of Insurance, Public Pension Division, "2017 Biennial Report (2015-2016)," p. 5, October 1, 2017.

¹⁰³ The Civic Federation, "Illinois FY2019 Budget Still Faces Major Hurdles," October 5, 2018.

¹⁰⁴ Sara Burnett, "Illinois Pension Buyouts May Not Bring Savings Budget Claims," Associated Press, June 1, 2018.

¹⁰⁵ State of Illinois, "Official Statement: General Obligation Refunding Bonds, Series of September 2018," p. E-33, August 22, 2018.

¹⁰⁶ "FY2019 Liabilities of the State Employees' Group Health Insurance Program," p. 15.

¹⁰⁷ The Civic Federation, "Governor's FY2019 Budget Depends on Benefit Cost Shift," February 23, 2018.

¹⁰⁸ Commission on Government Forecasting and Accountability, "State of Illinois Budget Summary: Fiscal Year 2019," August 1, 2018, p. 26.

¹⁰⁹ Governor's Office of Management and Budget, "Illinois State Budget: Fiscal Year 2019," February 14, 2018, p. 31.

¹¹⁰ GRS Retirement Consulting, "Illinois State Employees Group Insurance Program, GASB Statement No. 75,

Accounting and Financial Reporting for Postemployment Benefits Other than Pensions (Actuarial Valuation Report as of June 30, 2016)," pp. A1-A2.

¹¹¹ The Civic Federation, "Court Ruling on Health Insurance Could Add to State of Illinois Budget Woes," July 9, 2014.

¹¹² Ibid.

¹¹³ Ibid.

¹¹⁴ "FY2019 Liabilities of the State Employees' Group Health Insurance Program," p. 24.

¹¹⁵ This figure represents the present value of SEGIP retirement benefits (on average) for new employees, which includes healthcare, dental, vision, and life insurance benefits. It assumes that the new hire is 30 years old and will be Medicare eligible. It is calculated using the plan's discount rate and medical trend assumptions. Source: Analysis prepared for the Civic Committee by the Terry Group for policy analysis purposes. These results should not be relied on for other purposes and any actuarial analysis should be verified by the system itself.

¹¹⁶ The Pew Charitable Trusts, "State Retiree Health Care Liabilities: An Update," September 19, 2017.

¹¹⁷ Meeting with David Johnson, Partner, Franczek Radelet PC. October 3, 2018.

¹¹⁸ Governor's Office of Management and Budget, "Illinois State Budget: Fiscal Year 2019," February 14, 2018, p. 64.

¹¹⁹ David F. Merriman, Chuanyi Guo, and Di Qiao, "No Magic Bullet: Constructing a Roadmap for Illinois Fiscal Sustainability," Institute of Government and Public Affairs at the University of Illinois, March 1, 2018, p. 4.

¹²⁰ State of Illinois Comptroller's Office, "Fiscal Responsibility Report Card, 2016," Local Government Division, p. 17.

¹²¹ "State of Illinois Budget Summary: Fiscal Year 2019," August 1, 2018, p. 26.

¹²² US Census Bureau, "2012 Census of Governments."

¹²³ The Local Government Distributive Fund (LGDF) disburses State income tax revenues to localities according to a formula. The General Assembly included \$1.25 billion for LGDF deposits in the FY19 budget. Source: Commission on Government Forecasting and Accountability, "State of Illinois Budget Summary: Fiscal Year 2019," August 1, 2018, p. 23.

¹²⁴ The total state sales tax rate of 6.25% can be broken down into two pieces: 5% goes into State coffers and the remaining 1.25% is distributed to local governments according to a formula.

¹²⁵ In FY14, the most recent year of data available with income tax rates comparable to today (before the temporary income tax increase expired in 2015, the rate was 5%; today it is 4.95%), Illinois' revenues as a percentage of GSP were below the national average but its taxes as a

percent of GSP were 14th highest. Source: *Bringing Illinois Back: A Framework for our Future*, p. 12.

¹²⁶ Of particular note is the State's relatively low federal match on Medicaid spending for those who were eligible before the expansion of Medicaid under the Affordable Care Act. Illinois' Federal Medical Assistance Percentage (FMAP) is ranked 42nd and the State gets roughly \$1 for every \$1 spent by the State for this population. The State with the highest FMAP, Mississippi, gets roughly \$3.25 for every \$1 it spends on this population. The FMAP is calculated using a formula that takes into account the average per capita income for a state relative to the national average. Source: The Kaiser Family Foundation, "Federal Medical Assistance Percentage (FMAP) for Medicaid and Multiplier: FY19," <https://www.kff.org/medicaid/state-indicator/federal-matching-rate-and-multiplier/?currentTimeframe=0&sortModel=%7B%22collid%22:%22Location%22,%22sort%22:%22asc%22%7D#>. Accessed October 24, 2018.

¹²⁷ Based on FY16 state and local government financial data from the Census Bureau. Since data is from FY16 (when the State's personal and corporate income taxes were lower), it has been adjusted to reflect today's current tax rates. Source: Taxpayers' Federation of Illinois.

¹²⁸ Jared Walczak, Scott Drenkard, and Joseph Bishop-Henchman, "2019 State Business Tax Climate Index," The Tax Foundation, 2018. p. 3.

¹²⁹ For example, North Carolina is another flat tax state whose tax rate is approximately .5 percentage points higher (5.499% rate), and its ranking was 16th out of all states.

¹³⁰ The State is not obligated to meet the 7:5 ratio. The Illinois Constitution prohibits a ratio of more than 8:3, but does not require the State to raise personal and corporate income tax rates proportionately. Source: Illinois Constitution, Article IX, Section 3(a).

¹³¹ The corporate income tax is comprised of two parts: the base rate, which goes into State coffers, and the Corporate Personal Property Replacement Tax (CPPRT), which is collected by the State but is distributed to local governments. The base rate is currently 7%; the CPPRT is an additional 2.5% surcharge. Source: *Bringing Illinois Back: A Framework for our Future*, p. 17.

¹³² For example, someone who inherits an IRA (and is required by law to take distributions from that IRA) would not have to pay taxes on any of that income.

¹³³ Civic Committee calculations. Original data: Illinois Department of Revenue, Report IDs TDWR-IITEOY-002 and TDWR-IITEOY-017, Tax Years 2007-2015.

¹³⁴ Civic Committee calculations. Original data: Illinois Department of Revenue, "Illinois Individual Income Tax: Retirement Subtraction- Tax Year 2015," Final 1040 IIT Return File (August 2017).

¹³⁵ This figure assumes a 5.95% personal income tax rate. It also assumes no means testing beyond the current exemption phase out levels in place (\$250,000 for single filers, \$500,000 MFJ).

¹³⁶ Technically, Illinois' "sales tax" is actually a combination of four taxes: the Retailer's Occupation Tax (ROT), the Use Tax, the Service Occupation Tax (SOT), and the Service Use Tax (SUT). The four taxes are generally collectively referred to as the Sales Tax. Source: Source: Natalie Davila, Terry Crumly, Mike Klemens, Tom Johnson, and Mike Scaduto, "Illinois Business Taxes: Identifying Where Illinois is an Outlier," 2015, p. 44.

¹³⁷ The State portion of the sales tax is 5%, but it also collects an additional 1.25% that is distributed to local governments.

¹³⁸ Jared Walczak and Scott Drenkard, "State and Local Sales Tax Rates 2018," The Tax Foundation, Fiscal Fact No. 572. February 2018.

¹³⁹ This figure does not include excise taxes the State levies. Including excise taxes would bring Illinois' ranking up to 25th. Data provided by the Taxpayers' Federation of Illinois.

¹⁴⁰ Illinois Department of Revenue, "Excise Tax Rates and Fees," <https://www2.illinois.gov/rev/research/taxrates/Pages/excise.aspx>. Accessed November 13, 2018.

¹⁴¹ This survey looks at whether services are taxed, not how they are taxed (e.g., whether a service is subject to a general sales tax vs. an excise tax). Source: Federation of Tax Administrators, "FTA Survey of Services Taxation – Update," By the Numbers, July-August 2017.

¹⁴² It is a widely held principle that products should only be taxed on the final sale to avoid taxing on top of a tax (as could occur if inputs are taxed too), or "tax pyramiding." "Illinois Business Taxes: Identifying Where Illinois is an Outlier," p. 47.

¹⁴³ The Commission on Government Forecasting and Accountability considers full compliance to be 90%. This is based off of academic research, as well as discussions with the National Conference of State Legislatures and the Illinois Department of Revenue. Source: Commission on Government Forecasting and Accountability, "Service Taxes 2017 Update," January 2017, p. 9.

¹⁴⁴ Ibid, p. 11.

¹⁴⁵ Capital-based taxes are sometimes calculated on assets or net worth of a business; sometimes they are based on the capital stock of the company. Source: "Illinois Business Taxes: Identifying Where Illinois is an Outlier," p. 99.

¹⁴⁶ Paid-in capital refers to capital contributed to a corporation by investors through purchase of stock from the corporation.

¹⁴⁷ Ibid, p. 102.

¹⁴⁸ Morgan Scarboro, "Does Your State Levy a Capital Stock Tax?" The Tax Foundation, October 5, 2017.

¹⁴⁹ "Illinois Business Taxes: Identifying Where Illinois is an Outlier," p. 104.

¹⁵⁰ Commission on Government Forecasting and Accountability, "3-Year Budget Forecast, FY2019-FY2021," March 2018, p. 11.

¹⁵¹ Jared Walczak, "State Inheritance and Estate Taxes: Rates, Economic Implications, and the Return of Interstate Competition," The Tax Foundation, Special Report No. 235, p. 7. July 2017.

¹⁵² "3-Year Budget Forecast, FY2019-FY2021," p. 11.

¹⁵³ There were several iterations of federal estate or inheritance taxes prior to 1916, but they were all temporary. Source: Jeffrey A. Cooper, "Interstate Competition and State Death Taxes: A Modern Crisis in Historical Perspective," *Pepperdine Law Review*, Vol.33, Issue 4, 2006.

¹⁵⁴ Darien B. Jacobson, Brian G. Raub, and Barry W. Johnson, "The Estate Tax: Ninety Years and Counting," Internal Revenue Service, p. 120. <https://www.irs.gov/pub/irs-soi/ninetyestate.pdf>.

¹⁵⁵ Jeffrey A. Cooper, "Interstate Competition and State Death Taxes: A Modern Crisis in Historical Perspective," *Pepperdine Law Review* Vol. 33, Issue 4, p. 857. May 15, 2006.

¹⁵⁶ "State Inheritance and Estate Taxes: Rates, Economic Implications, and the Return of Interstate Competition," p. 7.

¹⁵⁷ Ibid, p. 8.

¹⁵⁸ According to the authors of the study, federal estate tax returns are the only kind of data available that provides information on a significant number of wealthy people and their locations. Source: Jon Bakija and Joel Slemrod, "Do the Rich Flee from High State Taxes? Evidence from Federal Estate Tax Returns," National Bureau of Economic Research, Working Paper 10645, July 2004. p. 4.

¹⁵⁹ The average effective state estate and inheritance tax rate for each wealth class is defined as the combined federal and state estate and inheritance tax liability as a share of net worth, less what it would be in a state with only a "pick up" estate tax. Ibid, pp. 5, 11.

¹⁶⁰ Federal estate taxes reflect the reported state of residence at the date of death, which may or may not reflect where high wealth individuals actually lived (state rules governing establishing residency vary). Ibid, pp. 4, 15-16.

¹⁶¹ The study does not address the reason for the change in migration pattern, rather, it only measures the estimated impact of that migration. Source: John Havens, "Migration of Wealth in New Jersey and the Impact on Wealth and Philanthropy," Center on Wealth and Philanthropy, Boston College, January 22, 2010. p. 2.

¹⁶² "Illinois Business Taxes: Identifying Where Illinois is an Outlier," p. 88.

¹⁶³ Current rankings are based on Civic Committee calculations using data available as of September 2018. Previous rankings are based on data available as of November 2016. Original Data: Bureau of Economic Analysis, "GDP in Current Dollars: Percent Change from Preceding Period, 2016-2017"; Bureau of Economic Analysis, "SA1 Personal Income Summary: Personal Income, Population, Per Capita Personal Income, 2017"; Bureau of Labor Statistics, "Local Area Unemployment Statistics (seasonally adjusted), June 2018"; Bureau of Labor Statistics, "State and Area Employment, Hours, and Earnings (total nonfarm, seasonally adjusted), June 2018".

¹⁶⁴ State of Illinois Governor's Office of Management and Budget, "General Funds Financial Walk Down, FY19-FY24." November 2018.

¹⁶⁵ Email from Chris Mier, CFA, Managing Director, Analytical Services Division, Loop Capital. October 17, 2018.

¹⁶⁶ US Census Bureau, "2012 Census of Governments."

¹⁶⁷ General and Special purpose governments include counties, municipalities, townships, and special purpose governments (e.g., park districts). Source: State of Illinois Comptroller's Office, "Fiscal Responsibility Report Card, 2016," Local Government Division, p. 18.

¹⁶⁸ Civic Committee calculations. Original source: "Fiscal Responsibility Report Card" pp. 19, 21, 24.

¹⁶⁹ Ibid, p. 18.

¹⁷⁰ Calculated as aggregate property taxes paid for owner-occupied residences divided by the value of those homes. Data provided by the Taxpayers' Federation of Illinois.

¹⁷¹ Average local tax rates are calculated as a weighted average. Source: "State and Local Sales Tax Rates 2018," February 2018.

¹⁷² Illinois Department of Revenue, "Annual Report of Collections Remitted to the State Comptroller," December 2017.

¹⁷³ The Civic Federation, "Update: How the State of Illinois FY2019 Enacted Budget will Affect Local Governments," June 14, 2018.

¹⁷⁴ Civic Committee calculations. Source: Illinois Department of Revenue, Property Tax Statistics, "Table 3: Property Tax Extensions by Type of District, 2015-2016," and "Table 4: Number of Taxing Districts by Type, 2007-2016."

¹⁷⁵ Douglas J. Gagnon and Marybeth J. Mattingly, "Limited Access to AP Courses for Students in Smaller and More Isolated Rural School Districts," Carsey Research National Issue Brief #80, University of New Hampshire Carsey School of Public Policy, Winter 2015.

¹⁷⁶ Skrikant Deveraj, PhD, Dagney Faulk, PhD, and Michael J. Hicks, PhD, "School Corporation Size and Student

Performance: Evidence from Indiana," Center for Business and Economic Research at Ball State University, August 15, 2017.

¹⁷⁷ DuPage County, "DuPage ACT Initiative Overview," <https://www.dupageco.org/ACTInitiative/>. Accessed October 16, 2018.

¹⁷⁸ Ulrich Boser, "Size Matters: A Look at School District Consolidation," Center for American Progress, August 2013.

¹⁷⁹ Lt. Governor Evelyn Sanguinetti, "Journal of Local Government Shared Service Best Practices, Second Edition," State of Illinois, July 31, 2018.

¹⁸⁰ State of Illinois Comptroller's Office, "Filing Requirements," <https://illinoiscomptroller.gov/financial-data/local-government-division/about-the-local-government-division/filing-requirements/>. Accessed October 16, 2018.

¹⁸¹ "Fiscal Responsibility Report Card," p. 15.

¹⁸² Transform Illinois, "2018 Spring Session Recap," <https://www.transformillinois.org/legislation>. Accessed October 16, 2018.

¹⁸³ North Carolina Local Government Performance Measurement Project, "Final Report on City Services for Fiscal Year 2015-2016: Performance and Cost Data," May 2017, pp. 3-8.

¹⁸⁴ Marc Holzer, John Fry, Etienne Charbonneau, Norma Riccucci, Sunjoo Kwak, and Eileen Burnash, "Literature Review and Analysis Related to Measurement of Local Government Efficiency," Local Unit Alignment, Reorganization, and Consolidation Commission. Rutgers University- Newark School of Public Affairs and Administration, May 6, 2009, p. 17.

¹⁸⁵ State of Illinois, "The Evidence-Based Funding for Student Success Act," PA 100-0465.

¹⁸⁶ "How the Property Tax Relief Pool Fund Drives Equity," Advance Illinois, p.1. June 9, 2018.

¹⁸⁷ "CPS Fiscal Year 2019 Budget- Pensions," Chicago Public Schools, <https://cps.edu/fy19budget/Pages/pensions.aspx>. Accessed September 12, 2018.

¹⁸⁸ Ibid.

¹⁸⁹ "Senate Bill 1947 Frequently Asked Questions," Funding Illinois' Future. http://fundingillfuture.org/wp-content/uploads/2017/09/SB1947_FAQ_092617.pdf. Accessed September 12, 2018.

¹⁹⁰ "Shifting responsibility" includes everything from a full normal cost shift (as was proposed in the Governor's FY19 budget), to responsibility for normal costs for new employees going forward (e.g., Tier 3), to the new requirement for employers to cover the cost of pensions above the 3% "spiking" cap.

¹⁹¹ Currently, this provision does not apply to any school district.

¹⁹² The formula determines the funding a school district is supposed to contribute locally, which is the “Local Capacity Target.” The law provides that districts with unfunded pension liabilities may subtract their payment to amortize the unfunded liability from their Local Capacity Target, which increases the gap the State must cover over time. Currently, this provision only applies to CPS because it is the only district responsible for its unfunded pension liabilities.

¹⁹³ The Unit Equivalent Tax Rate converts the school district’s operating tax rate to a uniform rate that accounts for discrepancies in the number of grades served by each type of school district. Source: “How the Property Tax Relief Pool Fund Drives Equity,” *Advance Illinois*, p.3. June 9, 2018.

¹⁹⁴ The new formula has a contingency plan for underfunding. If the State does not appropriate enough money to cover the Base Funding Minimum, the most adequately funded districts will lose money they’ve gotten through the formula first. If that is not enough to cover the shortfall, all districts would lose dollars on a per-pupil basis (rather than a percentage basis, as was the case with proration). Source: “Senate Bill 1947 Frequently Asked Questions,” *Funding Illinois’ Future*. http://fundingillfuture.org/wp-content/uploads/2017/09/SB1947_FAQ_092617.pdf. Accessed September 12, 2018.

¹⁹⁵ “The State of Education Funding in Illinois,” The Education Trust. <https://edtrust.org/graphs/?sname=Illinois>. Accessed January 29, 2019.

¹⁹⁶ “Illinois- Summary PARCC Performance by Low Income, Non Low Income- Composite,” *Illinois Report Card*, ISBE. <https://www.illinoisreportcard.com/state.aspx?source=trends&source2=achievementgapparcc&Stateid=IL>. Accessed September 12, 2018.

¹⁹⁷ State of Florida Statute §440.09 (1b).

¹⁹⁸ Evelina Radeva, “CompScope Medical Benchmarks for Illinois, 18th Edition,” *Workers’ Compensation Research Institute*, October 2017, p. 13.

¹⁹⁹ *Ibid*, p. 204.

²⁰⁰ *Ibid*, p. 7.

²⁰¹ For claims with >7 days lost time for 2014/17 (the first year listed in the dates for claims indicates the injury year; the second year indicates the maturity of the claim). Evelina

Radeva, “CompScope Benchmarks for Illinois, 18th Edition,” *Workers’ Compensation Research Institute*, October 2017, p. 18.

²⁰² *Ibid*, pp. 20-21.

²⁰³ *Ibid*, p. 22.

²⁰⁴ *Ibid*, pp. 22-24.

²⁰⁵ Either a complete disability that renders an employee unable to work or the complete loss of use of both hands, both arms, both feet, both legs, both eyes, or any two parts, e.g., one leg and one arm. Source: State of Illinois, 820 ILCS 305/8(f).

²⁰⁶ State of Illinois, “Permanent Partial Disability Benefits: Schedule of Body Parts,” <https://www2.illinois.gov/sites/iwcc/Documents/ppdschedule.pdf>. Accessed November 14, 2018.

²⁰⁷ “CompScope Benchmarks for Illinois, 18th Edition,” p. 24.

²⁰⁸ *Ibid*, p. 25.

²⁰⁹ “Oregon Workers’ Compensation Premium Rate Ranking: Calendar Year 2016,” *Central Services Division*, State of Oregon, p. 6. December 2016.

²¹⁰ When determining partial permanent disability (PPD) benefits, Illinois allows five different factors to be considered, including the AMA guide. However, the law does not allow any of the five factors to be the sole determinant of PPD benefits.

²¹¹ Comparison years for claims were 2008/2011 and 2012/2015. “CompScope Benchmarks for Illinois,” p. 6.

²¹² *Ibid*, p. 12.

²¹³ *Ibid*, p. 18.

²¹⁴ Chris Day and Jay Dotter, “2018 Oregon Workers’ Compensation Premium Rate Ranking Summary,” *Department of Consumer and Business Services*, State of Oregon, p. 2. October 2018.

²¹⁵ Illinois General Assembly, House Bill 2525, 100th General Assembly.

²¹⁶ Illinois General Assembly, House Bill 2622, 100th General Assembly.

²¹⁷ Governor’s Veto of HB2525, August 25, 2017.



Civic Committee
COMMERCIAL CLUB OF CHICAGO

RESTORE ILLINOIS:

A FOUNDATION FOR GROWTH