VOICES FOR ILLINOIS CHILDREN

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The Federal Economic Recovery Plan and the State Fiscal Crisis

Even with Additional Federal Assistance, Illinois Faces Huge Budget Deficits

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In early February, the Illinois Office of the Comptroller issued a sobering assessment of the state's fiscal condition. The cumulative General Funds budget deficit for FY 2009 and FY 2010 is expected to reach nearly $9 billion.[1] At the federal level, the American Recovery and Reinvestment Act, signed into law by President Obama in mid-February, includes several provisions that will provide significant fiscal relief for Illinois. Even with federal assistance, however, the state's two-year budget deficit will exceed $5 billion. In order to avoid massive budget cuts that could decimate a wide range of critical programs for children, families, and communities, policymakers must take advantage of the available federal aid, but they must also recognize the need to generate new state revenue and improve tax fairness.

Fiscal Relief in the American Recovery and Reinvestment Act

The federal economy recovery package provides more than $10 billion for state and local governments in Illinois. About half of this funding is specifically designated as state fiscal relief, primarily for education and health care. The legislation also includes funding for various state programs that benefit low- and moderate-income households — for example, unemployment insurance, child care assistance, employment and training services, and homelessness prevention.[2] The main purpose of these grants is strengthening programs and services during the recession, rather providing fiscal relief for states.

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[1] Illinois Office of the Comptroller, "Transitional Fiscal Report/FY 2010 Budgetary Outlook" (February 4, 2009) <www.ioc.state.il.us/ioc-pdf/dwhreportFeb2009.pdf>.

[2] See "American Economic Recovery and Reinvestment Act of 2009: State-by-State Estimates of Key Provisions Affecting Low- and Moderate-Income Individuals" (Center on Budget and Policy Priorities, Updated February 25, 2009) <www.cbpp.org>.

Most of the state fiscal relief is earmarked for education and health care. The State Fiscal Stabilization Fund is administered by the U.S. Department of Education, which will allocate grants to the governor of each state. The funds will be available immediately, and states must spend the money within two years. Each state's allocation will consist of an education block grant (about $1.7 billion for Illinois) and a flexible block grant ($374 million for Illinois), although the legislation does not use those particular terms. In each fiscal year, the education block grant can be used for elementary, secondary, and higher education, as well as for early childhood programs (if applicable in a given state). A governor must first use the federal revenue to maintain state support through its "primary elementary and secondary funding formulae" *and* state support for higher education. For both elementary-secondary and higher education, the baseline of state support is the FY 2008 or FY 2009 level, whichever is greater. The flexible block grant can be used for education purposes (including modernization, renovation, or repair of facilities) or for public safety and other government services (see Table 1).

Table 1: American Recovery and Reinvestment Act, Estimated Fiscal Assistance for Illinois (in $ millions)

State Fiscal Stabilization Fund	
Education block grant	$1,681
Flexible block grant	374
Total	**2,055**
State fiscal relief for Medicaid	
Increase in federal matching funds	
State FY 2009 (Oct. 2008 - June 2009)	880
State FY 2010 (July 2009 - June 2010)	1,340
State FY 2011 (July 2010 - Dec. 2010)	680
Disproportionate Share Hospital allotment	16
Total	**2,916**

Sources: U.S. Government Accountability Office; Center on Budget and Policy Priorities; Centers for Medicare and Medicaid Services.

The other major source of fiscal relief is a temporary increase in federal matching rates for Medicaid. The Federal Medical Assistance Percentage (FMAP), which is currently 50.32 percent for Illinois, will be increased by 6.2 percentage points, with additional adjustments for states with rising unemployment rates (which would include Illinois). The enhanced FMAP, which is designed to protect and maintain state Medicaid programs during the recession, will be applicable from October 2008 through December 2010. According to estimates from the U.S. Government Accountability Office, Illinois would receive about $2.9 billion in fiscal relief for Medicaid (see Table 1). In order to get this fiscal relief, the state cannot make its eligibility standards or enrollment procedures more restrictive, and it must assure prompt payments to Medicaid service providers, including hospitals, nursing facilities, and practitioners.[3]

The FMAP increase does not apply to the recently re-authorized Children's Health Insurance Program (CHIP) or to the Medicaid Disproportionate Share Hospital (DSH) program, which provides supplemental payments to hospitals that serve disproportionate numbers of low-income patients with special needs. The legislation does, however, include 2.5 percent increases in DSH allotments for federal fiscal years 2009 and 2010. Illinois would receive about $16 million from this provision.

Aside from the federal funds designated for state fiscal relief, the economic recovery legislation also includes grants that might be used to maintain existing levels of services while relieving pressure on the General Funds. For example, the state will receive additional funding for special education ($506 million), child support enforcement ($37 million), and administration of the Supplemental Nutrition Assistance Program — formerly the Food Stamp Program ($12 million).[4] In the case of special education, Illinois would have to request a waiver to use any portion of the new federal revenue to supplant rather supplement state grants for local school districts.

Impact on the General Funds Budget

The state's General Funds include the General Revenue Fund (GRF), the Common School Fund, and the Education Assistance Fund. According to the Comptroller, the budget deficit for FY 2009 is nearly $4.3 billion, not counting the cumulative backlog of Medicaid liabilities. For FY 2010, the state will need $1.95 billion for accommodating Medicaid enrollment growth and reducing the Medicaid backlog enough to sustain the financial viability of providers and to ensure the availability of services. (To qualify for Medicaid fiscal relief, Illinois will be compelled to reduce the backlog.) Another $1.2 billion will be needed for a legislatively mandated increase in contributions to state pension systems. The Comptroller assumes flat appropriations for everything else in the General Funds budget. This means a deficit of more than $4.6 billion for FY 2010 and a cumulative two-year deficit of about $9 billion (see Table 2).

Illinois will receive a substantial amount of federal aid from both the State Fiscal Stabilization Fund and the enhanced FMAP for Medicaid before the end of the current fiscal year. Fiscal stabilization grants, most of which will probably be used to maintain current levels of General State Aid to local school districts and state funding for higher education, would reduce the deficit by more than $2 billion over two years. The potential

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[3] See Iris J. Lav, Edwin Park, Jason Levitis, and Matthew Broaddus, "Recovery Act Provides Much-Needed Tartgeted Medicaid Assistance to States (Center on Budget and Policy Priorities, February 13, 2009) <www.cbpp.org>.

[4] Estimates from U.S. Department of Education <www.ed.gov>, Center on Budget and Policy Priorities <www.cbpp.org>, and Center for Law and Social Policy <www.clasp.org>.

impact of Medicaid fiscal relief is more complicated because only part of the new federal revenue can be used for deficit reduction.

Table 2: Estimated General Funds Budget Deficits, Fiscal Years 2009 and 2010 (in $ millions)

Fiscal Year 2009	
Estimated expenditures	
FY 2009 appropriations	$28,800
Lapse-period spending for FY 2008 appropriations	975
Transfers to other funds*	3,350
Estimated unspent appropriations	-515
Total estimated expenditures	**32,610**
Estimated revenue	**28,325**
Estimated FY 2009 deficit	**4,285**
Fiscal Year 2010	
Estimated expenditures	
Additional Medicaid spending (backlog reduction and enrollment growth)	1,950
Mandated increase for state pension systems	1,200
All other appropriations (same as FY 2009)	28,800
Transfers to other funds*	3,275
Estimated unspent appropriations	-415
Lapse-period spending to be paid with FY 2011 revenues	-975
Total estimated expenditures	**33,935**
Estimated revenue**	**29,175**
Estimated FY 2010 deficit	**4,660**
Estimated two-year deficit	**8,945**

* Primarily for Local Government Distributive Fund (income tax sharing) and long-term debt service.

** Includes $975 million in federal matching funds for additional Medicaid spending.

Source: Illinois Office of the Comptroller

The Illinois Medicaid program is eligible for an estimated $2.9 billion in enhanced federal matching funds. About $2.2 billion would be applicable to FY 2009 and FY 2010, with remainder not available until FY 2011. Moreover, not all of the $2.2 billion would necessarily offset the deficit. About 60 percent of Medicaid spending in Illinois comes from GRF, with the rest financed through various special state funds. For many of these funds, the non-federal share of Medicaid costs is covered not by state revenue but by provider assessments or intergovernmental transfers. In some instances, the relevant statutes specify that the special funds cannot be used to replace appropriations to the

Medicaid program by the General Assembly.[5] In a few other instances, the non-federal share comes from special state revenue sources.[6] The bottom line is that the temporary FMAP increase, combined with the higher DSH allotment, would directly reduce the two-year General Funds budget deficit by only about $1.3 billion. Additional federal revenue for some of the special funds could relieve pressure on GRF spending for Medicaid, but any impact on the deficit would be uncertain (see Table 3).

Table 3: Estimated Effects of American Recovery and Reinvestment Act on the State's Cumulative Budget Deficit for Fiscal Years 2009 and 2010 (in $ millions)

State Fiscal Stabilization Fund	**$2,055**
State fiscal relief for Medicaid	
FMAP increase, FY09-FY10	2,220
Estimated share for GRF	1,332
DSH allotment	16
Estimated total for GRF	**1,348**
Total estimated relief for General Funds	**3,403**
Comptroller's estimate of two-year deficit	**8,945**
Estimated remaining deficit	**5,542**

Fiscal assistance from the federal government would reduce the two-year General Funds deficit by estimated $3.4 billion, leaving a shortfall of $5.5 billion. The state budget crisis will be considerably more manageable, but the Governor and the General Assembly still face a daunting challenge for both the current fiscal year and the next fiscal year. The magnitude of the budget shortfall essentially precludes trying to close the gap with spending cuts alone. More than three-fourths of General Funds spending goes to education, health care, and human services. The state must recognize the need for raising a substantial amount of new revenue — without putting an unfair burden on low- and moderate-income households.[7] As Illinois tries to meet its fiscal and social responsibilities, the stakes for children, families, and communities are enormous.

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[5] This restriction applies to the Hospital Provider Fund, Cook County Provider Trust Fund, and Long Term Care Provider Fund.

[6] For example, Medicaid prescription drug costs are covered by the Drug Rebate Fund and the Tobacco Settlement Recovery Fund, as well as the General Revenue Fund.

[7] See "A Strategy for Income Tax Reform in Illinois" (Voices for Illinois Children, February 2008) <www.voices4kids.org>.

This issue brief was prepared as a part of the Budget & Tax Policy Initiative at Voices for Illinois Children. To promote discussion of the information and analysis presented in this brief, we invite readers to make copies of the brief and to disseminate it. For more information, contact Larry Joseph, Director of the Budget and Tax Policy Initiative, at 312-516-5556 or ljoseph@voices4kids.org.

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