



# A PREVIEW OF THE GOVERNOR'S FY 2013 BUDGET

## \$350 MILLION TO BE CUT FROM HUMAN SERVICES

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In early January, the Governor's Office of Management and Budget (GOMB) released its "Illinois' Economic and Fiscal Policy Report," together with a "Three-Year Budget Projection" for the General Funds. The budget projection includes revenue and expenditure estimates for the current fiscal year (FY 2012) and for FY 2013 through FY 2015 (see Exhibit 1). The estimates for state agency expenditures are not actually budget "projections," which would involve establishing a policy baseline and then projecting the future costs of maintaining current levels of programs and services. Rather, the report's expenditure figures reflect the Governor's intended budget priorities for future fiscal years.

This issue brief focuses on the GOMB report as a preview of the FY 2013 General Funds budget, which will be introduced in the Governor's budget address on February 22. This FY 2013 preview indicates modest revenue growth, a sharp increase in mandated pension contributions, level funding for education and healthcare, and \$574 million in reductions for other parts of the budget. Human service agencies would absorb 60 percent of these budget cuts.

**Exhibit 1: Overview of GOMB Three-Year Budget Projection for General Funds (in \$ millions)**

	FY 2012	FY 2013	FY 2014	FY 2015
<b>Resources</b>				
State revenue sources	27,485	28,087	28,913	27,380
Transfers from other funds	1,826	1,844	1,862	1,881
Federal revenue sources	3,830	4,200	4,200	4,200
Total	33,140	34,131	34,975	33,461
<b>Expenditures</b>				
Agency appropriations	25,256	24,682	24,682	24,682
Estimated unspent appropriations	-904	-500	-500	-500
Subtotal: operating budget	24,352	24,182	24,182	24,182
Pension contributions	4,135	5,250	5,593	5,905
Debt service: pension bonds	1,605	1,552	1,655	1,501
Debt service: capital projects	563	494	520	465
Statutory transfers out	2,366	2,226	2,226	2,226
Repayments to other funds	626	140	0	0
Total expenditures	33,648	33,845	34,176	34,279
Fiscal year surplus/deficit	-507	286	799	-818
Payments for backlog of outstanding bills	0	200	800	0

Source: Governor's Office of Management and Budget

## Revenue Projections

GOMB's projections show moderate revenue growth from state sources over the next two years — \$602 million (2.2%) in FY 2013 and \$826 million (2.9%) in FY 2014 (see Exhibit 2). These projections take into account revenue losses from various tax cuts enacted in December 2011 (Senate Bill 397) — about \$260 million for FY 2013 and \$325 million for FY 2014. Midway through FY 2015, the income tax increases enacted last year begin to phase out. The individual rate is scheduled to drop from 5 percent to 3.75 percent and the corporate rate from 7 percent to 5.25 percent. This will result in a projected net revenue loss of \$1.5 billion in FY 2015. An additional, much steeper drop in revenue is expected for FY 2016, when the lower rates will be effective for the entire year.

**Exhibit 2: Projected General Funds Revenue from State Sources (in \$ millions)**

	FY 2012	FY 2013	FY 2014	FY 2015
Individual income tax	15,062	15,273	15,791	14,315
Corporate income tax	2,354	2,550	2,718	2,446
Sales tax	7,100	7,235	7,385	7,570
Other state sources	2,969	3,029	3,019	3,049
Total	27,485	28,087	28,913	27,380

Note: Statutory transfers (primarily revenue from the state lottery and riverboat casinos) are not included.

Source: Governor's Office of Management and Budget

## Pension Costs

The GOMB projections also reveal the ongoing financial problems of the state-funded retirement systems — problems that are primarily the result of decades of underfunding. As the state struggles to adhere to a long-term plan for reducing unfunded pension liabilities, resources for other parts of the budget are being squeezed out. General Funds spending for mandated pension contributions increased from \$1.6 billion in FY 2008 to \$4.1 billion in the FY 2012 budget. Pension contributions for FY 2013 are projected to jump by 27 percent, mostly because of changes in actuarial assumptions by the various retirement systems and unintended consequences of pension reform legislation enacted last year (Senate Bill 1946). This increase of more than \$1 billion would be almost twice the projected growth in General Funds revenue from state sources (see Exhibit 1).

## State Agency Appropriations

The GOMB report presents agency operating expenditures in seven broad categories of “budget results” (see Exhibit 3):

*Education:* Proving a quality education and opportunities for growth

*Healthcare:* Improving access to and cost-effectiveness of healthcare

*Human services:* Protecting the most vulnerable among us

*Public safety and regulation:* Protecting lives and property

*Government services:* Improving the efficiency and fiscal stability of state government

*Economic development:* Enhancing economic well-being

*Quality of life:* Improving quality of life

**Exhibit 3: General Funds Appropriations for State Agencies, FY 2012 to FY 2015 (in \$ millions)**

	FY 2012 (actual)	FY 2013 (est.)	FY 2014 (est.)	FY 2015 (est.)
<b>Education</b>	8,946	8,946	8,946	8,946
State Board of Education	6,750	-----	-----	-----
State universities	1,294	-----	-----	-----
Illinois Student Assistance Commission	407	-----	-----	-----
Illinois Community College Board	361	-----	-----	-----
All other	134	-----	-----	-----
<b>Healthcare</b>				
DHFS: Medical assistance	6,639	6,639	6,639	6,639
<b>Human services</b>	6,873	6,523	6,523	6,523
DHFS: State employee group insurance	1,412	-----	-----	-----
DHFS: Administration	129	-----	-----	-----
Total outside DHFS	5,332	-----	-----	-----
Department of Human Services	3,389	-----	-----	-----
Department of Children & Family Services	813	-----	-----	-----
Department on Aging	737	-----	-----	-----
Department of Public Health	135	-----	-----	-----
Department of Juvenile Justice	124	-----	-----	-----
Department of Veterans' Affairs	64	-----	-----	-----
All other	71	-----	-----	-----
<b>Public safety and regulation</b>	1,531	1,408	1,408	1,408
Department of Corrections	1,222	-----	-----	-----
Department of State Police	272	-----	-----	-----
Department of Military Affairs	15	-----	-----	-----
Illinois Violence Prevention Authority	13	-----	-----	-----
All other	9	-----	-----	-----
<b>Government services</b>	1,104	1,016	1,016	1,016
Judicial agencies	318	-----	-----	-----
Secretary of State	260	-----	-----	-----
Department of Revenue	126	-----	-----	-----
Comptroller	108	-----	-----	-----
Legislative agencies	82	-----	-----	-----
Department of Central Management Services	70	-----	-----	-----
All other	140	-----	-----	-----
<b>Economic development</b>	94	87	87	87
Dept. of Commerce & Economic Opportunity	32	-----	-----	-----
Department of Agriculture	30	-----	-----	-----
Department of Transportation	21	-----	-----	-----
All other	10	-----	-----	-----
<b>Quality of life</b>	68	63	63	63
Department of Natural Resources	50	-----	-----	-----
Illinois Historic Preservation Agency	9	-----	-----	-----
Illinois Arts Council	9	-----	-----	-----
<b>Total agency appropriations</b>	25,256	24,682	24,682	24,682

DHFS = Department of Healthcare and Family Services

Source: Governor's Office of Management and Budget

Six of these categories were used in the Governor's FY 2012 budget book. Following a recommendation by the Budgeting for Results Commission, GOMB has added a new category for healthcare, which had previously been subsumed under human services.<sup>1</sup> In the final FY 2012 budget, education, healthcare, and human services represent almost 90 percent of total appropriations for state agencies. For FY 2013, the GOMB report shows flat funding for education and healthcare. Appropriations in the other five budget categories would be reduced by \$574 million, including \$350 million in human services. In FY 2014 and FY 2015, there would be level funding for all seven budget categories.

### *Education*

The education category includes the State Board of Education, state universities, community colleges, and other higher education agencies, as well as operating costs and group health insurance for the Teachers' Retirement System and the State Universities Retirement System. In FY 2012, appropriations were reduced by \$689 million (9%) for the State Board of Education and by \$62 million (3%) for higher education agencies. For FY 2013, the Governor intends to maintain overall education funding at the FY 2012 level.

The State Board of Education budget request for FY 2013 has a \$265 million increase (4%) from the General Funds, including \$201 million for General State Aid, \$20 million for the Early Childhood Block Grant, \$7 million for bilingual education, \$3.2 million for teacher and administrator mentoring, and \$380,000 for the Children's Mental Health Partnership. In order to accommodate these increases while adhering to level funding for the education category as a whole, the Governor's budget would have to make corresponding cuts in higher education programs.

### *Healthcare*

The healthcare category consists of medical assistance expenditures in the Department of Healthcare and Family Services (DHFS). Other parts of the DHFS General Funds budget — program administration and employee group insurance — remain in the human services category. DHFS medical assistance programs provide access to health care primarily for low-income families with children and for elderly and disabled individuals. About 95 percent of medical assistance spending is funded through Medicaid, with the federal government covering half of the costs. Most of the remainder is jointly financed through the Children's Health Insurance Program (CHIP), which involves a higher federal matching rate of 65 percent. A small portion of medical assistance spending is funded entirely by the state.

GOMB assumes no growth in medical assistance appropriations over the next three years. However, since Medicaid is a federal entitlement program, expenditures (i.e., incurred liabilities) cannot be controlled simply by limiting appropriations. As the report itself notes, rising Medicaid costs will inevitably exceed current appropriations levels, and the appropriations indicated for FY 2013 through FY 2015 would require "material reductions in Medicaid costs." Moreover, DHFS has estimated that FY 2012 appropriations for medical assistance are \$1.5 billion lower than anticipated liabilities and that program liabilities will increase by about 5 percent in FY 2013 and subsequent years.<sup>2</sup> In the absence of significant policy changes, keeping appropriations at the FY 2012 level will mean adding at least \$1.5 billion *each year* to the state's backlog of unpaid bills.

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<sup>1</sup> The author is a member of the Budgeting for Results Commission. For an overview of the Commission's recommendations, see "Budgeting for Results: Highlights of the BFR Commission Report" (Budget & Tax Policy Initiative, Voices for Illinois Children, November 2011).

<sup>2</sup> Illinois Department of Healthcare and Family Services, "Five-Year Medical Assistance Budget Outlook: General Revenue and Related Funds Only" (January 2012).

## *Human Services*

As noted above, GOMB's human services category includes DHFS program administration and employee group insurance.<sup>3</sup> The State Employees' Group Insurance Program (SEGIP) provides medical, dental, vision, and life insurance for employees, retirees, and their dependents. Medical coverage accounts for more than 90 percent of total costs. Between FY 2007 and FY 2011, SEGIP was significantly underfunded. General Funds appropriations declined while program costs grew, which generated a backlog of \$1.1 billion in outstanding liabilities. Without policy changes, the appropriation for SEGIP (\$1.4 billion in FY 2012) is likely to increase in FY 2013.

The remainder of the human services category encompasses the Department of Human Services, Department of Children and Family Services, Department on Aging, and various smaller agencies (see Exhibit 3). In FY 2012, appropriations for these agencies totaled \$5.3 billion. GOMB's budget estimate for FY 2013 indicates a \$350 million reduction. Budget cuts would not affect all agencies and programs equally, however. Medicaid-financed programs outside DHFS represent about \$1.5 billion in General Funds spending. These include developmental disability services and the Home Services Program for people with physical disabilities in the Department of Human Services, as well as the Community Care Program in the Department on Aging. If Medicaid-funded services outside DHFS are excluded, the FY 2012 funding baseline for human services is lowered from \$5.3 billion to \$3.8 billion. Given that GOMB plans to reduce FY 2013 appropriations for human services by \$350 million, program cuts would average close to 10 percent.

## **Conclusion**

The state's fiscal situation remains precarious. GOMB's budget projection for FY 2012 shows a modest fiscal year operating deficit of about \$500 million. The estimated carryover deficit from previous fiscal years is about \$4.7 billion. This will mean a cumulative deficit of \$5.2 billion at the end of FY 2012.<sup>4</sup> (This figure does not include other outstanding liabilities — about \$3 billion — for Medicaid, state employee group insurance, and corporate income tax refunds.) The GOMB budget projection for FY 2013 leaves only \$200 million to reduce the huge backlog of unpaid bills.

Those who claim that the income tax increase has not improved the state's financial situation are simply wrong. The new revenue enabled the state to stabilize its credit rating, cover mandated pension contributions for FY 2012 without borrowing, and avert much deeper budget cuts. Without the tax increase, the cumulative deficit at the end of FY 2012 would be more than \$15 billion (see Exhibit 4). Moody's Investors Service recently lowered the state's general obligation bond rating, largely because the fall legislative session did not produce steps to implement long-term solutions to "severe pension underfunding" or "chronic bill payment delays." At the same time, the rating agency also revised the state's financial outlook from "negative" to "stable," citing the income tax increases enacted last year.<sup>5</sup>

As a preview of the Governor's FY 2013 budget, the GOMB report raises several other important issues. The sharp increase in mandated pension contributions will consume all projected revenue growth — and then some. Pension reform legislation currently under consideration (Senate Bill 512) would not solve the problem of rising pension costs in the short-term. According to the Com-

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<sup>3</sup> There is no logical reason for dividing DHFS program administration from DHFS medical assistance (although a portion of administrative costs involves child support enforcement). The Budgeting for Results Commission has suggested that state employee group insurance appear as a separate item outside agency operating expenditures — along with pension contributions, debt service, and statutory transfers.

<sup>4</sup> State of Illinois General Obligation Bonds, Official Statement, January 11, 2012, p. 14.

<sup>5</sup> Globe Credit Research, January 6, 2012.

mission on Government Forecasting and Accountability, annual state contributions would actually be higher in the first 7-10 years of implementation. In FY 2013, mandated pension contributions under the proposed plan would increase by another \$476 million.<sup>6</sup>

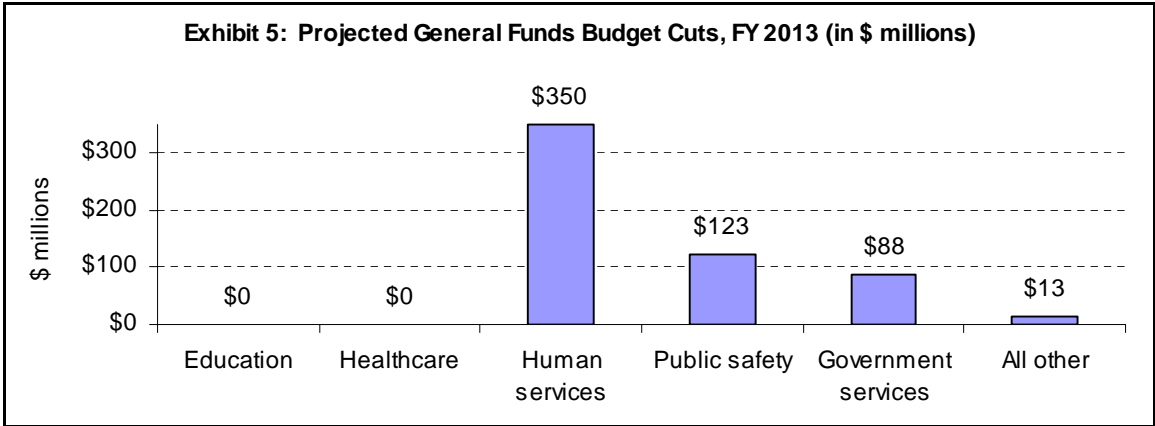
Healthcare costs present a very difficult set of policy dilemmas. At the end of FY 2012, the state will have about \$1.5 billion in outstanding medical assistance liabilities (about half of which would ultimately be covered by federal matching funds). Even without “normal” program growth (reflecting increased enrollment and other factors), there will be a comparable gap between appropriations and actual program costs in FY 2013 and each subsequent year. The state’s basic policy choices will be dramatic reductions in program costs or continued accumulation of deferred liabilities.

Finally, the GOMB report indicates that the FY 2013 budget will be devastating for human service agencies, which are slated for 60 percent of spending cuts (see Exhibit 5). Among all state agencies, the Department of Human Services (DHS) has been hit hardest by the budget crisis of the past several years. Since FY 2009, reductions in DHS grants for community-based providers have been in the range 20 percent to 50 percent or more. Program areas subject to deep cuts have included developmental disabilities, mental health, addiction treatment, and youth services. In the FY 2013 budget, DHS programs not protected by federal funding or federal mandates will be in the greatest jeopardy. The combination of budget cuts and long delays in payments from the state will continue to undermine the human services infrastructure in Illinois.

**Exhibit 4: Projected General Funds Deficit, FY 2012 (in \$ millions)**

<b>With tax increase*</b>	
Fiscal year balance	-508
Carryover deficit from previous years	-4,691
Cumulative deficit	-5,199
<b>Without tax increase**</b>	
Fiscal year balance	-7,500
Carryover deficit from previous years	-7,700
Cumulative deficit	-15,200

\* Estimate from Governor’s Office of Management and Budget.  
 \*\* Estimate from Budget & Tax Policy Initiative, Voices for Illinois Children.



<sup>6</sup> Commission on Government Forecasting and Accountability, Pension Impact Note, 97th General Assembly, SB 0512, as amended by HA 2, November 8, 2011.

## **About the Budget & Tax Policy Initiative**

The Budget & Tax Policy Initiative (BTPI) at Voices for Illinois Children provides timely, credible, and accessible information and analysis on fiscal issues that affect children, families, and communities in Illinois. BTPI is a member of the State Fiscal Analysis Initiative (SFAI), a network of nonprofit organizations in more than 40 states. SFAI is coordinated by the Center on Budget and Policy Priorities, a Washington, D.C.-based research organization and strategic policy institute that works on a range of federal and state issues.

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