The Unraveling of Illinois: What or who got us into this mess?

1. How bad is Illinois' fiscal crisis?

FY19 Budget

$1.5+ billion deficit - budgeting one-time revenues for operations, using fund sweeps and short-term borrowing and unrealistic estimates of savings from pension savings and other fantasies produce the illusion of a balanced budget

Waiting in the wings

- Fallout from two-year budget impasse:
    - $8 billion in unpaid bills
    - Lowest credit rating of any state – one level above junk status
    - Increased debt payment dues to long and short-term borrowing
    - State university funding at FY15 levels
    - Devastated non-profit social service network
- $130 Billion in unfunded pension liabilities means escalating pension payments for the next 25 years
- Structural Deficit - Continued divergence of spending and revenue curves
    - Structural spending pressures: Inability to control health care costs for Medicaid and state employees, unfunded pension liability, commitment to increase funding for K-12 Education and state higher education, infrastructure deficit
    - Structural limits of revenue system: flat income tax with major exemptions, narrow sales tax base, flat motor fuel taxes and fees, uncertain federal funding for Medicare and transportation – lags behind economic growth

Economic growth and demographic factors

- Low to flat population growth, aging population
- Real and perceived bad business climate
- Changing nature of the Illinois economy – particularly rural and downstate urban areas
- Lack of public investment in infrastructure

The Unknowns

- Man: technology, social media, artificial intelligence, recessions, trade wars, constitutional crisis, international crisis – 10th least prepared state to deal with a recession
- Nature: Climate change and disease/environmental

Can we tax, cut or grow our way out of this mess?

Hard Choices: One, some, all or none of the above. Understanding how we got here can help us decide.

Informed, engaged citizens can make a difference – with a long-term commitment and hard work - outrage and short-term passion only get your so far - throwing out the bums for new bums is not a fix.

II. How did we get into this mess?

Structural Factors; 1970 Constitution

Items that have been enforced

- Limitations on income taxation: A tax on or measured by income shall be at a nongraduated rate. Any tax imposed upon a corporation shall not exceed the rate imposed on individuals by more than a ratio of 8 to 5.
- Laws classifying the subjects or object of non-property taxes or fees shall be reasonable and uniformly applied. Exemptions and deductions shall be reasonable.
- Membership in a pension or retirement system of the State, unit of local government or school district shall be an enforceable contractual relationship. Benefits shall not be diminished or impaired.

Omissions

- No judicially enforceable balanced budget language
- No rainy-day fund requirement

Items that have not been enforced

- The state shall incur obligations for payment or make payments from public funds only as authorized by law.
- Governor's budget: Proposed expenditures shall not exceed funds estimated to be available for the fiscal year as shown in the budget.
- Budget passed by the General Assembly: Appropriations for a fiscal year shall not exceed funds estimated by the General Assembly to be available during that year.
- The state has the primary responsibility for financing the system of public education.

Items that have not been achieved their goals

- Legislative Redistricting - Gerrymandering and representation

- Elimination of cumulative voting for House of Representative (1980 Amendment)

Economic Factors

dot.com bubble and collapse – 1996-2003

- Personal income tax revenue went up and then disappeared
- Increased state spending from unstainable revenue

Great recession – 2007-2009 recession & 2010-2017 recovery

- Loss of revenue not reflected in state budget cuts, federal stimulus money used for operating expenses, not capital investments
- Stock market losses and slow growth hurt return on investment of pension funds
- Increased social service spending by state government
- Drag on rate of economic growth

Changing nature of Illinois' economy and diverging regional needs and problems

- Loss of manufacturing and mining jobs, loss of jobs to technology in business and agriculture, loss of jobs in retail
- Increased employee costs/loss of healthcare benefits and loss of retirement benefits from corporate decisions and shift to gig economy = flat take-home pay and pressure on social services

Lack of Economic Development and Growth

- Business climate – Reality and perception – right to work, workmen's comp, prevailing wage, taxes on corporations
- Ineffective state and local economic development incentives
- Decline of economic base in rural areas, small and medium sized cities
- Inequity in funding for public schools
- Disinvestment in Higher education
- Lack of investment in technical training/community colleges
- High property tax burden
- Deteriorating transportation and physical plant infrastructure.
- Lack of recent capitol plan – building and construction create jobs and economic activity. Recent capitol plans financed by bonds in 1985 (Build Illinois), 1999 (Illinois First), 2009 (Illinois Jobs Now).

Major drivers of state spending – General Revenue

- Medicaid (2 to 1 federal match) – Unable to control rate of growth – cost, usage, fraud
- K-12 education funding (funding for the evidence-based funding model) (hold harmless funding)
- Pension obligations – paying down unfunded liability and employer contributions for state workers, K-12 teachers and education employees, and university faculty and employees
- Local government revenue sharing ($6 billion from gross income tax receipts)
- Non-Medicaid social services
- Debt Service (Additional $700 million for unpaid bills bonds 2018, but total debt service decreases after 2020 as pension bonds from 2010-11 pension obligation bonds mature
- Employee and retiree healthcare costs (state workers, universities, community colleges)
- Corrections/public safety (expansion and contraction of prison population)
- University/Community colleges (current funding at FY15 levels, which were reductions from previous levels)

Revenue: Taxes and Exemptions

- Individual income tax (1972 exemptions for all retirement income = $1.75 billion) (property tax payment exemption = $500 million)
- Corporate income taxes (economic development tax credits)
- Sales and use taxes (no sales taxes on services = $1-4 billion loss) (1984 exemptions for food & drugs = $2 billion loss) (gasohol exemption = $100 million loss (30 exemptions from sales tax) (sales tax on gasoline at pump $0.11/gallon)
- Motor fuel taxes and automobile fees (base motor fuel tax per gallon last increase 28 years ago, $0.21 per gallon) (Fees for registration, title transfers, etc. below national average)
- More gambling and recreational marijuana – might make some of us feel better but won’t fix the budget

Pensions

- $7 billion contribution FY19 (unfunded liability and employer contributions). Under current law, that will increase yearly to $16.3 billion in 2045 when unfunded percentage will drop to 10%.
- $130 billion in unfunded liability in of FY17 (current unfunded percentage 41%) - $20 billion in FY1995
- $47.8 billion unfunded liability from reduced or skipped payment required by 1995 law
- $31 billion unfunded liability from reductions in investment return assumptions (FY 2010 5 system average $8.25%, current average $7%)
- $16 billion unfunded liability from demographic factors (mortality rates, rates of termination, etc.)
- $14 billion unfunded liability from investment return shortfalls
- $5.8 billion unfunded liability from benefits increases.
- Timeline
  - FY1990 Compounded COLA - Thompson
  - FY1995 Pension ramp legislation -Edgar
  - FY 1998 Benefit increase - Edgar
  - FY2001 Investment return shortfall - Post dot.com bubble - Ryan
  - FY 2003 Early retirement program- Ryan
  - FY2004 -2005 TRS Pension obligation bonds/early retirement option changes/pension holidays - Blagojevich
  - FY2008 Investment returns short fall – Great recession – Quinn
  - FY 2010 – Tier 2 pension category adopted – reduced benefits, increased employee contributions, increased retirement age
  - FY 2013 Legislation enacted eliminating waiver of healthcare premiums for qualified Tear 1 retirees – July 2014 ruled unconstitutional by State Supreme Court
  - FY2014 Pension reform bill lowing COLAs for Tier I employees and retirees passed – May 2015 ruled unconstitutional by State Supreme Court
  - FY 1997, 2007, FY2010, FY2012, FY2014, FY2016 Changes actuarial assumptions (rate of return and demographics)

Budget Gimmicks, Budget Deficits, Budgets Stalemates, and Unpaid Bills

- Illinois law allows the agencies to obligate funds at the end of one fiscal year and pay for expenditures out of revenues for the next fiscal year (Lapse period spending and Section 25 expenditures)
- Short-term borrowing and fund sweeps provide one-time revenue to fund continuing operating expenses
- Size of the float averaged more than $3 billion per year in FY2008-FY2015 and exceeded $6 billion in FY2016 and FY2017.
- Holding bills at the agency level rather than submitting them to the comptroller masks the total amount of spending
- During the two-year budget stalemate, unpaid bills reached $16.7 billion for FY2017.
- After borrowing $6 billion to pay down the backlog, unpaid bills currently sit at $7.7 billion
- Interest and penalties on unpaid bills (1% a month for bills more than 90 days overdue) = $1.14 billion for 2016-2018, exceeding the amount paid out over the previous 18 years
- From 1983 to 2009 Illinois credit rating dropped 4 levels from the highest rating (AAA). From 2010 to 2018 the state's credit rating dropped 5 more levels to one level above junk bond status (BB+/Ba1).

<u>Failures of Political Leadership</u>

<u>Illinois Political culture</u>

- Politics as winning, power and control
- Public good/public interest is no more than the aggregate of individual self-interests
- Party over principle – Good government is 5 votes on a Tuesday night
- Politics for professionals, not amateurs
- Politics of corruption – Chicago way , Kankakee way, and Vienna way. Tammany Hall prescient captain Fish Hooks McCarthy – "Oh Lord, give me strength and health, we'll steal the rest."

<u>Is it all Madigan's Fault?</u>

- Madigan – Speaker 34 of last 50 years including the last 26 – Chairman of Democratic Party of IL since 1998
- The Speaker of the Illinois House is the leader of one half of legislative branch that shares power with the executive and judicial branches.

- The Illinois Governor and legislative leaders also share power with the Mayor of Chicago, who has been directly responsible for the Chicago Public School system since 1995.
- Madigan is a political genius in terms of acquiring and exercising power in over a very long period of time in the face of changing circumstances.
- He built the office of the Speaker and Chair of the Democratic Party into powerful positions because he needed a power base outside of his Chicago Ward once his path to being Mayor of Chicago was blocked by events and circumstance following the death of Richard J Daley
- Ultimately he is not and never has been the "boss' of Illinois the way that Richard J. Daley was the "Boss" of Cook County from the mid 1950's to the mid 1970's.
- The Speaker is a pragmatist who accepts change to retain power – 2010 pension reform, balanced budget, workmen's comp and Medicare reforms, etc. aimed at winning elections
- You cannot run the state of Illinois from the legislature or the office of the Mayor of Chicago. The state fortunes rise or fall on the strength of executive leadership from the Governor.

<u>Bad (mostly) policy decisions and avoiding problems: Governors and Legislative Leaders</u>

- 1969 Richard Ogilvie R (4 years) – Strong policy change vision/effective - paired with State Senate President Russel Arrington R (4) and Speaker Walker R (2) and Blair R (2)
  - Enacted state income tax
  - Exempted retirement income from state income tax
- 1973 Dan Walker D (4 years) Strong politics change vision/ineffective/incompetent - paired with Speaker Blair R (2) and Redmond D (2) and Senate President Partee D (2) and Harris R (2)
- 1977 Jim Thompson R (14 years) – Strong policy change vision/effective - paired with Speaker Redmond D (4), Ryan R (2), and Madigan D (8 years) and Senate President Hynes D (2) and Rock D (12)
  - Enacted automatic COLA for state retirees (State of IL, K-12, State universities & community colleges
  - Exempted food and drugs from state sales tax
  - Enacted collective bargaining rights for state and local government employees, K-12 & university employees
  - Reduced state support for K-12 as a percentage of total costs

    - Enacted Build Illinois capital program
    - Enacted temporary income tax increases 1983 and 1989
- 1991 Jim Edgar R (8 years)– Moderate policy change vision/effective - paired with Speaker Daniels R (2) and Madigan D (6 years) and Senate President Rock D (2) and Philip R (6 years)
    - Made 1989 temporary tax increase permanent
    - Enacted pension ramp law to stretch out and back load state payments to state pension funds to decrease unfunded liability
    - Tax swap for increases in income tax and funding for school combined with a decrease in property taxes for schools back by Gov Edgar and passed by Democrat House (Madigan) defeated in Republican controlled Senate (Philip)
    - Budget surplus ($1 billion) passed on to next governor rather than used to pay down pension debt
- 1999 George Ryan R (4 years) – Cautious status quo vision/effective/corrupt - paired with Speaker Madigan D (4) and Senate President Philip R (4)
    - State spending increased to match income tax revenue increase due to Dot.com bubble
    - Enacted Illinois First capital plan
    - Enacted early retirement plan for state employees
- 2003 Rod Blagojevich D (6 years) – Personal ambition/corrupt/incompetent - paired with Speaker Madigan D (6) and Senate President Jones D (6)
    - Enacted $10 billion Pension obligation bond plan – proceeds used to pay down pension debt, but also used to fund budget expansion for health care services (one-time money for operations)
    - Blagojevich want to be President on the strength of being the healthcare governor
    - Enacted pension holiday to fund expanded healthcare obligations
- 2009 Pat Quinn D (6 years) – Cautious status quo vision/ineffective - paired with Speaker Madigan D (6 years) and Senate President Jones D (1) and Cullerton D (5 years)
    - Tier 2 public employee retirement category for new employees hired after 1/1/2010
    - Enacted temporary income tax increase
    - Enacted Illinois Jobs Now capitol plan

- Enacted Medicaid expansion under the Affordable Care Act
- Enacted legislation to eliminate payment of healthcare premiums for qualified (20-years for 100%) public employee retirees (Tier 1) – ruled unconstitutional by Illinois Supreme Court in 2014
- Enacted pension reform bill to reduce pension benefits for Tier 1 employees and retirees - ruled unconstitutional by Illinois Supreme Court in 2015.
- Backlog of unpaid bills exceeds $6 billion
- Legislature allows temporary tax increase to expire with Governor-elect Rauner's support

- 2015 Bruce Rauner R (4 years) – Strong politics and policy change vision/ineffective - paired with Speaker Madigan D (4) and Senate President Cullerton D (4)
  - Budget stalemate between Governor Rauner and Democratic legislative leaders resulted in no state budget being approved for FY16 and FY17
  - Continuing appropriations provide for payment of debt service and pension benefit
  - Federal court consent decrees and injunctions provide for funding of social programs with federal funds/mandates
  - State court injunction provides for continuing payment of salaries of state workers. Appellate Court ruling not appealed by Attorney General Madigan until spring of 2017
  - Funds for K-12 and early education appropriated for FY16 and FY17
  - No funding for non-profit social service agencies operating outside of court orders and injunctions. No funding to pay vendors who continued to deliver goods and services to the state. No funding for state universities or income-based student grants. Delays in appropriating federal funds and non-general revenue funds.
  - Unpaid bills reach $16.7 billion in 2017.
  - Permanent tax increase and FY18 budget passed over Governor's veto
  - $6 billion in borrowing authorized to paydown backlog of unpaid bills.
  - Comptroller Mendoza reports interest penalties on unpaid bill exceed $1.1 billion since 2015
  - State court rules that state must pay step increased for state workers that were frozen by Governor Rauner in 2016 after declaring an impasse with contract

negotiations with AFSCME – Potential cost $400 million not include in FY19 budget.

Roster of 50 years of Political Leadership

- Governors since 1969: Ogilvie R (4) Walker D (4) Thompson R (14) Edgar (8) Ryan R (4) Blagojevich D (6) Quinn D (6) Rauner D (4)
- House Speakers since 1969: Walker D (2) Blair R (4) Redmond D (6) Ryan R (2) Madigan D (8) Daniels D (2) Madigan D (26)
- Senate Presidents since 1969: Arrington R (4) Partee D (2), Harris R (2), Hynes D (2) Rock D (14) Philip D (10) Jones D (7) Cullerton D (9)
- Chicago Mayors since 1969: RJ Daley (8) Bilandic (3) Byrne (4) Washington (5) Sawyer (3) RM Daley (24) Emanuel (8)

III. Discussion: Who or what is to blame? Does it make any difference as we go forward?

Contact Information

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