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EXECUTIVE OFFICE OF THE GOVERNOR  
**GOVERNOR'S OFFICE OF MANAGEMENT AND BUDGET**  
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*Illinois' Economic and Fiscal Policy Report (HB 6268/Public Act 96-1354):* Requires the Governor's Office of Management and Budget to annually submit an economic and fiscal policy report to the General Assembly outlining the long-term economic and fiscal policy objectives of the state, the economic and fiscal policy intentions for the upcoming fiscal year and the subsequent two fiscal years.

The Three-Year Projection (*attached*) highlights revenues, expenditures, any deficit or surplus, and other General Revenue Fund liabilities through Fiscal Year 2015. The report demonstrates spending restraints, revenue growth, and a continuing commitment to fully pay the statutorily required pension contribution to stabilize and strengthen our pension systems.

## Introduction

For decades, Illinois' budget suffered from fiscal mismanagement, a situation compounded by the recent national recession. Despite the challenges, Illinois continues to put its financial house in order by returning the state to budget stability and continuing to grow the economy. ***Over the past three years, Illinois has consistently achieved meaningful reforms supported by both parties—pension, Medicaid, education, unemployment insurance, and workers' compensation reforms are changing the way government and business services are administered, and saving businesses and taxpayers billions of dollars.*** Continued bipartisan support will be necessary to move forward and achieve even greater reforms and savings.

## Governor Quinn's Economic & Fiscal Policy Objectives

### **Fiscal stability**

State government must continue to rightsize budgets and its workforce to live within available resources while working within its fiscal ability to protect areas of need. Despite decreased resources for agency spending—due to modest revenue growth more than offset by rising pension and Medicaid expenses—Governor Quinn continues to prioritize education. While

most areas of spending in Fiscal Year 2013 (FY13) will experience decreases from Fiscal Year 12 (FY12) levels, Governor Quinn intends to maintain education at FY12 levels. From early childhood to K-12 to community college and universities, Governor Quinn advocates quality education and opportunities for growth and learning for all students, which is one of the best ways to promote long-term economic growth in the state.

Healthcare appropriations should also be maintained at FY12 levels; however, rising Medicaid costs will exceed that level which will lead to reductions. All other areas of government should work within 9% reductions from FY12.

Burdened with a budget crisis since Governor Quinn took office, the administration continues to work with state agencies to reduce expenses and find efficiencies. Some operations reductions—such as replacing obsolete computers and fleet cars with gently used models rather than new ones—save tens of thousands of dollars. Other moves—such as reducing and consolidating office space, and eliminating excess printers and the obsolete reliance on paper processing—save tens of millions of dollars.

Since January 2009, when Governor Quinn took office, state headcount has decreased by over 2,000 or 3.68%. A headcount decrease of 2,000—and counting—produces close to \$200 million in annual savings. This reduction has come at a time when new mandates for many programs and initiatives have forced an increase in headcount in some agencies. Examples of such expanded headcount include nursing home inspectors at the Department of Public Health to implement nursing home reform and Capital Development Board staff for implementation of the capital bill. With further operations reductions coming in FY13, agencies will strive even harder to meet such mandates with smaller and smaller workforces.

In order to impose greater fiscal stability and responsibility, the administration's FY13 focus includes:

- Pension reform—Governor Quinn will convene a pension work group that will seek to stabilize and strengthen the pension system with further reforms. In 2010, Illinois enacted unprecedented pension reforms which have been projected to reduce the actuarial accrued liability by over \$200 billion by Fiscal Year 2045 (calculation as of spring 2010). These major reforms, together with paying the statutorily required pension contribution from revenues, have begun to stabilize and strengthen the pension system both for the state and the employees.
- Medicaid reform—Medicaid costs continue to rise at a rate far exceeding revenue growth. Signed into law in January 2011, bipartisan Medicaid reform legislation is expected to achieve savings of up to \$700 million over five years. Current reform measures include expanding coordinated care in Illinois, improving the efficiency of the prescription drug program and tightening the integrity of the eligibility process. However, further and larger reductions are needed to stabilize Medicaid costs. In FY12, appropriations for Medicaid were nearly \$2 billion less than the actual total fiscal year liability. These healthcare expenses are carried into future fiscal years and increase the state's accumulated deficit.
- Debt restructuring—With approximately \$7 billion in unpaid bills, Governor Quinn continues to work with legislators on the need for debt restructuring in order to immediately pay down several billion dollars in bills to provide financial relief to vendors and services providers, some of whom routinely wait six months for payment. Issuing

bonds to pay bills does not constitute “more” borrowing, but rather a restructuring of existing debt as the debt is transferred from unwilling lenders to willing lenders. This \$7 billion represents an accumulated deficit that includes:

- \$3.5 billion in vouchers held at the Comptroller’s Office
- \$2 billion in Medicaid vouchers held at agencies to manage payment cycle
- \$0.5 billion in business tax refunds
- \$1 billion in group health insurance premiums.

(All figures are approximated and as of December 2011.) The Three-Year Projection includes budget surpluses to address the bill backlog over time, or alternatively to help support debt service on a debt restructuring bond that would pay the backlog of bills during FY13.

### *Challenges*

FY13 will bring challenges. Shortfalls of billions of dollars mean a government must change what it does and how it does it. Such changes are difficult and cannot be accomplished overnight or even in one fiscal year. Rightsizing government and government spending is a multi-year challenge that requires cooperation and consensus-building on the part of the executive and legislative branches, as well as interest groups and individuals. The federal government is faced with this challenge as well, and we have seen that no one party or one person has all the answers. Continued bipartisan cooperation is necessary to address our decades-old challenges.

Statutorily required pension contributions continue to rise—FY13’s contribution of \$5.3 billion is over \$1 billion higher than FY12’s. Governor Quinn is committed to making the full statutorily required contribution amount, and has done so each year of his administration. After two years of financing this payment through pension bonds, the payment in FY12 is being made from existing resources. This contribution will continue to come from existing resources—but as that payment increases each year, resources available for other state spending decreases.

The individual and corporate tax increases of 2011 addressed Illinois’ previous structural deficit (of spending consistently exceeding revenues). However, FY12 appropriations were not sufficient to cover bargaining unit wage increases in many agencies, and Medicaid was under-appropriated by nearly \$2 billion. A November bipartisan agreement with the General Assembly to reallocate funds from the Governor’s vetoes to other areas of need achieved the goals of keeping seven state facilities slated for closure open throughout this fiscal year and keeping over 1,800 employees working. This reallocation allows the state to move towards the Administration’s long-term goal of more thoughtful, properly supported and successful community care transitions.

### **Economic Stabilization and Enhancing the Business Climate**

With Illinois mirroring the entire nation as it struggles to recover from the recession, Governor Quinn remains committed to leading the development of job creation programs, improving the state’s business productivity and competitiveness, and enhancing the economic well-being of working families.

Illinois exports have recovered early and led our economic expansion and are now in excess of pre-recession levels. Our diversified economy and transportation infrastructure make Illinois

the largest state exporter not on a coast, and its strength creates a strong competitive base for continued growth.

Economic development initiatives and reforms do not always produce instant results, but long-term, sustainable results can be felt for years following their implementation. They are also a signal that Governor Quinn and Illinois are serious in their determination to boost the state's economy and business reputation. Current initiatives and recent achievements having a positive influence on the Illinois economy include:

- Capital program—Passed with bipartisan support in 2009, the *Illinois Jobs Now!* capital program enhances the state's infrastructure, brings economic development to communities across the state and creates thousands of jobs each year. *Illinois Jobs Now!* will continue in FY13 and beyond.
- Workers' compensation reform—Another bipartisan achievement, signed into law in June 2011, workers' compensation reform will save employers over \$500 million annually in premiums. This reform allows Illinois to be more competitive and a better place to do business, while protecting injured workers.
- Tax reform—The Economic Growth and Tax Reform Package, passed by the General Assembly this past December, delivers economic growth and tax reform for both employers and working families. The proposal increases the Illinois Earned Income Tax Credit (EITC) to 7.5% of the federal EITC in 2012 and to 10% of federal EITC in 2013. The increase puts \$105 million into working families' pockets, the largest increase in EITC since its inception. Doubling the EITC and indexing the personal exemption to inflation for all taxpayers support job creation by allowing everyday working people to spend those dollars at local businesses in their communities. Additionally, the Research and Development Tax Credit and other small business tax credits included in this package will help spur job creation, investment and economic development statewide.
- Education reform—The 2011 education reform bill, commended as a model for the nation, prioritizes teacher performance, changes the way teachers earn tenure and creates a longer school day and year for the city of Chicago, which for years has had one of the nation's shortest school days. Long-term, this will also enhance the state's economic and business climate, as schools will produce better educated, more qualified students.
- Unemployment insurance—Bipartisan legislation, passed in November 2011, will strengthen the integrity of Illinois' unemployment insurance program. The reforms are expected to save Illinois businesses more than \$400 million, provide 16 percent unemployment insurance tax reductions for companies that have not laid off workers, and identify and punish those that defraud the unemployment system.
- Environmental permit streamlining—Last summer, the Governor signed legislation that will make it easier to open and expand a business in Illinois. The legislation will help employers create more jobs by streamlining the environmental permitting process in Illinois, establish a plan for long-term funding, and make the Illinois Environmental Protection Agency more efficient.

## Illinois Economic Conditions and Forecast

While Illinois continues its slow growth out of the recession, there are many positive signs in the state's economy.

- **Economic Growth**—In calendar year 2012, the Illinois economy is expected to grow at a rate of 2.0 percent. This growth forecast considers both the Philadelphia Federal Reserve Bank Index of Leading Economic Indicators for Illinois and IHS Global Insight's forecast for Gross State Product.<sup>1</sup> Additionally, the Index of Leading Economic Indicators for Illinois is the second highest in the Midwest.<sup>2</sup>
- **Employment and Wages**—Though statewide unemployment remains high, the Illinois economy gained 62,300 net new jobs in 2011 (through November). Many industries are also seeing higher wages for workers, due to a mixture of increased average weekly hours and higher hourly earnings.<sup>3</sup>
  - **Leading sectors for new jobs include:**
    - Business and Professional Services: 28,500 jobs
    - Educational and Health Services: 15,600 jobs
    - Trade Transportation and Utilities: 14,400 jobs
    - Manufacturing: 10,800 jobs
  - Average weekly earnings have increased across a variety of industries due to a mixture of increased average weekly hours and higher hourly earnings. The top five industries for each metric are summarized below<sup>4</sup>:

*Top five industries for increased weekly earnings*

<b>Industry</b>	<b>Percentage Change</b>
Non-durable goods manufacturing	8.6%
Plastics and rubber manufacturing	7.0
Durable Goods Manufacturing	6.6
Fabricated Metal Manufacturing	5.8

<sup>1</sup> The leading index for each state predicts the six-month growth rate of the state's coincident index. In addition to the coincident index, the models include other variables that lead the economy: state-level housing permits (1 to 4 units), state initial unemployment insurance claims, delivery times from the Institute for Supply Management (ISM) manufacturing survey, and the interest rate spread between the 10-year Treasury bond and the 3-month Treasury bill. A time-series model (vector autoregression) is used to construct the leading index. Current and prior values of the forecast variables are used to determine the future values of the index. Federal Reserve Bank of Philadelphia, "State Leading Indexes", Retrieved December 19, 2011. <http://www.philadelphiafed.org/research-and-data/regional-economy/indexes/leading/>

<sup>2</sup> Midwest states include: Illinois, Indiana, Iowa, Ohio, Minnesota, Michigan and Wisconsin. Ranking based on report retrieved December 19, 2011 . <http://www.philadelphiafed.org/research-and-data/regional-economy/indexes/leading/>

<sup>3</sup> Job numbers are based on the Illinois Department of Employment Security, November 2011 Current Employment Statistics Program. While many industry sectors did add new jobs others, including government, did reduce the total number of jobs. 57,800 is the total number of net new jobs, accounting for all gains and losses, added to the Illinois economy calendar year to date in November.

<sup>4</sup> Average weekly earnings, average weekly hours and average hourly earnings are year to date averages of the monthly averages based on based on the Illinois Department of Employment Security, November 2011 Current Employment Statistics Program.

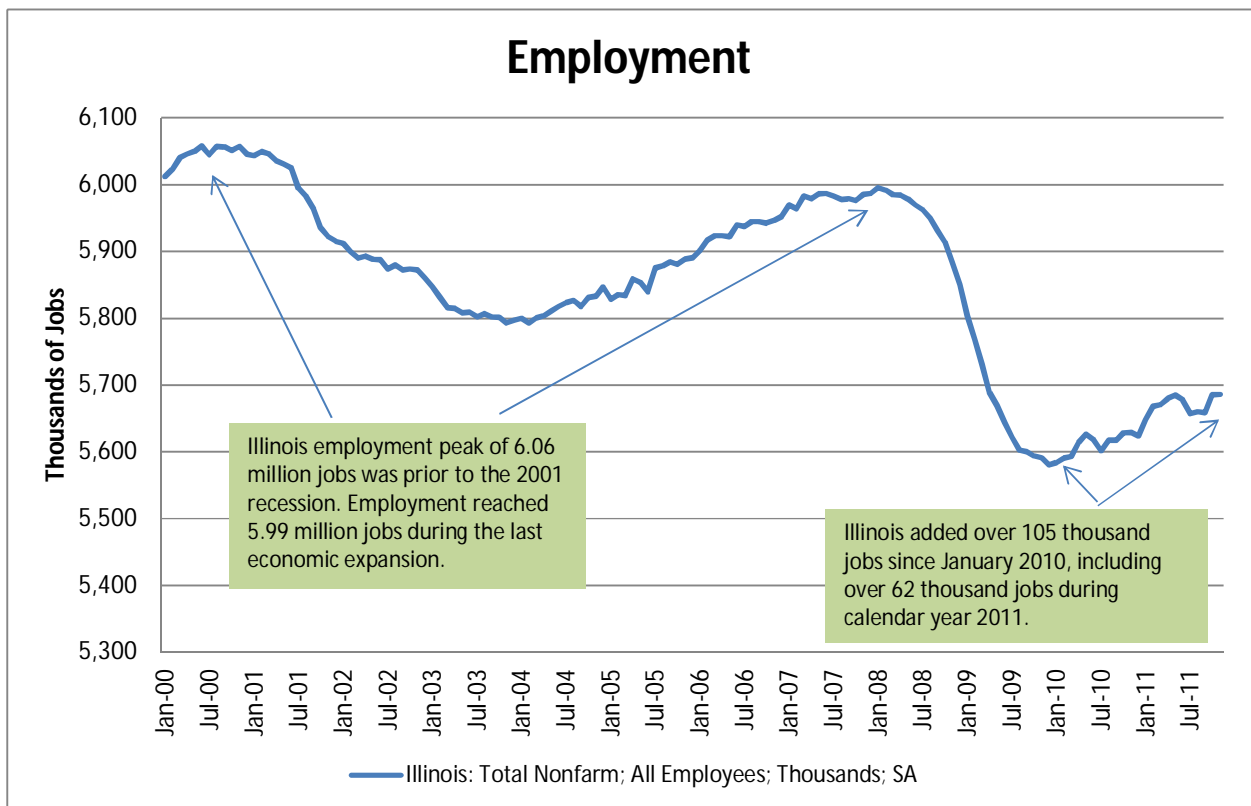
Educational and Health Services	5.4
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*Top five industries for increased weekly hours*

Industry	Percentage Change
Machinery Manufacturing	2.7 %
Construction	2.2
Motor Vehicle Parts Dealers	1.9
Fabricated Metal Manufacturing	1.8
Durable Goods Manufacturing	1.6

*Top five industries for increased hourly earnings*

Industry	Percentage Change
Plastics and rubber manufacturing	7.9%
Non-durable goods manufacturing	7.5
Merchant Wholesalers, Non-Durables	5.7
Educational and Health	5.0
Durable Goods	4.9



Source: U.S. Department of Labor, Bureau of Labor Statistics

*Employed Persons, Annual Averages (In Thousands)*<sup>5</sup>

	<b>Total Employment</b>	<b>Agricultural</b>	<b>Non Agricultural, Private</b>	<b>Non Agricultural, Public</b>	<b>Self Employed</b>
2010	5,970	61	4,838	785	283
2009	5,945	59	4,773	838	271
2008	6,246	71	5,072	819	281
2007	6,336	53	5,167	798	317

Source: U.S. Department of Labor, Bureau of Labor Statistics

- Exports and International Competitiveness—Illinois has made substantial progress toward its goal of doubling exports in five years. Illinois ranks fourth among states as the origin of movement for international exports, up from sixth in 2009. Illinois' international exports increased 32.4 percent in the third quarter of 2011 compared with 2010.<sup>6</sup>

*Illinois primary trading partners, percent of exports*<sup>7</sup>:

<b>Trading Partner</b>	<b>Percentage of Illinois Exports</b>
Canada	30.0%
Eurozone	11.1
Mexico	8.5
China	6.3
Australia	4.7
Brazil	4.1
Japan	3.7

<sup>5</sup> Totals may not add due to rounding. Release date for 2011 employment data inclusive of agricultural jobs and self-employed is October 2012. Data retrieved December 30, 2011.

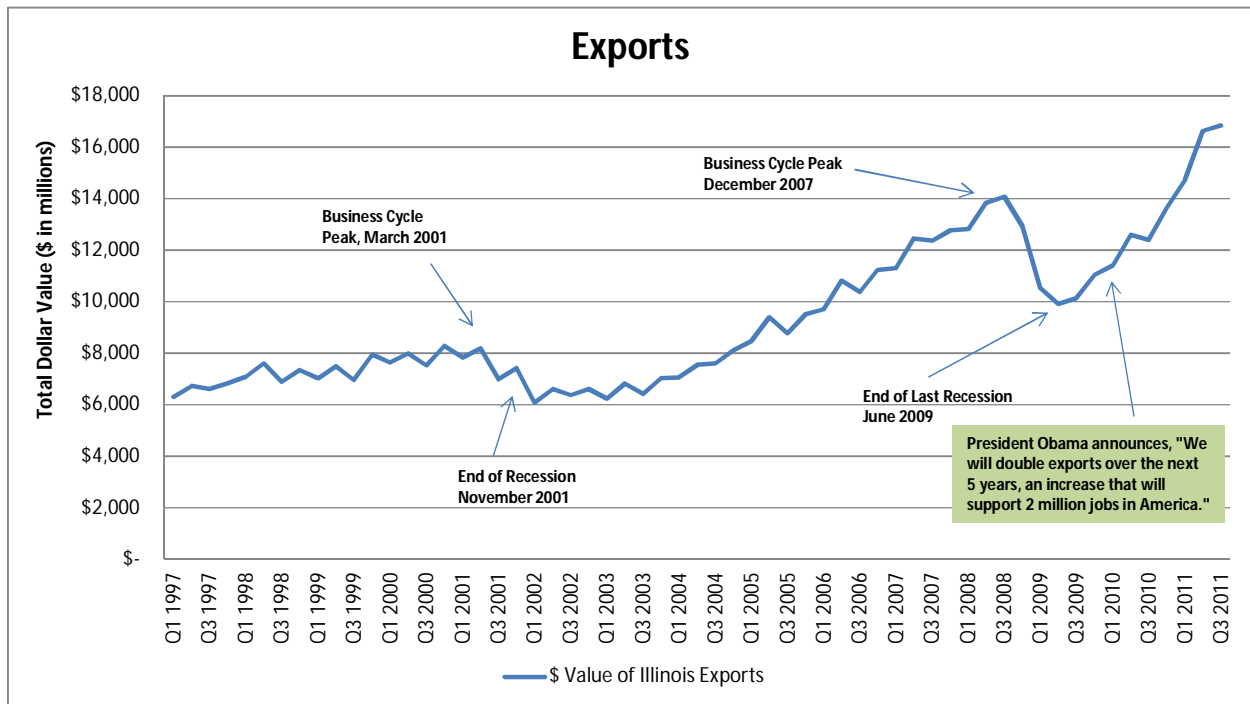
<sup>6</sup> In certain cases, the export origin of movement does not reflect the transportation origin. Specifically whenever shipments are consolidated, the state will reflect the consolidation point rather than the origin of movement. This effect is particularly noticeable for agricultural shipments. For these shipments intermediaries located in inland states are shipping agricultural commodities down the Mississippi River for export from the port of New Orleans. In this case, the state reflects Louisiana, the state where the port of New Orleans is located, as the state of origin of movement. The states in which the commodities were grown and originally shipped are lost. Retrieved 12-27-2011 from <http://www.census.gov/foreign-trade/aip/elom.html>.

<sup>7</sup> Based on calendar year 2010 U.S. Census Bureau data retrieved December 28, 2011, from <http://www.census.gov/foreign-trade/statistics/state/data/il.html>.

Over 94 percent of the increase in goods exports is contained in 10 industries.

*Ranked by dollars exported the 10 industries are:*

Industry	Exports (\$ in millions)
Machinery Manufacturing	\$4,266
Petroleum and Coal Products	2,017
Chemical Manufacturing	1,620
Transportation Equipment	933
Agricultural Products	760
Computer and Electronic Products	544
Fabricated Metal Production Manufacturing	428
Electrical Equipment, Appliances, and Component	357
Miscellaneous Manufactured Commodities	105
Food and Kindred products	89



Source: U.S. Census Bureau, Total U.S. Exports (Origin of Movement) via Illinois, data collected by WISERTrade