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SPECIAL REPORT BUDGET & TAX

Budget Solutions 2014:
Pension reform and responsible spending for state and local governments

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ILLINOIS POLICY INSTITUTE

About the Illinois Policy Institute

Vision

The Illinois Policy Institute's vision is to make Illinois first in economic outlook and job creation and to become a free enterprise leader for the rest of America.

Mission

The Illinois Policy Institute inspires changes in hearts, minds and laws through its mission to promote personal freedom and prosperity in Illinois and America. As a leading independent research and education organization, the Illinois Policy Institute generates positive and sustainable policy solutions for citizens and lawmakers that help unleash talent and entrepreneurial ability.

Approach

The Illinois Policy Institute's approach is to transform liberty principles into marketable policies that become law. The ultimate sign of success is when free market ideas are turned into law and change lives for the better. What does this look like? Individuals and businesses become more prosperous without the fear of government favoritism or interference, families can choose a high-quality education for their kids and citizens respect their government because it is open and transparent to all.

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EXECUTIVE SUMMARY BUDGET & TAX

Budget Solutions 2014:

Pension reform and responsible spending for state and local governments

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Illinois is in crisis. According to official government numbers, Illinois has an unfunded pension liability of $96 billion – the worst in the nation. This heavy debt burden, combined with the state's culture of out-of-control, wasteful spending, has driven the state into an economic death spiral.

Illinois cannot be economically prosperous until real pension reform is implemented. And without reform, government workers are at risk of not having a retirement at all. Illinois' largest and most troubled pension system, the Teachers' Retirement System, is only 40 percent funded. Even the executive director of the fund has said that TRS will run dry by 2029 if reform is not enacted. Meanwhile, taxpayers – who are tapped out – continue to see money meant for core services used by lawmakers to fund retirements.

Over the years, Illinois has enacted a variety of pension "fixes." Former Illinois Gov. Jim Edgar's widely hailed pension ramp, which was meant to fund state pensions by 2045, failed within 10 years of its inception. Former Gov. Rod Blagojevich borrowed $10 billion to pay for pensions. His successor, current Illinois Gov. Pat Quinn, borrowed another $7 billion to pay for pensions. These plans all failed to fix pensions because they ignored the root cause of Illinois' problem: a defined benefit system.

The state must change course. The Illinois Policy Institute's plan shows lawmakers how.

Reforming pensions is the foundation of pulling Illinois out of its economic death spiral. But pension reform alone isn't enough.

As outlined in this publication, reviving Illinois' economy will also require implementing a multistep plan: one that returns $7 billion to taxpayers by repealing the 2011 income tax hike and implementing spending reforms; pays down the state's $9.3 billion in unpaid bills by 2016; and improves health care and education to ensure the state's most needy residents receive the support they deserve.

Paired with the Illinois Policy Institute's pension reform plan, these measures provide Quinn and the Illinois General Assembly a roadmap to making Illinois first in economic outlook and job creation.

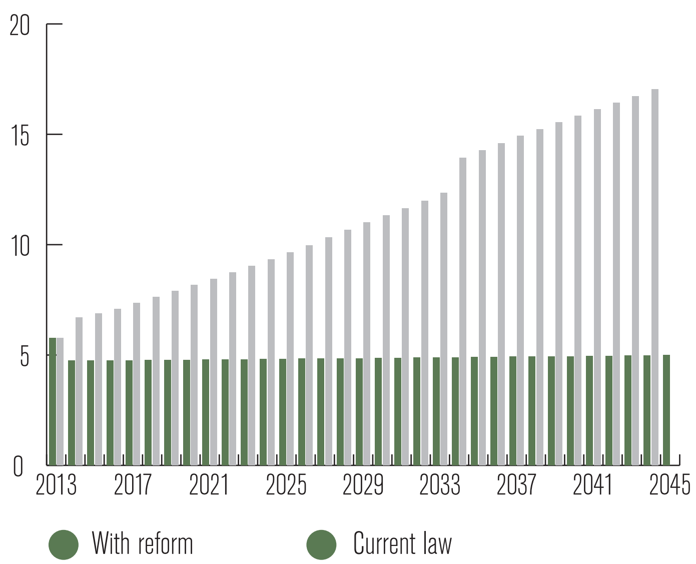
Budget Solutions 2014: Pension reform plan - Overview

Summary of the problem: Illinois has the worst-funded pension systems in the nation. The unfunded liability currently stands at more than $96 billion according to official government numbers, and that number grows by $21 million every day lawmakers fail to enact reform. The problem at the root of Illinois' pension crisis is the unmanageable, unsustainable defined benefit system.

Summary of our solution: The only way to end Illinois' pension crisis is to empower government workers by transitioning benefits for all future work to a defined contribution system. The Illinois Policy Institute's solution cuts unfunded pension debt in half and includes a defined contribution plan as the main pillar of its reforms while protecting already-earned benefits for government workers.

Institute reforms cut state pension contributions by 61% during next 32 years

Contributions to TRS, SURS and SERS under current law and with reform *(in billions of dollars)*



Source: Commission on Government Forecasting and Accountability; Illinois Policy Institute.

Summary of why this works: This is the only proposal that ultimately solves Illinois' pension crisis. This plan also modernizes the state's retirement system by eliminating political control and giving government workers the secure retirement they deserve. Ultimately, these reforms restore fiscal order to the state by eliminating unsustainable pensions and unfunded liabilities. This paves the way for the economy to flourish, fostering an environment where businesses can thrive and create the jobs Illinoisans need.

Here are the plan's major outcomes:

1. Reduces fiscal year 2014 unfunded liability by $46 billion. This 46 percent reduction brings the unfunded liability down to $55 billion from $101 billion, the government's fiscal year 2014 projection.
2. Reduces fiscal year 2014 state contributions to $4.7 billion, a nearly 30 percent drop from $6.7 billion under current law.
3. Protects constitutionally guaranteed benefits already earned by retirees and current workers.
4. Empowers current workers to control their retirement savings going forward with 401(k)-style plans modeled after the existing State Universities Retirement System's 401(a) plan.
5. Reduces the state's annual pension contribution by more than $2 billion in the first year and eliminates the state's unfunded liability by 2045. Ends the irresponsible repayment ramp and instead moves to level annual payments.
6. Freezes cost-of-living adjustments until retirement systems return to healthy funding levels.
7. Aligns the retirement age with Social Security's retirement age while still protecting workers who are nearing retirement under current law.
8. Promotes accountability and fiscal responsibility by requiring local governments to pay the employer share of their employees' retirement savings plans.
9. Makes government workers' retirement savings plans portable, giving workers more flexibility and freedom to move their plan from job to job.

SPECIAL REPORT

Budget Solutions 2014: Pension reform plan

The problem: defined benefits lead to out-of-control state pension debt

Illinois has the worst-funded pension systems in the nation. The unfunded liability currently stands at more than $96 billion according to official government numbers, and that number grows by $21 million every day lawmakers fail to enact reform.[1]

Illinois' largest and most troubled pension system is the Teachers' Retirement System, which has $52 billion in debt and only 42 percent funding overall.[2]

Numbers like these are impossible to ignore. Investors and analysts alike see lawmakers' inaction on pension reform as a sign that the state's leaders won't be able to improve Illinois' finances. The state's massive pension debt crisis has led credit rating agencies to downgrade Illinois to the worst credit rating in the nation.[3]

These numbers and actions by outside agencies tell a disturbing story and lead to one undeniable conclusion – the problem at the root of Illinois' pension crisis is the defined benefit system.

This structure not only gives politicians control over government workers' retirement dollars, but it also puts taxpayers on the hook when these politicians promise overly generous benefits the state can't afford and when the pension systems fail to hit their optimistic investment targets. There is no way for state bureaucrats to predict how much the systems will cost from year to year.

And state taxpayers are tapped out. In 2011, the state raised taxes by a record $7 billion, and almost all the money generated by the tax hike went to pensions. The past two decades are replete with other failed pension "fixes."[4] Former Illinois Gov. Jim Edgar's widely hailed plan to fund state pensions by 2045 flopped within 10 years of its inception, and to date taxpayers have paid $8 billion more into the pension system than the ramp originally called for.[5] Former Gov. Rod Blagojevich used a bond issue to borrow $10 billion to pay for pensions.[6] Current Illinois Gov. Pat Quinn has borrowed more than $7 billion to make pension payments.[7] All of this money still hasn't plugged the hole. Things have only gotten worse. The unfunded pension liability is nearly five times larger than when Edgar enacted his reforms.

None of the ideas lawmakers have presented to date would end Illinois' pension crisis because they keep in place a broken defined benefit system. Most proposals on the table today also include a repayment ramp. Minor reforms that try only to patch up the problem by making minor, temporary fixes won't end Illinois' pension crisis.

The harsh truth is that continuing to rely on the defined benefit system and dangerous repayment ramps inflicts massive pension debt onto future generations and will only perpetuate Illinois' cycle of fiscal self-destruction.

Our solution: cut pension debt in half and empower employees with defined contribution plans for all future work

The only way to end Illinois' pension crisis is to move benefits for all future work to a defined contribution system. The Illinois Policy Institute's solution cuts unfunded pension debt in half and includes a defined contribution plan as the main pillar of its pension reforms while protecting already-earned benefits for state workers.

This is the only plan that ends Illinois' pension crisis. This plan gives government workers control of their own retirement plans and protects taxpayers by removing the burden of funding a failed system – giving them financial security. The end result is government workers with retirement security, a stable budget and taxpayers free from the burden of funding a failed system.

Protect already-earned benefits for all workers

Government workers, unions and taxpayers alike have long decried politicians' mismanagement of the state's pension funds. It's time to take control over retirement savings away from the politicians and give it back to the workers.

The only way to do that is to move away from the state's broken defined benefit structure. This outdated structure is unaffordable and unpredictable, which is why 85 percent of private sector employers have moved away from it during the past few decades. Under the current defined benefit structure, true costs are never realized until after the fact, when the pension funds come back asking for more money to make up for lower investment returns and mistaken assumptions.

Each year lawmakers fail to move to a defined contribution system is another year the state accrues more debt, as government workers continue to earn more service credit and higher salaries. The Illinois Policy Institute's plan moves away from the defined benefit structure, freezing the defined benefit plan at current levels to ensure the state's pension liability stops growing.

Doing this provides security for government workers who have already earned these benefits and also gives them control over their retirement savings for future work. Likewise, this protects taxpayers from facing an even larger bill for unearned future benefit accruals. Government workers will still receive already-earned pension benefits, but future benefits will accrue in 401(k)-style plans.

Empower employees with defined contribution plans for all future work

The cornerstone of the Illinois Policy Institute's pension reform plan is moving future benefits to defined contribution plans for all government workers. This gives government workers control over their retirement savings and doesn't rely on taxpayers for a bailout. More than 10,000 government workers in Illinois already manage their own retirement plans through the State Universities Retirement System's, or SURS, optional, self-managed 401(a) plan.[8]

The Illinois Policy Institute's plan bases its defined contribution structure on the self-managed plan currently operating in SURS. Under the SURS plan, the employee contributes 8 percent of his or her salary toward retirement savings, while the employer matches 7 percent of salary.[9]

Under the Illinois Policy Institute's plan, all members whose benefits are not coordinated with Social Security will receive this generous match. These employees will contribute 8 percent of their salary toward retirement savings, while the employer will match 7 percent of salary. Members whose retirement benefits are coordinated with Social Security would be required to contribute less and receive a lower employer match. These workers will contribute 3 percent of salary, while the employer will match 3 percent of salary. This money is deposited into personal accounts, through which workers can invest in multiple funds that meet their needs and retirement objectives.

At retirement, the employee can roll the money over to another qualified plan, take a lump-sum withdrawal or purchase a lifetime monthly annuity. If he or she leaves government service before retirement, the worker has several options available, including leaving the money in the self-managed account, moving the money to another qualified plan or taking a lump-sum refund.

The Illinois Policy Institute's self-managed plan gives workers real control over their retirement savings. They control investment decisions based on their individual preferences and circumstances, rather than being forced to watch politicians squander their money. Workers are also free to make different career moves with portable retirement plans.

This plan creates greater budget certainty for taxpayers, empowers government workers with control over their own retirement savings and ultimately moves retirement costs to a more sustainable path.

Freeze future cost-of-living adjustments for all retirees

Under current law, Illinois pensioners receive a 3 percent compounded, annual increase to their pensions. This cost-of-living adjustment functions as an automatic raise and makes the current defined benefit plan even more unaffordable.

Given the severity of the crisis, the Illinois Policy Institute's plan suspends all cost-of-living adjustments until the pension funds are fully funded. Retirees will still receive the cost-of-living adjustments they have earned to date, but all future adjustments will be frozen at least until the funds are healthy again. Thereafter, the cost-of-living adjustment formula may be restructured to better reflect inflation and actual pension fund returns.

Equitably raise the retirement age for future retirees

Workers are living longer and the labor force's demographics are changing, meaning that retired workers are collecting more retirement benefits for longer periods than in the past. State lawmakers recognized the need for increasing the retirement age when they enacted changes to the pension program for new employees starting after January 2011 (Tier 2 employees). It's also one of the biggest drivers of the state's current unfunded liability.

The Illinois Policy Institute plan is modeled after the Rhode Island pension reforms and aligns the retirement age with the Social Security retirement age, while still protecting workers who are nearing retirement under current law.[10] In order to protect near-retirees, this change will be done in direct proportion to the percent of service credit completed toward the current retirement age. The closer a worker is to the previous state retirement age, the less his or her new retirement age will increase. This ensures that older workers near retirement will be affected less, but that the retirement age is equitably increased to protect the systems from insolvency.

Enact local retirement accountability

Teachers and university employees are not state employees, but for decades the state government has paid and continues to pay the employer's share of teacher pensions. The state pays more than $632 million in retirement costs for public school employees and another $440 million for state university workers.[11] This means that one unit of government hands out benefits while another pays for them, leading to abuse and the elimination of spending accountability.

Under the Illinois Policy Institute's plan, going forward school districts will be required to pay the employer contribution to their employees' defined contribution plans. Many have claimed that this shift will result in property tax increases. This is simply untrue. The shift to defined contribution plans will cost districts, on average, an amount equal 3 percent of their total education expenditures.

Costs should be paid where they are incurred. School districts will better manage their overall compensation costs and improve the security of the retirement system under this plan. The same requirement applies to state universities, which also dole out pension benefits without having to incur the costs.

The shift to defined contribution plans will make employer annual retirement costs predictable and affordable. In order to ensure school districts and state universities can manage these costs, however, the state should provide them with greater flexibility to operate more efficiently and reduce unfunded state mandates.

Additionally, the state should give government employers the freedom to exit the state's retirement systems in the future. Local school districts and state universities should be free to stay in the new defined contribution plan for future work or to design their own retirement plans from the ground up. The state, however, should make clear to them that state taxpayers will not be responsible for those plans. If a school district chooses to create a new retirement plan, there will be no bailout from state taxpayers down the road.

The Illinois Policy Institute's plan also provides more flexibility to school districts and universities to manage costs by taking away the prevailing wage requirement, project labor agreements and other unfunded mandates.

Eliminate the irresponsible repayment ramp

Under current law, the state's pension payments grow larger and larger in the future, which overloads future taxpayers. This repayment ramp is irresponsible because it lowers today's payments at the expense of future costs.

In fiscal year 2014, the state's annual pension payment for Illinois' three major pension systems is scheduled to be $7 billion, which is set to grow under current law until it reaches $17 billion in 2045.[12] Even after these ever-increasing contributions, the systems will have an unfunded liability of $34 billion in 2045.[13]

The Illinois Policy Institute's comprehensive pension reforms reduce the fiscal year 2014 payment to approximately $4.7 billion, which then stays level through 2045. This would enable the systems to become 100 percent funded by 2045.[14]

How the Illinois Policy Institute's plan affects the Teachers' Retirement System

The Commission on Government Forecasting and Accountability recently scored a plan to reform the Teachers' Retirement System, or TRS, by freezing the defined benefit plan in place, creating a new defined contribution plan for all future work, freezing all future cost-of-living adjustments and aligning the retirement age with the Social Security retirement age. They found the following results:

- The unfunded liability for fiscal year 2014 is reduced to $30 billion, a 48 percent drop from $58 billion under current law.
- Total liability for fiscal year 2014 is reduced to $68 billion, a 31 percent drop from $98 billion under current law.
- By 2045, the total liability in TRS will be just $46 billion, compared with $224 billion under current law.

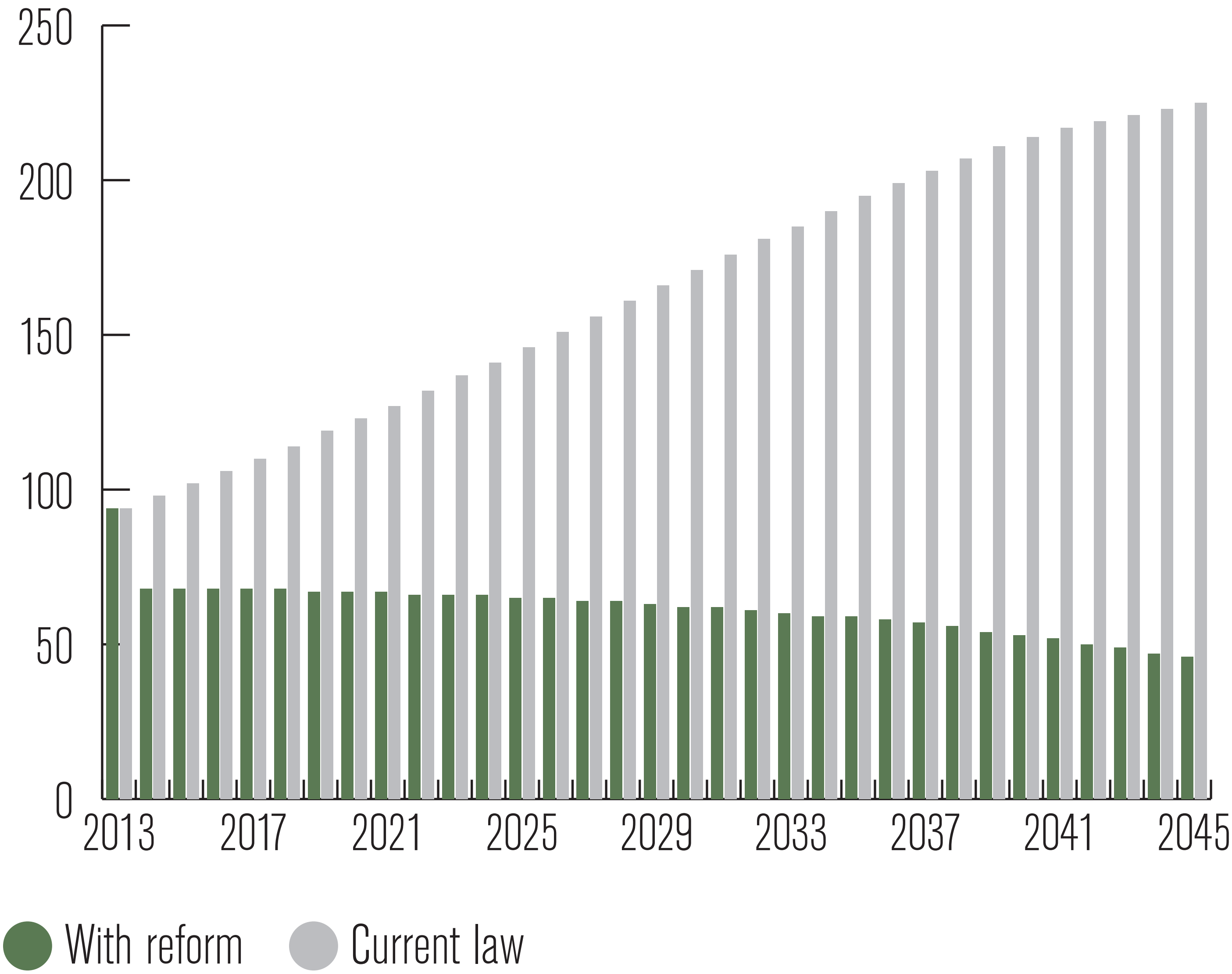
Based on this scoring, the Illinois Policy Institute's plan:

- Increases the funding level of the plan in fiscal year 2014 to 56 percent, up from 41 percent under current law.
- Reduces the state's fiscal year 2014 state contribution to $2.5 billion, a 25 percent drop from $3.4 billion under current law.
- Reduces the state contribution for fiscal year 2045 to $2.5 billion, a 75 percent drop from $10 billion under current law.
- Cuts the amount the state will pay to TRS between now and 2045 to $81 billion, compared with $211 billion under current law.
- Eliminates the payment ramp and makes all future pension contributions on a level-dollar basis.
- By 2045, the state will no longer have an unfunded liability, compared with the $22 billion unfunded liability under current law.

Budget Solutions 2014: Pension reform plan Continued

Institute reforms reduce the total liability in TRS to just $46 billion, compared with $224 billion under current law

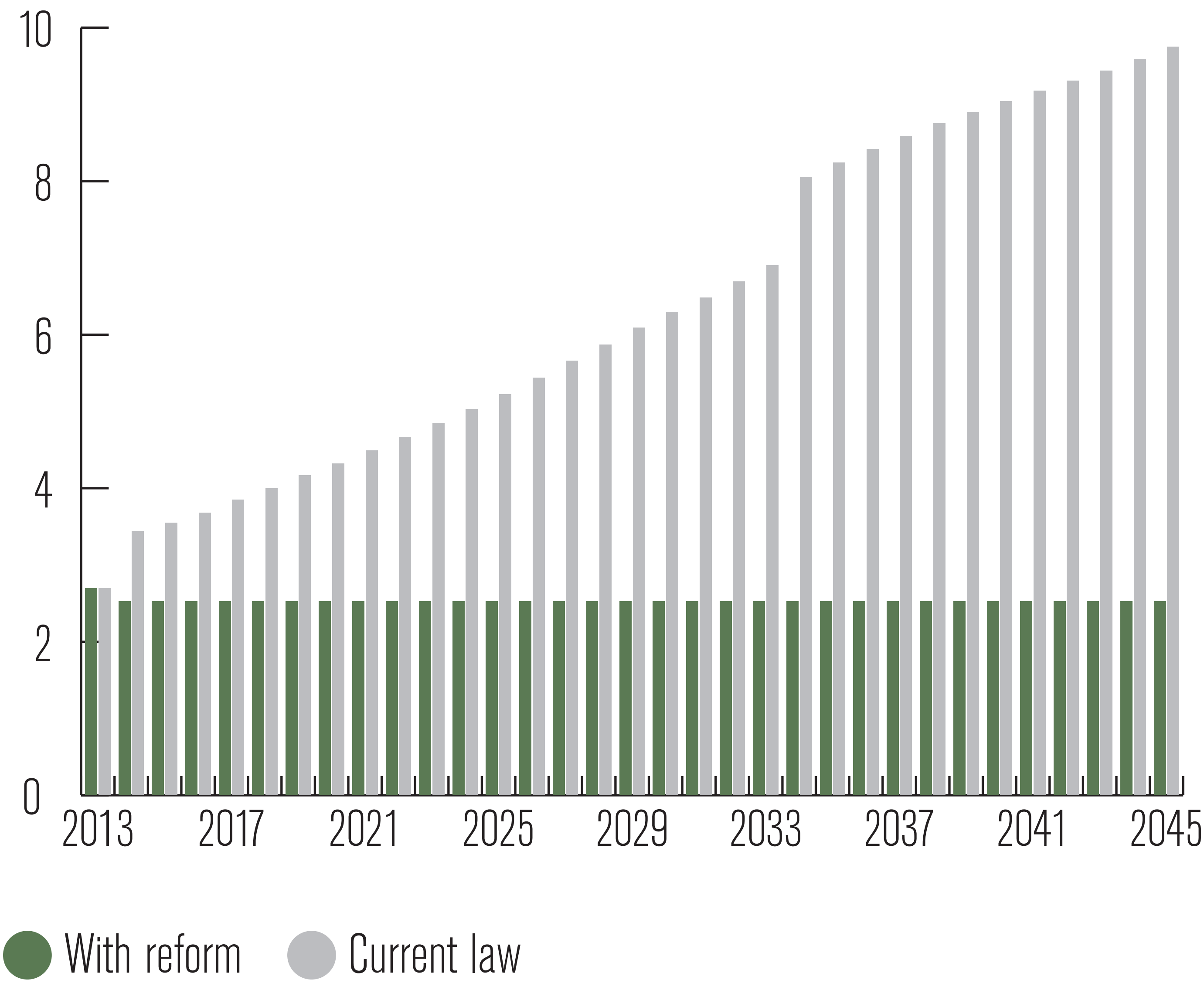
Contributions to TRS under current law and with reform *(in billions of dollars)*



Source: Commission on Government Forecasting and Accountability; Illinois Policy Institute.

Institute reforms reduce the state contribution for fiscal year 2045 by 75 percent compared with current law

Contributions to TRS under current law and with reform *(in billions of dollars)*



Source: Commission on Government Forecasting and Accountability; Illinois Policy Institute.

The impact of the Illinois Policy Institute plan on the three major systems – TRS, SERS and SURS

An extrapolation of COGFA's scoring of the TRS plan to the other two major systems reveals the following results:

- The fiscal year 2014 unfunded liability is reduced to $55 billion, a 46 percent drop from $101 billion under current law.
- The fiscal year 2014 funding ratio is increased to 54 percent, up from 41 percent under current law.
- The fiscal year 2014 total liability is reduced to $118 billion, a 31 percent drop from $170 billion under current law.
- The fiscal year 2014 state contribution is reduced to $4.7 billion, a 29 percent drop from $6.7 billion under current law.
- The fiscal year 2045 state contribution is reduced to $5.2 billion, a 70 percent drop from $17 billion under current law.
- By 2045, the total liability will be just $80 billion, compared with $345 billion under current law.
- By 2045, the unfunded liability will be $0, compared with $34 billion under current law.
- Between now and 2045, the state will pay $146 billion to the pension systems, compared with $374 billion under current law.
- The payment ramp is eliminated and all repayment of existing pension debt is made on a level-dollar basis.

Institute reforms reduce total pension liability to $80 billion, compared with $345 billion under current law.

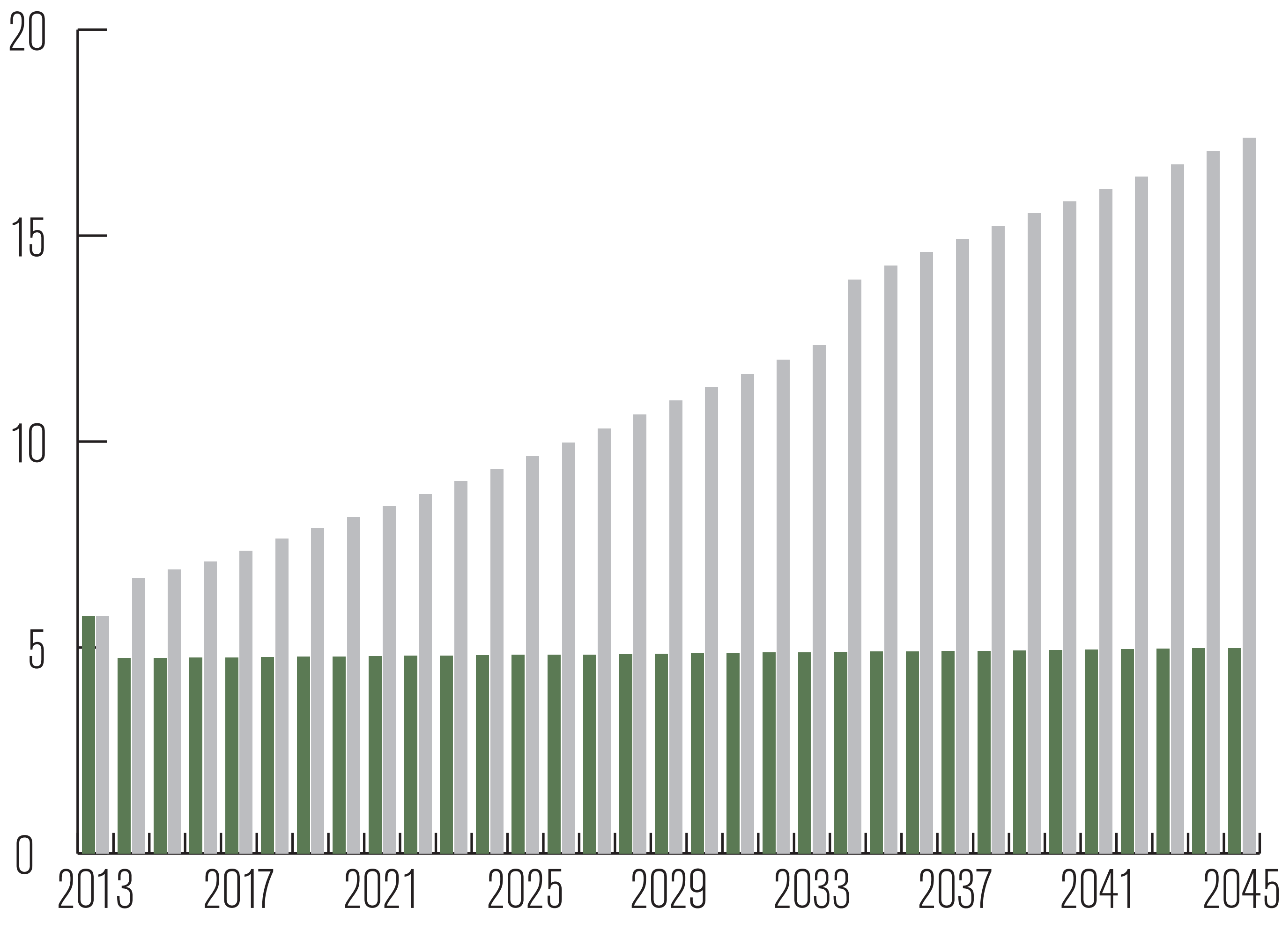
Contributions to TRS, SURS and SERS under current law and with reform *(in billions of dollars)*

Source: Commission on Government Forecasting and Accountability; Illinois Policy Institute.

Budget Solutions 2014: Pension reform plan Continued

Illinois Policy Institute reforms cut state pension contributions by 61% during next 32 years

Contributions to TRS, SURS and SERS under current law and with reform *(in billions of dollars)*



Source: Commission on Government Forecasting and Accountability; Illinois Policy Institute.

Budget Solutions 2014: Pension reform plan Continued

Why this works

The Illinois Policy Institute's pension reform plan immediately cuts the state's unfunded pension liability in half and ultimately eliminates the unfunded liability. This is the only proposal that solves the pension crisis. This plan also modernizes the state's retirement system by eliminating political control and giving government workers the secure retirement they deserve. This type of plan is already working in Illinois. The state currently offers self-managed retirement plans to workers in the State Universities Retirement System – and more than 10,000 workers have chosen to participate in this option.

Protecting already-earned benefits and offering state workers choice and mobility by creating 401(k)-style retirement plans also creates greater budget certainty for the state moving forward, ending the pension repayment ramp and replacing it with level annual payments.

Ultimately, the Illinois Policy Institute's pension reform plan restores fiscal order to the state by eliminating unsustainable pensions and unfunded liabilities. This paves the way for the economy to flourish, fostering an environment where businesses can thrive and create the jobs Illinoisans need. Based on COGFA's recently scored plan to reform TRS, the Illinois Policy Institute's plan brings down Illinois' unfunded pension liabilities more than any other proposed plan.

Government workers and taxpayers deserve a sustainable plan that provides security and protection – and that's what the Illinois Policy Institute's pension reform plan provides.

Budget Solutions 2014: Responsible spending for state and local governments - Overview

- **Balances Illinois' budget for the first time since 2001**
- **Rebalances state spending to $27.4 billion**
- **Returns $7 billion to taxpayers by repealing the 2011 tax hike early**
- **Pays down the state's $9.3 billion in unpaid bills by 2016**
- **Enacts structural spending reform to sufficiently fund core services**

Introduction – An alternative budget

Four years ago, Illinois Gov. Pat Quinn took over a government trapped in a cycle of overspending and financial decline. Quinn had the unique opportunity to provide the fiscally responsible and moral leadership that Illinois so desperately needed.

At that same time, the Illinois Policy Institute introduced its first alternative budget. The Institute's alternative budget offered Quinn and the General Assembly a plan to balance Illinois' budget without a tax hike, rein in out-of-control spending and provide better outcomes for Illinoisans.

Fast forward to 2013. Illinois' leadership failed to capitalize on the opportunity to restore Illinois' financial stability. The state's fiscal condition now is worse off than it was four years ago. Illinois' unpaid bills have more than doubled as a result of yearly budget deficits. Illinois has the worst-funded pension systems in the nation.[15] Lawmakers passed a record income tax increase in January 2011, and state debt continues to soar. Illinois now has the worst credit rating in the nation.[16]

And when it comes to jobs and economic opportunity for the average Illinoisan, the state's situation is still gloomy. Illinois' unemployment rate is 1.6 percentage points higher than the average of its neighboring states, more than a million Illinoisans are unemployed and underemployed,[17] and people continue to leave the state at an alarming rate.

All of this could have been avoided if Illinois had made responsible decisions.

The 2011 tax hike is scheduled to sunset in January 2015 and legislators must keep that promise. Illinois' political leadership needs to discern what government can and should be doing, and return to the basics of good public policy – spend within its means and operate under a balanced budget.

Budget Solutions 2014 is the Institute's fifth alternative budget proposal. This plan returns $7 billion to taxpayers by repealing the 2011 income tax hike and implementing spending reforms; pays down the state's $9.3 billion in unpaid bills[18] by 2016; reforms the state's retirement system; and improves health care and education to ensure the state's most needy residents receive the support they deserve. Paired with the Illinois Policy Institute's pension reform plan, these solutions provide Quinn and the General Assembly with the reforms needed to make Illinois prosperous again.

Budget Solutions 2014 calls on lawmakers to:

1. Implement the Illinois Policy Institute's pension reform plan to save an estimated $2.011 billion *(pages 4-13)*
2. Strengthen Illinois' balanced budget requirement *(page 18)*
3. Enact a responsible spending limit *(page 19)*
4. Establish a competitive grant funding system to save an estimated $180 million *(page 20)*
5. Reform state retiree health insurance to save an estimated $685 million *(page 21)*
6. Empower patients with health care choice to save an estimated $1.45 billion *(page 22)*
7. Eliminate ineffective revenue sharing programs to save an estimated $1.7 billion *(page 23)*
8. Rededicate General State Aid money for education to save an estimated $750 million *(page 24)*
9. Improve quality and efficiency in human services to save an estimated $512 million *(page 25)*
10. Right-size state payroll to save an estimated $318 million *(page 26)*

SPECIAL REPORT

Budget Solutions 2014: The essential numbers - Summary

Budget Solutions 2014 is the Illinois Policy Institute's fifth alternative budget proposal, providing Gov. Pat Quinn and the General Assembly with the reforms needed to turn Illinois around. The Institute's budget returns billions to Illinois taxpayers, rebalances spending to $27.4 billion and eliminates Illinois' entire $9.3 billion backlog in unpaid bills.

Budget Solutions 2014: big picture reform

1. Returns billions to taxpayers
2. Rebalances spending to $27.4 billion
3. Pays down Illinois' backlog of unpaid bills

Illinois general funds budget (dollars in millions): Budget Solutions 2014 – the essential numbers

Budget projections	FY 2012	FY 2013	FY 2014 reforms	FY 2014	FY 2015	FY 2016
Revenue	**33,797**	**33,880**		**34,693**	**28,158**	**28,955**
Spending/(reforms)	**33,521**	**33,131**	**(7,637)**	**27,416**	**27,225**	**27,127**
Operating expenditures	25,164	24,127	(3,926)	20,201	20,201	20,201
Pensions & statutory transfers out	8,357	9,004	(3,711)	7,215	7,024	6,926
Operating surplus/(deficit)	276	749		7,277	933	1,828
Unpaid bills						
Beginning bill balance		9,327		8,527	1,250	317
Pay bill backlog		800		7,277	933	317
Ending bill balance	9,327	8,527		1,250	317	0
Total spending including bill payment	**33,521**	**33,931**		**34,693**	**28,158**	**27,444**
Total surplus/(deficit)	276	(51)		0	0	1,512

Sources: "State of Illinois Budget Summary 2013," Governor's Office of Management and Budget.
"3 Year Budget Projection," Governor's Office of Management and Budget.
"3 Year Budget Forecast 2013-2015," Commission on Government Forecasting and Accountability.

Budget Solutions 2014 (savings in billions)

Implement Illinois Policy Institute pension reform plan	$2.011
Strengthen Illinois' balanced budget requirement	-
Enact a responsible spending limit	-
Establish a competitive grant funding system	$0.180
Reform state retiree health insurance	$0.685
Empower patients with health care choice	$1.450
Eliminate ineffective revenue sharing programs	$1.700
Rededicate General State Aid money for education	$0.750
Improve quality and efficiency in human services	$0.512
Right-size state payroll	$0.318
Total savings	**$7.606**

Sources: "State of Illinois Budget Summary 2013," Governor's Office of Management and Budget.
"3 Year Budget Projection," Governor's Office of Management and Budget.
"3 Year Budget Forecast 2013-2015," Commission on Government Forecasting and Accountability.

Budget Solutions 2014: The essential numbers - Spending

Illinois general funds budget (dollars in millions): Budget Solutions 2014

Budget projections	FY 2012	FY 2013	FY 2014 reforms	FY 2014	FY 2015	FY 2016
Spending/(reforms)	**33,521**	**33,131**	**(7,637)**	**27,416**	**27,225**	**27,127**
Operating expenditures	**25,164**	**24,127**	**(3,926)**	**20,201**	**20,201**	**20,201**
Education	8,843	8,521	(750)	7,771	7,771	7,771
Medicaid	6,694	6,768	(1,450)	5,318	5,318	5,318
Human services	5,404	5,123	(512)	4,611	4,611	4,611
Public safety	1,531	1,433		1,433	1,433	1,433
Government services	2,522	2,137	(685)	1,452	1,452	1,452
Economic development	93	78	(31)	47	47	47
Quality of life	77	67		67	67	67
Competitive grant funding			(180)	(180)	(180)	(180)
State employee pay			(318)	(318)	(318)	(318)
Pensions & statutory transfers out	**8,357**	**9,004**	**(3,711)**	**7,215**	**7,024**	**6,926**
Unspent appropriations	(311)	(650)		0	0	0
Pension contributions	4,135	5,100	(2,011)	4,100	4,100	4,100
Pension obligation bonds	1,607	1,552		1,655	1,501	1,418
Transfers out	2,473	2,533	(1,700)	958	958	958
Capital obligation bonds	453	469		502	465	450
Pay bill backlog		800		7,277	933	317
Total spending including bill payment	**33,521**	**33,931**		**34,693**	**28,158**	**27,444**

Sources: "State of Illinois Budget Summary 2013," Governor's Office of Management and Budget.
"3 Year Budget Projection," Governor's Office of Management and Budget.
"3 Year Budget Forecast 2013-2015," Commission on Government Forecasting and Accountability.

1. Budget Solutions 2014 offers structural spending reform that saves the state more than $7 billion. Total general fund spending is reduced to $27.4 billion in fiscal year 2014.
2. The most significant spending reforms:
   - Education spending is reduced by 9 percent, or $750 million, as a result of eliminating inappropriate subsides in the state's General State Aid formula.
   - Medicaid spending is reduced by 21 percent, or $1.45 billion, as a result of building on the success of Florida's Medicaid reforms.
   - Spending on human services is reduced by 10 percent by trimming $512 million in program costs.
   - Spending on government services is reduced by 32 percent, or $685 million, as a result of requiring retirees to pay more of their insurance premiums and eliminating retiree health insurance for new employees.
   - Transfers out are reduced by 67 percent, or $1.7 billion, by eliminating the Local Government Distributive Fund and similar ineffective revenue sharing programs.
   - Competitive grant funding in the state's budgeting process saves $180 million annually.
   - State employee pay is reduced by 10 percent, or $318 million annually, as a result of payroll reductions.
   - State pension contributions are reduced by 33 percent, or $2.011 billion compared with $6.1 billion required under current law, as a result of the Illinois Policy Institute's pension reform plan.

Budget Solutions 2014: The essential numbers - Revenue

Illinois general funds budget (dollars in millions): Budget Solutions 2014

Budget projections	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Revenue	**33,797**	**33,880**	**34,693**	**28,158**	**28,955**
State sources	**28,177**	**28,427**	**29,139**	**22,780**	**23,577**
Individual income tax	15,512	15,365	15,687	9,924	10,271
Corporate income tax	2,461	2,675	2,863	1,967	2,036
Sales taxes	7,226	7,340	7,524	7,698	7,967
All other state sources	2,978	3,047	3,065	3,191	3,303
Federal sources	**3,682**	**3,682**	**3,694**	**3,482**	**3,482**
Transfers in	**1,938**	**1,771**	**1,860**	**1,896**	**1,896**

Sources: "State of Illinois Budget Summary 2013," Governor's Office of Management and Budget.
"3 Year Budget Projection," Governor's Office of Management and Budget.
"3 Year Budget Forecast 2013-2015," Commission on Government Forecasting and Accountability.

1. Budget Solutions 2014 repeals the entire 2011 income tax hike, effective July 1, 2014. The repeal returns the personal income tax rate to 3 percent and the corporate income tax rate to 4.8 percent. Repealing the tax hike returns $7 billion to taxpayers.
2. Compared with fiscal year 2014, fiscal year 2015 has a 37 percent reduction in individual income tax revenue and a 31 percent reduction in corporate income tax revenue as a result of repealing the 2011 income tax hike. Budget Solutions uses base revenue projections from the Commission on Government Forecasting and Accountability, or COGFA, to determine its individual and corporate income projections.
3. Budget Solutions 2014 increases the amount Illinois receives in federal sources according to COGFA by $350 million in federal match funds for paying $700 million in 2013 Medicaid bills. As a result of a $1.45 billion reduction in Medicaid spending, Illinois will receive $725 million less in federal match revenues.

SPECIAL REPORT

Budget Solutions 2014: Strengthen Illinois' balanced budget requirement

The problem: Despite Illinois' existing balanced budget requirement, the state hasn't had a balanced budget since 2001. Illinois' inability to spend within its means has resulted in massive debt; the household share of total state debt is more than $63,000.[19]

Our solution: In addition to a spending limit, Illinois needs a more stringent and enforceable balanced budget requirement that will force lawmakers to rein in spending.

Why this works: A real balanced budget requirement lays the foundation for fiscal responsibility in Illinois and sets the stage for an economic turnaround.

The problem

- Illinois has failed to balance its budget since 2001 despite a constitutional requirement to do so. Politicians consistently find loopholes that make the requirement ineffective. The result is a culture of deficit spending and a backlog of $9.3 billion in unpaid bills.[20]

Illinois: no balanced budget since 2001

Fiscal year	Fulfills constitutional requirement?	Balanced?
2000	Yes	Yes
2001	Yes	Yes
2002	Yes	No
2003	Yes	No
2004	Yes	No
2005	Yes	No
2006	Yes	No
2007	Yes	No
2008	Yes	No
2009	Yes	No
2010	Yes	No
2011	Yes	No

Source: State of Illinois Comptroller, "General Funds Overview"

- Illinois politicians have used borrowing and budgeting gimmicks, rather than real spending reforms, to present the false appearance of balanced budgets. For example:
  - » In May 2011, less than six months after the General Assembly enacted a 67 percent state income tax hike, lawmakers passed what they called a balanced budget. In reality, this budget used an accounting gimmick to push more than $1 billion in unpaid bills to the next fiscal year.[21]
  - » In fiscal year 2010, Gov. Pat Quinn borrowed $3.5 billion to finance the state's pension systems. In fiscal year 2011, Quinn borrowed another $3.7 billion for the same reason.[22]
  - » Illinois' unwillingness to balance its budget has resulted in long payment delays to government vendors. Many institutions have been forced to reduce or cut services after waiting six months or more to be paid.
- Illinois' fake balanced budget requirement allows lawmakers to spend beyond the state's means, ignore unpaid bills, incur deficits and put taxpayers on the line for more debt.

Our solution

- Any spending incurred during a fiscal year must be paid for with revenue from the same fiscal year.
- Borrowing or dipping into other state funds and refinancing debt cannot be counted as revenues.
- A checks and balances system would require the comptroller to verify revenue estimates and spending proposals from the governor's Office of Management and Budget.
- The governor must submit to the General Assembly a balanced budget and the lawmakers must pass a balanced budget that adheres to a strong spending limit tied to the growth of inflation plus population.

Why this works

- The most basic tenet of good public policy and fiscal management is not to spend more than what is available. Strengthening the balanced budget requirement would hold politicians accountable for their spending decisions.
- A balanced budget would restore the confidence of investors, businesses and entrepreneurs to invest in Illinois.
- A balanced budget would end the cycle of credit downgrades and set the foundation for a positive outlook.

SPECIAL REPORT

Budget Solutions 2014: Enact a responsible spending limit

The problem: State government spending has grown at three times the rate of inflation since 1990. Illinois government is spending more money than it takes in and must learn to live within its means.

Our solution: Enact a spending limit tied to the growth of population and inflation.

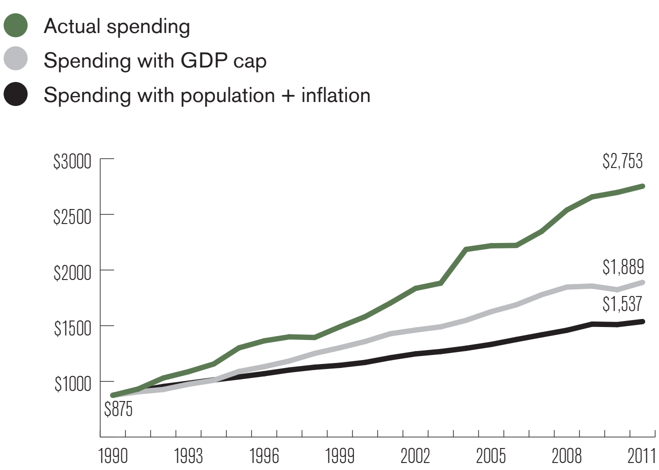
Why this works: More resources in the market economy allow entrepreneurs and small businesses to thrive.

The problem

- Politicians and others have attributed Illinois' fiscal problems to not having enough revenue and the effects of the national recession. These are not the root of Illinois' problems. At the core of the state's fiscal woes is decades of overspending and overtaxing.
- Illinois' state spending per capita was $875 in 1990. In 2011, that amount was $2,753, up 83 percent when adjusted for inflation.
- If Illinois had limited its spending growth since 1990 to the rate of inflation, per capita spending would be $1,537 – 44 percent less. A responsible spending limit could have prevented the state's many crises.

Illinois' spending grows 3x faster than inflation

Per capita spending 1990 - 2011



Source: U.S. Census Bureau state government finances; Bureau of Economic Analysis population and GDP by state; Illinois Policy Institute calculations

Our solution

Illinois needs a real and effective spending limit. Legislators passed a fake limit in 2011 that set the ceiling far too high. The limit is arbitrary and far greater than available resources. The 2015 limit, for example, is $5 billion higher than Illinois' expected revenue. [23]

Illinois' fake spending limit exceeds available revenue by $5 billion in 2015
Numbers in billions

Fiscal year	Spending limit	Revenue forecast	Difference
2013	$37,554	$33,990	$3,564
2014	$38,305	$35,068	$3,237
2015	$39,072	$33,628	$5,444

Source: Public Act 096-1496, COGFA 3-year budget forecast

Illinois' spending limit should be:

1. Tied to the sum of the growth in the state's inflation and population.
2. Codified in the state's constitution.
3. Based on spending, not revenues.
4. Designed to require a supermajority from the General Assembly and a public vote for an override.
5. Designed to automatically refund surpluses in excess of the limit.

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Why this works

- A responsible spending limit forces government to spend within its means and limits politicians' ability to make promises they can't keep.
- Codifying a spending limit in the constitution makes it binding.
- Reducing government spending lessens the tax burden on individuals and businesses, encouraging economic growth.

SPECIAL REPORT

Budget Solutions 2014: Establish a competitive grant funding system

Potential savings: $180 million

The problem: Hundreds of line items and grants within the state budget receive little scrutiny. The process contains no real system to weed out ineffective programs and reduce waste.

Our solution: Establish a competitive grant funding system based on program effectiveness and need.

Why this works: The state has scarce resources and should focus on paying for the most necessary programs. Competitive grant funding would force entities seeking state dollars to compete for them, allowing lawmakers to allocate the money where it would be most beneficial.

The problem

- Hundreds of small grants and budget line items not exceeding $5 million each cost Illinoisans almost $300 million annually.[24] That sum is larger than the total operating budget of several state agencies.
- These small line items and grants receive little oversight and attention during the budgeting process. Lack of oversight perpetuates Illinois' culture of waste, abuse and disrespect for taxpayer money.
- Nontransparent programs and those that fail to achieve their goals easily can slip through the approval process.
- The state lacks adequate performance requirements and metrics needed to measure program effectiveness. A competitive process would force government agencies to prioritize spending and weed out failing programs.

Our solution

- Require grants and line items smaller than $5 million to compete for scarce state resources.
- Have programs compete for funds from a pool of $100 million based on their effectiveness and need. Funding decisions are made by an independent review panel.
- Competitive grant funding saves the state roughly $180 million annually.

Why this works

- Competitive grant funding forces programs to prove their worth and effectiveness.
- Programs that already are effective and transparent should have no problems competing for state resources.
- Introducing competition into government spending improves government services and rewards innovation.

Examples of programs that would be eligible for competitive grant funding

Department	Program	Fiscal year 2013 appropriations
Department Of Central Management Services	For Awards and Expenses of the State Government Suggestion Award Board	$7,000
Department Of Central Management Services	Diversity Enrichment	$150,000
Illinois Violence Prevention Authority	Bullying Prevention	$273,000
Office of the Governor	Expenses Related to Ethnic Celebrations, Special Receptions and Other Events	$455,000
Board Of Higher Education	Grants Authorized by the Diversifying Higher Education Faculty in Illinois Program	$1,640,000
Illinois Arts Council	Grants to Public Radio and Television Stations and Related Administrative Expenses	$1,812,000
Board Of Higher Education	Grow Your Own Teachers Program	$2,500,000
Illinois Community College Board	Community Colleges - Workforce Development Grants	$3,311,300
Illinois Arts Council	Grants and Financial Assistance for Arts Organizations	$3,878,300

Source: Governor's Office of Management and Budget, Illinois State Budget Fiscal Year 2013

Budget Solutions 2014: Reform state retiree health insurance

Potential savings: $685 million

The problem: State government retirees contribute little to nothing to their health insurance plans. The state has a $54 billion unfunded retiree health insurance liability and no money to pay it down.

Our solution: Require current retirees to pay at least half of their health insurance premiums, mirroring what other states pay on average. Going forward, the state should eliminate this benefit for new employees.

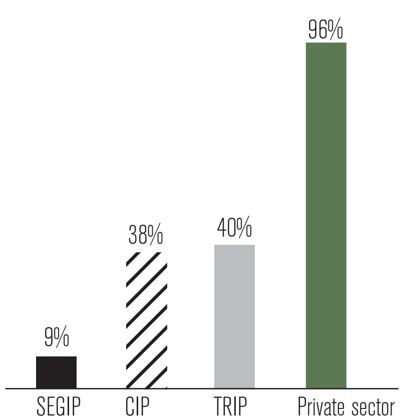
Why this works: These reforms dramatically reduce the unfunded liability, yet protect current retirees through a need- and merit-based formula.

The problem

- Illinois provides health insurance for more than 180,000 government retirees from the State Employees' Group Insurance Program (SEGIP), the Teachers' Retirement Insurance Program (TRIP) and the College Insurance Program (CIP).
- The state subsidizes more than 90 percent of the insurance premium for state retirees in SEGIP. This perk is virtually unheard of in the private sector. Government workers in other states pay more than half of their premiums.
- Health insurance costs for government retirees are growing 2½ times faster than state revenues. The total unfunded liability for retiree health insurance now exceeds $54 billion, but the state has no plan and no money to pay for it.[25]
- The state rewards early retirement by providing additional subsidies to state workers retiring at 55. State costs almost triple to cover early retirements when compared with those for normal retirees. A state that can't pay its bills to charities, hospitals and schools shouldn't be providing nearly free health insurance to government workers.

Illinois government workers pay little toward retiree health insurance compared with private sector workers

Amount paid by employees for insurance



Source: Illinois Policy Institute calculations

Our solution

- Reduce subsidies for health insurance premiums based on a retiree's ability to pay, years of service and retirement age. The state's average premium subsidy should be no more than the national average, equal to 46 percent.[26]
- Increasing retiree contributions to an average of 54 percent would save the state $437 million from SEGIP. Shifting the remainder of the employer share of state university workers' group insurance coverage to the universities would save an additional $158 million.
- Increasing retiree contributions to an average of 54 percent and shifting the remainder of the employer share of TRIP and CIP would save the state $90 million.
- End the practice of paying higher subsidies to those who retire early.
- End retiree health insurance subsidies for new hires.

Why this works

- This solution ensures current retirees' benefits are protected through a need- and merit-based formula. In 2012, the General Assembly passed Senate Bill 1313, which was aimed at curbing retiree health insurance costs. However, the governor has yet to set the rates that retirees should pay and the law has yet to be enforced.
- Reforming retiree health insurance will help prevent ballooning costs from crowding out core government services.
- A dramatically lower unfunded liability will significantly reduce stress on the state's fragile finances.

SPECIAL REPORT

Budget Solutions 2014: Empower patients with health care choice

Potential savings: $1.45 billion

The problem: Access to high-quality care for Medicaid enrollees has collapsed, even as record amounts of taxpayer dollars are spent on a program covering a quarter of the state's population.

Our solution: Empower patients by providing choice from a variety of health plans that meet their needs.

Why this works: Giving patients meaningful choices improves health outcomes, increases satisfaction and reduces the burden on taxpayers.

The problem

- Medicaid's original goal was to provide medical care to the state's most vulnerable populations. A near doubling in Medicaid enrollment during the past decade has undermined that goal.

Medicaid enrollment balloons

Doubling Medicaid enrollment crowds out services for neediest Illinoisans

Source: Medicaid Statistical Information System

- Illinois' Medicaid system is overloaded and the state is late paying providers, meaning many doctors no longer will treat Medicaid patients. This results in Medicaid patients experiencing worse outcomes.
- Because of eligibility expansions, almost 60 percent of Medicaid recipients in Illinois have incomes exceeding the federal poverty level. Scarce dollars are being siphoned away from those most in need.[27]
- Illinois spent $11 billion on Medicaid in fiscal year 2012 in general funds and related funds, but the doubling in enrollment has put an enormous strain on the program.[28]
- An overcrowded Medicaid has forced the state to ration the money it reimburses to doctors and hospitals, which have to wait several months for payment.
- Low reimbursement rates and payment delays have forced many doctors to close their doors to Medicaid patients, forcing many to use emergency services or forgo care. Those who are fortunate enough to receive care have worse outcomes when compared with the privately insured and even the uninsured.[29]

Our solution

In addition to requesting a block grant from the federal government in the amount equal to the federal funding received for Medicaid in fiscal year 2013, Illinois should also build on the success of Florida's Medicaid reforms:

- Give Medicaid patients meaningful choices for their health plans from a variety of provider service networks and managed care organizations.
- Allow health plan providers to customize their plans to meet the individual needs of their enrollees, which will help ensure plans compete on value.
- Pay plan providers a fixed, risk-adjusted monthly rate based on enrollment in a particular plan. In the automatically enrolled populations, this would result in $1.1 billion in annual budget savings.[30]
- Allow low-income families that qualify for federal subsidies to buy private insurance to exit the Medicaid program. This would save Illinois $350 million a year.[31]

Why this works

- Health care choices improve outcomes, increase satisfaction and reduce the burden on taxpayers.
- Similar reforms experienced average annual savings of more than 20 percent when compared with per-person spending in traditional Medicaid programs.[32]
- Most of these reforms can be implemented without a waiver from the federal government.

SPECIAL REPORT

Budget Solutions 2014: Eliminate ineffective revenue sharing programs

Potential savings: $1.7 billion

The problem: The Local Government Distributive Fund (LGDF), one of Illinois' largest revenue sharing programs, exemplifies the shell game of government spending in Illinois; one unit of government raises money and another spends it. This arrangement fosters waste and abuse.

Our solution: Eliminate ineffective revenue sharing programs and return $1.7 billion to taxpayers in the form of lower state income taxes.

Why this works: Ensures that services provided by local government reflect the willingness of residents to pay for those services through local taxes.

The problem

- Each year Illinois' state government collects billions in income tax revenues. As part of a revenue sharing agreement, the state is required to send more than $1 billion back to local governments through the LGDF.[33]
- These shared revenues are placed by the state in the LGDF, which distributes the money to local governments based on each locality's share of the state population. These shared revenues allow localities to spend money on local programs without having to directly raise those taxes from their taxpayers. This arrangement allows local governments to avoid spending accountability.
- There is no real justification for state government to play the middleman between taxpayers and local governments. The LGDF simply perpetuates the spending shell game for which Illinois is well known.
- In addition to the more than $1 billion in state income tax redistributed to local governments, the state also spends almost $700 million of general fund money on special funds dedicated to projects such as agriculture promotion, downstate public transportation and tourism promotion.[34]

Illinois' FY 2013 revenue sharing programs (in billions)

Fund	Amount
Local Government Distributive Fund	$1.08
Other revenue sharing programs	$1.45
Total	**$2.53**

Source: Data from the governor's Office of Management and Budget.

Our solution

1. **End LGDF revenue sharing.** This eliminates the transfer of more than $1 billion in state tax revenues to local governments.
2. **Reduce the state income tax.** By ending LGDF revenue sharing, the state will have $1 billion in excess tax revenues. That amount should be returned to taxpayers in the form of lower state income taxes.
3. **Require local spending accountability.** Without LGDF funds from the state, local government officials must reassess programs and services or ask taxpayers to pay higher local taxes to preserve them.
4. **End other tax revenue redistribution programs.** The same logic and steps apply to $700 million in other general fund transfers.

Why this works

Eliminating the LGDF and other nontransparent funds:

- Allows for the return of billions of taxpayer dollars to Illinoisans in the form of lower tax rates.
- Holds local government agencies accountable for their spending because these agencies can't ask the state to pay for programs that only benefit local taxpayers.

SPECIAL REPORT

Budget Solutions 2014:
Rededicate General State Aid money for education

Potential savings: $750 million

The problem: More than $750 million of Illinois' $4.3 billion general fund for education subsidizes costs unrelated to education.

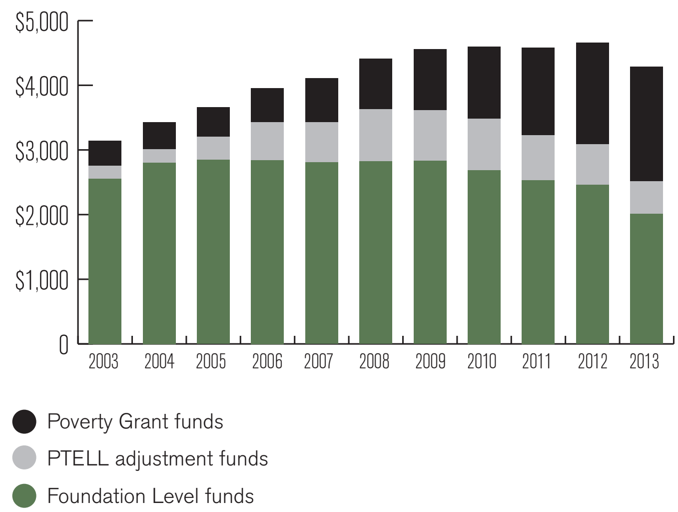
Our solution: Eliminate inappropriate subsidies and return the General State Aid (GSA) to its original intent: paying school districts based on need.

Why this works: Ensuring that education money is distributed equitably and based on need improves educational outcomes.

The problem

- Need-based state education money, or GSA funds, was meant to ensure that needy school districts have a base level of funding per student, known as the Foundation Level. But today, only 50 percent of the GSA is distributed to school districts to help them reach that base level funding, down from 90 percent in 2000.[35]
- The remaining 50 percent of the funding goes to two items that undermine the GSA's stated goal of funding districts based on need:
  1. **Property Tax Extension Limitation Law (PTELL) adjustment**. To protect taxpayers from skyrocketing property tax increases, state law allows communities to cap property tax revenue growth. These caps were meant to keep local government spending at responsible levels. The problem is the school districts in these tax-capped areas refused to rein in spending. Instead, they requested relief from state lawmakers, who adjusted the GSA formula to help these districts make up for their excess spending. The end result is that state law forces taxpayers across Illinois to subsidize districts with property tax caps.
  2. **Tax Increment Financing (TIF) districts.** TIFs are special tax zones established by cities in an effort to spur economic development. In many towns across Illinois, local governments choose to give tax breaks to private developers that invest in these special tax zones. These tax breaks reduce the amount of tax revenues communities have available for education. Facing shortfalls in education funding, these school districts were granted relief by state lawmakers, who adjusted the GSA formula. However, by providing this relief, education funding indirectly subsidizes private developers located in special tax zones.
- The failures of the GSA formula push the state further away from the important concept of allowing money to follow the child.

General State Aid subsidizes costs unrelated to education *(in billions)*



Source: Illinois State Board of Education

Our solution

- End GSA subsidies that enable school districts to bypass local spending limits. Savings: $500 million.
- End GSA subsidies that, in effect, fund real estate development projects. Savings estimate: $400 million.
- By implementing both of these reforms at the same time, the state would realize an overlap in savings totaling $750 million.

Why this works

- Ending inappropriate GSA subsidies increases spending accountability and transparency, and ensures that the GSA funds what it is meant to: school districts most in need.

SPECIAL REPORT

Budget Solutions 2014: Improve quality and efficiency in human services

Potential savings: $512 million

The problem: Illinois' human services programs are creating a cycle of government dependency that fails the state's most vulnerable residents. These ever-expanding programs sap resources from Illinois' economy, destroying real opportunities for personal betterment.

Our solution: Refocus state resources for human services to better provide care for Illinois' most vulnerable residents.

Why this works: This population would benefit from a vibrant economy that increases standards of living and provides sustainable opportunities for those who need it most.

The problem

- Human services programs are meant to provide a safety net for Illinoisans. The programs cover the poor, elderly, children, disadvantaged and others in need. Despite the original goal of providing a temporary safety net, the state continues to expand these programs, trapping more people in a cycle of government dependency. Witness the results: more than 15 percent of Illinoisans are on food stamps; one-fourth are on Medicaid;[36] and more than half of Illinois' students are classified as living in poverty.[37]
- While spending on human services has failed to enhance the quality of life for the state's most vulnerable population, it has succeeded in squeezing out resources for the market economy. The negative effects are clear: Illinois ranks 44th in GDP growth since 2000,[38] the state has the worst credit rating in the nation, almost 600,000 Illinoisans are looking for work[39] and its residents are leaving at the rate of one every 10 minutes.[40]
- The state resources required to fund these large human services programs have squeezed out private sector activity, destroyed sustainable opportunities for those in need and created a greater demand for a government safety net.

Our solution

- Reduce human services spending by 10 percent, or $512 million. Increase focus on transparency and accountability.
- Spend more time improving those services that government can provide effectively. When government cannot provide high-quality human services, allow private organizations to offer assistance to those in need.

Why this works

- Human services can be enhanced through consolidation, prioritization, improved efficiency and technology-based solutions. Realigning resources will enable departments to more efficiently provide better care for those who need it most.
- The free enterprise system is the greatest force for good created in the human sphere and the best way to improve lives for all individuals. Illinois' model has failed to improve the lives of Illinoisans. Removing government as a middleman between communities and service organizations will allow Illinoisans to direct resources to the groups doing the most good.

"Learned helplessness is just the opposite of earned success: it's what happens when our rewards and punishment aren't tied to effort and merit. When people don't feel that their efforts are likely to result in success, they give up and become passive. And they become terribly unhappy in the process."

-Arthur Brooks
President of the American Enterprise Institute

SPECIAL REPORT

Budget Solutions 2014: Right-size state payroll

Potential savings: $318 million

The problem: Illinois is broke and skyrocketing employee compensation costs are at the center of the crisis.

Our solution: Reduce payroll costs.

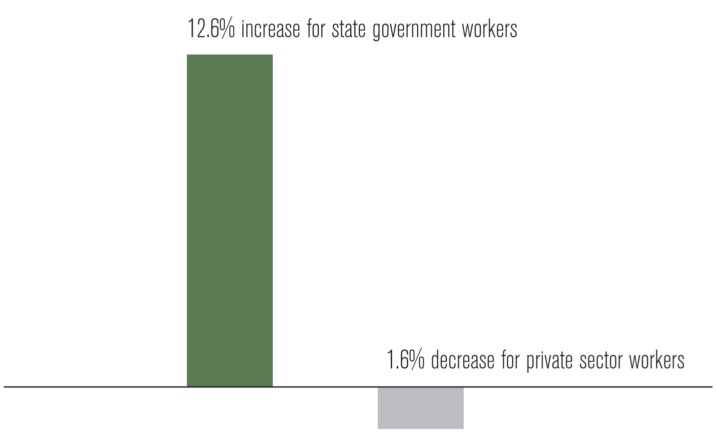
Why this works: Limiting the cost of government is an important step to stabilizing Illinois' fiscal position.

The problem

- Payroll for state employees will cost $3.18 billion during fiscal year 2013.[41] Any private business in a crisis as severe as Illinois' would pare back these costs. Illinois cannot continue increasing its payroll costs; even after imposing a record-high income tax increase in 2011, the state is nearing insolvency.
- Total government employee costs will consume more than one-third of the state's general funds budget in 2013. That figure includes salaries, wages and fringe benefits for current workers, and pension benefits and health insurance costs for retired workers.
- Between 1993 and 2008, private sector pay declined while state worker pay continued to climb. Private sector employee wages and salaries declined 1.6 percent. At the same time, state government wages and salaries increased 12.6 percent. There is no justification to take more from the shrinking family budget to pay for overly generous government employee compensations.

Illinois government worker pay out of sync with private sector

Salaries and wages, 1993 - 2008



Source: Wendell Cox, "Out of sync: Government and private employee compensation in Illinois" Illinois Policy Institute (2011)

- Employee salaries determine the size of future pensions and other fringe benefits. Because salaries are the driver for total government employee costs, reforms to bring down ballooning compensation costs must begin with payroll reductions.
- Gov. Pat Quinn signed a contract in 2010 that included five pay raises to government workers during the course of just 13 months.[42] Due to budget constraints, not all state employees were given all five pay raises; but it's contracts like these that continue to drive up salaries for state workers.

Our solution

- Reduce the cost of government by reducing payroll costs 10 percent.
- End automatic pay increases for state employees and make merit pay increases contingent on economic or fiscal factors.

Why this works

- A reduction in the size of employee payroll costs will slow the dramatic growth in other benefits, making the security of future employee benefits more likely.
- Reducing the cost of government is a necessary step to improving Illinois' finances.
- These reforms help salvage Illinois' fiscal situation, thus enhancing the job security of current state employees.

[1] Dan Hankiewicz, "Special pension briefing: State retirement systems overview," Commission on Government Forecasting and Accountability (2012), http://www.ilga.gov/commission/cgfa2006/Upload/1112specialPensionBriefing.pdf.

[2] Ibid.

[3] Ted Dabrowski, "Without real reforms, Illinois' credit downgrades will just keep coming," Illinois Policy Institute (2013), http://illinoispolicy.org/blog/blog.asp?ArticleSource=5470.

[4] Ben VanMetre, "Two-year anniversary of 2011 tax hike nothing to celebrate," Illinois Policy Institute (2013), http://illinoispolicy.org/blog/blog.asp?ArticleSource=5429.

[5] Jonathan Ingram, "Illinois pensions: A dangerous game of guesswork," Illinois Policy Institute (2012), http://illinoispolicy.org/blog/blog.asp?ArticleSource=5360.

[6] Gregg Scott, "A report on the financial condition of the IL state retirement systems," Commission on Government Forecasting and Accountability (2012), http://www.ilga.gov/commission/cgfa2006/Upload/FinCondILStateRetirementSysFY%20 2011Mar2012.pdf.

[7] Ibid.

[8] Leslie L. Thompson et al., "Actuarial valuation report as of June 30, 2012," State Universities Retirement System (2012), http://www.surs.com/pdfs/invinfo/avr12.pdf.

[9] The employer contribution to the defined contribution plan ranges from 6.6 percent to 7.6 percent of salary, depending on the normal cost of providing disability benefits. See, e.g., State Universities Retirement System, "Self-managed plan: Member guide," State Universities Retirement System (2010), http://www.surs.com/pdfs/mem_guide/Guide-SMP.pdf.

[10] For more details on the Rhode Island plan, see Employees' Retirement System, "An employee's guide to understanding the Rhode Island Retirement Security Act," Employees' Retirement System (2012), https://www.ersri.org/public/documentation/FINAL_RIRSAGuide_January2012.pdf.

[11] Authors' calculations based upon fiscal year 2012 actuarial valuations for the Teachers' Retirement System and the State Universities Retirement System.

[12] Dan Hankiewicz, "Special pension briefing: State retirement systems overview," Commission on Government Forecasting and Accountability (2012), http://www.ilga.gov/commission/cgfa2006/Upload/1112specialPensionBriefing.pdf.

[13] Ibid.

[14] Authors' calculations based upon fiscal year 2012 actuarial valuations for the Teachers' Retirement System, the State Employees' Retirement System and the State Universities Retirement System, as well as actuarial analysis of the effect on the Teachers' Retirement System of freezing the defined benefit plan in place, creating a new defined contribution plan for all future work, freezing all future cost-of-living adjustments and aligning the retirement age with the Social Security retirement age.

[15] http://nopensionbailout.com/your-state/.

[16] Ted Dabrowski, "Without real reforms, Illinois' credit downgrades will just keep coming," Illinois Policy Institute (2013), http://illinoispolicy.org/blog/blog.asp?ArticleSource=5470.

[17] Data obtained from the U.S. Bureau of Labor Statistics.

[18] "Illinois Financial and Economic Policy Report 2013," governor's Office of Management and Budget (2013), http://www.state.il.us/budget/Financial%20Reports/FiscalandEconomicPolicyReport2013.pdf.

[19] An Illinoisan's share of the total debt burden includes $209 billion in pension debt (http://illinoispolicy.org/news/article.asp?ArticleSource=4986), $54 billion in unfunded retiree healthcare (http://illinoispolicy.org/news/article.asp?ArticleSource=4784), $30 billion in bonds (http://www.state.il.us/budget/Financial%20Reports/FiscalandEconomicPolicyReport2013.pdf) and $9 billion in unpaid bills (http://www.state.il.us/budget/Financial%20Reports/FiscalandEconomicPolicyReport2013.pdf).

[20] "Illinois Financial and Economic Policy Report 2013," Governor's Office of Management and Budget (2013), http://www.state.il.us/budget/Financial%20Reports/FiscalandEconomicPolicyReport2013.pdf.

[21] "Budget FAIL: Plan Awaiting Gov. Quinn's Signature Grows Spending, Debt," Illinois Policy Institute (2011), http://illinoispolicy.org/news/article.asp?ArticleSource=4219.

[22] Ben VanMetre, "Two year anniversary of 2011 tax hike nothing to celebrate," Illinois Policy Institute (2013), http://illinoispolicy.org/blog/blog.asp?ArticleSource=5429.

[23] Ben VanMetre, "Illinois needs a strict spending limit," Illinois Policy Institute (2012),

http://illinoispolicy.org/blog/blog.asp?ArticleSource=5459.

[24] "Operating Budget FY2013," Governor's Office of Management and Budget (2012),

http://www.state.il.us/budget/FY2013/FY13OperatingBudget.pdf.

[25] Jonathan Ingram, "Another $54 billion?! In addition to pensions, the state owes billions more in retiree health benefits," Illinois Policy Institute (2012), http://illinoispolicy.org/news/article.asp?ArticleSource=4784.

[26] Ibid.

[27] Forthcoming research report to be released March 2013, Illinois Policy Institute.

[28] Ibid.

[29] Ibid.

[30] Ibid.

[31] Ibid.

[32] Ibid.

[33] Data received from the governor's Office of Management and Budget.

[34] Ibid.

[35] Data received from the Illinois State Board of Education.

[36] Forthcoming research report to be released March 2013, Illinois Policy Institute.

[37] Data received from the Illinois State Board of Education.

[38] U.S. Bureau of Economic Analysis and Illinois Policy Institute calculations.

[39] Data obtained from the U.S. Bureau of Labor Statistics.

[40] Ted Dabrowski, "Still leaving Illinois: An exodus of people and money," Illinois Policy Institute (2012),

http://illinoispolicy.org/news/article.asp?ArticleSource=4576.

[41] Data received from the governor's Office of Management and Budget.

[42] Kristina Rasmussen, "Billions in the Hole? Time for Pay Raises!" Illinois Policy Institute (2012), http://www.illinoispolicy.org/blog/blog.asp?ArticleSource=2815.

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