The ILLINOIS Report 2013

INSTITUTE OF
GOVERNMENT & PUBLIC AFFAIRS
UNIVERSITY OF ILLINOIS
URBANA-CHAMPAIGN • CHICAGO • SPRINGFIELD

Foreword

The University of Illinois is recognized around the world as a leader in education and innovation.

Our legacy of academic excellence attracted nearly five times more applications than available seats in the freshman classes on our three campuses last fall. The potential of our faculty's pioneering research pushed funding to a record $813 million last year, and federal research dollars ranked among the top six university systems in the nation. We send more than 20,000 graduates into the professional world each year with degrees that put them on the fast track to success.

The University is proud to share the power of its expertise to help build a better tomorrow for our state and its citizens, who are key stakeholders in our success and longtime partners in our pursuit of progress.

The Illinois Report reflects the University's deep commitment to Illinois and its future.

Every year, this publication provides an objective, in-depth analysis of the state's most pressing challenges, developed by experts from the University's Institute of Government and Public Affairs (IGPA). Since it was created by the General Assembly in 1947 to give decision makers a place to turn for guidance, IGPA has emerged as a national leader in public policy research – in fields ranging from public finance and governance to health care and social policy.

This year's seventh edition examines critical issues such as our state's economy and fiscal condition, charity care by hospitals, and the impact of the interaction of state and local policy on property tax bills. The analyses in these pages provide evidence-based insights that will help inform decision makers as they work to overcome the state's challenges and chart a new course for economic growth and social progress.

Channeling our vast resources to advance society has been at the core of the University's mission since its founding nearly a century and a half ago, and I am proud to offer *The Illinois Report 2013* as our latest addition to that rich heritage.

Robert A. Easter
President
University of Illinois

Preface

Each year, the Institute of Government and Public Affairs examines critical issues facing our state and presents the results in *The Illinois Report.* This seventh edition continues the University of Illinois' commitment to provide our state's decision makers with information that is rooted in scholarship and based on the best available evidence. *The Illinois Report 2013* represents the work of University faculty and professionals who devote their careers to seeking solutions to society's problems.

The mission of the University of Illinois is to "transform lives and serve society by educating, creating knowledge and putting knowledge to work on a large scale and with excellence." We are committed to public service, and *The Illinois Report 2013* represents an example of putting our academic pursuits to work for the people of our state. Difficult decisions await and we are eager to assist in achieving solutions that bring new vitality to Illinois.

Christophe Pierre
Vice President for Academic Affairs
University of Illinois

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Editor: James R. Paul, Assistant Director, IGPA
Online Content Editor: Kelsey McCoy
Designer: Deb Eisenmann
Photographers: Kelsey McCoy, Institute of Government and Public Affairs; L. Brian Stauffer and Jason Lindsey, U of I News Bureau; Roberta Dupuis-Devlin, UIC Photo Services; UIS Public Affairs.
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The Illinois Report 2013
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Introduction

A year ago, we used these introductory pages to discuss Illinois' public pension liability—unmatched by any other state—and its mountain of unpaid bills. And we lamented that the state's structural budget deficit—more obligations than income to pay for them—had yet to be addressed.

A year has passed. These same problems remain.

We also noted then, as we do now, that it took years to create our fiscal mess and it will take years to extract ourselves from it. If nothing else, 2012 perhaps allowed us to begin looking at the glass as half-full, rather than half-empty. Some critical steps have been taken that can help achieve fiscal balance, and there are signs that tough decisions will be confronted rather than avoided.

Our economy, ravaged by the Great Recession of 2007-2009, continues to recover ever so slowly. The University of Illinois Flash Index of the state's economic activity began 2012 at 98.8, still in a state of decline. It had climbed back into growth territory (above 100) by March and reached 104.6 in December. Home sales have increased since 2011 and the median price has climbed, as well.

In his budget message in February 2012, Gov. Pat Quinn said the state had reached a "rendezvous with reality" with regard to its financial straits. Since then, extremely difficult decisions have been made to cut programs and close institutions, and finally there is wide agreement that the pension liability must be addressed with substantial reform. The decisions still to come will be even more difficult, but there are signs that those elected to make these decisions are firmly resolved to make them.

"If nothing else, 2012 perhaps allowed us to begin looking at the glass as half-full, rather than half-empty."

Shortly after the November election, we at the Institute of Government and Public Affairs were privileged to hold a series of policy briefings for the 46 newly elected members of the General Assembly. We were encouraged by what we saw and heard in our discussions—a realization among these new office holders that they and their new colleagues bear a huge responsibility, but also a resolve to find solutions that will put Illinois back on the road to prosperity. We hope this enthusiasm and determination can be infused throughout Springfield.

With *The Illinois Report 2013*, as with the six editions that have preceded it, IGPA researchers seek to provide information and context to help decision makers tackle the state's pressing problems. Our mission is to present evidence-based research and analysis that brings critical issues into focus.

We begin with an examination of the state's economy and fiscal health. Economist J. Fred Giertz, who compiles the monthly Flash Index, points out that job growth remains slow but that the trends continue to indicate a steady recovery. IGPA's *Fiscal*

Futures Project team, led by Richard Dye and David Merriman, reports that while state government has made progress toward fiscal sustainability, the need remains to devise a long-term strategy for balancing the budget, keeping the bills paid, and securing the state's financial future.

Transparency has been a critical part of the *Fiscal Futures Project's* recommendations for improving Illinois' long-term fiscal health. Researchers Nathan Anderson and Rob Ross suggest a new design for the semiannual tax bill that is intended to better communicate answers to taxpayers about how their taxes are computed. Their report provides a remarkable new strategy for informing citizens and holding local governments accountable.

No conversation about the economy is complete without a comprehensive look at the effects of the recession on people. IGPA's Cedric Herring uses the term 'precarity' to describe the feeling of insecurity people may experience after a period of economic turmoil that has seen their job security falter or their wages fall. Herring's analysis provides some valuable insight for policymakers who seek to engage a recession-weary constituency.

Other highlights of *The Illinois Report 2013:*

- An examination of a new approach to intervention in some lower-risk child-welfare situations. Differential Response helps connect families with vital safety net services to better serve children and build lasting relationships among families, communities and the state. A pilot project was just completed in Illinois.

- Suggestions for changes in the hospital industry that could help lower health care costs. Health economists Robert Kaestner and Anthony Lo Sasso take a close look at tax exemptions for non-profit hospitals, the Medicaid hospital assessment formula, and the state's Certificate of Need law.

- A look at the impact of 2011 redistricting on the 2012 election. IGPA political scientists analyze how results in congressional elections were affected by the district remapping after the 2010 census and demonstrate the impact of partisan gerrymandering on the electoral process.

The Institute of Government and Public Affairs is dedicated to improving public policy and public service by producing research and analysis such as you find in the following pages, engaging the public in dialogue about critical policy issues, and providing practical assistance in decision making for government and policymakers. We are proud to bring the expertise of the University of Illinois into the policy discussion in Illinois, and are ready to respond when called upon for assistance.

James R. Paul
Assistant Director, IGPA
Editor, The Illinois Report 2013


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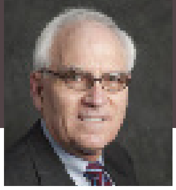


Giertz

After the Great Recession, Where is the Great Recovery?

By J. Fred Giertz

This chapter provides a broad overview of trends in economic growth that demonstrate a slow but steady recovery from the Great Recession. The state still faces a precarious situation with stagnant job growth. Economic development, and especially job growth, will continue to be a focus for the recovery in 2013.

NEED TO KNOW

- The recovery from the Great Recession has been significantly slower than recoveries from past recessions. Although Gross Domestic Product has been positive for the past three years, it has been slower than in most other recoveries.
- The slow rate of recovery can be attributed in part to high unemployment. Rates during the recovery are considerably higher than rates at the depths of the 1991 and 2001 recessions.
- The short-term problem is how to accelerate the recovery from the recession and decrease unemployment. The longer term and more difficult problem is how to bring about fiscal balance over the next several decades.
- The picture in Illinois reflects the national situation. Economic performance did increase in 2012, but the gains have been especially slow for this stage of recovery.

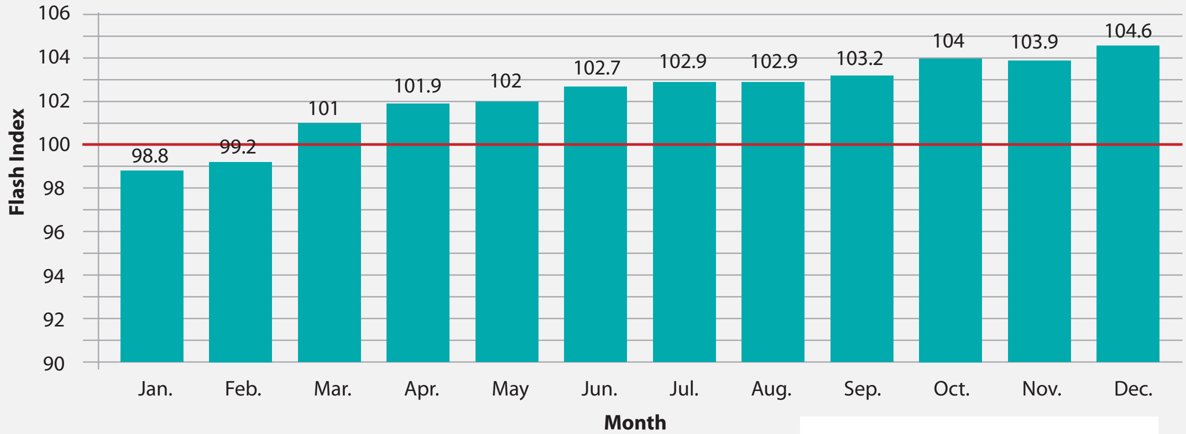
The Great Recession that began in late 2007 has been over officially for 3½ years. This may come as a surprise to some, since the health of the national and state economies is far from robust. Not only was the 2007-2009 recession the most severe since the Great Depression of the 1930s, it has also been followed by an extremely slow and painful recovery.

The recovery has been bifurcated. On the positive side, Gross Domestic Product (GDP) growth has been positive the past three years at slightly more than 2 percent in real terms. However, the rate of GDP growth has been considerably slower than in most other recoveries. There was a belief that sharp declines in the economy such as those experienced in late 2008 and early 2009 would be followed by a strong V-shaped recovery. This was the case after the deep recessions of the early 1980s, but it did not materialize this time. Business profits have also been strong as reflected by an approximate doubling of the stock market since the low point in early 2008. The major negative has been the continued high rate of unemployment. Late in 2012, the national unemployment rate stood at 7.7 percent with the Illinois rate about one percentage point higher. The current unemployment rates during the recovery are considerably higher than the rates at the depths of the 1991 and 2001 recessions and far higher than the "normal" 5 to 6 percent rates that we came to expect during the 20 years before the recession. Not surprisingly, real wage growth also has been sluggish.

Several factors explain the unemployment puzzle. Unlike many previous recessions, productivity growth has continued strong during and after the recovery. This is good news for the long-term health of the economy, but negative for the employment outlook. Because productivity is growing at about the same rate as overall output, firms do not need to hire more workers to produce the extra output. Until the economy expands at a faster rate than productivity, unemployment will remain high.

Figure 1

The Flash Index in 2012



Note: The Flash Index is a measure of future ecomomic activity (100 = no growth).
Source: Analysis by the Institute of Government and Public Affairs, University of Illinois.

A related issue is the large percentage of working-age people who are not employed. In addition to unemployment, more people have withdrawn from the workforce because of early retirement and disability. Some observers believe that the availability of non-work options has accentuated this trend. The extension of unemployment benefits to 99 weeks compared to 26 weeks in non-recession situations has been a boon to the unemployed and has stimulated spending, but it has also reduced the incentives for low-wage workers to seek jobs.

Some workers who have lost their jobs face daunting changes in the workforce. There are numerous reports about the mismatch of job requirements and the skills of the unemployed. Some older workers may choose to retire early rather than look for a job that they may not qualify for and that may pay substantially less than their previous position. Disability retirements have also increased markedly with no evidence that workers are actually in worse health or suffering more accidents.

During the second half of 2012, there was policy uncertainty associated with the "fiscal cliff" that faced the nation at the beginning of 2013. Not all of that uncertainty was resolved in the deal reached by Congress, and the prospect of sudden tax increases and reduced federal spending still may dampen economic activity. Avoiding the cliff will also result in a number of tax and spending changes, but the uncertainty will be reduced, at least in the near term.

"Not only was the 2007-2009 recession the most severe since the Great Depression of the 1930s, it has also been followed by an extremely slow and painful recovery."

The short-term prospects for 2013 are relatively positive. The economy now appears to be growing at a steady pace. However, there have been several times in the last three years when the economy seemed poised to break out of its malaise, but it never quite happened. A double-dip recession has been avoided, but the strong growth that would make a major dent in the unemployment rate has not materialized. This time may be different.

Two years ago in this report, a distinction was made between the near-term and long-term economic problems facing the economy. Unfortunately, these two problems remain. The short-term problem still is how to accelerate the recovery from the recession and lower unemployment. The longer term and more difficult problem is how to bring about fiscal balance over the next several decades where projected spending, largely related to rising government health care costs and Social Security, will grow far faster than the projected growth in revenue under our current tax system. This will require a major restructuring that will likely result in reduced rates of growth in redistribution programs, along with somewhat higher taxes. An agreement on the fiscal cliff problem is only a small step toward resolving the long-term fiscal imbalance. Optimistically, it might reduce the deficit by less than one-half of 1 percent of GDP, which falls far short of dealing with the long-term problem.

The national problems also apply to Illinois. The state's recovery remains sluggish. The U of I Flash Index, a measure of state economic performance, broke through the 100 level (the dividing line between growth and decline) in March 2012 and continued to increase, reaching 104.6 in December (see Figures 1 and 2). This is good news, but the index is relatively low for this stage of a recovery. Unemployment is still very high at slightly below 9 percent, well above the national level. There are prospects for continued growth, but this is unlikely to result in a dramatic decline in the unemployment rate.

Illinois' long-term fiscal problems are much nearer than those facing the federal government. The income tax increase enacted two years ago along with some needed spending discipline has reduced the annual general fund deficit, but major problems remain. The state is far behind in making payments to health care providers and to state universities, and continues to be billions of dollars behind on its bills.

An even more difficult problem is the huge unfunded state pension liability that must be addressed. The pension problem is largely the result of the state often not making the so-called required contributions for the last several decades. The state faces the dilemma of either reducing the benefits of current employees and retirees (which may be unconstitutional) or raising taxes and reducing other spending to meet future pension demands. There is no easy answer to the problem, but there is considerable pressure from the financial markets to address the imbalance.

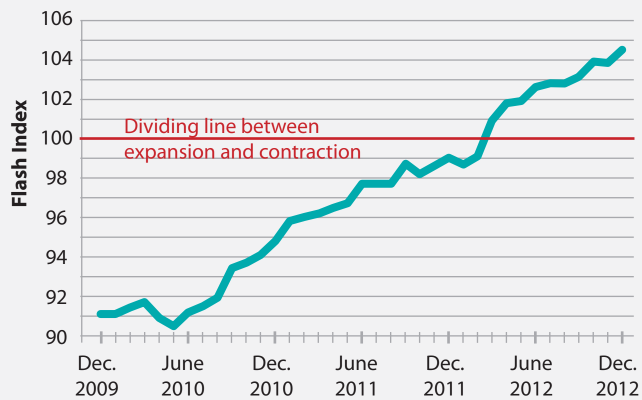
The uncertainty relating to state finances has impact on state economic activity similar to that at the national level. Illinois businesses may consider these problems in their decisions to expand in Illinois or relocate elsewhere. Firms considering Illinois as a new location must also weigh the impact of moving into an unfavorable fiscal environment.

Not everything is negative for the state. Illinois remains a high per capita income state, ranking 16th nationally with income more than 105 percent of the national average. This compares with neighboring states that are faring less well: Indiana—86 percent; Kentucky—82 percent; Missouri—91 percent; Iowa—99 percent; and Wisconsin—95 percent. However, Illinois' margin of superiority is eroding. Twenty years ago, Illinois ranked 10th nationally at 107 percent of the national average. Among its advantages, Illinois has the economic engine of the Chicago region and the O'Hare Airport transportation hub. The agricultural sector remains strong, having been hardly affected by the recession.

Illinois may take some comfort in the fact that state budget discipline is not the only determinant of economic success. Even though Indiana has received considerable publicity for its fiscal prudence, this has not made the state an economic dynamo. Twenty years ago, Indiana's per capita income was 90 percent of the national average. It is now 86 percent.

It is unlikely that 2013 will mark the end of the economic malaise and the return to pre-recession levels of unemployment for either the nation or the state. However, continued progress is likely with the hope of some acceleration. ■

Figure 2
Flash Index December 2009 through December 2012



Note: The Flash Index is a measure of future ecomomic activity (100 = no growth).
Source: Analysis by the Institute of Government and Public Affairs, University of Illinois.

CHAPTER 2

Dye Merriman Hudspeth Crosby

And Miles to Go Before It's Balanced: Illinois Still Faces Tough Budget Choices

By Richard F. Dye, David F. Merriman, Nancy Hudspeth and Andrew Crosby

This chapter discusses decisions that must be made now to set the state budget on a path toward balance. The authors observe that although progress has been made toward sustainability through policies implementing cost reductions (especially in health care) and increased revenue (through income and cigarette taxes), the state will need to focus on a longer-term strategy going forward.

NEED TO KNOW

- Progress was made on several fronts in 2012, but unpaid bills (the state has about $5 billion in unpaid obligations from prior years), Medicaid expenditures, and pensions will continue to be issues for the state moving forward.
- The *Fiscal Futures Model* demonstrates that the combination of increased income tax, large cuts in spending, and the effect of a gradually improving economy will decrease the deficit to an estimated $4.9 billion in FY2013 and a projected $1.6 billion in 2014.
- The *Fiscal Futures Model* also illustrates several important outcomes for different policy options, such as:
  - Holding Medicaid expenditures to the rate of inflation would decrease spending by $3 billion by 2020.
  - Avoiding getting farther behind on pension liabilities would cost an extra $1 billion to $2 billion for each of the next 10 years.
- Although Illinois has taken important steps to deal with its fiscal challenges, more action will be needed in the coming years. The authors present several policy options for consideration.

Editor's Note: *The Fiscal Futures Project at the Institute of Government and Public Affairs is dedicated to informing the public and policymakers about state budget transparency and long-term budget concerns. Each year since 2009, the Fiscal Futures Project team has presented its assessment of Illinois government's financial condition as part of The Illinois Report. This chapter represents that assessment for 2012-13.*

I. Careening Toward a Date with Fiscal Reality

The Illinois budget has been unbalanced and unsustainable for many years. Recently, national attention was focused on the state's fiscal problems by the State Budget Crisis Task Force, which concluded:

"[W]ithout any sort of long-term financial plan to restore balance, and without reserves … Illinois has been doing backflips on a high wire, without a net."[1]

A harsh statement, but a reasonable characterization of the risky behavior involved. As a result of these "fiscal backflips" —paying for expanded programs with borrowing, pension holidays, delayed payments to creditors, fund-balance transfers and

[1] State Budget Crisis Task Force. *Report of the State Budget Crisis Task Force: Illinois Report*, October 2012 (p. 7). http://www.statebudgetcrisis.org/wpcms/wp-content/ images/2012-10-12-Illinois-Report-Final-2.pdf (Archived by Web Cite® at http://www.webcitation.org/6CS0WV10v)

other gimmicks—Illinois was effectively insolvent going into the Great Recession. In late 2010, the future appeared so bleak that we characterized Illinois' fiscal condition as "Titanic and Sinking."[2]

Two years later we see signs of progress. Illinois certainly has a long way to go to achieve fiscal balance, but problems are being recognized and state leaders have taken several positive steps during the past year. One of the biggest strides occurred in June 2012 with a $2.7 billion plan to "save" Medicaid that consisted of cost reductions, significant new revenue, and other changes. In addition, Illinois' implementation of *Budgeting for Results* has broadened the state's budget focus and key budgeting players are now considering a longer-term picture in budgeting.

However, recent developments have, at best, temporarily fixed a number of looming problems. Medicaid expenditures are expected to continue to rise, placing additional budget pressures on Illinois. The state faces an estimated $100 billion in unfunded pension obligations with no clear solution. Finally, in what has become a tradition in Illinois budgeting, the state will use approximately $5 billion in fiscal year 2013 revenues to pay fiscal 2012 bills, and has no agreed upon plan to address the backlog.[3]

Section II of this chapter reviews the budgetary events of the past year. In Section III, we present our long-term projections of the state's structural deficit from the *Fiscal Futures Model*. In Sections IV and V, we analyze and present projections regarding Medicaid and pensions, respectively. Section VI reviews recent state efforts to adopt improved financial practices, such as *Budgeting for Results* and the addition of multiyear projections. Finally, we offer concluding remarks and policy options.

$5 BILLION *The estimated amount of current revenue that will be used to pay last year's bills.*

II. 2012 – Year in Review

Over the past year, the *Fiscal Futures Project* team collaborated with the State Budget Crisis Task Force, a national working group headed by former Federal Reserve Chairman Paul Volcker and former New York Lieutenant Governor Richard Ravitch. The Task Force studied the fiscal conditions in six states and identified six major threats to states' fiscal stability. It concluded that all six apply to Illinois. These include critical problems of unfunded pension liabilities, debt service, and Medicaid costs, which are growing faster than the state's revenue sources. Illinois' lack of transparency and the use of borrowing and budget maneuvers—such as putting off bills until next year—contributed to the lack of recognition of the state's desperate fiscal condition.

Going forward, "Illinois faces serious threats from future federal budget cuts and diminishing economic growth. Its revenues were stagnant for a decade before the onset of the Great Recession and have eroded over time. It is likely that state revenues will not be able to offset predicted cuts in federal funds," according to the task force.[4] As the federal government works to reduce its own deficits and expands spending on health care under the Patient Protection and Affordable Care Act (PPACA, also known as simply ACA or "Obamacare"), other areas of discretionary spending—such as grants to state and local governments—will probably be cut. In Illinois, this means that there probably will be reductions in federal monies for education, transportation, human services, and natural resources.

[2] Richard Dye, Nancy Hudspeth, and David Merriman, "Titanic and Sinking: The Illinois Budget Disaster." *The Illinois Report 2011*, Institute of Government and Public Affairs at the University of Illinois (Board of Trustees of the University of Illinois, 2011) 27-38. http://igpa.uillinois.edu/node/1282 (Archived by WebCite® at http://www.webcitation.org/6AepU2dOD).

[3] Judy Baar Topinka, Comptroller of Illinois, "Backlog Grows – Fiscal Outlook Cloudy," *The Illinois State Comptroller's Quarterly*, 7, November 2012.

[4] Ibid.

In November, Democrats won a supermajority in both houses of the Illinois General Assembly, potentially breaking a political stalemate.[5] This could reduce political obstacles to progress on Illinois' most pressing issues.

"Illinois' lack of transparency and the use of borrowing and budget maneuvers—such as putting off bills until next year—contributed to the lack of recognition of the state's desperate fiscal condition."

Medicaid. In summer 2012, Illinois enacted cuts and efficiencies in the Medicaid program expected to save $1.6 billion in fiscal year (FY) 2013.[6] With President Obama's re-election removing much of the uncertainty about the phase-in of the ACA, Illinois is moving to expand its Medicaid program. The state is opting into the ACA early in Cook County to collect federal monies to pay health care costs of an estimated 115,000 previously uninsured patients.[7] Illinois is also reportedly making progress on establishing a state health insurance exchange.[8] We look at the impact of the recent cuts, ACA expansion and other ideas for Illinois' Medicaid program later in this chapter.

Unpaid bills. Although the state's ability to carry Medicaid and employee health bills over to the next fiscal year is being phased out,[9] Illinois' perennial problem with late payments to vendors and service providers continues. According to the Illinois comptroller, "Illinois is again on track to use approximately $5 billion in current revenue to pay prior year liabilities."[10] In November

5 Reuters. "Illinois faces own fiscal cliff after big Democratic election win." November 10, 2012, http://www.reuters.com/article/2012/11/10/usa-campaign-illinois-idUSL1E8M8AC820121110 (Archived by WebCite® at http://www.webcitation.org/6CxP1ee4a)

6 Cuts – see Dave McKinney, "Gov. Quinn signs Medicaid cuts, cigarette tax into law." *Naperville Sun*, June 14, 2012. http://napervillesun.suntimes.com/business/13180145-420/gov-quinn-signs-medicaid-cuts-cigarette-tax-into-law.html (Archived by WebCite® at http://www.webcitation.org/6CxZxuFcZ). Also see Dave McKinney, "Illinois House passes bill to cut $1.6 billion from Medicaid." *The Southtown Star*, May 24, 2012. http://southtownstar.suntimes.com/news/12753459-418/illinois-house-passes-bill-to-cut-16-billion-from-medicaid.html (Archived by WebCite® at http://www.webcitation.org/6CxZWvLpT) and Ray Long, "Illinois legislature passes deep health care cuts." *Chicago Tribune*, May 25, 2012. http://articles.chicagotribune.com/2012-05-25/news/chi-health-care-cuts-gain-team-in-illinois-house-20120524_1_discount-drug-coverage-people-from-medicaid-coverage-payment-rates (Archived by WebCite® at http://www.webcitation.org/6CxZbkvvG) Cigarette taxes - see Rick Pearson and Ray Long, "Lawmakers OK $1-a-pack cigarette tax hike." *Chicago Tribune*, May 30, 2012. http://articles.chicagotribune.com/2012-05-30/news/ct-met-illinois-legislature-0530- 20120530_1_cigarette-tax-tobacco-tax-measure-tax-hike (Archived by WebCite® at http://www.webcitation.org/6CxTdLpfP) and Doug Finke, "Quinn wants Medicaid cuts, $1 cigarette tax hike." *The State Journal-Register*, April 20, 2012. http://www.sj-r.com/top-stories/x787558596/Quinn-wants-Medicaid-cuts-1-cigarette-tax-hike. (Archived by WebCite® at http://www.webcitation.org/6CxTZ99UY).

7 Lewis Wallace, "Cook County begins enrolling 250,000 new Medicaid recipients." *WBEZ 91.5*, November 19, 2012. http://www.wbez.org/news/cook-county-begins-enrolling-250000-new-medicaid-recipients-103902 (Archived by WebCite® at http://www.webcitation.org/6Cxb2Eu2h) and The Associated Press, "Cook County gets go-ahead to expand Medicaid coverage early, bringing in more federal dollars." *Chicago Tribune,* October 31, 2012. http://www.chicagotribune.com/news/local/sns-ap-il—cook-county-medicaid-expansion-20121031,0,482870.story. (Archived by WebCite® at http://www.webcitation.org/6CxatFptF).

8 The Associated Press. "Illinois keeps pace on Obama's health law." *Crain's Chicago Business*, November 16, 2012. http://www.chicagobusiness.com/article/20121116/NEWS03/121119806/illinois-keeps-pace-on-obamas-health-law (Archived by WebCite® at http://www.webcitation.org/6CxbQk1Gv) and Dave McKinney, "Legislative battle looms over Illinois health-insurance exchange." *Chicago Sun-Times*, November 11, 2012. http://www.suntimes.com/news/16282096-418/illinois-pursues-health-exchange-but-faces-fight-over-control.html (Archived by WebCite® at http://www.webcitation.org/6CxaiZ7J3) and Peter Frost, "Illinois to submit health exchange blueprint Friday." *Chicago Tribune*, November 15, 2012. http://articles.chicagotribune.com/2012-11-15/business/chi-illinois-to-submit-health-exchange-blueprint-friday-20121115_1_health-insurance-plans-health-care-illinois-plans (Archived by WebCite® at http://www.webcitation.org/6CxaatcBT).

9 Under Section 25 of the Illinois State Finance Code, liabilities for Medicaid, state employees' and retirees' health insurance (and some liabilities in the Department of Public Health) that were incurred in Year 1 could be carried forward and paid with Year 2 revenue. Medicaid reform legislation enacted in January 2011 requires that this practice be phased out over a ten-year period and eliminated in FY 2021.

10 Judy Baar Topinka, Comptroller of Illinois, "Backlog Grows – Fiscal Outlook Cloudy," *The Illinois State Comptroller's Quarterly*, 7, November 2012.

2012, Gov. Pat Quinn proposed issuing bonds to pay the backlog.[11]

Pensions. With the worst unfunded public pension liability of any state, the biggest issue facing Illinois continues to be pension reform. However, progress has been made in increasing awareness of the severity of the problem. For the first time in two years, Illinois did not issue bonds to cover its mandatory contributions to the state pension systems in FY 2012, but that meant cuts in other areas. In August 2012, before a special legislative session to deal with pension reform, Governor Quinn's office issued analyses arguing that increased pension costs are putting pressure on education spending and without reform the situation will grow worse. The governor's office launched a new media campaign that said that Illinois has been underfunding its pension systems since their inception in the 1940s.[12]

"Moody's downgraded Illinois General Obligation Bonds to A2 in January 2012, making Illinois its lowest-rated state and giving Illinois the lowest rating it has had in at least a dozen years."

State retiree health insurance. A new law enacted in June 2012 changed the formula that determined retiree health insurance premiums. Potentially, this will require annuitants to pay part of their health care premiums, based on ability to pay. The new law states that the Department of Central Management Services (CMS) will determine the state's contribution to the program, as well as retiree premiums. CMS had not yet finalized a new premium reimbursement formula by the end of 2012.[13]

Bond ratings downgrade. Illinois' bond rating was downgraded twice in 2012, largely due to the unpaid bill backlog and failure to reform state pensions.[14] Moody's downgraded Illinois General Obligation Bonds to A2 in January 2012, making Illinois its lowest-rated state and giving Illinois the lowest rating it has had in at least a dozen years. On December 13, 2012, Moody's lowered Illinois' credit outlook to "negative" from stable, noting that "fiscal 2014 marks the last year before Illinois' 2011 income tax increases are partly unwound, putting the state on track to deal with simultaneous growth in pension funding needs and loss of revenue."[15] Standard & Poor's downgraded Illinois in August 2012, after a special legislative session to reform pensions was unproductive, making Illinois its second-lowest rated state, ahead of only California.

[11] Reuters. "Illinois governor eyes bonds to pay off growing bill pile." November 15, 2012. http://www.reuters.com/article/2012/11/15/illinois-bills-idUSL1E8MFIZ620121115 (Archived by WebCite® at http://www.webcitation.org/6Cxa4eJw5).

[12] Monique Garcia and Rick Pearson, "Quinn's pension marketing push is derided as 'juvenile.'" *Chicago Tribune*, November 18, 2012. http://www.chicagotribune.com/news/local/ct-met-governor-quinn-pension-reform-20121119,0,3422889.story. (Archived by Web Cite® at http://www.webcitation.org/6CxV7ESYN).

[13] Jeff Houch, "Legislative Update," *The SURS Advocate*, November 2012, p. 3 http://www.surs.org/pdfs/advocate/November12.pdf. (Archived by WebCite® at http://www.webcitation.org/6Cyxjb6Aw).

[14] Moody's January – see Jamey Dunn, "Moody's downgrades Illinois' credit rating." *The Illinois Issues Blog*, January 6, 2012. http://illinois issuesblog.blogspot.com/2012/01/illinois-credit-rating-downgraded.html (Archived by WebCite® at http://www.webcitation.org/6CxTxF2d3). Also see, The Associated Press, "Moody's lowers Illinois credit rating, again." *Lake County News-Sun*, January 6, 2012, http://newssun.suntimes.com/news/9859142-418/moodys-lowers-illinois-credit-rating-again.html (Archived by WebCite® at http://www.webcitation.org/6CxULTUOk) and Brian Chappatta, "Illinois Becomes Moody's Lowest-Rated U.S. State With Debt Downgrade to A2." *Bloomberg*, January 6, 2012. http://www.bloomberg.com/news/2012-01-06/illinois-rating-lowered-to-a2-by-moody-s-with-32-billion-of-debt-affected.html (Archived by WebCite® at http://www.webcitation.org/6CxUWkE0V) S&P August – see Reuters, "UPDATE 2 - S&P cuts Illinois rating to A, outlook still negative." August 29, 2012. http://www.reuters.com/article/2012/08/29/illinois-rating-sp-idUSL2E8JT9FD20120829 (Archived by WebCite® at http://www.webcitation.org/6CxUh2W6P). Also see Monique Garcia, "Illinois' credit rating downgraded after pension reform failure." *Chicago Tribune*, August 30, 2012, http://articles.chicago tribune.com/2012-08-30/news/ct-met-quinn-credit-rating-20120830_1_pension-reform-pat-quinn-credit-woes (Archived by WebCite® at http://www.web citation.org/6CxUqIwg1) and Mark Peters and Kelly Nolan, "Illinois Suffers Credit Downgrade." *The Wall Street Journal*, August 29, 2012.

[15] *Chicago Sun-Times*, "Moody's lowers Illinois' credit outlook." December 14, 2012. http://www.suntimes.com/business/17001449-420/moodys-lowers-illinois-credit-outlook.html (Archived by WebCite® at http://www.webcitation.org/6CzXqk1s1).

New revenue. Although new revenue sources for Illinois are an important step toward fiscal stability, those that have been recently created will generate modest additional revenue and are insufficient to solve Illinois' long-term fiscal issues. In June 2012, the cigarette tax was increased from $0.98 per pack to $1.98. The legislation also expanded the definition of a "cigarette" and raised taxes on other tobacco products. This increase is estimated to raise $675 million that will be used for Medicaid.[16]

In September 2011, a private company began managing the Illinois State Lottery with the intent to increase earnings by $4.8 billion over the next five years, or nearly $1 billion per year.[17] Although lottery receipts reported by the Illinois Comptroller's Office did increase—from about $1.09 billion in FY 2011 to $1.27 billion in FY 2012—they fell short of the target.[18]

After several years of regulatory delays, video gambling machines began operating in about 65 locations in October 2012.[19] Due to the controversial nature of gambling, several municipalities, including the City of Chicago, opted not to legalize video gambling. Similarly, proposals to increase the number of casinos—including a land-based casino in Chicago—were not enacted.

$675 MILLION *Amount of money estimated to be raised for Medicaid from the cigarette tax.*

III. Fiscal Futures Model Projections

As in previous editions of *The Illinois Report*, we present the projected gap in Illinois' consolidated budget from the *Fiscal Futures Model,* which:

- Consolidates the General Funds and more than 600 other state funds, meaning:
  - Year-to-year accounting reassignment of budget items between funds will not be confused with a change in the state's fiscal condition
  - Within-year transfers between funds will not be confused with a change in the state's fiscal condition;
- Divides the budget into a number of categories of spending and receipts that are consistently defined over time;
- Estimates the statistical relationship between budget categories and selected economic or demographic "driver" variables from historical data;
- Uses the current year's consolidated funds budget as a starting point;

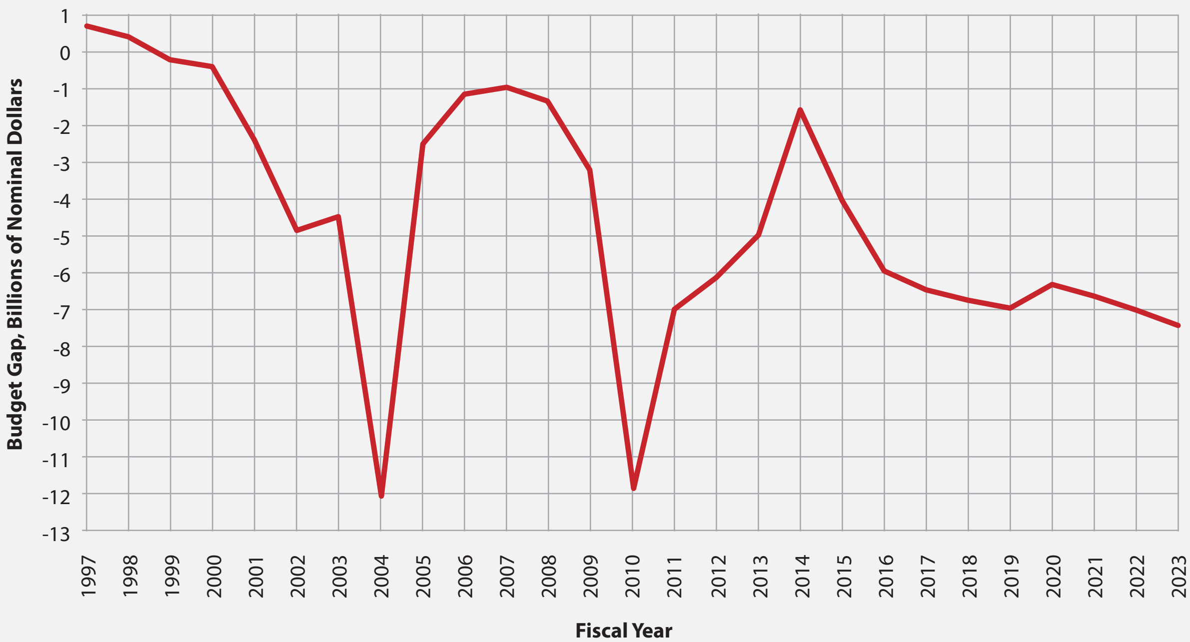
16 Rick Pearson and Ray Long, "Lawmakers OK $1-a-pack cigarette tax hike." *Chicago Tribune*, May 30, 2012. http://articles.chicagotribune.com/2012-05-30/news/ct-met-illinois-legislature-0530-20120530_1_cigarette-tax-tobacco-tax-measure-tax-hike (Archived by WebCite® at http://www.webcitation.org/6CxTdLpfP) and Doug Finke, "Quinn wants Medicaid cuts, $1 cigarette tax hike." *The State Journal-Register*, April 20, 2012. http://www.sj-r.com/top-stories/x787558596/Quinn-wants-Medicaid-cuts-1-cigarette-tax-hike. (Archived by WebCite® at http://www.webcitation.org/6CxTZ99UY).

17 Matthew Walberg, "Lottery management firm could owe state millions." *Chicago Tribune*, November 9, 2012. http://articles.chicagotribune.com/2012-11-09/news/ct-met-lottery-arbitrator-20121109_1_northstar-lottery-group-illinois-lottery-revenue-targets (Archived by WebCite® at http://www.webcitation.org/6CyyyxMiV). Also see *Chicago Sun-Times*. "Northstar begins Illinois Lottery management, (No Date). http://www.suntimes.com/news/metro/3378774-418/story.html. (Archived by WebCite® at http://www.webcitation.org/6CxPdSoml.

18 Paul Merrion, "Big penalty scratched for Illinois Lottery's private manager." *Crain's Chicago Business*, November 9, 2012. http://www.chicagobusiness.com/article/20121109/NEWS02/121109730/big-penalty-scratched-for-illinois-lotterys-private-manager (Archived by WebCite® at http://www.webcitation.org/6CxTSU4oF) and Matthew Walberg, "Lottery Manager Misses Revenue Goal by about $100M," *Chicago Tribune*, July 31, 2012. http://articles.chicagotribune.com/2012-07-31/news/ct-met-lottery-appeal-20120731_1_northstar-lottery-group-illinois-lottery-private-manager (Archived by WebCite® at http://www.webcitation.org/6Agf CRdoQ).

19 Erin Meyer, "It's official: Video gambling now legal in Illinois." *Chicago Tribune*, October 9, 2012. http://articles.chicagotribune.com/2012-10-09/news/chi-video-gaming-legal-in-illinois-beginning-today-20121009_1_video-poker-machines-businesses-or-clubs-central-computer-system (Archived by WebCite® at http://www.webcitation.org/6CxT0Ngkp) and Tammy Webber, "Video Poker Arrives in Illinois." *NBC Chicago*, October 9, 2012. http://www.nbcchicago.com/news/business/illinois-video-poker-173402711.html (Archived by WebCite® at http://www.webcitation.org/6CxTFbFX4).

Figure 1
Illinois Consolidated Funds Expenditures Minus Receipts FY 1997-2023



Source: IGPA Fiscal Futures Model, November 2012.
Notes: Borrowing and fund balance transfers not counted as receipts. FY 1997 to 2011 are based on historical data; FY 2012 data is preliminary; FY 2013 is estimated based on appropriations and other information; FY 2014 to 2023 are projected by the Fiscal Futures Model.

- Uses forecasts of the driver variables and the estimated relationships to project each spending and receipt category into future budget years;
- Assumes no borrowing—or reductions in preexisting fund balances—as receipts.

In Figure 1, we revise our earlier projections with updated numbers for the FY 2012 and 2013 budgets and more recent forecasts of the economic and demographic variables that drive the projections of future budget years. The figure presents the budget gap, which equals expenditures minus receipts and serves as a single measure of the state's fiscal condition.

For reference, Figure 1 includes the consolidated budget gap for completed fiscal years 1997 to 2012. The budget was roughly balanced from FY 1997 to 2001, but moved to a roughly $5 billion deficit in FY 2002 and 2003. Since the budget gap measure presented here does not count borrowing as a receipt, there was a huge increase in the deficit associated with spending the proceeds of pension obligation bonds in 2004. FY 2006-2008 was a period of peak economic activity and revenue collections, but still had a roughly $1 billion deficit on a consolidated funds basis without considering borrowing as a source of revenue.

Figure 1 shows the precipitous decline in Illinois' fiscal condition between FY 2008 and FY 2010 associated with the Great Recession. In *The Illinois Report 2012,* we described the tax increases of 2011 and the other policy changes made in response to the state's fiscal crisis.[20] The combination of increased income taxes, large cuts in many areas of spending, and the effect of a gradually improving economy will decrease the deficit to an estimated $4.9 billion in FY 2013 and to a projected $1.6 billion in FY 2014.

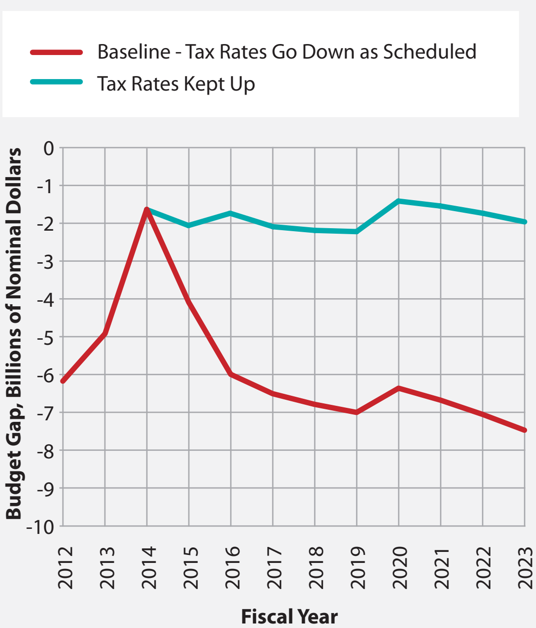
[20] Richard Dye, Nancy Hudspeth, and David Merriman, "Through a Dark Glass: Illinois' Budget Picture is Dire and Distorted." *The Illinois Report 2012*, Institute of Government and Public Affairs at the University of Illinois (Board of Trustees of the University of Illinois, 2012) 41-56. http://igpa.uillinois.edu/IR12/pdfs/ILReport2012web.pdf (Archived by WebCite® at http://www.webcitation.org/6AjnahvnQ).

After 2014, the temporary tax increases of 2011 start to be phased out and by FY 2016 the projected deficit increases to $6 billion. Figure 2 projects the fiscal condition of the state if personal and corporate income tax rates do not fall as scheduled in calendar year 2015. The red line in the diagram is the baseline budget projection from currently scheduled tax rates (identical to Figure 1 except beginning in FY 2012). The blue line in Figure 2 projects a budget deficit on the order of $2 billion per year for the 2015 to 2023 period even if the tax rates stayed at the current 5 percent for individuals and 7 percent for corporations.[21]

IV. Medicaid: A Temporary Fix; Long-Term Concerns

This section is divided into two parts. First, we analyze the impact of the June 2012 Medicaid reform legislation. Second, we look at the expansion of Illinois' Medicaid program under the ACA.

Figure 2
Illinois Consolidated Funds Budget Gap Projections to FY 2023 with and without Phase-Out of Higher Income Tax Rates After 2014



Source: IGPA Fiscal Futures Model, November 2012.
See notes to Figure 1.

A. June 2012 Medicaid Reform Legislation

In our chapter in *The Illinois Report 2012*, we estimated that the budget could balance in 2019 *if* the higher (2011) income tax rates do not expire in 2015 *and* all programs except pensions and debt service were held to grow only at the rate of inflation. In recent years, Illinois' Medicaid expenditures have been increasing about 2 percent per year above inflation. What would it look like if growth of Illinois Medicaid expenditures were held to inflation?

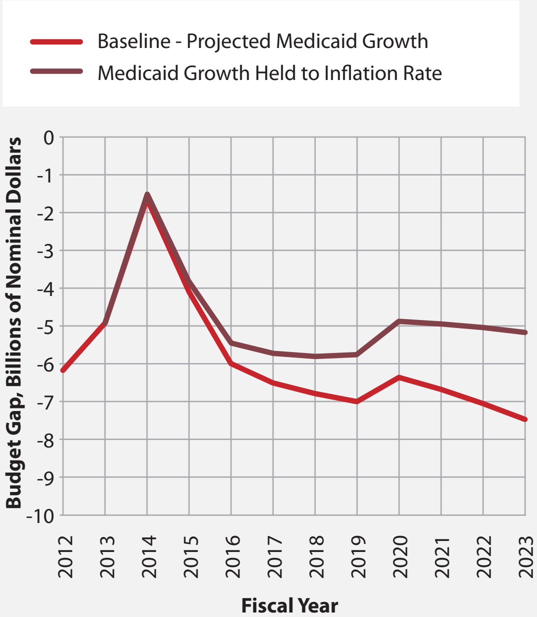
"The combination of increased income taxes, large cuts in many areas of spending, and the effect of a gradually improving economy will decrease the deficit to an estimated $4.9 billion in FY 2013 and to a projected $1.6 billion in FY 2014."

Figure 3 (page 20) illustrates the budget gap with two alternatives going forward from 2013: (1) the baseline projection of the model based on historical growth in Medicaid expenditures higher than the rate of price inflation (red line); or (2) holding Medicaid expenditures to the rate of inflation (purple line). If Medicaid expenditures were held to the rate of inflation, expenditures would be about $3 billion less for FY 2020. The cuts needed to keep Medicaid at zero growth in real dollars would be significant but even this, by itself, would be nowhere near enough to balance the budget.

The American Recovery and Reinvestment Act (ARRA) provided Illinois with additional federal funds for Medicaid through an increase in the reimbursement rate from 50 percent to 61.88 percent for

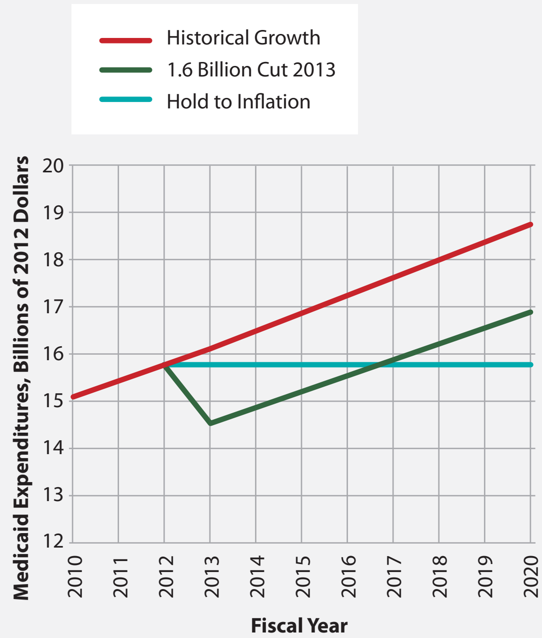
[21] Note that by choosing to report projections of the model only 10 years into the future, the projections stop in FY 2023 and do not show the baseline impact of scheduled cuts in the personal income tax rate to 3.25 percent and the corporate income tax rate to 4.8 percent in calendar year 2025.

Figure 3
Illinois Consolidated Funds Budget Gap Projections to FY 2023 with Medicaid Growth as Projected or Held to Consumer Price Index Inflation Rate



Source: IGPA Fiscal Futures Model, November 2012.
See notes to Figure 1.

Figure 4
Illinois Medicaid Expenditures Projections to FY 2020: Historical Growth, Held to Consumer Price Index Inflation Rate, $1.6 Billion Cut and Historical Growth



Source: IGPA Fiscal Futures Model, November 2012.

FYs 2009-2011.[22] In FY 2012, as the federal stimulus ended, Illinois received $2.7 billion less in federal monies than it had received in FY 2011. To offset this reduction, Illinois leaders enacted a plan of cost savings and cuts expected to save $1.6 billion in FY 2013. If Medicaid growth continues at historical rates, the one-time cuts of $1.6 billion made in 2013 will hold spending below its inflation-adjusted 2012 level for about five years (Figure 4).

B. Medicaid Expansion under ACA

The Affordable Care Act (ACA) will expand Medicaid to provide health coverage for those with incomes at 138 percent of the federal poverty level (FPL) and below.[23] Because the Illinois Medicaid program has historically provided broader coverage than many other states, analysts anticipate that the ACA will have less impact upon Illinois. For example, Illinois already covers patients up to 133 percent of the FPL. However, Illinois relies on federal funds

[22] For Q1 and Q2 of Federal Fiscal Year (FFY) 2009 the match rate was increased to 60.48 percent; then increased to 61.88 percent Q3 FFY 2009 thru Q1 FFY 2011; then dropped to 59.05 percent for Q2 FFY 2011, 57.16 percent for Q3 FFY 2011, 50.20 percent for Q4 FFY 2011 and back to 50.0 percent in Q1 FFY 2012. The federal fiscal year begins October 1; the state fiscal year begins July 1. Q1 federal FY = Q2 state FY. See The Council of State Governments, "States Face Medicaid Match Loss After Recovery Act Expires." March 2011, http://knowledgecenter.csg.org/drupal/system/files/States_Face_Medicaid_Match_Loss_After_Recovery_Act_Expires_0.pdf (Archived by WebCite® at http://www.webcitation.org/6CdtSjxW9).

[23] The ACA will expand Medicaid to cover individuals in households with incomes below 133 percent of the FPL. However, 5 percent of income will be disregarded, which effectively raises the limit to 138 percent of the federal poverty level. See Kaiser Family Foundation, "Determining Income for Adults Applying for Medicaid and Exchange Coverage Subsidies: How Income Measured With a Prior Tax Return Compares to Current Income at Enrollment." March 2011, http://www.kff.org/healthreform/upload/8168.pdf . (Archived by WebCite® at http://www.webcitation.org/6CxSUoHoM).

for many other budgetary priorities. It is likely that increases in federal spending on health care will require discretionary spending to be cut, which could affect Illinois' budget for education, human services, transportation, and natural resources.

"It is likely that increases in federal spending on health care will require discretionary spending to be cut, which could affect Illinois' budget for education, human services, transportation, and natural resources."

Somewhere between 600,000 and 970,000 new patients are likely to enroll under the ACA.[24] In 2011, our colleagues Robert Kaestner and Nicole Kazee estimated that the ACA would increase Medicaid enrollment between 640,000 and 962,500.[25] Similarly, a 2010 study by the Kaiser Family Foundation estimated between 631,000 and 911,000 new Medicaid enrollees. Of these, about 70 percent would be those who were previously ineligible for Medicaid.[26] Approximately 200,000 people ("current eligibles") would qualify for Medicaid under current laws.

Much of the debate about the cost of the ACA to states is focused on the number of people who are currently eligible for Medicaid and are not enrolled in the program, but will enroll during the ACA expansion. These enrollees will be covered by a 50 percent federal match, not the 90-100 percent that covers the newly-eligible.[27] For this reason, providing health care for additional current eligibles is the main cause of increased expenses for states under the ACA. However, other costs are possible. If increased federal spending on health care leads to reductions in federal funds for education, transportation and human services, Illinois may increase its spending in these areas.

Kaestner and Kazee estimated that Illinois' Medicaid expenditures would increase by 5 to 9 percent by 2020, suggesting that Illinois' share of total Medicaid spending would increase from about $5.5 billion in FY 2011 to close to $6 billion in FY 2020, due to the ACA.[28] A 2010 study by the Kaiser Commission on Medicaid and the Uninsured found that Illinois state spending would increase $1.2 billion to $2.4 billion over the five-year period 2014-2019.[29]

24 Media reports indicate 500,000 new enrollees but there is no source cited for this estimate. Dean Olsen, "Illinois likely to expand Medicaid under federal insurance law." *The State Journal-Register*, July 22, 2012. http://www.sj-r.com/top-stories/x691231625/Illinois-likely-to-expand-Medicaid-under-federal-insurance-law?zc_p=1. (Archived by WebCite® at http://www.webcitation.org/6CxS5KOor). Also see Dean Olsen, "Illinois eyes expansion of Medicaid rolls under federal health care law." *The State Journal-Register*, September 25, 2012, http://www.sj-r.com/top-stories/x1784770704/Illinois-eyes-expansion-of-Medicaid-rolls-under-federal-health-care-law. (Archived by WebCite® at http://www.webcitation.org/6CxSP1FJz).

25 Robert Kaestner and Nicole Kazee, "Health Reform and Medicaid: Covering the Uninsured." *The Illinois Report 2011*, Institute of Government and Public Affairs at the University of Illinois (Board of Trustees of the University of Illinois, 2011) 61-67. http://igpa.uillinois.edu/node/1282 (Archived by WebCite® at http://www.webcitation.org/64ZKV8DjP).

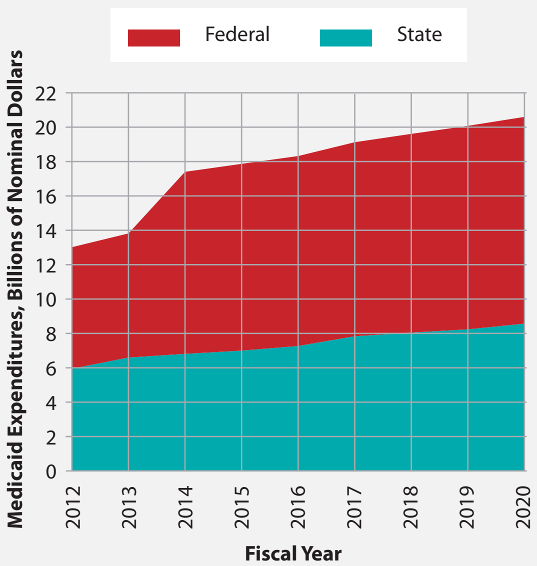
26 John Holahan and Irene Headen, "Medicaid Coverage and Spending in Health Reform: National and State-by-State Results for Adults at or Below 133% FPL." Kaiser Commission on Medicaid and the Uninsured, Kaiser Family Foundation, May 2010. http://www.kff.org/healthreform/upload/Medicaid-Coverage-and-Spending-in-Health-Reform-National-and-State-By-State-Results-for-Adults-at-or-Below-133-FPL.pdf (Archived by WebCite® at http://www.webcitation.org/64jCCYCqe).

27 From FY 2014 thru 2016, the federal government will pay 100 percent of the Medicaid expenses for those who are newly-eligible under the ACA. Beginning in FY 2017, the federal share will drop gradually to 90 percent in FY 2020 and beyond.

28 Robert Kaestner and Nicole Kazee, "Health Reform and Medicaid: Covering the Uninsured." *The Illinois Report 2011*, Institute of Government and Public Affairs at the University of Illinois (Board of Trustees of the University of Illinois, 2011) 61-67. http://igpa.uillinois.edu/node/1282 (Archived by WebCite® at http://www.webcitation.org/64ZKV8DjP).

29 John Holahan and Irene Headen, "Medicaid Coverage and Spending in Health Reform: National and State-by-State Results for Adults at or Below 133% FPL." Kaiser Commission on Medicaid and the Uninsured, Kaiser Family Foundation, May 2010. http://www.kff.org/healthreform/upload/Medicaid-Coverage-and-Spending-in-Health-Reform-National-and-State-By-State-Results-for-Adults-at-or-Below-133-FPL.pdf (Archived by WebCite® at http://www.webcitation.org/64jCCYCqe).

Figure 5
Illinois Medicaid plus ACA Expenditures with State and Federal Shares, FY 2012-2020



Sources: Fiscal Futures Project, Kaiser Foundation.
Note: 2012 numbers are preliminary.

Governor Quinn has said that Kaiser's estimate of $2.4 billion in additional state spending is too high, but at the time of this writing the state had not yet released its own estimates.[30]

Our projection of future Medicaid spending under ACA (using data from the Kaiser Foundation) is shown in Figure 5. Note that FY 2012 numbers are preliminary because final data were not available, but estimates show total Medicaid spending rising above $20 billion by 2020. However, the federal share will be much larger than in the past, due to the higher match rate for some expenditures under ACA.

$96.8 BILLION *Total unfunded liabilities of the five state-funded pension systems (combined) as of 2012.*

V. Pensions

A. State of the Current Systems

As shown in Table 1, Illinois' five state-funded systems combined had a total of $96.8 billion in unfunded liabilities as of 2012. Illinois has the biggest unfunded pension liability of any state, with some of the lowest funded ratios in the nation.[31] The overall funded ratio for the state systems is 39 percent, with the State Universities Retirement System (SURS), General Assembly Retirement System (GARS), and the Judicial Retirement System (JRS) far below the combined ratio.

Underfunding of state pensions dates back decades. In 1994, the Illinois General Assembly acknowledged the problem and established a plan—known as the "pension ramp"—to achieve a 90 percent funded ratio for its systems by 2045. However, the payment schedule has ramped up so slowly that in 2013, 18 years into the plan, the state is still not making large enough payments to keep the unfunded liability from growing.

Even though payments are not yet sufficient to reduce the unfunded liability, Illinois is having serious trouble meeting its scheduled obligations. In several past years, Illinois has taken "pension holidays" and skipped or only partially made payments. In FY 2010 and 2011, the state had to borrow to make its payments. In each of the three years from FY 2011 to 2014, the state's scheduled contribution increased another $1 billion per year. If debt service on the

[30] Dean Olsen, "Illinois likely to expand Medicaid under federal insurance law." *The State Journal-Register*, July 21, 2012. http://www.sj-r.com/top-stories/x691231625/Illinois-likely-to-expand-Medicaid-under-federal-insurance-law?zc_p=1. (Archived by WebCite® at http://www.webcitation.org/6CxS5KOor).

[31] Illinois Department of Healthcare and Family Services. "Institutional Provider Rate Reductions Effective July 1, 2012." June 30, 2012. http://www.hfs.illinois.gov/html/063012n9.html. (Archived by WebCite® at http://www.webcitation.org/6CxQzeGHa).

Table 1
Summary Statistics for Illinois State Retirement Systems

FY 2011	Teachers	State Universities	State Employees	General Assembly	Judicial	TOTAL
Active Members (# persons)*	133,920	71,888	66,363	180	968	273,319
Current Annuitants (# persons)*	90,967	42,682	47,002	291	720	181,662
FY 2012						
Actuarial Accrued Liability ($ billion)**	90.0	33.1	33.2	2.0	0.3	158.6
Assets (current market value, $ billion)**	36.5	11.0	13.7	0.6	0.1	61.8
Unfunded Liability ($ billion)**	53.5	22.1	19.5	1.4	0.3	96.8
Funded Ratio (Assets pct. of Liability)**	40.6%	33.1%	41.3%	28.6%	17.4%	39.0%
State Contribution ($ billion)*	2.4	1.0	1.4	0.01	0.1	4.9

* Commission on Government Forecasting and Accountability. A Report on the Financial Condition of the Illinois State Retirement Systems as of June 30, 2011. (March 2012). http://www.ilga.gov/commission/cgfa2006/Upload/FinCondILStateRetirementSysMarch2011.pdf.
** Commission on Government Forecasting and Accountability. Special Pension Briefing (November 2012). http://www.ilga.gov/commission/cgfa2006/Upload/1112specialPensionBriefing.pdf.

pension obligation bonds issued in 2003, 2010 and 2011 is added to the scheduled payments to the pension funds, pension costs are projected to take one-quarter of state tax revenue by 2015.

B. Scheduled Payments vs. "Required" Contributions

Because defined benefit pensions are calculated from employees' years of service and salary, the state incurs future pension obligations for its workforce each year. If the state does not put aside current resources to match those future obligations, unfunded liabilities will grow. This has been the historical pattern in Illinois. Some important terminology for this discussion:

- **Normal cost** is the present value of future pension obligations incurred in the current year;
- **Unfunded liability** is the difference between the present value of all future pension liabilities minus the value of assets held by the pension fund;
- **Normal cost plus interest** on pre-existing unfunded liability is how much the state would have to pay in the current year to keep unfunded liability from growing;
- **Annual required contribution (ARC),** a concept defined by the Government Accounting Standards Board (GASB), is normal cost plus a 30-year amortization of pre-existing unfunded liability (or normal cost, plus interest, plus a payoff of principal);
- **Employer's annual required contribution** is ARC net of investment income and employee contributions.

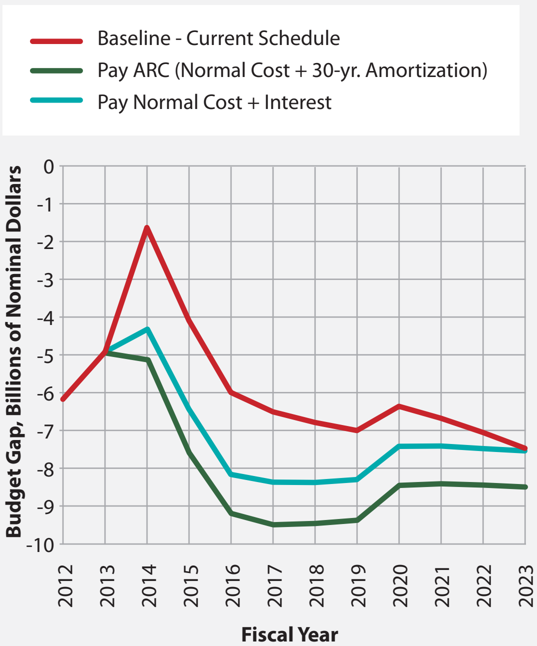
It is noteworthy that the state of Illinois, which manages but does not fund the Illinois Municipal Retirement Fund (IMRF), requires that participating local governments pay the ARC each year, and as a result IMRF has a modest unfunded liability. The state has not imposed the same requirement on itself.

"If debt service on the pension obligation bonds issued in 2003, 2010 and 2011 is added to the scheduled payments to the pension funds, pension costs are projected to take one-quarter of state tax revenue by 2015."

Figure 6 (page 24) presents the state's projected budget gap for the next 10 years under three alternative scenarios: the baseline gap with payments as currently scheduled; the larger gap if the state paid normal cost plus interest to keep unfunded liabilities from growing; the even larger gap if the state paid the ARC to gradually pay down the unfunded liability.

The red baseline budget gap projection is the same as earlier figures and includes the pension payment schedule required under current law. It is not

Figure 6
Illinois Consolidated Funds Budget Gap Projections to FY 2023 with Three Alternative Pension Funding Scenarios



Source: IGPA Fiscal Futures Model, November 2012.
See notes to Figure 1.

shown in the figure, but the existing schedule shows pension payments would increase from $5.9 billion in FY 2013, to $9.2 billion in FY 2023, to $11.5 billion in 2030, and to $17.6 billion in 2045. It is not until after 2030 that estimated unfunded liabilities start to decline and not until 2045 that a 90 percent funded ratio is achieved under this scenario.

The blue line in Figure 6 represents how much more funding would be required to keep the amount of unfunded liability from growing. This simulation assumes that the new funding target is part of the FY 2014 to 2023 budgets. The extra amount required would be $2.6 billion in 2014, declining to almost zero in 2030. After 2030, the existing funding schedule—which has put off all the big payments into later years—would have larger contributions.

The green line in Figure 6 simulates how much larger the budget gap would be if the state were to pay ARC or normal cost plus amortization of unfunded liabilities at a rate that would achieve 100 percent funding in 2045 (just over 30 years). Compared to the baseline case, this would require an extra $3.5 billion in 2014, declining to an extra $1 billion in 2023. State payments would stay in the $8 billion to $10 billion range instead of rising to $17.6 billion in 2045 under the existing ramp law.

One of the problems that helped to create the current fiscal mess is that Illinois uses cash accounting and does not show unfunded liabilities or the annual accrual of additional liabilities in the form of normal cost plus interest. Real costs have been hidden from view and consequently it has been easier to avoid paying them in a timely fashion. Another way of viewing the alternative scenarios in Figure 6 is that they represent the full cost—cash plus accruals—of pension promises: what it would take to not get in a deeper hole (the blue line) or what it would take to eventually cover past underpayments and fill in the hole (the green line).

C. Pension Reform

Figure 6 illustrates the magnitude of the problem facing pension reformers. The current unfunded liability is close to $100 billion. Just avoiding getting farther behind would cost an extra $1 billion to $2 billion for each of the next 10 years, and eliminating the unfunded liability would cost an extra $1 billion per year on top of that.

Some of the major pension reform options have involved increasing employee contribution rates, delaying the normal retirement age, reducing how much benefits are increased in post-retirement years, and shifting the burden of paying normal costs to school districts and universities. The information given with these plans is hard to translate into annual savings for the *Fiscal Futures Model*. However, the simulations of Figure 6 have shown how large the shift in lower benefits would have to be, and how high employee and employer contributions would have to go to manage Illinois' unfunded pension liabilities.

In a sense, even the daunting calculations underlying Figure 6 are overly optimistic because they rely on current estimates of Illinois' unfunded pension liabilities. Currently, Illinois discounts its future liabilities using an assumed rate of return of about 8 percent. New Government Accounting Standards Board (GASB) rules announced in June 2012 will require Illinois and other states with unfunded liabilities to calculate the present value of future pension obligations with lower discount rates. The lower discount rate will increase unfunded pension liabilities and decrease the funded ratio significantly.[32] Compliance with these new GASB rules will require even larger fiscal adjustments than shown in our projections.

"A number of these recommendations, particularly the requirement for long-term projections and the consideration of spending commitments outside the appropriation process, have the potential to improve fiscal decision making."

VI. Reviewing Budgetary Reform Efforts

In 2010 and 2011, Illinois enacted *Budgeting for Results* (BFR), a reform that will "institute a results-based budgeting practice that will end the practice of funding programs based on prior budgets" and instead will shift funding to a performance-based system.[33] In November 2012, the BFR Commission released its second annual report as required by law. The report included 18 new recommendations for 2012, which include:[34]

- More public hearings and greater efforts to engage stakeholders in BFR;
- Infrastructure improvements to support program evaluation;
- Legislative changes to the appropriations and budget approval process to ensure BFR is fully realized;
- Projection of revenue, expenditures, and liabilities for three years in the Governor's Office of Management and Budget's annual economic and fiscal policy report;
- Changing the state budget process to address liabilities that incur outside of the appropriation process (for example, Medicaid).

A number of these recommendations, particularly the requirement for long-term projections and the consideration of spending commitments outside the appropriation process, have the potential to improve fiscal decision making.

Despite a promising mission, Illinois will not be in a position to achieve its stated goal of ending incremental budgeting in the immediate term. Only in FY 2014 will baseline data be collected for state agencies, and only in FY 2015 will the state be in a position for "greater agency coordination, eliminating program redundancies, sharing best practices and encouraging innovation."[35] In addition, as noted in the recommendations highlighted above, legislative approval is required to change the appropriations and budget approval process, so even in FY 2015 an end to incremental budgeting is far from assured.

VII. Conclusion and Policy Options

As a result of a combination of past shortsighted decisions, difficult current economic conditions, long-term trends in health care costs, and the aging population, Illinois will face extraordinarily tough fiscal choices for the foreseeable future. Current spending levels cannot be sustained with currently

[32] Lisa Lambert and Nanette Byrnes. "New rules may make public pensions appear weaker." Reuters, June 25, 2012, http://www.reuters.com/article/2012/06/25/us-usa-pensions-standards-idUSBRE85O01Z20120625 (Archived by WebCite® at http://www.webcitation.org/6CxR9CNBO). Also see *Chicago Tribune*, "Demanding truth in numbers: Finally, more honest measures of an Illinois (and Chicago) debacle. July 2, 2012, http://articles.chicagotribune.com/2012-07-02/news/ct-edit-pension-20120702_1_pension-funds-pension-systems-major-pension-plans (Archived by WebCite® at http://www.webcitation.org/6CxROETu6).

[33] State of Illinois Budgeting for Results Commission. *Budgeting for Results Commission: 2nd Annual Report*, November 1, 2012 (p. 6). http://www2.illinois.gov/gov/budget/Documents/Budgeting%20for%20Results/Related%20Documents/Budgeting%20for%20Results%20Commission%20Report%20Nov%202012.pdf (Archived by WebCite® at http://www.webcitation.org/6CS1Fp8Nz).

[34] Illinois BFR report, pp. 15-16.

[35] Ibid, p. 31.

available revenue. Compounding Illinois' problems are the scheduled phase-out of the 2011 income tax rate increase, new GASB rules requiring accounting adjustments to the pension systems' unfunded liabilities, federally required expansion of the Medicaid population due to health care reform, and the potential decline in federal support for non-health-care spending.

"Illinois will face extraordinarily tough fiscal choices for the foreseeable future."

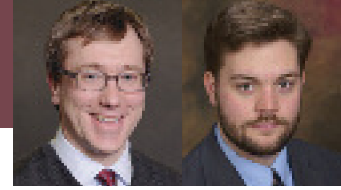
Illinois has begun to take important steps to deal with its fiscal challenges. There have been significant actions to increase revenue (increases in income and cigarette taxes) and to trim spending (important cuts in Medicaid), and general spending restraint. Perhaps even more importantly, there have been major changes in the legislative processes—*Budgeting for Results* and the requirement that the governor present three-year projections of revenue and spending—and serious discussions about resolving the problem of unfunded pension liabilities.

More action will be needed in the coming years. The Task Force on the State Budget Crisis has made a series of specific recommendations with respect to tax reform, pensions, Medicaid, infrastructure, and Illinois' "fiscal toolkit"—i.e. the way Illinois calculates and reports its revenue, expenses and liabilities. All of these recommendations deserve serious consideration. In a sense, the fiscal toolkit recommendations—technical changes such as timely reporting, multi-year forecasting, consolidated budget reporting, and apolitical revenue estimates—are both the easiest and the hardest to accomplish. They are easiest because they can be done at little or no cost and therefore need not compete with other spending priorities. They are hardest because they have the greatest potential to alter the information used in fiscal decision making on an ongoing basis, and thus the greatest potential to fundamentally change budgeting. One option would be to use the *Budgeting for Results* apparatus that is now in place to study and develop a complete and coherent response to the fiscal toolkit recommendations of the Task Force on the State Budget Crisis. Such an action might show Illinois' understanding of fundamental problems in its fiscal apparatus and could demonstrate to citizens, creditors and the rest of the nation its good-faith efforts to improve. This could even please credit-rating agencies enough to lower Illinois' borrowing costs.

Of course, Illinois will also need to deal with the specific elements of its current fiscal imbalance. Although Illinois made important adjustments to its Medicaid program in 2012, our analysis shows that without fundamental changes to the current program design, costs are still likely to rise faster than available revenue. Illinois faces three fundamental (but not mutually exclusive) options: (1) make permanent adjustments in the benefits offered to Medicaid recipients to slow the growth in program costs; (2) identify efficiencies perhaps by using the Budgeting for Results apparatus; and (3) adopt policies to increase revenue that are timed to Illinois' expected increase in Medicaid costs from natural growth of the program and from the phase-in of the ACA.

Another area of potential spending growth is Illinois' underfunded public pensions. This is almost certain to get prominent discussion in the 2013 legislative session. Our analysis shows that the magnitude of the underfunding challenge depends in part on how it is conceptualized. We show that even making the currently annual scheduled pension payments—which allow unfunded pension liabilities to grow in the short-term—will present Illinois with enormous fiscal challenges. If Illinois is to reduce or eliminate the underfunding of its public pension system it will require additional resources. We have not explored the fiscal implications of the various pension reform plans, but some would shift the burden from the state to the local level. If pension costs are to be shifted between levels of government it is important to understand the long-term fiscal pressures that each is likely to face.

Illinois faces enormous fiscal challenges, but clear thinking and transparent explanations of the costs and consequences of alternative decisions can help make the transition to budgetary balance and sustainability in the fairest and most efficient way. ■



Anderson Ross

Rethinking Property Taxation

By Nathan B. Anderson and Rob Ross

This chapter takes a look at local governments' biggest source of revenue: property taxes. The authors provide a primer on how the taxes are calculated, and new formulas for understanding an individual's tax share. The authors also propose an alternative format for local property tax statements that can be used to better communicate answers to taxpayers who wonder why their property tax liability has changed.

NEED TO KNOW

- Local governments in Illinois rely heavily on property taxes as a source of revenue—in 2010, local governments collected approximately $23.4 billion in property taxes. Illinois has the fourth highest property tax burden in the United States.

- The property tax base in Illinois is determined using a four-step process based on the property's fair cash value. The sum of the tax bases of all individual properties within a taxing district creates the total tax base. The tax share is the ratio of a property's taxable equalized assessed value to the total tax base in the taxpayer's jurisdiction.

- A large portion of annual changes in individual property tax liabilities are due to changes in tax shares rather than changes in tax extensions, or revenue.

- The authors present a new property tax statement that conveys the changes in tax liability by including information on the jurisdictions' revenue and tax bases and the taxpayer's tax shares.

Local governments in Illinois collect more in property taxes than the state government collects from any of its major taxes. In 2010, local governments collected approximately $23.4 billion in property taxes, $8 billion more than the state government collected from its individual income tax and general sales tax combined.[1] When comparing the tax burdens of Illinois taxpayers to taxpayers in other states, Illinois ranks fourth highest in property tax burden and 22nd highest in both individual income tax burden and general sales tax burden.[2]

The debate over property taxes in Illinois seems to be an endless recycling of reforms. The one thing that is clear is that property taxes are confusing. We believe this is so primarily because people expect their property taxes to behave like other major taxes. Yet the institutions of property taxation are not at all like the institutions of income and sales taxation, and we should expect the property tax to behave differently. In this chapter, we invite you to rethink the Illinois property tax and appreciate its unique institutions.

1 U.S. Census Bureau, State and Local Government Finances, Table 1, 2010.

2 This comparison is based on 2007 data. We use 2007 because the US Census of Governments is the only nationwide survey of state and local government finances, and the most recent data are from 2007. Tax burdens are measured as a percentage of state per capita personal income. Per capita personal income data are from the Bureau of Economic Analysis. Rank includes the District of Columbia.

$23.4 BILLION

Amount local governments in Illinois collected in property taxes in 2010, $8 billion more than the state government collected from its individual income tax and general sales tax combined.

We believe this rethinking is important because a failure to understand property taxes may cause voters and policymakers to propose and support property tax policies and reforms that are not in their best interest, or in the best interest of their community or the state of Illinois. We believe that full information is essential to understanding the consequences of tax policies and tax reforms and that this information is often lacking in debates about property taxes.

We begin by reviewing some basic facts about the level of property taxation in Illinois and then move on to discuss Illinois' property tax institutions. Although the institutions of property taxation are different from other major taxes, the property tax institutions in Illinois are similar to those of most other states.

"The debate over property taxes in Illinois seems to be an endless recycling of reforms. The one thing that is clear is that property taxes are confusing."

The most unique feature of property taxation is that, instead of selecting property tax rates, local governments in Illinois and other states have the ability to select property tax revenue. This ability to select revenue, rather than rates, has important implications. Chief among these is that the property tax is best thought of as a local cost-sharing system that determines how the members of a local community share the total cost of providing the community's public services.

Next, we argue that thinking about the property tax as a cost-sharing system helps explain why a person's property tax liability changes from one year to the next as well as how tax relief programs affect tax liabilities. Most importantly, we explain why increases in your property tax liability are unreliable signals of increases in government revenue. These unreliable signals make it difficult for taxpayers to monitor the relative fiscal restraint of their local governments.

In the final section of the chapter, we propose a modest innovation to property tax statements. Twice a year, counties mail property tax statements to property owners. We propose to reshape these statements so they can provide additional information to explain changes in individuals' tax liability. We argue that incorporating new information will make it easier for taxpayers to understand why their property tax liability changes from one year to the next, thereby reducing the cost to taxpayers of monitoring their local governments' fiscal policies. In addition, we argue that our modified property tax statement makes it easier for taxpayers to predict future changes in their tax liabilities, anticipate the consequences of tax reform proposals, and evaluate the cost of proposed increases in government spending.

Basic Facts About Illinois Property Taxes

Property taxes are relatively high in Illinois because our local governments rely more heavily on property taxes than local governments in many other states. Local governments rely on two broad revenue sources: money they raise themselves and money they receive via transfers from other governments. In 2010, local governments in Illinois had $70.1 billion in total revenue, $39.9 billion of which they raised themselves, $17.2 billion from the state government, and $3.3 billion from the federal government. Property taxes represented 59 percent of revenue raised locally. The share of locally raised revenue derived from the property tax is higher in Illinois than all other neighboring states except Wisconsin.[3]

Many people associate property taxes primarily with the funding of K-12 public education. In 2010, school districts in Illinois collected more than half of all property taxes, while municipalities collected about 17 percent and all other jurisdictions combined collected the remaining 25

[3] U.S. Census Bureau, State and Local Government Finances, Table 1, 2010.

percent.[4] In the United States overall, property tax revenue accounts for 35 percent of school districts' general revenue. In Illinois, that figure is 52 percent. Illinois ranks fourth highest among the states in terms of the share of school district revenue raised by the local property tax.[5]

Within Illinois, however, there are large differences between school districts in the extent of property tax reliance. In Cook County, local taxes—the vast majority of which are property taxes—account for 60 percent of all public school revenue. In the northeast of the state, excluding Cook County, local taxes account for nearly 80 percent of all public school revenue, but in the southeast, they account for 36 percent.[6] The across-district differences in the relative importance of the property tax are driven by across-district differences in the amount of state and federal aid.

The Institutional Structure of the Illinois Property Tax

All property tax systems are defined by a state's choice of the definition of the tax base and the restrictions it imposes, if any, on the freedom of local governments to access that tax base. Illinois defines the tax base of an individual property using a four-step process. In the first step, the assessor determines the property's fair cash value, usually by estimating the price that the property would sell for in an arms-length transaction as of January 1 of that year. Next in Step 2, the assessor multiplies the fair cash value by a number called an assessment ratio. In Step 3, the assessor multiplies the number from Step 2 by another number (that may exceed one) called an equalization factor. The value produced after Step 3 is called equalized assessed value (EAV). In Step 4, the assessor subtracts certain amounts—called exemptions—from the EAV to produce "taxable" EAV. The equation for taxable EAV is below.

Math Legend

- $\equiv$ is identical to
- Δ the change from one year ago in
- $\approx$ is approximately equal to
- $\%\Delta$ the percentage change from one year ago in

$$\text{taxable EAV} = (\text{estimated market value}) \times (\text{assessment ratio}) \times (\text{equalization factor}) - (\text{total exemptions})$$

Thus, the tax base of an individual property is determined via estimation (Step 1), multiplication (Steps 2 and 3), and subtraction (Step 4).

As a consequence of defining tax base in terms of market value, the state must determine how often it requires local assessors to update their market value estimates to account for actual changes. In counties other than Cook, local assessors must update market value estimates at least every four years.[7] In Cook County, estimates must be updated at least every three years.[8]

The sum of the tax bases of all individual properties within a taxing district—county, municipality, school district, special district, and/or township—creates the district's total tax base. In all counties, assessors update the total tax base each year to incorporate the estimated value of new and improved property.

[4] The Illinois Department of Revenue.

[5] U.S. Census Bureau, Local Government Finances by Type of Government and State, Table 2, 2006-07.

[6] Illinois I-Learn: http://webprod1.isbe.net/ilearn/ASP/LstARCDData.asp

[7] The four-year standard applies to counties with fewer than 3 million inhabitants. 35 ILCS 200 §9-215.

[8] The three-year standard applies to counties with more than 3 million inhabitants. 35 ILCS 200 §9-220. Local assessors have the authority to update estimates of fair market value every year. 35 ILCS 200 §9-205.

If the taxing district has unfettered access to its total tax base, it is able to choose the amount of revenue it wants to raise.[9] This amount is referred to as the levy and it is reported to the county clerk. Next, the clerk is required to determine which tax rate, when multiplied by the total tax base, produces the amount of levy requested by the taxing district.[10] If the state has imposed restrictions on the district's access to the tax base, the clerk does not allow the district to set a levy higher than the maximum allowed under the restrictions. The amount of revenue allowed by the clerk is referred to as the tax extension. Thus, a taxing district's tax rate is defined by the following accounting identity.

$$\text{tax rate} \equiv \frac{\text{tax extension}}{\text{total tax base}}$$

In Illinois, the most important restrictions on access to tax base are tax rate ceilings and a ceiling on the annual increase in tax extensions—revenue—called the Property Tax Extension Limitation Law (PTELL). These rate ceilings vary across and within types of taxing districts. PTELL restricts the percentage increase in a taxing district's extension to the lessor of 5 percent or the rate of inflation. Taxing districts can exceed the PTELL ceilings and many tax rate ceilings through referenda and various non-referenda exemptions.

Further details on tax rate ceilings and PTELL are beyond the scope of this chapter, but note that these restrictions do not apply uniformly across the state or across types of taxing districts. For example, tax rate ceilings apply in all counties while PTELL applies only to non-home-rule taxing districts in 39 counties. In addition, tax rate ceilings are more likely to bind revenue choices in districts with low levels of total tax base, while PTELL is likely to bind districts regardless of the level of their total tax base.

9 See the following statutes: 35 ILCS 200 §18-10 (counties) and §18-15 (municipalities and school districts).

10 See the following statute: 35 ILCS 200 §18-45.

Understanding Individual Tax Liabilities

In this section, we introduce a new concept—tax share—that is helpful in explaining individuals' tax liabilities. We believe that understanding the concept of tax share helps make the property tax system more transparent, and it is essential to our proposed new property tax statement.

"In the United States overall, property tax revenue accounts for 35 percent of school districts' general revenue. In Illinois, that figure is 52 percent."

Although the county issues a single property tax statement, a property owner owes taxes to multiple taxing districts. Most will owe taxes to their municipality, school district, county, and at least several special districts, such as a park district, library district, or water reclamation district. Because each district may have a different extension and total tax base, each taxing district has its own tax rate.

For simplicity, it is best to consider the taxes that a property owner owes to one of its taxing districts. Generally, an owner's property tax liability to one taxing district is equal to the product of the district's tax rate and the property's taxable EAV.

$$\text{Tax Liability} \equiv \text{tax rate} \times \text{taxable EAV}$$

If we replace "tax rate" by its definition from above we get

$$\text{Tax Liability} \equiv \frac{(\text{tax extension})}{(\text{total tax base})} \times \text{taxable EAV}$$

If we allow "taxable EAV" and "tax extension" to switch places, we arrive at a different accounting identity for tax liability.

$$\text{Tax Liability} \equiv \frac{\text{taxable EAV}}{(\text{total tax base})} \times (\text{tax extension})$$

A taxpayer's tax share is the ratio of his or her taxable EAV to the total tax base in this taxing jurisdiction.

$$\text{tax share} \equiv \frac{\text{taxable EAV}}{\text{total tax base}}$$

Because these are accounting identities, we know that the two equations for tax liability are equivalent. That is, the equations always produce identical tax liabilities; both are true.

$$\text{Tax Liability} \equiv \text{tax rate} \times \text{taxable EAV}$$
$$\equiv \text{tax share} \times \text{tax extension}$$

Importantly, this equation shows that the tax share equals the cost to an individual taxpayer for each additional dollar of property tax revenue. In other words, your tax share is the amount by which your tax liability would increase if your taxing district increased its extension by one dollar. Because this will be a very small number, when interpreting the tax share in this way it is informative to multiply it by $1 million so that the tax share is the amount your taxes would increase if your taxing district increased its extension by $1 million.

Although this new equation for tax liability is only a rearranged version of the standard equation, it allows us to decompose the annual change in an individual's tax liability into two parts: the part explained by tax share changes and the part explained by tax extension changes. These two parts are mutually exclusive and can be readily calculated from administrative data.[11]

$$\Delta\ \text{Tax Liability} =$$
$$\text{tax share effect} + \text{tax extension effect}$$

The tax share effect isolates the part of the total annual change in an individual's tax liability that is caused solely by changes in the tax share and not by changes in tax extensions. It is the answer to the question: if my taxing district had left its tax extension unchanged, my tax liability would have changed by how much?

$$\text{tax share effect} \approx$$
$$(\text{new tax share} - \text{old tax share}) \times (\text{old extension})$$

The tax extension effect isolates the part of the total annual change in an individual's tax liability that is caused by changes in the tax extension and not by changes in tax share. It is the answer to the question: if my tax share had stayed the same, my tax liability would have changed by how much?

$$\text{tax extension effect} \approx$$
$$(\text{new extension} - \text{old extension}) \times$$
$$(\text{old tax share})$$

The tax share effect and the tax extension effect explain changes in the level of tax liability.[12] Perhaps more intuitive is the role of the tax share and tax extension in explaining percentage changes in tax liability. The equation below is a useful rule of thumb for calculating percentage changes in an individual's property tax liability.

$$\%\Delta\ \text{Tax Liability} \approx$$
$$\%\Delta\ (\text{tax share}) + \%\Delta\ (\text{extension})$$

This rule says that the percentage change in an individual's property tax liability is approximately equal to the percentage in her tax share plus the percentage change in her taxing district's extension.

This has at least four provocative implications. First, an individual's tax liability can increase from one year to the next, even though an individual's tax district does not increase its revenue (i.e., extension). Second, although PTELL may prevent the

[11] Programs such as tax increment finance (TIF) do not interfere with these calculations. Tax relief programs that operate outside of the assessment system, such as the property tax credit on individual income taxes or abatements financed by taxing districts, are not accounted for by the equation but the equation can easily be modified to do so.

[12] The expressions for calculating the actual (rather than approximate) tax share and tax extension effects are similar to those presented, but are a bit less intuitive. For small changes in tax shares and extensions, the approximate effects will be almost identical to the actual effects. On the tax bill we calculate the actual and not the approximate effects.

extension from increasing by more than 5 percent, tax share changes can cause a taxpayer's liability to increase by more than 5 percent. Third, tax share changes, by themselves, cause changes in individuals' tax liabilities. Fourth, through no fault of the taxing district, an individual's property tax liability can increase even though her property value and taxable EAV declined.

To understand why tax liability may increase while taxable EAV decreases, note that the percentage change in any individual's tax share is approximately equal to the difference between the percentage change in the taxable EAV of her property and the percentage change in total tax base.

$$\%\Delta \text{ (tax share)} = \%\Delta \text{ (taxable EAV)} - \%\Delta \text{ (total tax base)}$$

Consider an individual whose property depreciated in value and the local assessor adjusted downward the estimate of market value, and, as a result, the individual's taxable EAV decreased by 5 percent. Suppose, however, that nearly all the properties in the individual's school district also decreased in value. As she should, the local assessor adjusted her estimate of market value for all properties and, as a result, the total tax base decreased by 10 percent. According to the equation for percentage changes in tax share, the individual's tax share has increased by about 5 percent even though her taxable EAV declined by 5 percent. Our rule of thumb implies that even if her school district decreased its extension by 2 percent, her tax liability increased by 3 percent. In sum, her tax bill increased because her decline in market value was not as steep as those of her neighbors and thus some of their taxes shift onto her.

We think that taxpayers will find the answers to these two questions valuable. In particular, the tax extension effect offers taxpayers a simple method of monitoring the extent to which increases in government revenue are responsible for an increase in their taxes.

These simple equations allow us to explain the effects of important policies in Illinois, including reassessment, homestead exemptions, and tax increment financing. The rules of thumb demonstrate that a reassessment affects a taxpayer's property tax liabilities only if it increases her tax share or if her taxing district decides to increase its extension. For example, suppose that a reassessment causes the taxable EAV of all property in your school district to increase by 10 percent. Your tax share will remain unchanged. Thus, the only reason your property tax liability will increase is if your school district chooses to increase its extension. Because school districts set extensions, leaving the rate constant to collect more revenue is a conscious decision to change the extension rather than a default policy.

"Through no fault of the taxing district, an individual's property tax liability can increase even though her property value and taxable EAV declined."

The rules of thumb also demonstrate how homestead exemptions affect property tax liabilities. The homestead exemption in Illinois subtracts $6,000 from a property's EAV.[13] The tax share rule of thumb shows that the homestead exemption decreases your tax share only if it produces a larger percentage decrease in your taxable EAV than it produces in the total tax base. In other words, a homestead exemption reduces not only your taxable EAV but also that of all other properties that receive it. The reductions in taxable EAV of other properties increase your tax share while the reduction in your EAV decreases your tax share. Within the same school district, properties with lower pre-exemption taxable EAV benefit more from the same $6,000 exemption than properties with higher pre-exemption EAV. Thus, the homestead exemption shifts taxes from low-valued homes to high-valued homes and away from homes onto non-residential properties.

Tax increment finance districts (TIF) have an effect similar to homestead exemptions. The full mechanics of TIFs are too detailed to include in this chapter, but the bottom line for, say, a school district, is that a TIF within its boundaries reduces the school

[13] 35 ILCS 200 §15-175.

district's total tax base by exempting some portion of TIF properties' EAV from taxation by the school district. For properties within the school district but outside the TIF boundaries, the TIF causes their tax shares to increase. Thus, TIF districts increase the costs of raising property tax revenue for all non-TIF taxpayers in a school district.[14]

Property Taxes in Cook County

To demonstrate the potential importance of the tax share effect, we examine the tax liabilities of some actual (anonymous) taxpayers in Chicago. Within the city, there are nine major taxing bodies that account for all property revenues raised outside of tax increment finance (TIF) districts and special service areas (SSA). Of these nine districts, two are home-rule jurisdictions and are not limited by PTELL's cap on property tax revenue growth. These two are the City of Chicago and Cook County.

"The variation in annual tax payments for this property is mostly due to changes in its tax share."

Figure 1 demonstrates the relationship between tax extensions, tax shares, and the tax liabilities of individual taxpayers. We consider three taxing jurisdictions: Cook County, the City of Chicago and the Board of Education, which, together, account for a majority of the tax revenue collected. The first column shows, for each jurisdiction, the nominal tax extension (blue), total tax base (red) and tax rate (gold). These nominal figures are indexed to their 2000 levels. For example, the top graph shows that between 2000 and 2010, the nominal extension for Cook County decreased by 20 percent, while over the same 11 years the extensions for the City of Chicago and the Board of Education increased by about 20 percent and 40 percent. One important observation is that between 2007 and 2010 the City of Chicago held its nominal extension virtually constant. This implies that during this period, any individual taxpayer's liability to the City of Chicago changed only if his or her tax share changed.

[14] This is the case as long as properties within the TIF experiences increases in their taxable values.

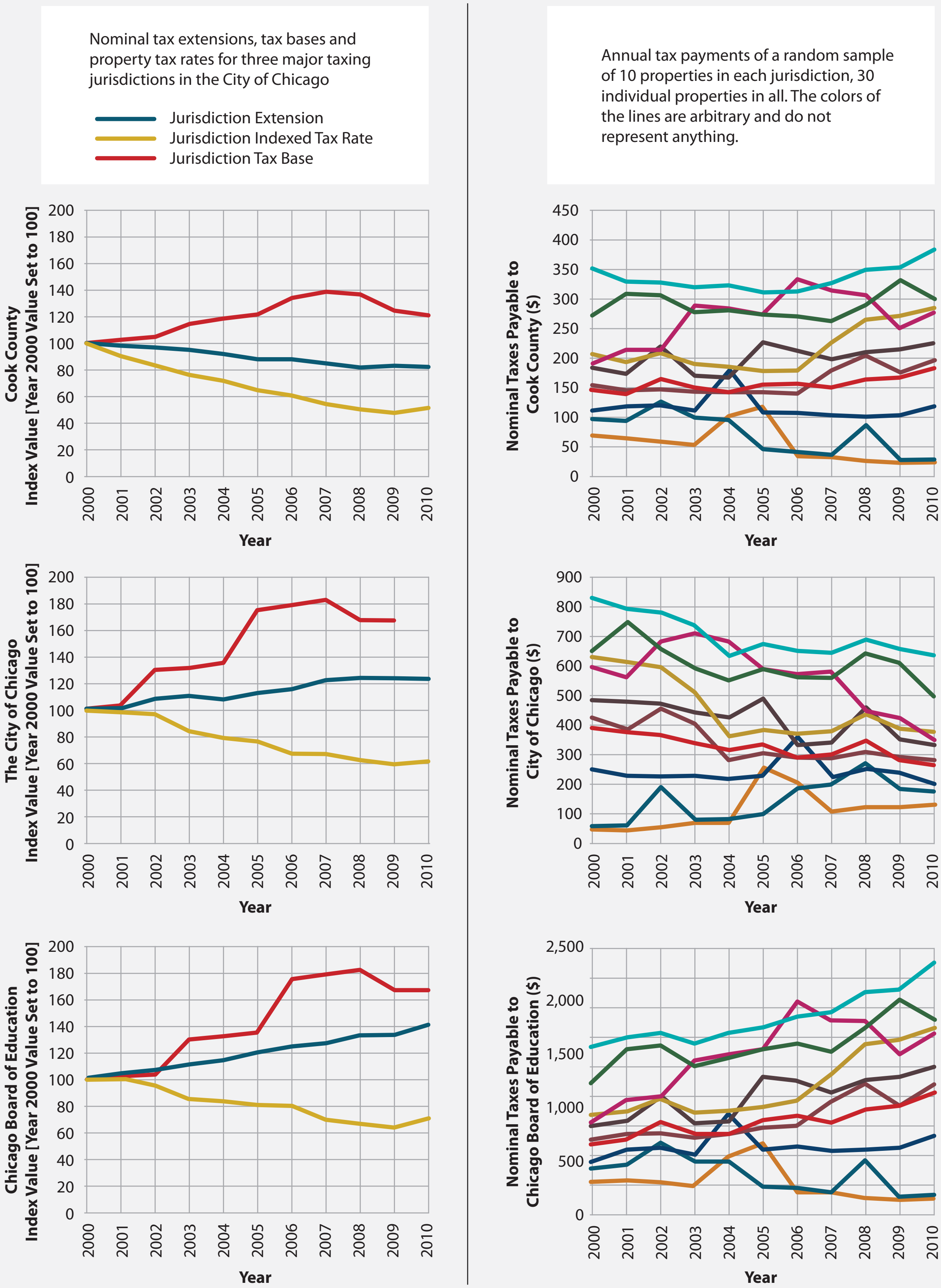
The second column shows for 10 randomly selected actual taxpayers located within Chicago the taxes they owed to Cook County, the City of Chicago, and the Board of Education from 2000-2010. Notice that the annual liabilities of these individual taxpayers move around a lot more than tax extensions. For example, compare the smooth path of the City of Chicago's tax extensions to the sharp increases and decreases in individual tax liabilities. Note also that although the tax extension increased during this period, the majority of our 10 taxpayers experienced net decreases in tax liabilities. If tax shares were constant over time, the tax liabilities would mimic the path of the tax extension. Overall, there is often little connection between changes in a jurisdiction's extension and changes in the tax liabilities of individual payers. This is consistent with our argument that a large portion of annual changes in individual property tax liabilities are due to changes in tax shares rather than changes in tax extensions.

In Figure 2 (page 36) we provide evidence of the importance of the tax share effect. Each row displays information on a different property's tax liability to a specific jurisdiction between 2006 and 2010. The three properties selected are not atypical. For each jurisdiction, we display the property with the median amount of variation in tax liability. In the first column, we describe each property's level of tax liability. The red line shows each property's actual tax liability and the blue line shows what each property's tax liability would have been if the jurisdiction held its extension at its 2006 level. That the blue lines increase over time demonstrates that even if extensions had remained constant, tax liabilities would have still increased. This demonstrates the importance of the tax share effect in explaining property tax increases and that holding the tax extension constant does little to reduce annual variation in tax liability."

In the second column, we decompose the annual changes in each property's tax liabilities into the part attributable to changes in jurisdictions' extensions and the part attributed to changes in its tax share. The blue bar represents the change in tax liability caused

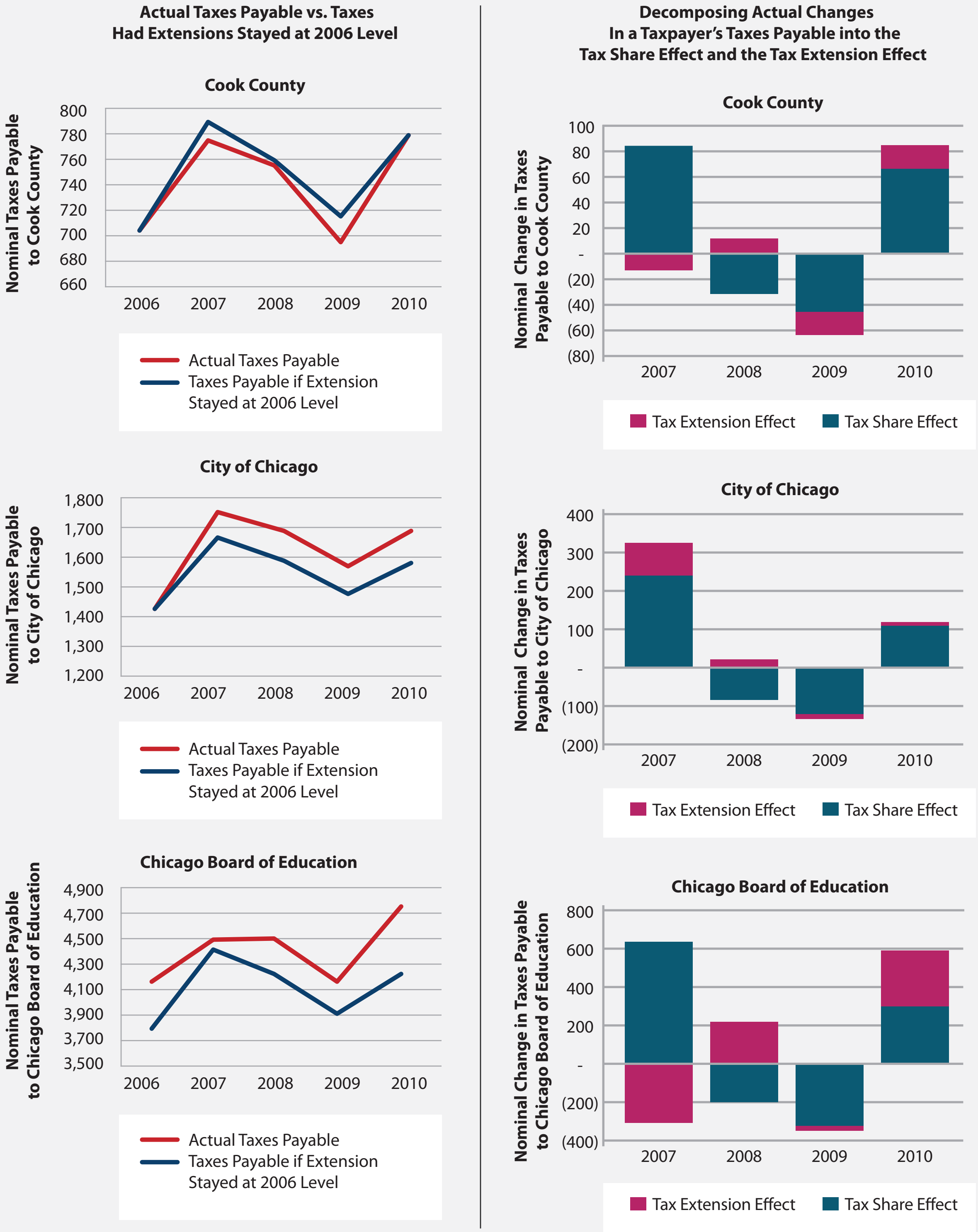
Figure 1

Individual Tax Payments Are More Volatile Over Time than Total Tax Extensions



Source: Authors' tabulations using data provided by the Office of the Cook County Clerk.

Figure 2
The Tax Share Effect Explains Most of the Changes in Individual Taxes Payable Over Time



Source: Authors' tabulations using data provided by the Office of the Cook County Clerk by the tax share effect and the red bar represents the change caused by the tax extension effect. The sum of the two bars equals the total actual change in tax liability. Consider the middle row, were we show the annual changes in a property's tax liability to the city of Chicago. The bars for 2007 decompose the taxpayer's change in tax liability from 2006 to 2007. The blue bar demonstrates that the tax share effect caused an increase in tax liability of about $250 and the tax extension effect caused an increase of about $60. Thus, from 2006 to 2007 actual tax liability increased by $310. From 2007 to 2008, the tax share effect caused tax liability to decrease by about $90 while the tax extension effect caused tax liability to increase by about $10. Thus, from 2007 to 2008 actual tax liability decreased by about $80. In all years and in all three jurisdictions, the tax share effect explains at least half of the total actual change in tax liability.

Both columns show that the variation in annual tax payments for this property is mostly due to changes in its tax share. In the first column, the blue and red lines move in tandem, indicating that holding the tax extension constant does little to reduce annual variation in tax liability. In the second column, blue bars that are larger than the red bars indicate that changes in tax share account for most of the annual changes in this property's tax liability.

A Proposal For A New Property Tax Statement

Figures 3 and 4 (on pages 38 and 39) each show a different property tax statement for the same property. Though all identifying information has been removed from the statements, they reflect tax liability for an actual property in the North Chicago Township. We refer to our reformulation of the statement as the "new statement" (Figure 3) and the statement as it was mailed in 2009 as the "old statement" (Figure 4).

The main difference between the old and new statements is the way information about changes in tax liability is conveyed to the taxpayer. The old statement includes information on jurisdictions' tax rates. In the new statement, we drop the tax rates in favor of information on jurisdictions' extensions and tax bases and taxpayers' tax shares. The old statement includes none of this information.* Because the tax rate is the ratio of the extension to the tax base, excluding tax rates does not substantively change the content of the bill. But it does allow taxpayers to better understand the reasons their taxes change from one year to the next.

We now compare the old and new statements, starting from the top of the new statement and working our way down.

Panel 1 of the new statement shows the same information shown along the right-hand column of the old statement. The only difference is that the new statement reports the exemption in terms of EAV, rather than in dollars subtracted from the property's tax bill. Property tax rates do not appear anywhere in the new statement, but they can be calculated from the information on the new statement. Panel 2 reports the property's tax share. This is neither reported on the old statement nor can a taxpayer calculate it from the information on the old statement.

Panel 3 reports the extensions and tax bases of all taxing jurisdictions in the City of Chicago, except TIFs and SSAs. This information is also not reported on the old tax statement, and cannot be calculated from information on the old statement.

Panel 4 reports the tax payments due from this property to each taxing jurisdiction. This is the same information reported in the center panel of the old tax statement, but the new statement omits the tax rates. Panel 5 provides a simple analysis of the change in this property's tax liability from, in this illustration, 2008 to 2009. First, it gives the dollar amount of the change. Then, it reports the tax share effect and the tax extension effect.

*** Cook County Treasurer Maria Pappas revealed a new property tax statement days before this chapter went to press. Our understanding is that although the new statement differs from our proposal, it also increases taxpayers' ability to monitor their governments. (*Chicago Tribune*, January 26, 2013)**

Figure 3

"New" Property Tax Statement for an Actual Property in the North Chicago Township

2009 Second Installment Property Tax Bill

Payee: John Doe

Chicago, IL 60613

Amount Due By 12/13/2010

$3655.84

Property PIN:
Property Address:
Chicago, IL 60613
Vol. 000 **Tax Code:** 00000
Tax Year: 2009 (Payable in 2010)
Township: North Chicago

Late penalty is 1.5% per month by state law

Panel 1—Your Taxable Value

	2008	2009	% Change
Estimated Market Value	458,650	252,250	-45%
Assessed Value	45,865	25,225	-45%
Exemptions	6,000	6,000	0%
Equalization Factor	2.9786	3.3701	13%
Adjusted Equalized Assessed Value (AEAV)	130,613	**79,011**	-40%

Panel 2—Your Tax Share*

	2008	2009	% Change
Cook County	0.79	**0.44**	-44%
City of Chicago	1.69	**0.93**	-45%

***Tax Share** is the additional amount you would have to pay in the event the government increased its levy by $1 million. In 2009, each $1 million in City revenues cost you 93 cents, and each $1 million in County revenues cost you 44 cents.

Panel 3—Jurisdiction Extensions and Tax Bases

Jurisdictions you pay taxes to	Extension* 2008	Extension* 2009	Tax Base* 2008	Tax Base* 2009
County Jurisdictions				
Cook County	721	702	173,642	178,071
Forest Preserve System of Cook County	89	87	173,642	178,071
Metro-Water				
Metropolitan Water Reclemation District	429	455	170,097	174,468
City Jurisdictions				
Chicago Libraries	83	84	80,983	84,592
City of Chicago	751	750	80,983	84,592
School Building and Improvement Fund	95	95	80,983	84,592
Chicago Board of Education	2,002	2,001	80,930	84,592
Chicago Community Colleges	126	127	80,930	84,592
Chicago Park District	249	250	80,983	84,592
Aquarium and Bonds	12	12	80,978	84,587
Total	**4556**	**4562**	**173,642**	**178,071**

*Figures in millions of dollars

Panel 4—Your Taxes Due

Jurisdictions you pay taxes to	Tax Bill 2008	Tax Bill 2009
County Jurisdictions		
Cook County	566.95	311.30
Forest Preserve System of Cook County	69.67	38.72
Metro-Water		
Reclemation District	344.27	206.22
City Jurisdictions		
Chicago Libraries	139.34	78.22
City of Chicago	1,267.68	700.78
School Building and Improvement Fund	159.83	88.49
Chicago Board of Education	3,379.09	1,869.27
Chicago Community Colleges	213.10	118.45
Chicago Park District	420.74	233.07
Aquarium and Bonds	20.49	11.06
Total	**6,581.15**	**3,655.57**

Panel 5—Additional Information

Amount Your Taxes Changed:
-$2,925.58

Change Due to Changes in Tax Shares:*
-$2,909.74

Change Due to Changes in Extensions:*
-$15.85

2009 Inflation Rate:
1.01%

*Approximations

Figure 4
"Old" Property Tax Statement for an Actual Property in the North Chicago Township

PAY ONLY THIS AMOUNT
$ 4,088.02*
BY 12/13/10 (on time)

* INCLUDES 1ST INSTALLMENT BALANCE OF $3,633.33

2009 Second Installment Property Tax Bill

Property Index Number (PIN)	Volume	Code	Tax Year	(Payable In)	Township
	493	74001	2009	(2010)	NORTH CHICAGO

IF PAID LATE 12/14/10 - 01/13/11	IF PAID LATE 01/14/11 - 02/13/11	IF PAID LATE 02/14/11 - 03/13/11
$ 4,142.86	$ 4,197.70	$ 4,252.54

LATE PENALTY IS 1.5% PER MONTH, BY STATE LAW.

PAY THIS BILL AT COOKCOUNTYTREASURER.COM OR ANY CHASE BANK.

Property location and classification for this PIN

CHICAGO IL   Property Classification 2-99

Taxing District	2009 Tax	2009 Rate	2009 %	Pension	2008 Tax	2008 Rate
MISCELLANEOUS TAXES						
Metro Water Reclamation District	206.22	0.261	5.64%	11.85	304.55	0.252
Parks-Museum/Aquarium Bond	11.06	0.014	0.30%		18.13	0.015
Chicago Park District	233.08	0.295	6.38%	9.48	372.23	0.308
Miscellaneous Taxes Total	450.36	0.570	12.32%		694.91	0.575
SCHOOL TAXES						
Board of Education	1,869.40	2.366	51.13%		2,987.49	2.472
Chicago Community College Dist 508	118.52	0.150	3.24%		188.53	0.156
School Taxes Total	1,987.92	2.516	54.37%		3,176.02	2.628
MUNICIPALITY/TOWNSHIP TAXES						
Chicago School Bldg & Imp Fund	88.49	0.112	2.42%		141.40	0.117
Chicago Library Fund	78.22	0.099	2.14%		123.27	0.102
City of Chicago	700.83	0.887	19.17%	322.36	1,121.52	0.928
Municipality/Township Taxes Total	867.54	1.098	23.73%		1,386.19	1.147
COOK COUNTY TAXES						
Cook County Forest Preserve District	38.72	0.049	1.06%	0.79	61.64	0.051
County of Cook	154.86	0.196	4.24%	56.09	270.69	0.224
Cook County Public Safety	90.07	0.114	2.46%		126.90	0.105
Cook County Health Facilities	66.37	0.084	1.82%		103.93	0.086
Cook County Taxes Total	350.02	0.443	9.58%		563.16	0.466
(Do not pay these totals)	3,655.84	4.627	100.00%		5,820.28	4.816

TAX CALCULATOR

2008 Assessed Value	**45,865**
2009 Property Value	252,250
2009 Assessment Level	X 10%
2009 Assessed Value	= **25,225**
2009 State Equalization Factor	X 3.3701
2009 Equalized Assessed Value (EAV)	= 85,011
2009 Local Tax Rate	X 4.627%
2009 Total Tax Before Exemptions	= 3,933.46
Homeowner's Exemption	– 277.62
Senior Citizen Exemption	– .00
Senior Assessment Freeze Exemption	– .00
2009 Total Tax After Exemptions	= 3,655.84
First Installment	3,201.15
Second Installment	+ 454.69
Total 2009 Tax (Payable In 2010)	= 3,655.84

KEEP UPPER PORTION FOR YOUR RECORDS

We believe the new statement is superior to the old statement in a number of ways. We have already discussed in detail the decomposition of changes in tax liability into the portions attributable to changes in extensions and tax shares. That information is reported in Panel 5 of the new statement. Another advantage of reporting tax extensions is that it allows taxpayers to better monitor their local governments. In 2009, the Cook County assessor reduced his estimate of the value of nearly all properties in the county. Some properties, however, depreciated faster than others, leading many taxpayers to experience coincidentally decreasing assessed values and increasing property taxes. Some believed this was caused by increases in extensions.[15] From the new statement, however, it is clear that city jurisdictions increased their extensions by a net $1 million, though some, including the city itself, decreased their extension. One advantage of the new bill, then, is to allow taxpayers to see when their government increases, or doesn't increase, its property tax extension. Taxpayers may want to know, for example, that the Chicago Board of Education actually decreased its extension from 2008 to 2009, two years before a major dispute with the Chicago Teachers' Union over teacher pay.

Thank you to the Cook County Clerk's Levies, Rates and Extensions Office for providing data. ■

[15] Jorovsky, Ben. "My property tax bill is defective—I want a refund!" *The Chicago Reader.* February 29, 2012.

CHAPTER 4

Herring

Life at the Edge: Precarity and Economic Insecurity in Illinois and the United States

By Cedric Herring

This chapter examines precarity and economic insecurity in the United States and Illinois. Precarity is a condition that exists when there is little predictability or security with respect to a person's material well-being or psychological welfare. The author provides an overview of patterns that undergird precarity by presenting trends in economic well-being before, during and after the Great Recession.

NEED TO KNOW

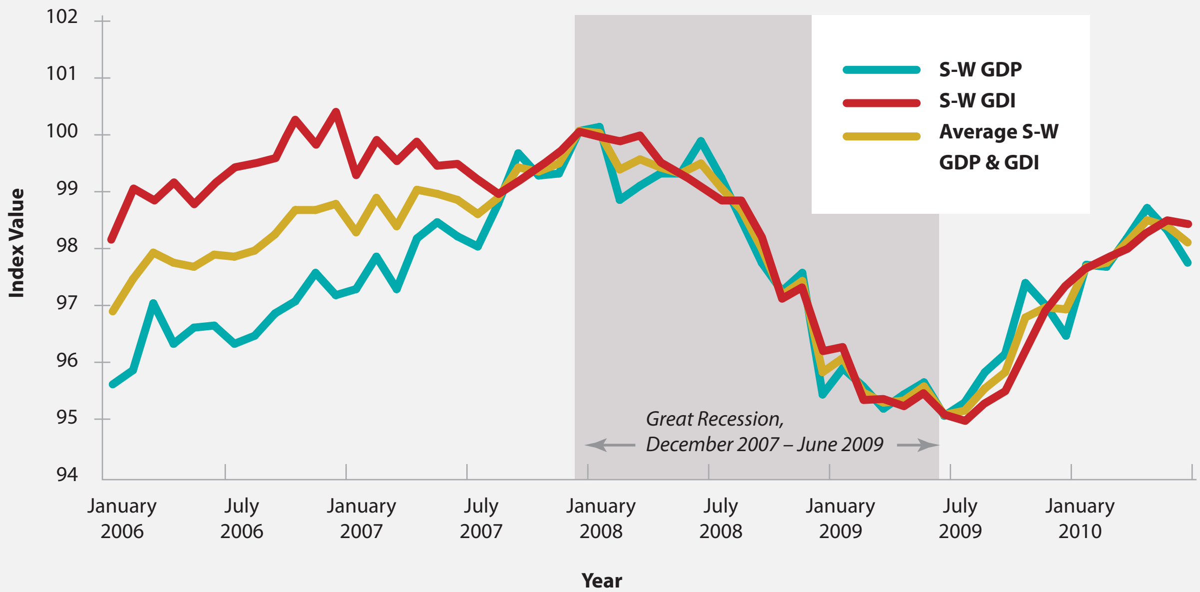
- During the recession, median income plunged to the lowest point since 1997. By September 2011, it had rebounded. Yet attitudes about economic security have gotten worse. Levels of precarity increased after the Great Recession officially ended in mid-2009.
- Americans' outlook concerning their family financial situation has become more pessimistic. The percentage of Americans surveyed in 2011 who thought their financial situation would become worse during the following year rose to 34.8 percent, from 8.8 percent in 2006.
- Precarity is associated with several factors, including race, political affiliation, and with whom one holds responsible for the current state of the U.S. economy.
- Illinois citizens are not experiencing precarity at rates as high as the rest of the nation, or as high as their Midwestern neighbors.

Many Americans are in the midst of an historical moment where they feel that they are living on the edge. Many of those who were once solidly in the middle class or working class have either fallen into poverty or fear that they are about to do so. Millions of people have experienced a collapse of their living standards. Millions more feel they may soon slip into poverty or a substantial worsening of their lifestyles. This is the unfortunate fate of those living in these uncertain times of "precarity."

Precarity is not a word commonly heard in the United States, but it can be defined as a condition that exists when there is little predictability or security with respect to a person's material well-being or psychological welfare. It is, in its classic definition, the labor conditions that arose after the transition from life-long, stable jobs common in the industrial era to temporary, insecure, low-paying jobs that have emerged with the rise of the service and financial economy. Precarity increases during times of economic uncertainty. But there can be a paradox associated with precarity: the sense of doom can become worse even as objective conditions improve.

This chapter will examine precarity and economic insecurity in Illinois and in the United States. It will provide an overview of patterns that undergird the sense of insecurity by presenting trends in economic well-being before, during, and after the Great Recession. It will also show how precarity is shaded by racial and political considerations.

Figure 1
Monthly Output, Jan. 2006 - June 2010, Indexed to Dec. 2007 = 100



Source: The NBER's Business Cycle Dating Procedure

Recessions, Precarity, and Economic Insecurity

The United States has had five major recessions since 1980. According to the National Bureau of Economic Research, the most recent—the Great Recession—began in December 2007 and ended in June 2009.[1] The general contours of the Great Recession are depicted in Figure 1, which presents the Stock-Watson Average of Gross Domestic Product (GDP) and Gross Domestic Income (GDI).

The Great Recession of 2007-2009 was the longest and, by most accounts, one of the worst economic crises since the Great Depression. In particular, the Census Bureau determined that real median income in 2009 fell to the lowest amount since 1997, and was the largest decline in income in a single year of any recession since at least 1967.[2] The Great Recession essentially wiped out more than a decade's worth of gains. But not all households experienced economic decline equally, as the downturn dealt more of a blow to middle-class and the low-income households. Households at the 50th percentile earned as little in 2009 as they did in 1996. The bottom 10 percent of households earned as little as they did in

5 *Number of major recessions in the US since 1980.*

1994. In contrast, the top 10 percent of households earned as much as they did in 2002. In other words, the highest earners were better protected than others. At the same time, the Census Bureau also indicated that 15.1 percent of Americans were in poverty, the highest level since 1993.[3]

As unsettling as this might have been, the U.S. economy began its turnaround by the middle of

[1] See *The NBER's Business Cycle Dating Procedure* at http://www.nber.org/cycles/recessions_faq.html.

[2] Source: U.S. Census, Current Population Survey, 1960-2011 Annual Social and Economic Supplements.

[3] Source: U.S. Census, Current Population Survey, 1960-2011 Annual Social and Economic Supplements.

2009. Again, as Figure 1 shows, by the beginning of 2010, the GDP had already surpassed that of early 2007 before the Great Recession began. Median incomes rebounded as of September 2011.[4] Unemployment rates began to fall as of January 2010 and had fallen to pre-recession levels as of September 2012. And in 2011, the poverty rate in the U.S. had begun to decline for the first time in four years.[5]

> *"Despite these improvements in objective indicators of well-being…the levels of precarity have increased since the Great Recession officially ended."*

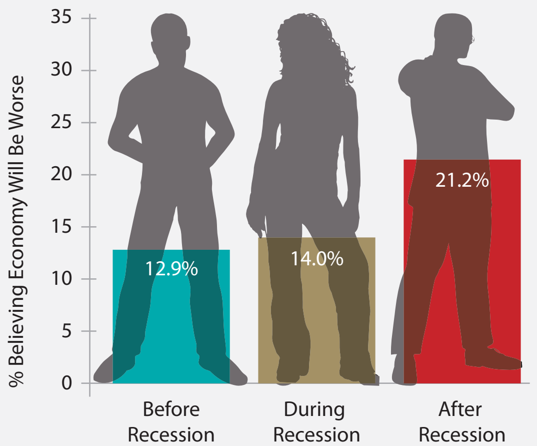
Despite these improvements in objective indicators of well-being, as Figure 2 shows, the levels of precarity have increased since the Great Recession officially ended. In particular, in 2006 (before the Great Recession), 12.9 percent of Americans believed the nation's economy would get worse in the following year. During the Great Recession in 2008, 14 percent believed the nation's economy would worsen in the following year. And by 2011, the level of pessimism and apprehension had increased, as 21.2 percent believed that the nation's economy would worsen in the following year.

Similarly, Americans' outlook concerning their family financial situation also became more pessimistic. Figure 3 shows that in 2006, 8.8 percent of Americans thought their financial situation would become worse during the following year. By 2011, it had exploded to 34.8 percent.

These trends confirm precarity. They reflect economic insecurity and uncertain living and working conditions that working- and middle-class Americans experienced during the Great Recession. Moreover, they mirror the precarious everyday experiences of workers facing increasing changes in what they

Figure 2

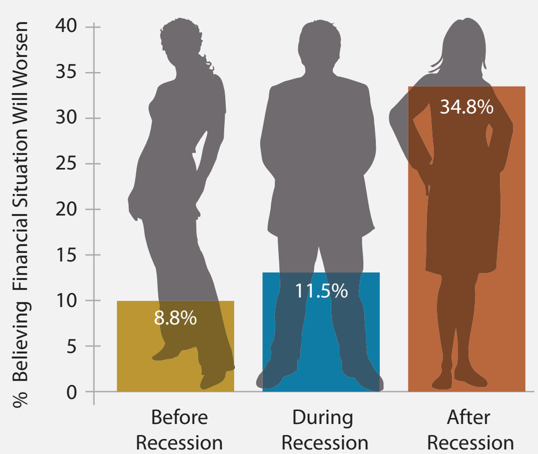
Percentage Believing the Nation's Economy Will Worsen in the Following Year



Source: 2006 American National Election Survey, 2008-2009 American National Election Survey Panel Study, and the 2010-2012 American National Election Survey Evaluations of Government and Society Study.

Figure 3

Percentage Believing Their Financial Situation Will Worsen in the Following Year



Source: 2006 American National Election Survey, 2008-2009 American National Election Survey Panel Study, and the 2010-2012 American National Election Survey Evaluations of Government and Society Study.

[4] See *The Median Household Income Index* at http://www.sentierresearch.com/Charts/HouseholdIncomeIndex_-UnemploymentRate_08_2012.jpg.

[5] See Census Bureau report at http://www.census.gov/hhes/www/poverty/about/overview/index.html

thought were previously assured employment conditions, entitlement benefits, and safety net programs. These trends also affect large segments of the population who are being subjected to lower pay, intermittent income, housing problems, property loss, and deteriorating standards of living.

During the Great Recession, people of color fared worse, as many of them fell through the gaping holes in the social safety net. In particular, jobless African-Americans were more likely than their white counterparts to report that they could not afford to pay for needed food and medicine. According to data from the 2010 American National Election Survey, 56 percent of jobless African-Americans reported bankruptcies or property losses compared with 13 percent of jobless whites. Among whites, 28 percent of the jobless experienced housing problems. In comparison, 44 percent of jobless African-Americans reported housing difficulties. Similarly, the results also show that 52 percent of unemployed whites said that they were worse off financially. This compares with 81 percent of unemployed African-Americans who reported that they were worse off financially. But they were not necessarily the most likely to experience precarity.

Precarity expanded to a growing range of social sectors. Increasingly, economic insecurity also came to characterize the circumstances of young people growing up in precarity who come to be viewed by their parents' generation as underperforming because they have not secured the full-time jobs for life they were expected to receive upon graduation. As a result, many recent graduates continue living with their parents and relying on them financially for much longer than expected. Rather than getting a stable career-path job, many end up moving between different semi-self-employed positions and low-paying positions in the service sector. These Millennials are the most recent generation to enter the labor market. Many are still coming of age during this era of economic uncertainty. They have already lived through the Great Recession and their employment prospects look rather grim. They are concerned about how they will gain access to the job market and launch their careers, as previous generations appear to be staying on the job longer and unemployment rates remain high. They are often saddled with student loans that exceed their ability to repay. There is fear that Millenials will be the first American generation to be worse off than their parents.[6]

"Increasingly, economic insecurity also came to characterize the circumstances of young people growing up in precarity who come to be viewed by their parents' generation as underperforming because they have not secured the full-time jobs for life they were expected to receive upon graduation."

There are, however, other forces at work that drive precarity. In some real sense, these dynamics are undergirded by racial and political elements.

Precarity in the Era of Obama

Before the Great Recession, most Americans were hopeful about the future. For many, there was great optimism as the first person of African ancestry was elected President of the United States. Barack Obama's election was hailed as marking a fundamental change in America. Many people concluded that the election of Obama was proof that America had reached the post-racial, colorblind society that so many have struggled to attain. Obama's candidacy, as well as his electoral success, was based on the premise that the United States had undergone an enormous transformation in racial attitudes among its citizens.

But Obama's election was not greeted the same by everyone. For some, it triggered the fear that America was headed in the wrong direction. This fear, coupled with rising joblessness during the Great Recession, led to heightened precarity among some segments of the population. Indeed, precarity in America is both racial and political.

[6] Winograd, Morley and Michael D. Hais. 2011. *Millennial Momentum: How a New Generation Is Remaking America*. Pitscataway, NJ: Rutgers University Press.

Just how racialized was precarity? Figure 4 shows that by the end of 2011, 23.3 percent of whites feared that their financial situations would worsen in the following year. This compares with 9.7 percent of African Americans, 19.3 percent of Latinos, and 19.4 percent of Asians who held such beliefs.

Figure 5 also suggests that precarity had a political basis. In particular, it shows that 13.8 percent of Democrats believed that their financial situation would worsen in the next year. This compares with 19.9 percent of Independents, 32.0 percent of Republicans, and 44.3 percent of those supportive of the Tea Party.

"Generally, these results suggest that precarity is a racialized, politicized, and partisan condition. In other words, it is not simply based on objective conditions."

Even more, Figure 6 (page 46) suggests that precarity is associated with whom one holds responsible for the current state of the U.S. economy. Almost half (48.9 percent) of those who saw President Obama as being responsible for the current state of the economy thought the country's economic situation would worsen in the following year. In contrast, only 15.8 percent of those who thought President Bush was mostly responsible for the current state of the economy thought the country's economic situation would worsen in the following year. It should also be noted that 22.2 percent of those who believe that Wall Street was mostly responsible for the current state of the U.S. economy thought their financial situation would worsen in the next year.

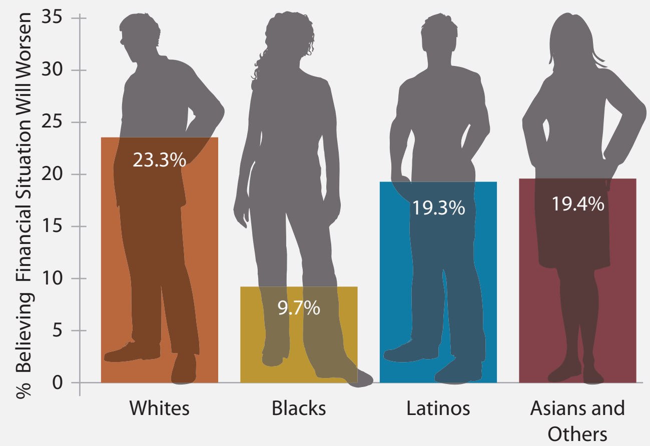
Generally, these results suggest that precarity is a racialized, politicized, and partisan condition. In other words, it is not simply based on objective conditions.

Precarity in Illinois

Like the rest of the nation, the Great Recession ravaged the Illinois economy. The crises in employment, housing, and credit markets increased the general level of insecurity. Large segments of the middle class and the working class are now experiencing precarity.

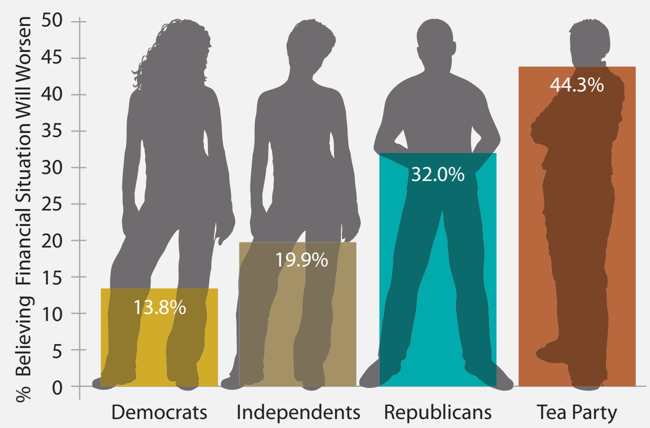
But how do residents of Illinois compare with those of other states? Figure 7 (page 46) suggests that residents of Illinois are not experiencing precarity at

Figure 4
Percentage Believing Their Financial Situation Will Worsen in Following Year by Race/Ethnicity



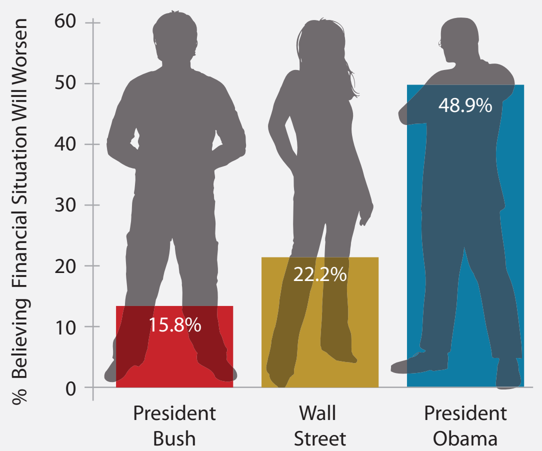
Source: The 2010-2012 American National Election Survey Evaluations of Government and Society Study.

Figure 5
Percentage Believing Their Financial Situation Will Worsen in Following Year by Party Affiliation



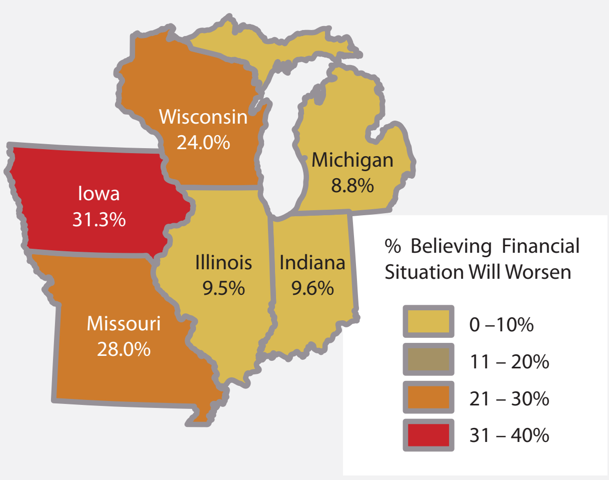
Source: The 2010-2012 American National Election Survey Evaluations of Government and Society Study.

Figure 6
Percentage Believing Their Financial Situation Will Worsen in Following Year by Belief About Who Is Mostly Responsible for Current Economic Conditions



Source: The 2010-2012 American National Election Survey Evaluations of Government and Society Study.

Figure 7
Percentage Believing Their Financial Situation Will Worsen in Following Year for Illinois and Other Midwestern States



Source: The 2010-2012 American National Election Survey Evaluations of Government and Society Study.

rates as high as the rest of the nation (21.2 percent), or as high as their Midwestern neighbors. In particular, only 9.5 percent of Illinois residents believed that their financial situation would worsen in the next year. This was similar to residents of Indiana (9.6 percent). Among the Midwestern states, only the residents of Michigan were more optimistic about their future financial situations, as only 8.8 percent of them believed that their financial situations would worsen in the next year. Figure 7 shows that 31.3 percent of Iowa residents, 28 percent of Missouri residents, and 24 percent of Wisconsin residents believed that their financial situations would worsen in the next year. These results suggest that precarity is also regional.

Conclusions

The Great Recession had a human toll that went beyond the worsening financial status of families. It sapped many Americans of their hope and optimism about the future. It took from them the idea that they could achieve the American Dream. The realities of economic crisis dashed the dreams of millions. It led people to be afraid, angry, worried, and even outraged. It made people feel as if they were living on the edge. In short, it has led to precarity.

Precarity has far-reaching social effects. One of these is the decline in the feeling of being part of the national social collective. Another is that it decomposes social bonds. The decline of secure employment has also produced terrified reactions from those who fear that values such as trust, community spirit, and the importance of work are collapsing.

Of course, there are also psychological and emotional effects of precarity. Anxiety about slipping in status becomes a general social condition. Another effect is psychological over-arousal or a sense of relative deprivation. And a final invisible effect of precarity is widespread psychological pain.

There are also demographic and social effects of precarity. For example, people are less likely to have children when their finances and relationships are insecure. Young adults are less likely to leave the homes of their parents. And, perhaps people are less likely to take reasonable risks that could improve their lives.

It is also possible that feelings of insecurity, unease and precariousness have also been channeled into fear of difference. Prejudice and xenophobia are not causes of precarity, nor are they reasons for its spread. Often, however, they are effects of precarity. At times, racial and ethnic minorities and recent immigrants are scapegoated as the reason for precarity.

As the analysis above demonstrates, precarity is a racialized, politicized, and partisan condition that is also linked to geography. During the presidency of Barack Obama, for example, African Americans have been more optimistic than have other racial and ethnic groups about their financial futures. Similarly, Democrats have been much more upbeat than Republicans and Tea Party sympathizers about their financial futures. It also appears that whom one holds responsible for current economic conditions has a bearing on how optimistic or pessimistic one is about the future. Finally, residents of Illinois are not experiencing precarity at rates as high as the rest of the nation, or as high as their Midwestern neighbors.

"Ultimately, the only true solution for precarity is sustained, vigorous economic growth with fairness for all, but how to get there and to get people to believe that such growth is real and sustainable remains a challenge."

Current perceptions of insecurity are complex and cannot be traced to a single source such as precarity at work, the volatility of financial markets, or fear of terrorism. At the existential level, such experiences come together to create a general feeling of unease. So, what can be done to reduce levels of precarity? Results from this analysis suggest that precarity has real and consequential effects. The problem of economic insecurity provides some formidable challenges to policymakers concerned with reducing the waste of human capabilities. Many policies to expand the social safety net or to stimulate growth in the economy or to reduce unemployment—such as public jobs programs or the direct intervention of government in the economy and the private labor market—are politically unpopular, especially as governments seek to cut their budgets. Many fiscal conservatives suggest that budget-cutting measures will grow the economy, reduce debt, and enforce greater self-reliance. Unfortunately, these laissez-faire policies do not appear to address several forms of this problem. Ultimately, the only true solution for precarity is sustained, vigorous economic growth with fairness for all, but how to get there and to get people to believe that such growth is real and sustainable remains a challenge. ■


My Family

Abner Gordon

Differential Response to Child Abuse and Neglect in Illinois

What is differential response? How might Illinois use it to support families?

By Kristin Abner and Rachel A. Gordon

In 2009, the Illinois Department of Children and Family Services (DCFS) began a pilot program and evaluation of one of the latest approaches to serving lower-risk children referred into the child welfare system (differential response). This intervention approach connects low-risk households to community services, and is completely voluntary. This chapter provides an overview of the practice, its effectiveness, and future policy needs.

NEED TO KNOW

- Seventeen states are implementing differential response in full, and another 13 had a program that included at least some components. Illinois just ended a five-year pilot program. The full evaluation is expected in 2013.
- The core features of differential response can appeal to a bipartisan agenda: it shifts responsibility from the government to neighborhoods and communities, and also offers a safety net to families struggling with structural barriers, like poverty, rather than criminalizing poor families.
- A look at all differential response tracks in the country reveals that children are not at increased risk when placed in a differential response track. For most programs, rates of recurrence were better—or no different from—the investigatory track. And, families in the differential response track are more satisfied with the intervention they received than families in the investigations track.
- Going forward, Illinois lawmakers will need to consider: ways to maintain child safety; the implications of voluntary service delivery; approaches to building information supports and community capacity; and strategies to increase collaboration across human service silos.

In 2010, the Illinois Department of Children and Family Services (DCFS) began a pilot program and evaluation of one of the latest approaches to serving lower-risk children referred into the child welfare system. This approach, differential response, allowed caseworkers to place families in a non-investigatory track when risks to child safety were low. In this track, caseworkers assessed and addressed family needs in an effort to prevent removing a child from the home.

Differential response is one of the most recent changes in a department that historically has faced repeated challenges. In the early 1990s, the American Civil Liberties Union accused DCFS in a lawsuit of failing to keep children safe. As a result, a federal consent decree provided standards for child welfare practice, including child placement, upfront assessment, caseload sizes, and protective services.[1] Over the past 20 years, DCFS has radically changed its practices resulting in reduced caseloads and

[1] Kosanovich, A., & R.M. Joseph. 2005. "Child Welfare Consent Decrees: Analysis of Thirty-Five Court Actions from 1995 to 2005." Child Welfare League of America. Retrieved from http://www.cwla.org/advocacy/consentdecrees.pdf.

fewer out-of-home placements—and Illinois has implemented new service delivery approaches, one of which is differential response.[2]

Even with these changes, the challenges at DCFS continue. In early 2012, the media called attention to very high caseloads that violated a federal mandate for DCFS investigators' monthly workload. Even so, DCFS faces the potential for additional funding cuts due to the current state budget deficit.[3] In this climate, it is unclear whether and how the differential response approach might continue in the future. The five-year pilot program was funded by outside sources and ended in May 2012, but the evaluation was not yet completed in early 2013. In this chapter, we describe the Illinois program and offer insights from other states' programs.

Differential Response across the country is also referred to as:

- Multiple Response
- Alternative Response
- Dual Track
- Family Assessment Response

What is Differential Response?

In the early to mid-1990s, researchers and advocates began to question the uniform treatment approach in child welfare, which failed to recognize families' differing risk levels.[4] Families experiencing lower risk (such as poverty-related neglect versus severe physical abuse) were often investigated by child welfare caseworkers as the result of a report, but if the case was not formally opened, services were not offered.[5] This situation was problematic because these families were treated in an adversarial way even when they were not at risk for the types of extreme neglect and abuse that most people associate with child protective services. That is, these parents were often doing their best to raise their children under extremely impoverished circumstances. The situation was also problematic because these lower-risk families needed different types of services than those offered by child welfare agencies, such as cash assistance, emergency housing, or food subsidies. Because the system was not designed to refer those families to appropriate services, they often ended up receiving no help at all.[6] Differential response offered a non-adversarial way to respond to these lower-risk families and to connect them with needed services. In doing so, differential response also allowed child protective services to focus their investigative resources on the most severe cases.[7]

"Differential response offered a non-adversarial way to respond to these lower-risk families and to connect them with needed services."

[2] McDonald, Jess, Connie Flower, and Mike Sumski. 2005. "The Child Welfare Workforce Crisis: Implications for Leadership." *Common Ground*, New England Association of Child Welfare Commissioners and Directors; Illinois Department of Children and Family Services n.d. "Signs of Progress in Child Welfare Reform." Retrieved from http://www.jessmcdonald.com/f/Signs_of_Progress.pdf.

[3] http://articles.chicagotribune.com/2012-06-10/news/ct-met-dcfs-triplett-20120610_1_dcfs-reforms-dcfs-workers-budget-cuts.

[4] Conley, Amy. 2007. "Differential Response: A Critical Examination of a Secondary Prevention Model." *Children and Youth Services Review* 29: 1454–1468; Schene, Patricia A. 1998. "Past, Present, and Future Roles of Child Protective Services." *Future of Children* 8 (1): 23-38.

[5] Ibid.

[6] U.S. Department of Health and Human Services, Administration for Children and Families, Administration on Children, Youth and Families, Children's Bureau. 2010. "Child Maltreatment 2009." Available from http://www.acf.hhs.gov/programs/cb/stats_research/index.htm#can.

[7] Conley, Amy. 2007. "Differential Response: A Critical Examination of a Secondary Prevention Model." *Children and Youth Services Review* 29: 1454–1468; Waldfogel, Jane. 1998. *The Future of Child Protection: How to Break the Cycle of Abuse and Neglect*. Cambridge, MA: Harvard University Press.

Differential response interventions began in 1994 in Missouri and Florida. By early 2012, there were 17 states implementing the approach in full and another 13 had a program that included at least some components.[8]

50
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The number of differential response eligible families in some areas in the city of Chicago.

Differential response implementation differs across the country, but there is consensus on the core elements of differential response. These include:

- Different intervention responses are allowed for different kinds of maltreatment reports.
- The type of response is determined by the presence of imminent danger, risk level, previous reports, report source, and case characteristics.
- The type of response can change based on additional information gathered (i.e. cases in the differential response track can move to the investigation track if child safety becomes a risk).
- Services in the differential response track are voluntary.
- Caseworkers connect families with existing services in their communities and neighborhoods.
- A formal determination of maltreatment is not made/substantiated, and the perpetrators and victims are not identified.[9]

There is still variation in how states implement these core features. For example, states vary in which families may participate in differential response, although most exclude the most serious cases, such as those involving physical or mental injury, sexual abuse, abandonment, or medical neglect.[10] The suite of services offered to lower-risk families also varies across states, but typically includes economic support (housing, transportation, employment services), substance abuse programs, family counseling, and parenting classes.[11]

Two of the most salient hallmarks of differential response are its voluntary nature and its reliance on community partnerships. Unlike an investigation, in which families must cooperate, families can choose whether or not they will participate in differential response services. However, some states require services even if the family declines. In some states, if child risk is higher, the family might be re-assigned to the investigatory track, where services are mandatory. Other states mandate services through court intervention but do not require an investigation.[12] Caseworkers in differential response programs typically approach parents as partners, a sharp contrast to the standard adversarial approach to child protective services. Differential response

"Two of the most salient hallmarks of differential response are its voluntary nature and its reliance on community partnerships."

[8] Ibid; Waldfogel, Jane. 2009. "Differential Response." Pp. 139-155 in *Preventing Child Maltreatment: Community Approaches,* edited by K. A. Dodge and D.L. Coleman. New York, NY: The Guilford Press; Crane, Kelly. 2012. "State Legislative Experience with Differential Response." Council on Contemporary Families Annual Conference, Family Impact Seminar, Chicago, IL.

[9] Merkel-Holguin, Lisa, Caren Kaplan, and Alina Kwak. 2006. "National Study on Differential Response in Child Welfare." Denver, CO: American Humane Association and the Child Welfare League of America, p. 10.

[10] Kaplan, Caren and Lisa Merkel-Holguin. 2008. "Another Look at the National Study on Differential Response in Child Welfare." *Protecting Children* 23 (1&2): 5-22.

[11] National Quality Improvement Center on Differential Response in Child Protection, 2009b. "Online Survey of State Differential Response Policies and Practices Findings Report. Washington, DC: U.S. Department of Health and Human Services, Administration for Children and Families, Children's Bureau.

[12] Kaplan, Caren and Lisa Merkel-Holguin. 2008. "Another Look at the National Study on Differential Response in Child Welfare." *Protecting Children* 23 (1&2): 5-22.

caseworkers also individualize their approaches to families, aiming to connect them with various community-based organizations and to reinforce informal supports in neighborhoods and families.[13] Indeed, differential response calls for "informal and natural helpers, drawn from families and communities, to play a much more active role in child protection."[14]

These core features of differential response can appeal to a bipartisan agenda. On the conservative side, differential response shifts responsibility from the government to neighborhoods and communities. On the liberal side, it offers a safety net to families struggling with structural barriers, like poverty, rather than criminalizing poor families. However, differential response programs also face political and practical challenges. For example, neighborhoods and communities vary in their capacity to support families. The very communities with families most in need of differential response may also be the places with the fewest services to offer. Indeed, early data from Illinois' differential response implementation revealed that the city of Chicago had some areas with more than 50 differential response-eligible families per square mile.[15] In other areas, services may be available, but inaccessible, due to insufficient or nonexistent public transportation.[16]

"The very communities with families most in need of differential response may also be the places with the fewest services to offer."

2009 *Year Governor Quinn signed the Differential Response Program Action*

The History of Differential Response in Illinois

Differential response began in Illinois as a way to reduce recurrence of child mistreatment in families, offer child protective services with a family centered approach, promote community well-being, and address racial disproportionality in the child welfare system. In 2008, the Illinois Department of Children and Family Services hired the Children and Family Research Center at the University of Illinois to compile existing literature, which generated interest in the beginning of a differential response model in Illinois. Based on the findings, the department put together a group of stakeholders in 2009 to formulate a strategy for developing differential response criteria, determining appropriate outcome measures for the evaluation, identifying computer system changes, and formulating public awareness campaign.[17,18]

In August 2009, Governor Pat Quinn signed the Differential Response Program Action (SB807), and in December 2009, the National Quality Improvement

[13] Waldfogel, Jane. 1998. *The Future of Child Protection: How to Break the Cycle of Abuse and Neglect*. Cambridge, MA: Harvard University Press, p. 138.

[14] Ibid.

[15] McEwen, Erwin. 2010. "Differential Response." Presentation at the *Illinois Child Welfare Data Summit: 1st Annual Leadership Summit*. Chicago, IL.

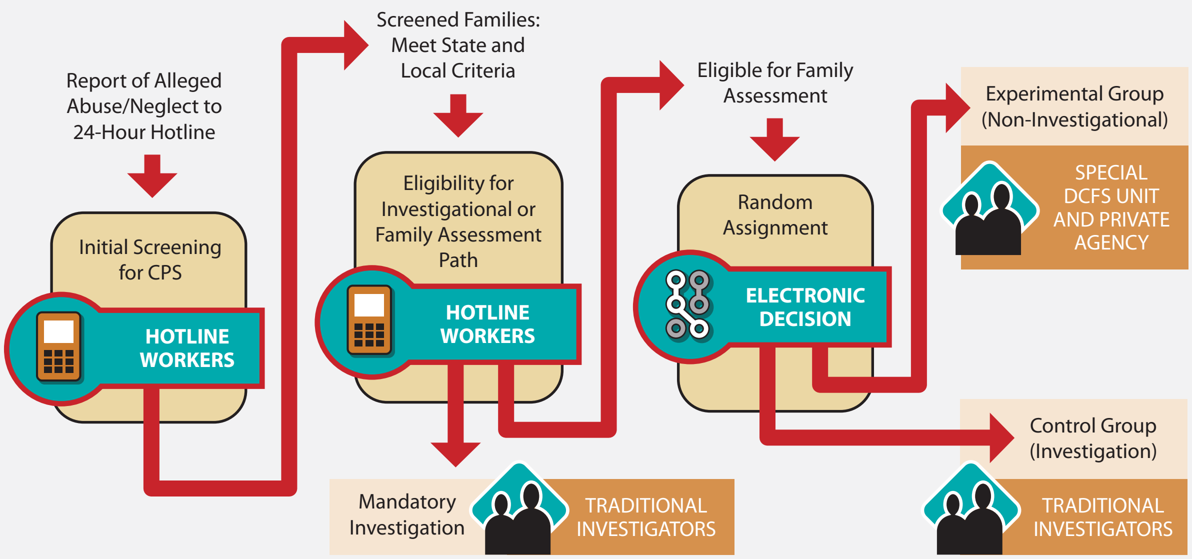
[16] In short, as Crain and Tonmyr argue, "it is critical to acknowledge that a weakness of some differential response systems is the assumption that community support services are available." Crain, Jennifer and Lil Tonmyr. 2007. "Differential Response Models of Child Protection and Implications for the Canadian Incidence Study of Reported Child Abuse and Neglect – 2008." Pp. 21-26 in *Canada's Children: Child and Youth Maltreatment*, edited by the Child Welfare League of Canada. Ottawa, Canada: Author. (p. 22).

[17] Jones, Womazetta, William Wolfe, Tamara Fuller, and Kathleen Kearney. 2010. "Putting It All Together: Lessons Learned from Implementing Differential Response in Illinois." 2010 Conference on Differential Response in Child Welfare.

[18] Source for flowchart: http://www.state.il.us/DCFS/docs/CFS_1050-49_Differential_Response_Brochure.pdf

Figure 1

Illinois DCFS Pathways to Strengthening and Supporting Families



Source: Information from http://www.state.il.us/DCFS/docs/CFS_1050-49_Differential_Response_Brochure.pdf

Center on Differential Response in Child Protective Services (QIC-DR) awarded Illinois a grant to pilot differential response for five years and to evaluate the program's effectiveness, including a randomized control trial. The program, called *Pathways to Strengthening and Supporting Families* (PSSF), was implemented statewide in November 2010 (Figure 1).

Illinois' differential response criteria focused on lower-risk neglect allegations. Families were screened for the differential response track, as opposed to the child welfare investigations track, when a report of child abuse or neglect came into the Department of Children and Family Services' reporting hotline with any of the following allegations: lock out; inadequate food, shelter, or clothing; environmental neglect; mental injury; medical neglect; inadequate supervision; or risk of harm due to neglect. Child physical and sexual abuse allegations were not eligible for differential response. Additional criteria for the Illinois demonstration and evaluation included:

- The family must not have had a previous or pending indicated report of abuse or neglect;
- The family's address and other identifying information was available;
- The alleged perpetrator was the parent or legal guardian of the child;
- The children were not wards of the court; and
- It was not necessary to take protective custody of the child.

Illinois implemented a paired team approach to service where one representative from DCFS accompanied one local community-based service worker (SSF worker) for the initial visit with the

> *"Beginning January 1, 2010, the Department of Children and Family Services may implement a 5-year demonstration of a 'differential response program' in accordance with criteria, standards, and procedures prescribed by rule. The program may provide that, upon receiving a report, the Department shall determine whether to conduct a family assessment or an investigation as appropriate to prevent or provide a remedy for child abuse or neglect."*
>
> — SB807

family. These visits occurred within three days of the report. The SSF worker then acted as a coach and advocate for the family. The SSF worker had a maximum of 12 cases at one time, and served as an agent of change for the family.[19]

The home visit included an interview with the child to assess his/her developmental level and various other health and risk assessments for both child and family. The SSF worker stayed in contact with the family on a weekly basis in-person to provide short-term support, for example teaching a mother how to diaper her new baby. Or the worker might connect the mother to federal and statewide food assistance programs or help her secure reliable childcare. The SSF worker could also help the family identify its existing social support network, which was assessed in terms of its helpfulness, intensity, durability, accessibility, proximity, reciprocity, and size.[20] The case remained open for 90 days, but the family could request extensions for another 90 days.[21]

The Children and Family Research Center was expected to complete its evaluation of the state differential response program by mid-2013. The evaluation includes a process component, an outcome component, and a cost analysis.[22] The randomized control trial (RCT) offering services to families ended on May 25, 2012. The process evaluation component includes implementation information from steering committee meetings to case tracking.

For More Information

A report on Illinois' differential response research and demonstration project is expected by the end of 2013. Please check the University of Illinois' Children and Family Research Center web site for its release at http://www.cfrc.illinois.edu/differentialresponse.php.

For more information on differential response in Illinois, please contact Womazetta Jones, Project Director for Differential Response at womazetta.jones @illinois.gov.

Outcome data will be provided through administrative case records, caseworker case closing reports, surveys from families after case closure, focus groups with DCFS staff and community providers, interviews with families, and observations of family-caseworker interactions.[23] Once evaluation materials become available, Illinois will assess whether to re-institute the differential response track.

Differential Response in Other States

Differential response varies considerably across the country, which makes it difficult to generalize but also provides many alternative models for Illinois to consider. Overall, 21 states have completed or are currently conducting some sort of evaluation of differential response.[24] Minnesota, Ohio, and New York have completed a randomized control trial (RCT) experimental evaluation of differential response (Figure 2). Illinois and Colorado are in the process of

[19] Jones, Womazetta. 2012*a*. "Differential Response in Illinois – What Is It?" Council on Contemporary Families Annual Conference, Family Impact Seminar, Chicago, IL; Fuller, Tamara. 2012. "Differential Response: Sounds Great, But Does it Work?" Council on Contemporary Families Annual Conference, Family Impact Seminar, Chicago, IL.

[20] Illinois Department of Children and Family Services, Division of Service Support, Office of Training and Professional Development. 2010. Illinois' *Pathways to Strengthening and Supporting Families Training Modules.* Springfield, IL.

[21] Fuller, T.L., Kearney, K.A., & Lyons, S.L. (2012). *Differential Response in Illinois: 2011 Site Visit Report*. Urbana, IL: Children and Family Research Center, University of Illinois at Urbana-Champaign. http://cfrc.illinois.edu/pubs/rp_20120327_DifferentialResponseInIllinois2011SiteVisitReport.pdf.

[22] Ibid.

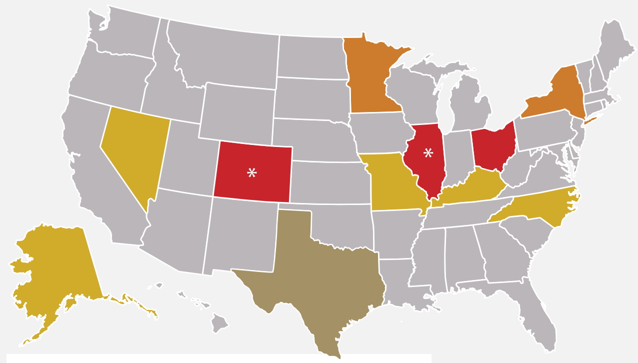
[23] Children and Family Research Center. (2012). An Introduction to Differential Response. http://cfrc.illinois.edu/pubs/bf_20120101_AnIntroductionToDifferentialResponse.pdf

[24] National Quality Improvement Center on Differential Response in Child Protection, 2011. "Differential Response in Child Protective Services: A Literature Review, Version 2." Washington, DC: U.S. Department of Health and Human Services, Administration for Children and Families, Administration for Children, Youth, and Families, Children's Bureau.

finishing RCTs. Ohio is doing an extended evaluation that is expected to be finished in 2013. Other states have completed quasi-experimental and non-experimental evaluations.[25] Quasi-experimental designs have matched and compared families or sites based on similar characteristics. Non-experimental designs have included case reviews or pre-and post-data comparison.[26] We focus primarily on results from the RCTs and quasi-experiments because they provide the most rigorous evidence of the causal impact of the programs.

The following is an overview of previous state evaluations. For a list of the evaluations, please see the end of this chapter.

Figure 2
Differential Response Evaluations by State



Source: See footnote 24 on page 54.

Child Safety and Recidivism

> *Child safety is an important outcome for differential response evaluations because children remain in the home after they come to the attention of child protective services.*

Overall, evaluations of differential response show that children are not at increased risk when placed into the differential response track as opposed to the investigation track. These evaluations generally defined child safety in terms of caseworkers' assessments and by using re-reports into the child welfare system. Other outcomes like child injuries or deaths have been less often examined.

The equivalent safety of children in both tracks from the caseworker perspective has been shown in several states, including Minnesota, Ohio, and Missouri. In Missouri, researchers coded the safety concerns and severity descriptions in case files, comparing pilot to control counties. Researchers found improved safety for children in the pilot (differential response) counties with reported neglect of basic needs, lack of supervision and proper care, and less serious physical and verbal abuse, such as injuries resulting from discipline.[27]

Equivalent recurrence rates were descriptively documented with data from five states in the National Child Abuse and Neglect Data System (NCANDS), revealing that repeated reports to the system were about the same for families in each track.[28] Evaluations in five states also showed that recurrence was

[25] Fuller, Tamara. 2012. "Differential Response: Sounds Great, But Does it Work?" Council on Contemporary Families Annual Conference, Family Impact Seminar, Chicago, IL.

[26] National Quality Improvement Center on Differential Response in Child Protection, 2011. "Differential Response in Child Protective Services: A Literature Review, Version 2." Washington, DC: U.S. Department of Health and Human Services, Administration for Children and Families, Administration for Children, Youth, and Families, Children's Bureau.

[27] Siegel, G. L., & Loman, L. A. (1997). *Missouri family assessment and response demonstration: Final evaluation report.* St. Louis, MO: Institute of Applied Research.

[28] Ortiz, Mary Jo, Gila R. Shusterman, and John D. Fluke. 2008. "Outcomes for Children with Allegations of Neglect Who Receive Alternative Response and Traditional Investigations: Findings for NCANDS." *Protecting Children* 23 (1&2): 57-70.

either lower in the differential response than the investigatory track (in Kentucky, Missouri, and Minnesota) or no different between the two tracks (in New York and North Carolina). After re-reporting, three states also found that the results of investigations were more favorable or no different for families originally in the differential response track. Specifically, fewer differential response families had children removed in subsequent investigations in both Minnesota and Ohio. In Nevada, there was no significant difference in child removal rates.

"Consistently, state evaluations have found that families receiving differential response were more satisfied with the intervention that they have received…"

Service Delivery and Take-Up

> *Differential response arose from the premise that lower-risk families need different kinds of services than higher-risk families. Voluntary service delivery is also a core component of differential response, thus it is important to examine whether families offered services actually accept them.*

If families refuse to participate in differential response, then the case is either closed or, in some states, moved into the investigatory track. In Illinois, the case is closed if the family refuses to receive services. In contrast, when in the investigatory track, families can be required by the court to participate in services.

State evaluations indicate that families in the differential response track receive more services, more quickly than families in the investigations track. In Missouri, differential response families received services within 17 days of the incident report as opposed to 34 days for families receiving investigations. In Minnesota, 54 percent of differential response families reported receiving specific services other than case management as opposed to 36 percent of the control group of investigations families. This service advantage is especially true in terms of basic items needed for children, like diapers and formula and economic help like assistance with utility bills (Colorado; Minnesota; Missouri; New York; Ohio). The counties in North Carolina implementing differential response also increased the number of minutes per case on "frontloading" services pre- and post-implementation from (344 minutes per child to 441 minutes per child, respectively). Frontloading is defined as bringing services and supports more quickly to families. Differential response workers were also more likely to link families to community resources, which is an important component of differential response. For example, in New York differential response caseworkers referred families to neighborhood organizations (11 percent more than investigations), community action groups (12 percent more), and self-help groups (13 percent more).

Family Satisfaction and Engagement

> *Differential response caseworkers involve families as partners, rather than as clients, thus family satisfaction and engagement are important outcomes.*

Consistently, state evaluations have found that families receiving differential response were more satisfied with the intervention that they have received, and caseworkers also report that families are more satisfied (Minnesota; Missouri; New York; North Carolina; Ohio).

The Minnesota evaluation, for example, documented this greater satisfaction and involvement among families in the differential response track.[29] Workers in Minnesota likewise reported that families in differential response were more cooperative. In Ohio, families reported being offered more services, deemed their caseworker more helpful, and were more likely to participate in services than families in the investigative track.[30] Families in New York's differential response track reported

[29] Loman, L. Anthony. 2009. "Differential Response and Family Poverty: Evidence from Evaluations." Conference on Differential Response in Child Welfare.

[30] Ibid.

more positive feelings after the initial meeting with caseworkers, and reported their caseworker listened and respected them more than investigative track families did. And, if the family had prior experience with child protective services, they noted a better experience when in the differential response track.

Family satisfaction is one of the few areas in which findings are available for Illinois' differential response evaluation. So far, there is evidence that families in the differential response track are more satisfied with the quality and substance of interactions with workers than other families. Differential response families also report that they have more pathways to receive more services and are satisfied with the help they receive. Caseworkers likewise report that the differential response approach track allows them to make more progress with clients.[31]

Considerations for the Future

As already noted, differential response programs can appeal to lawmakers from both sides of the aisle, which speaks to its potential long-term viability. Consistent with conservative ideology, differential response shifts the role of child protection from the federal and state governments to local government and community-based organizations. By offering voluntary services to families, it also promotes family responsibility and accountability. On the liberal side, differential response programs recognize that situational forces, such as poverty, contribute to families coming into contact with the child welfare system. Such families are connected with social safety nets rather than criminally investigated.

Considerations for Policymakers:

- Service array
- Safety issues
- Family participation in services
- Reoccurrence of families in DCFS system
- Definitions of abuse and neglect and determinations of levels of risk
- Cost savings
- Community resources

Source: (Crane 2012)

Yet differential response also faces political and practical challenges. We highlight four main considerations and implications for Illinois lawmakers to consider: (a) maintaining child safety, (b) understanding the implications of voluntary service delivery, (c) building informal supports and community capacity, and (d) collaborating across human service silos.

Maintaining Child Safety. Child protective services always face a tension between a desire to keep families intact and a desire to protect children from harm. Public and political support can be quickly undermined when a child is seriously injured or killed after being left at home, despite a mistreatment report to the state. Due to this possibility, states implementing differential response have excluded the highest-risk cases from participating. States also provide continuous safety and risk monitoring for children who are in the differential response track. In Illinois, the community-based worker has weekly in-person contact with families in the differential response track. Continued vigilance to child safety will be essential for maintaining support for future differential response legislation.

Understanding the Implications of Voluntary Service Delivery. As discussed, families' voluntary participation is a core feature of differential response. In Illinois, about 90 percent of families participated when offered differential response services. We do not yet fully understand why some of these families accepted services and why others did not, and this knowledge will be important to increasing participation if the program is reinstated.[32] More information is also available from other states about short-term versus long-term follow-up with families. For example, it is not clear whether differential response families remain more likely to receive services after contact with their caseworker ends. Such longer-term follow-ups will also be important to future programming.

[31] Fuller, Tamara. 2012. "Differential Response: Sounds Great, But Does it Work?" Council on Contemporary Families Annual Conference, Family Impact Seminar, Chicago, IL.

[32] Schene, Patricia A. 2005. "The Emergence of Differential Response." *Protecting Children* 20 (2&3): 4-7.

Building Informal Supports and Community Capacity. As discussed above, differential response relies on existing community services. Such resources will vary across communities, and may be least available in the areas with the highest concentration of families in need of services. In the future, sub-state evaluations would allow Illinois and other states to better understand whether differential response is more successful in some communities than others. Illinois' evaluation will include a sub-state analysis. More information is also needed about how caseworkers establish linkages with local community agencies, and whether this relationship building varies across locales and types of agencies. For example, Missouri's evaluation indicates that workers reported a better relationship with community agencies and schools, but no change in the relationship with the juvenile court and police, as a result of differential response.

"The recession reduced states' abilities to fund these short-term investments. Yet the recession also accentuated the need for the program."

Collaborating Across Human Service Silos. More cost-benefit analyses of differential response are also needed. Differential response has the potential to increase efficiencies *within* state child protection agencies because caseworkers can focus investigations on the highest-risk families. However, to the extent that differential response caseworkers duplicate efforts of other human service agencies, state spending may be less efficient *across* agencies. Currently, state cost-benefit analyses of differential response have shown mixed results. Ohio's evaluation showed that differential response cost about $100 more per family when calculated over a 15-month period. However, differential response in Minnesota cost around $200 less per family when considered long-term (the mean length for counties for the second follow-up was 453 days). It is also unclear how community-based differential response workers are connecting families to other human service systems, such as Temporary Assistance for Needy Families (TANF; cash assistance) or the Supplemental Nutrition Assistance Program (SNAP; food stamps). In order to truly enable organizational change within DCFS and across agencies, multiple stakeholders must be involved. Differential response will likely be best sold across state agencies as one component of a wider effort to more effectively deliver a system of care to clients. Tippecanoe County in Indiana recently reformed its child welfare system after a highly publicized case involving a child's death. Community organizations planned public forums to raise awareness about the prevalence of child abuse and neglect in the county, the types of services available for families, and to foster ideas from the community about moving forward to keep children safe. The county also began to foster collaboration between agencies as a way to prevent child mistreatment and improve service delivery to families in the caseload.[33] Externally, the program needs to be well described to the media, legislators, judges, and other stakeholders, so that they understand this paradigm shift in child welfare and its long-term policy goals.

Conclusions

In Illinois and the nation, child protective services face a continual tension between keeping children safe and keeping families intact. Differential response represents the most recent shift in child welfare practice to help address this tension, recognizing that families differ in their level of risk and needed response. However, the impact of this program not only for families, but also state governments, is only partially understood.

Unfortunately, this innovative approach is being considered at the same time that state budgets are shrinking.[34] The short-term investment in starting the program might lead to increased efficiencies within and across state agencies, and to longer-term benefits to the extent that fewer families come back into contact with child protective services and

33 Biggs-Reed, P., Smith Grossman, A., Rush, L., & Wilson, S. (2008). "White Paper: Understanding Child Abuse and Neglect in Tippecanoe County." Retrieved from http://www.ourkidstippecanoe.org/child_abuse_neglect_white_paper1.pdf.

34 Waldfogel, Jane. 2009. "Differential Response." Pp. 139-155 in *Preventing Child Maltreatment: Community Approaches,* edited by K. A. Dodge and D.L. Coleman. New York, NY: The Guilford Press.

to the extent that more families are connected with services to get and keep them on their feet.[35]

The recession reduced states' abilities to fund these short-term investments. Yet the recession also accentuated the *need* for the program. In a study of the effect of the current economic recession on child well-being, children in poverty were at higher risk for both abuse and neglect, and reports of child neglect increase during times of economic recession.[36]

The impending report on the full evaluation of differential response in Illinois will importantly sharpen understanding of whether differential response met its goals, and whether it has the potential to bolster existing policy and foster the creation of new programs targeted to vulnerable families—not only in Illinois, but also across the country.

State Evaluations

Center for Child and Family Policy. 2006. Multiple Response System (MRS) Evaluation Report to the North Carolina Division of Social Services (NCDSS). Duke University.

Huebner, R. A. (2005). *Program evaluation of the multiple response system: Kentucky*.

Loman, L. Anthony and Gary L. Siegel. 2004*a*. "Minnesota Alternative Response Evaluation: Final Report." A Report of the Institute of Applied Research, St. Louis, Missouri.

Loman, L. A., & Siegel, G. (2004*b*). *Differential response in Missouri after five years: Final report*. St. Louis: Institute of Applied Research.

Loman, L. A., Filonow, C.S., & Siegel, G. (2010). *Ohio alternative response evaluation: Final report.* St. Louis, MO: Institute of Applied Research.

Ruppel, Joanne, Yufan Huang, Gail Haulenbeek. 2011. "Differential Response in Child Protective Services in New York State Implementation, Initial Outcomes and Impacts of Pilot Project." New York State Office of Children and Family Services.

Siegel, G. L., & Loman, L. A. (1997). *Missouri family assessment and response demonstration: Final evaluation report.* St. Louis, MO: Institute of Applied Research.

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Winokur, M., et al. 2012. Colorado year 1 site visit final report. Fort Collins, CO: Colorado State University Social Work Research Center. ■

Family Impact Seminar

This chapter is a component of the 2012 Illinois Family Impact Seminar, on the topic of *Differential Response to Child Abuse and Neglect: Where is Illinois and What Can We Learn from Other States?* The 2012 Family Impact Seminar was part of the Council on Contemporary Families Annual Conference, co-sponsored by the University-Based Child and Family Policy Consortium. The event, "Crossing Boundaries: Public and Private Roles in Assuring Child Well-Being," was held in Chicago on April 27 and 28. At the 2012 Family Impact Seminar, hosted by IGPA and several co-sponsors, researchers, practitioners, and experts on family policy gathered to discuss the effectiveness of differential response, and ways to ensure the approach's success in Illinois. The panel included widely respected experts on the differential response approach, including:

Womazetta Jones, Project Director, Differential Response, Illinois Department of Children and Family Services

Tamara Fuller, Director, Children and Family Research Center, School of Social Work, University of Illinois at Urbana-Champaign

Kelly Crane, Child Welfare Policy Specialist at the National Conference of State Legislatures

Joel Rosch, Senior Research Scholar, Policy Liaison, Center for Child and Family Policy, Duke University

Acknowledgments

The Illinois Family Impact Seminar is an annual series directed by Dr. Rachel Gordon at the University of Illinois' Institute of Government and Public Affairs. The series connects decision makers with research evidence to inform pressing family policy issues. The Illinois Family Impact Seminars benefit from the good advice of members of the Policy Network for Family Impact Seminars, directed by Karen Bogenschneider at the University of Wisconsin-Madison and the members of the Illinois Family Impact Seminars advisory committee. Additional materials and video of the 2012 seminar can be found at igpa.uillinois.edu/pe/fis.

[35] Loman, L. Anthony. 2005. "Criminal Arrests for Severe Physical and Sexual Abuse." A Report of the Institute of Applied Research, St. Louis, Missouri.

[36] Sell, Katherine, Sarah Zlotnik, Kathleen Noonan, and David Rubin. 2010. "The Recession and Child Maltreatment." The Effect of the Recession on Child Wellbeing. First Focus, Washington, DC.


EMERGENCY
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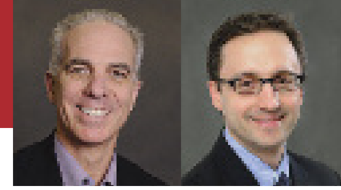


Kaestner Lo Sasso

Public Policies to Increase Hospital Competition, Improve Quality of Inpatient Care and Lower Health Care Costs

By Robert Kaestner and Anthony Lo Sasso

This chapter provides an assessment of three state policies that are targeted at the hospital industry in Illinois. The authors take a close look at tax exemptions for not-for-profit hospitals, the Medicaid hospital assessment program, and the Certificate of Need laws. The authors discuss strategies to alter these policies in a way that could lower costs and create a more competitive, higher quality hospital industry.

NEED TO KNOW

- Not-for-profit (NFP) hospitals receive public subsidies from the state, most notably through tax exemptions and subsidies in the bond market.
- The Affordable Care Act will reduce the number of persons without health insurance, reducing the problem of uncompensated charity care that the tax exemptions are supposed to address.
- The hospital assessment program, a per diem payment matched by the federal government to reduce the cost of operating Medicaid, is not as effective as intended and has been targeted by national deficit reduction strategies for elimination.
- Certificate of Need (CON) regulations require an oversight authority to limit the growth of medical facilities to hold down health care costs. However, CON rules are anti-competitive and are prone to corruption. The authors suggest they should be eliminated.

The hospital industry in Illinois is important in terms of both its economic impact and its role in maintaining population health. According to the Illinois Hospital Association, hospitals in Illinois contributed directly $32.8 billion, and indirectly $78.7 billion to the Illinois economy in 2010-2011.[1] In terms of health care, the Kaiser State Health Facts database reported that hospitals in Illinois provided 1.6 million days of inpatient care (0.6 per person in Illinois) and 6.8 million outpatient visits (2.5 per person in Illinois) in 2010.[2] As the magnitude of these numbers indicates, hospitals are vitally important to both the economy and population health of Illinois.

Most hospitals in Illinois are not-for-profit (NFP). Of the 191 community hospitals in Illinois that provide general medical and surgical care (e.g., not psychiatric care), 150 are NFP institutions, 25 are operated by state (i.e., University of Illinois Hospital) or local (e.g., Stroger Hospital in Cook County) governments, and 16 are for-profit organizations. Illinois has relatively fewer for-profit and government-operated hospitals than other states. A distinguishing feature of NFP hospitals is that they receive subsidies from the federal and state government; state subsidies include exemptions from property and

[1] (http://www.ihatoday.org/uploadDocs/1/2012economicreport.pdf)

[2] (http://www.statehealthfacts.org/profilecat.jsp?rgn=15&cat=8)

sales taxes and subsidies related to issuance of debt in the bond market.[3] In this chapter, we assess the need for and consequences of these state subsidies.

The hospital industry in Illinois is regulated by the state along several dimensions, but one of the most important dimensions is the oversight of entry and exit of hospitals into new geographic areas or into new services. The Illinois Facilities Planning Board has oversight authority on hospital construction and its objective is to hold down the cost of health care by limiting the creation of new facilities so as to prevent unnecessary capacity. This chapter also considers the efficacy of this state policy.

15%

Portion of total inpatient revenue paid for by the Illinois Medicaid program in 2010 (approximately $5 billion).

The last feature of the hospital industry that we highlight here is the significant share of hospital revenue that comes from the state through the Medicaid program. Kaiser State Health Facts reported that the Illinois Medicaid program spent approximately $5 billion on inpatient hospital services in 2010, which represents approximately 15 percent of hospital inpatient revenue in Illinois. Of course, for some hospitals, for example those located in lower income areas, Medicaid payments represent a much greater share of revenue. Such an important stream of revenue can obviously affect hospital performance because of both the level of payment, (is it adequate to cover costs?) and the structure of payment, (is it per diem or per episode of care?). In addition, for the past several years, Illinois has imposed a provider tax on hospitals, which helped attract federal dollars that reduced the state fiscal burden for Medicaid. In 2012, the provider tax raised $900 million in revenue and brought an additional $770 million in federal dollars to Illinois, and the assessment will increase in 2013-2014. A large share of the hospital assessment is repaid to hospitals under a complicated, legislated formula. In sum, the size and nature of the state contribution to hospital revenue will affect patient care. In this chapter, we discuss the consequences of this aspect of the hospital industry in Illinois.

Tax Exemption for Not-for-Profit Hospitals

Hospitals are unique in the health care sector in that they are dominated by NFP operators. Almost all other health care providers are for-profit. What explains this circumstance? One often cited explanation is that consumers may prefer NFP hospitals because the quality of care is difficult to observe for the consumer and NFP hospitals may be less likely to exploit this information asymmetry for organizational gain (i.e., profit). In short, NFP hospitals may provide higher quality care and, as a result, be preferred by consumers. This preference would provide non-profits with a competitive advantage and result in dominance in the market. Evidence on this issue suggests that there is relatively little difference between the quality of care provided by NFP and for-profit hospitals, but it is difficult to make an accurate assessment.[4] There is limited, high-quality evidence from the nursing home sector that NFP facilities provide higher quality care, but whether this evidence applies to the medical/surgical sector is unknown.[5] Overall, however, it seems unlikely that the explanation for NFP dominance is because of differences

[3] Colombo, John D., "Federal and State Tax Exemption Policies and Healthcare for the Poor," 51 *St. Louis University Law Journal* 433 (2007) (Health Law Symposium issue).

[4] Sloan, Frank A., Gabriel A. Picone, Donald H. Taylor, Jr. and Shin-Yi Chou, "Hospital Ownership and Cost and Quality of Care: Is There a Dime's Worth of Difference?" *Journal of Health Economics*, 20(1), 1-21, 2001; Roseneau, Pauline Vaillancourt and Stephen H. Linder, "Two Decades of Research Comparing For-Profit and Nonprofit Health Provider Performance in the United States," *Social Science Quarterly*, 84 (2) (June 2003): 219-224; Eggleston K, Shen Y.C., Lau J, Schmid CH, Chan J. "Hospital ownership and quality of care: what explains the different results in the literature?" *Health Economics* 2008 Dec;17(12):1345-62.

[5] Chou, Shin-Yi. "Asymmetric Information, Ownership and Quality of Care: An Empirical Analysis of Nursing Homes," *Journal of Health Economics*, 21(2), 293-311, 2002.

in the quality of care provided by them vis-à-vis for-profit hospitals.

Another explanation for the dominance of NFP hospitals is that they provide public goods (i.e., non-excludable goods such as use of emergency room by uninsured persons) that for-profit firms will not produce because they are unprofitable. However, this explanation is not particularly compelling because the majority of goods produced by hospitals are not public goods.

In our view, the best, although least validated, explanation of the dominance of NFP hospitals is that these institutions have different organizational objectives, for example providing charity care to the poor and uninsured, and that these objectives are best served by NFP status and are historically rooted.[6] Perpetuation of the NFP institutional form is maintained by public policy (for example, tax-exempt status of NFP hospitals) which provides a cost advantage, and by the possibility that NFP hospitals have been "captured" by stakeholders such as managers, physicians, and other hospital personnel. While NFP hospitals are legally bound to return any surplus (i.e., profit) to the organization, that does not eliminate the surplus, which may be particularly large given the cost advantage associated with NFP status, and when there are no shareholders keenly interested in obtaining the profit, those who operate the hospital may be able to control the surplus.[7] Moreover, conversion to for-profit status would be resisted by these entrenched interests, which may have limited the ability of for-profit hospitals to expand.

"Not-for-profit hospitals receive public subsidies from the state, most notably through tax exemptions and subsidies in the bond market."

Regardless of the explanation, the fact is that NFP hospitals receive public subsidies from the state, most notably through tax exemptions and subsidies in the bond market. Here, we consider the rationale for and consequences of this policy. The most prominent explanation for the subsidies provided to NFP hospitals is that they provide community benefits (quid pro quo theory). Indeed, recently enacted legislation in Illinois (SB2194) explicitly links tax-exempt status to the value of community benefits, which is defined in the legislation to include, among other things, charity and uncompensated care and the shortfall between Medicaid payments to hospitals for services and the hospital's costs for those services. Illinois now requires that hospitals provide community benefits that exceed the value of the property tax exemption they receive.

While the tax exemption seems reasonable and the newly passed legislation in Illinois is arguably a good start on requiring the quid pro quo criterion be fulfilled, further analysis suggests that there are good reasons to eliminate the tax exemption. First, the tax exemption makes the hospital the decision maker on what is the community benefit—for example free use of some hospital services. The community may prefer other benefits much more highly than the benefit the hospital provides.[8] Consider the case of a hospital in a very high property tax district that is required to provide community benefits equal to the value of its tax exemption. Such a hospital may encourage the use of relatively idle resources (CAT scanner during off hours) or spend money on activities with questionable community value (e.g., sponsor a cancer walk-a-thon) to meet its community benefit quota, whereas those in

[6] Horowitz, Jill R., "Hospitals Making Profits And Providing Care: Comparing Nonprofit, For-Profit, And Government," *Health Affairs*, 24, no.3 (2005):790-801.

[7] Brickley, James A., and R. Lawrence Van Horn. "Managerial Incentives in Nonprofit Organizations: Evidence from Hospitals," *Journal of Law and Economics*, Vol. 45, No. 1 (April 2002), pp. 227-249.

[8] David, Guy and Lorens Helmchen. "An Uncertain Prescription," *Regulation* 2006.

the community may prefer to receive other medical services or even non-medical services. Why should a hospital decide how a community spends the state subsidy? Why not let the community itself, or the elected representatives of the community, decide? Second, and a related point, is that the tax exemption is not well targeted to low-income persons who may be a priority for state subsidies. The exemption is largest where property taxes are highest, but communities in high property tax areas arguably require less state assistance and are a low priority for state subsidies. Nevertheless, hospitals in these areas will try to meet the community benefit requirement by providing services that are low value and/or low cost. Moreover, no matter how the legislation is written, hospitals will almost surely find a way to meet the community benefit criteria because costs are difficult to measure. This is why a hospital's reported "charges" for services are routinely ignored by all hospital payers, and community benefits are difficult to define, so "better-written" legislation is unlikely to be the answer.

"The reduction in the number of uninsured persons in Illinois as a result of the ACA greatly reduces the problem of uncompensated and charity care that the tax exemption for hospitals is supposed to address."

The third reason to eliminate the tax exemption is that there will be a marked decrease in the community benefit that is the most salient to the tax exemption—the provision of uncompensated and charity care. The Patient Protection and Affordable Care Act (ACA) will have a significant impact on health care

1.9 MILLION *Number of uninsured Illinois citizens*

in Illinois and the United States, and its greatest effect will be to reduce the number of persons without health insurance. In Illinois, there are approximately 1.9 million uninsured persons.[9] The ACA will reduce this figure to roughly 650,000 through expansions in Medicaid and federally-subsidized private insurance.[10] Notably, most of the people who will remain uninsured after the ACA will be undocumented immigrants who are ineligible for these two options. The reduction in the number of uninsured persons in Illinois as a result of the ACA greatly reduces the problem of uncompensated and charity care that the tax exemption for hospitals is supposed to address. The ACA will also result in the uninsured being concentrated in geographical areas in which undocumented immigrants reside. Therefore, a statewide tax exemption will almost surely misallocate resources because it does not target hospitals and areas in which the uninsured will reside. Again, better-written legislation cannot address this problem because it is simply too easy to manipulate the definition of community benefit and to spend money to meet the requirements of any legislation.

The tax exemption for NFP hospitals also provides a competitive advantage to NFP hospitals because of the lower costs resulting from state subsidies. This cost advantage can lead to larger hospitals (lower cost of capital) and therefore fewer hospitals in a market.[11] Indeed, NFP hospitals are on average much larger than for-profit hospitals.[12] Again,

9 statehealthfacts.org.

10 There are approximately 525,000 undocumented, foreign-born persons in Illinois (Pew Hispanic Center, http://www.pewhispanic.org/2011/02/01/iv-state-settlement-patterns/) who are not eligible for Medicaid or federal subsidies. We assume that all of them will be uninsured. In addition, approximately 10 percent of the remaining 1.4 million uninsured will be uninsured after ACA according to CBO estimates. This leaves a total of approximately 650,000 persons uninsured.

11 Lakdawalla, Darius & Philipson, Tomas. "The nonprofit sector and industry performance," Journal of Public Economics, Elsevier, vol. 90(8-9), pages 1681-1698, September 2006.

12 Guy David (2009), "The Convergence between Nonprofit and For-Profit Hospitals in the United States," *International Journal of Health Care Finance and Economics*, Vol. 9(4), pp 403-428, December 2009.

consider the NFP hospital located in a high property tax area. The cost advantage of the NFP in that area is relatively large, and it will be difficult for a for-profit hospital to enter and compete in this market because inpatient care is still a largely locally-provided service. In short, the tax exemption is anti-competitive and is likely to raise the cost of inpatient care.

Overall, there are strong arguments to eliminate the tax exemption for NFP hospitals. Most importantly, and ignoring the correct argument that there are more efficient ways to provide care for uninsured people (e.g., provide insurance for them) than through a tax exemption for NFP hospitals, there will be a significant decline in the need for hospitals to provide charity care because of the ACA. The need to provide charity care will also be concentrated in areas with large populations of undocumented immigrants. A statewide tax exemption is misplaced under these circumstances. Second, the tax exemption for NFP hospitals is anti-competitive and, as a result, likely raises prices for consumers. Third, the tax exemption is an abdication of the legislative responsibility to provide benefits that are most valued by the community. Residents or their representatives, not hospitals, should decide what benefits are most valued by the community. Finally, for all of the reasons just listed, eliminating the tax exemption will improve state and local fiscal circumstances and improve the efficacy of government in terms of providing valued benefits to citizens at the least cost.

Hospital Provider Assessment and Medicaid Reimbursement of Hospitals

Like almost all other states, Illinois has an assessment (tax) on hospitals that provides additional federal funds to use to reduce the cost of operating the state Medicaid program. The key to the hospital assessment is the fact that the federal government matches state expenditures on Medicaid and the assessment dollars are used to pay hospitals, which make these dollars eligible for federal matching dollars. The mechanics of the hospital assessment are as follows. The state assesses hospitals based on the number of (non-Medicare) occupied bed days the hospital provides. In 2012, the assessment rate was approximately $218 per occupied bed day and it raised $900 million. This rate and total amount will increase in 2013 and 2014. The state kept $130 million of $900 million to use for other purposes and returned the remaining $770 million to hospitals as payments through a complicated, legislated payment system that is largely a per diem payment to hospitals for inpatient care. The federal government then matches the $770 million that the state spent. The net result is that the state attracted $770 million in federal funds that it otherwise would not have received, and the hospitals benefited by receiving $640 million of that $770 million (after getting paid back $900 million for the assessment).

So what is wrong with this policy? All states do it and it brings in a lot of federal money. The hospital assessment seems like a great idea. It is. And that is part of its problem—it is too good and the federal government knows it. A quote from the *Wall Street Journal* editorial page sums up the inside-the-beltway view of these hospital assessment policies:

"A deal also ought to end the long-running 'bed tax' scam in which states charge hospitals a fee to increase health-care spending and thus their federal matching rate. Then they launder some of the money back to the hospitals to offset the fee. This is real waste, fraud and abuse, not the talking-point version."[13]

While the *Wall Street Journal* is known to favor Republican positions, the bull's eye on hospital assessment taxes has been nonpartisan. Both the National Commission on Fiscal Responsibility and Reform (Bowles-Simpson) and President Obama's Framework for Shared Prosperity and Shared Fiscal Responsibility proposed limiting the use of hospital tax assessments.

Regardless of the political support and long-term viability of the assessment, which is somewhat recognized by current Illinois law that limits the

[13] "An Entitlement Reform Guide." Editorial. *Wall Street Journal* east. ed. 3 Dec. 2012: A16. Print.

assessment to the end of the 2014 fiscal year, another major problem with the assessment is that hospitals end up being paid for services on largely a per diem basis. Indeed, the distribution of the hospital assessment funds is embedded in legislation and is quite complicated (see Public Act 097-0688, SB2194). The per diem nature of the payments provides little incentive for hospitals to manage costs efficiently. In contrast, the federal government through its Medicare program pays hospitals a lump sum per admission and the amount of money the federal government pays depends on the severity of the illness (diagnosis related group, or DRG) and expected use of resources. The DRG payment mechanism is widely recognized as an effective way to provide an incentive for hospitals to be efficient and cost effective, particularly with respect to length of hospital stay. Illinois also pays hospitals on the basis of DRGs for part of their reimbursement, but at rates that are frozen at 1993 levels.

A disadvantage of the per diem hospital payments stemming from the hospital assessment is that this system significantly reduces the incentives provided by the DRG reimbursement mechanism. Therefore, it is likely that hospital length of stay of Medicaid patients in Illinois is more than it would be otherwise because the hospital has less incentive to move patients out—the hospital is reimbursed for every day. There are also several other "adjustments" such as the Medicaid volume adjustment and outpatient service adjustment that dictate how much of the hospital assessment money flows back to hospitals. In the end, the amount of Medicaid payment to a hospital for inpatient care may be relatively far removed from the amount of actual (as opposed to "charges") resources used to treat Medicaid inpatients. The weakening of the relationship between actual resources used and payments received for that admission may have perverse incentives, for example, by providing an incentive for the hospital to avoid patients with high costs. Under the DRG system, this problem is diminished because DRG payments account partly for expected costs of an admission. The per diem payments with substantial "adjustments" break the link between resource use and payments. It provides an incentive for a hospital to take on relatively healthy patients who use fewer resources.

The second disadvantage of the per diem payments is that it is very difficult to assess whether the total Medicaid payments for inpatient care are adequate. For example, it is very difficult, if not impossible, to compare on an equivalent basis what a hospital in Illinois receives in payment for a heart attack admission for a Medicaid patient to a similar (e.g., urban, academic medical center) hospital in New York, Detroit or Atlanta.

"Paying hospitals on a per diem basis weakens the incentive to be efficient in determining the optimal length of stay for a Medicaid patient."

In sum, while the Illinois hospital assessment program brings in substantial federal revenue that helps patch a structural deficit related to Medicaid financing, it has a couple of features that diminish its overall effectiveness. Most importantly, the hospital reimbursement system that surrounds the hospital assessment program may seriously distort hospital incentives with respect to how they treat patients and how they structure the hospital. As noted, paying hospitals on a per diem basis weakens the incentive to be efficient in determining the optimal length of stay for a Medicaid patient, which may significantly increase length of stay and hospital costs. The current reimbursement system also weakens the link between actual resource use and payments and creates an incentive for hospitals to select healthier patients. Third, the complicated and non-transparent way of paying hospitals makes it nearly impossible to compare payments to hospitals in Illinois' Medicaid system to payments in other states, and it makes it difficult to assess the adequacy of payments. While recent legislation has called for moving to a 100 percent DRG system, the legislation does not require it. Finally, the hospital assessment is likely to be ended by federal budgetary problems and the well-recognized frisking of federal coffers by state Medicaid agencies.

Certificate of Need Regulation

Certificate of Need (CON) regulations were originally instituted as part of the federal "Health Planning Resources Development Act" of 1974. The intent of CON laws is to restrain health care facility capacity in the belief that, if hospitals and other health care institutions are prevented from being built, then medical costs will fall (or not rise as fast). The 1974 federal law required all 50 states to have in place some structure requiring a formal approval from a state health planning agency before beginning any major capital projects, such as building expansions or ordering new high-tech devices. Federal funds provided incentives for states to implement CON regulations. The law (and federal CON subsidies) was repealed in 1987, leading 14 states to discontinue their CON programs. Illinois is one of the 36 states that still maintain some type of CON regulation.

The basic premise of the CON regulation is that there is a need for an oversight authority because once a medical facility is built the organization running it will be able to create demand for its services regardless of actual need. This "induced-demand" will raise costs. Accordingly, there is a need to limit the growth of medical facilities to hold down health care costs. Unfortunately, this hypothesis has never been demonstrated in the scientific literature. In fact, the evidence is clear that allowing competitors to enter a market serves to exert downward pressure on prices.[14] The Federal Trade Commission and Department of Justice issued a report suggesting that CON regulations if anything served to increase prices by limiting competition.[15] A study in 1998 found "no evidence of a surge in acquisition of facilities or in costs following removal of CON regulations".[16]

"In the end, the amount of Medicaid payment to a hospital for inpatient care may be relatively far removed from the amount of actual…resources used to treat Medicaid inpatients."

36 *States, including Illinois, that maintain some type of Certificate of Need regulation.*

Moreover, given that existing hospitals have a strong incentive to lobby against new competition, the opportunity for corruption is intense. Illinois' recent experience with CON regulations is instructive. In Illinois in 2004, the CON Board (then known as the Illinois Health Facilities Planning Board) came under scrutiny when it became apparent that a member of the board attempted to engineer payments for him and his friends in exchange for votes. The evidence was obtained when a hospital CEO with a project that needed approval by the board wore a wiretap for the FBI for several months. The resulting investigation led to a number of convictions.

The anti-competitive nature of CON laws and the potential for corruption should be sufficient to end this state policy. It is difficult to justify why nine gubernatorial appointees would be privy to more information about the need for expanded health care options and choices than the private investors who are willing to put forth their own money to undertake such an investment. The evidence specific to CON laws and on the benefits of competition in the hospital industry simply do not provide any support for the existence of CON laws.

[14] Gaynor, Martin & Vogt, William B. " Competition among Hospitals," *RAND Journal of Economics*, The RAND Corporation, vol. 34(4), pages 764-85, Winter 2003; Vogt, W. and R. Town. 2006. "How Has Hospital Consolidation Affected the Price and Quality of Hospital Care?" RWJ Research Synthesis #9; Abraham, Jean Marie, Martin Gaynor and William B. Vogt. "Entry and Competition in Local Hospital Markets," *Journal of Industrial Economics*, Wiley Blackwell, vol. 55(2), pages 265-288, 2006.

[15] Federal Trade Commission, Department of Justice, Improving Health Care: A Dose of Competition (Washington D.C.: FTC, DOJ, 2004) 361 pages. http://www.justice.gov/atr/public/health_care/204694.pdf accessed on December 3, 2012.

[16] Conover C.J. and F.A. Sloan. "Does removing certificate-of-need regulations lead to a surge in health care spending?" *J Health Polit Policy Law*. 1998 Jun; 23(3):455-81.

Conclusion

In this chapter, we have provided an assessment of three state policies targeted at the hospital industry in Illinois: tax exemptions for not-for-profit hospitals, the Medicaid hospital assessment program, and the Certificate of Need (CON) law. While state policymakers have recently altered each of these policies, the steps taken can be improved upon, and by so doing Illinois can have a more competitive, lower cost and higher quality hospital industry.

"While state policymakers have recently altered each of these policies, the steps taken can be improved upon, and by so doing Illinois can have a…higher quality hospital industry."

The most obvious change based on the evidence is to eliminate the CON law. Many studies have shown that greater competition in the hospital industry leads to lower prices for consumers. There is little theoretical or empirical justification for limiting such competition in Illinois.

Another way to increase the competitiveness of the hospital industry in Illinois, and thus lower prices and increase quality, is to eliminate the tax exemption that provides a substantial cost advantage to not-for-profit hospitals and limits the ability of for-profit firms to compete. The tax exemption can be eliminated on other grounds, too. It is poorly targeted to those most in need; it allows hospitals instead of legislators or community residents to decide what the community benefit should be; and the most salient community benefit it is intended to provide is disappearing because of the large decrease in the number of uninsured persons that will result from full implementation of the Affordable Care Act.

Finally, the Medicaid hospital assessment needs significant modification. While it clearly brings in federal revenue for the state, it distorts incentives for hospitals in terms of how many patients to treat, and how they should be treated. The hospital assessment system, and the hospital reimbursement structure that has arisen from it, is also non-transparent and prevents easy assessment of the adequacy of payments. More importantly, the hospital assessment and reimbursement system helps preserve the status quo and dampens competition by providing existing hospitals with fixed payments that would not readily adjust to changes in hospital size, patient base or other organizational characteristics. ■

Redraw 2012 – 2020 District Boundaries

Gaines Kuklinski Mooney

Revisiting Redistricting: Who Should Be Afraid of Partisan Mapmaking?

By Brian J. Gaines, James H. Kuklinski and Christopher Z. Mooney

Delving into the complicated and often politically fraught process of redrawing electoral district boundaries after each decennial census, this chapter examines whether there is evidence that the purportedly gerrymandered maps played a role in the 2012 election. Using the 2012 U.S. House election, the authors reveal why partisan control of the process should be regarded with suspicion.

NEED TO KNOW

- For the first time since 1970, Illinois did not have divided government in the first session following a census and reapportionment, and thus Democrats were free to draw any maps they liked.
- After Illinois lost a House seat due to reapportionment, the Democrat-drawn map ensured that Republican incumbents faced fewer familiar voters than Democrats. The new district map produced fewer competitive seats, most of which lean to the Democrats, providing Democratic U.S. House candidates in Illinois a clear advantage.
- Nineteen states, including Illinois, gave complete control to one party or the other in 2011 U.S. House redistricting. Republicans controlled redistricting in 14 states having 164 seats, while Democrats did so in only five states, having a mere 42 seats.
- When one party drew the new U.S. House map in a state after the 2010 census, that party did comparatively well in 2012. Parties that gained control of redistricting in 2011, not having had it in 2001, seem to have engineered larger swings in their own favor.

The 2012 election brought mostly bad news to Republicans, who failed to unseat President Obama despite a poor economy and lost 11 of the 14 U.S. Senate races regarded as "in play." Their one bright spot was comfortable retention of control of the U.S. House, where they lost only eight seats. The president's home state was a conspicuous exception to this point that the U.S. House was the best venue for Republicans in 2012: in Illinois, Republicans fell from holding 11 of 19 congressional seats to having only six of 18. More than half of their net losses nationwide can be assigned to the Land of Lincoln. Explanations for how Republicans weathered the storm in the U.S. House and why Illinois was unusually stormy for them both involve district lines. One cannot forecast U.S. House results, or understand the election outcomes after the fact, without paying attention to where and how the districts were drawn. Most important, in the end, is who drew them.

In 2011, the Institute of Government and Public Affairs published *Rethinking Redistricting: A Discussion About the Future of Legislative Redistricting in Illinois*. The project described in that report began immediately following the 2010 census, and preceding the design of new electoral maps for the Illinois House and Senate and for the U.S. House seats in the state.

One component of the study was a public-opinion survey of registered voters in Illinois, aimed at assessing what they regard as fair redistricting. Unsurprisingly, we found that most did not know how U.S. House and General Assembly districts are drawn. Despite that ignorance, however, they had no difficulty identifying fairness criteria, for both process and outcomes. For instance, nearly 50 percent said they preferred that maps be drawn by an independent, nonpartisan commission whose members do not directly participate in politics; less than 3 percent said that redistricting should be done by the legislature and governor. With respect to outcomes, the respondents preferred that districts take relatively simple shapes and that they follow preexisting county and city boundaries wherever possible. About 60 percent ranked one of these two goals as the highest priority. The third most popular outcome criterion was that "as many districts as possible should be about equally balanced between Democratic and Republican voters."

"One cannot forecast U.S. House results, or understand the election outcomes after the fact, without paying attention to where and how the districts were drawn. Most important, in the end, is who drew them."

50% *Of respondents said they would prefer maps to be drawn by an independent, nonpartisan commission whose members do not directly participate in politics.*

Following Pat Quinn's narrow defeat of Bill Brady in the 2010 gubernatorial election, however, Democrats controlled both chambers of the General Assembly and the governor's office. For the first time since the 1970 Constitution took effect, Illinois did not have a divided government in the first session following a census and reapportionment, and thus Democrats were free to draw the maps as they liked. Not surprisingly, they did not opt to relinquish control by reforming the system, notwithstanding public preferences for nonpartisan mapmaking. All of the maps they drew—for U.S. House districts and for the state Senate and House districts, the latter having to be nested in the former—are widely regarded as partisan gerrymanders. In other words, observers believe the maps were designed to maximize Democratic and minimize Republican seat totals. Certainly, it would be difficult, if not impossible, to argue that the Democrats in control of Illinois state government prioritized any of the criteria cited above as most popular with voters.

So what? There is nothing illegal about triumphant parties using their power to try to lock in their advantages for the future. To the victor go the spoils. Equally, however, there is nothing to celebrate in politicians designing electoral institutions to be deliberately unresponsive to public sentiment. Hereafter, we try to determine if there is, indeed, clear evidence that the supposedly gerrymandered maps played a role in the outcomes of the 2012 election. We begin by focusing in some detail on Illinois and then widen our domain by considering other states, many of which saw Republicans designing their U.S. House maps unilaterally. To simplify our task, we set aside state legislative electoral maps, which deserve their own analysis. Our larger purpose is to reiterate the sentiment of Illinois registered voters that redistricting done by one party alone is typically detrimental to the standard of "free and fair" elections, often held to be the quiddity of democracy.

A Very Brief Primer on Gerrymandering

Gerrymandering means drawing electoral districts with some express political purpose, and it is thus a highly elastic term. It takes many forms, but it usually refers to three particular politically meaningful criteria: race, incumbency status, and partisan balance.

First, districts can be drawn based on the racial and ethnic composition of the electorate, to concentrate or disperse particular groups. A very rough summary of the complicated and shifting jurisprudence on racial gerrymandering in the U.S. is that, as the 2012-20 maps were being drawn, it was widely understood that the Voting Rights Act of 1965 (renewed and amended in 1970, 1975, 1982, and 2006) *requires* states with sufficiently large black and/or Hispanic populations to draw as many majority-minority districts as possible.[1] Hence, all discussion of other forms of gerrymandering hereafter is to be understood as manipulation of district boundaries under the initial constraint that, in many states, several districts must be constructed to have populations that are mostly minority. Following the 2010 census in Illinois, the presumption was that no U.S. House map would pass judicial scrutiny unless at least three of the 18 districts were majority-black and at least one was majority-Hispanic. The latter, in particular, cannot be created without violating any standard of compactness (simplicity of shapes), but courts treat this and other such desiderata as secondary, and thus dispensable.

"Gerrymandering usually refers to three particular politically meaningful criteria: race, incumbency status, and partisan balance."

Second, incumbent politicians obviously have strong interests in how their districts are altered, and gerrymandering has often been done with the goal of protecting as many incumbents as possible. This outcome often prevails when the two parties jointly draw a map, thus eliminating the potential for a partisan arrangement. For example, the often bizarrely shaped congressional districts drawn in Illinois in 2001 were largely seen as an incumbent-protection gerrymander. But there is no compelling public policy reason to draw maps that are clearly intended to help or harm incumbents' efforts to be re-elected. Generally, incumbents do extremely well getting re-elected in American legislative elections, and political scientists agree that there is a substantial incumbency advantage, a vote bonus accrued by virtue of holding office. The precise size of the bonus varies by time and place, but most estimates are in the broad range of 3-10 percent. In other words, any given legislative candidate can be expected to win several extra percentage points of vote share when running as an incumbent, all else equal. Although there is ongoing debate about what factors explain this bonus, familiarity is clearly one component. In turn, incumbents highly value electorates who already know them, with whom they have cultivated a "personal vote." For that reason, continuity with old districts is a key trait that assists incumbents, to the detriment of potential challengers.

[1] Interested readers might compare *Thornburg v. Gingles*, 478 U.S. 30 (1986), *Shaw v. Reno*, 509 U.S. 630 (1993), *Johnson v. DeGrandy*, 512 U.S. 997 (1994), and *Bush v. Vera*, 517 U.S. 952 (1996) to try to piece together the status quo on when, why, and how majority-minority districts are permitted and/or mandated.

The third common type of gerrymandering, and perhaps the one most frequently suggested by the term, is the partisan gerrymander. Candidates prefer familiar electorates, but it is even more important for them to be able to run in districts that are friendly in terms of partisan balance. Voting by individuals and vote totals for whole constituencies are never entirely predictable, but there are strong regularities that can be detected in a series of elections. Hence, every district has a "normal vote" that describes its degree of partisan lean.

"Candidates prefer familiar electorates, but it is even more important for them to be able to run in districts that are friendly in terms of partisan balance."

However, the incentives for the party as a whole differ. Parties (or party leaders) prefer not to "waste" votes in overly safe districts. The most efficient translation of votes into seats for a given party requires fairly competitive seats that lean only a little in the direction of that party. In turn, if Democrats (Republicans) craft a map to favor their party, collectively, and harm Republicans (Democrats), collectively, they will draw a small number of extremely safe Republican (Democratic) districts and a larger number of less safe districts that lean in their direction. The result is a partisan gerrymander in which Democrats (Republicans) win a higher number of seats than their total vote in the state would seem to warrant because they win many seats by relatively close margins, while the Republicans (Democrats) who win do so by landslides, essentially wasting votes.

18 Number of U.S. House Seats that Illinois was apportioned following the 2010 census, down from 19 in the years before.

U.S. House Elections in Illinois in 2012: Breaking Up the Personal Vote Is Not Hard to Do

The first sign that the U.S. House districts for the 2012-20 elections in Illinois were designed to make life difficult for Republican incumbents is which districts were most radically altered. Based on the 2000 census, Illinois was apportioned 19 seats for 2002-10, but the state grew slowly enough, vis-à-vis other states, that the apportionment based on the 2010 census allocated the state only 18 seats. That fact, coupled with fairly large discrepancies in population across the 19 old districts as of 2010, ensured that lines would have to move a good deal. Population shifts differed across seats, and all of the eight seats held by Democrats after the 2010 election were undersized, relative to the new quota (the 2010 Illinois population divided by 18), by an average of 88,461. By contrast, the 11 Republican-held districts consisted of six that were undersized, by an average of 52,883, and five that were oversized, by an average of 53,413. That contrast suggests that one might have expected the Democratic incumbents to see their constituencies changed more than the Republicans, on average, in a nonpartisan process. After all, simply by trimming, one could have constructed five new districts with 100 percent familiar constituents for the Republican incumbent in the oversized 8th, 11th, 13th, 14th, and 16th districts.

"As important as familiarity is in determining a person's vote for his/her lawmaker, political party matters much more."

What the Democratic mapmakers concocted, by contrast, was a map depriving Republican incumbents of familiar constituents at a much greater rate than Democrats. With Jerry Costello having retired, the eight Democratic U.S. Representatives who sought re-election ended up competing in districts having, on average, 74 percent constituents from their old districts. (They all ended up in districts with the same number as their prior districts as well.) Costello announced his plans to retire after the new map had been signed into law, so one might prefer to include him in the calculation. With 94 percent of the residents in the new 12th having lived in the old 12th, including him increases the Democratic average to 76 percent. The 11 Republican incumbents, meanwhile, found themselves competing in districts that had, on average, only 42 percent familiar constituents. That figure includes Tim Johnson, who won the primary for the new 13th (only 27 percent of which was part of the old 15th, represented by Johnson), but withdrew before the general election. The new 16th district saw a primary face-off between Republican incumbents Don Manzullo and Adam Kinzinger. Forty-five percent of the district consisted of territory from the old 16th (Manzullo) and 32 percent was drawn from the old 11th (Kinzinger). Neither of them could have avoided an intra-party battle without running in a seat having less than 10 percent overlap with his old district. The *highest* continuity value for any Republican was 64 percent, the proportion of the new 18th district that was also part of the old 18th (both won by Aaron Schock). The *lowest* value for any Democrat was also 64 percent, for the 4th district (the majority-Hispanic seat held by Luis Gutierrez that is utterly safe in the general election for whichever Democrat wins the primary election). No one familiar with the large literature on the personal vote would doubt that the strong bias toward maintaining familiar constituencies for Democrats and not Republicans would be advantageous for the former and disadvantageous for the latter, all else equal.

Choosing Normal Votes

As important as familiarity is in determining a person's vote for his/her lawmaker, political party matters much more. Thus, the most important feature of a map of legislative districts is the distribution of partisanship. For each district, one can estimate the expected outcome in a "normal" election, that is, an open-seat race where there is no incumbency advantage at play, in a year without a strong partisan tide favoring either side, when roughly equal candidates compete, spending about equal amounts. With sufficient data, one can use statistical models to decompose election results into components, including an estimate of the normal vote plus estimates of incumbency advantage, high-quality challenger (or open-seat candidate) effects, spending benefits, and inter-election tides. Unfortunately, one cannot produce such estimates with results from only one election, and so we cannot yet use that method to compare the 2002-10 and 2012-20 maps in terms of normal vote.

Instead, we can consider two simpler estimates of each district's normal vote: the average of Barack Obama's 2008 and John Kerry's 2004 vote shares and the Cook Partisan Voting Index, which is based on those same data, but adjusted to the national outcome.[2] The key feature for both measures is that we use the same data to gauge the districts from the old and new maps, and so focus strictly on how the clumps of partisan voters were re-grouped to alter the partisan composition of the districts.

Whichever measure we use, we reach the same basic conclusion. The top panels of Figure 1 (page 75) show that whereas the old map featured eight districts in the partisan-competitive range, where the mean Democratic presidential vote share was between 45 percent and 55 percent, the new map has only four such districts. Over the 2002-10 period, those eight districts were won by Democrats 37 percent of the time (15/41) and by Republicans 63 percent of the time (26/41), about what one would expect from the 5:3 split on either side of the 0.5 line. But note that both parties won races from each bin. The Democratic wins included Debbie Halvorson's 2008 win in the 11th, where the average Democratic presidential vote was 49.5 percent. In 2010, Republican Bobby Schilling won the 17th, where the average of Kerry and Obama's 2008 shares was 54 percent.

Only one race using the new map produced a surprise in terms of this measure of normal vote: Republican Rodney Davis won the new 13th district, where the Kerry-Obama average is 52.5 percent. Eleven of the new districts, however, appear to be out-of-reach for Republican candidates, based on recent precedent for how safe a seat has to be in normal partisan vote before one party has no hope of winning, barring extreme scandal.[3]

The bottom panels, based on the Cook Partisan Voting Index, reveal essentially the same basic shift. By this measure, Illinois had 11 competitive seats between 2002 and 2010, nine of which were slightly friendlier to Republicans, plus seven seats safe for Democrats. Now, with a reduction of one seat, there are 10 potentially competitive seats, seven of which lean to the Democrats, plus another two safe Republican seats and six safe Democratic seats. The new "normal" outcomes thus favor Democratic candidates much more than those under the old lines.

Paint it Blue

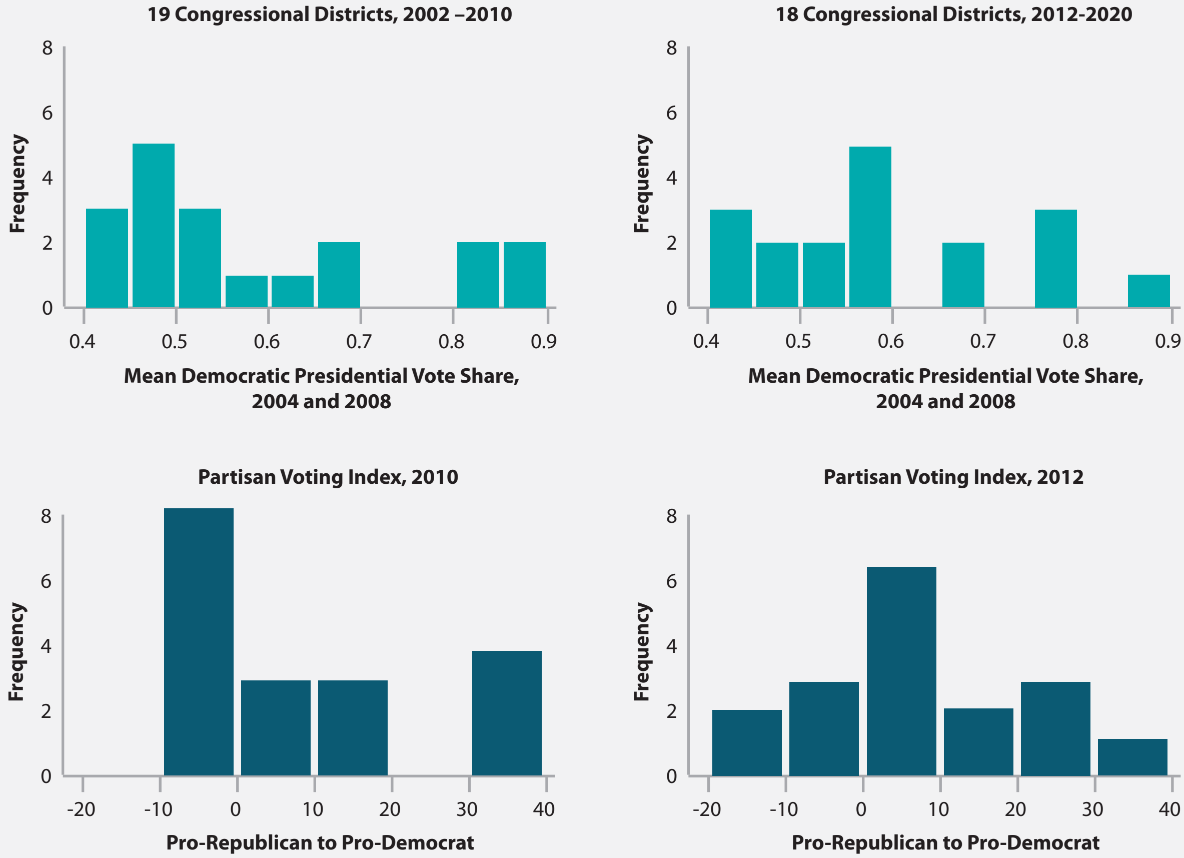
The evidence thus far suggests that the new Illinois U.S. House map was skillfully designed to reduce the number of Republican members in the delegation. The prior map, in place from 2002 to 2010, was a bipartisan, incumbency-protection gerrymander,

[2] Cook's index is computed by the political analyst Charlie Cook. Values for 2010 and the 2004 and 2008 presidential votes shares at the congressional district level for the old maps are reported in *The Almanac of American Politics 2012* (Michael Barone and Chuck McCutcheon). These same data for the new map are reported at ballotpedia.org.

[3] A good example of scandal tipping a district in an otherwise unthinkable direction was the Louisiana 2nd district in 2008. The district was about 60 percent black and gave Barack Obama 75 percent of its vote (matching John Kerry's share). But Republican Joseph Cao, a Vietnamese American, narrowly edged nine-term Democratic incumbent William Jefferson, who had been indicted for accepting bribes in 2007 and would subsequently be convicted and sentenced to 13 years in jail. By contrast, in the 2012 race in the Illinois 2nd, incumbent Jesse Jackson easily won re-election despite having declined to campaign and taken a leave from House duties. His absence was initially unexplained, and then attributed to medical treatment for bipolar disorder. Shortly after the election, however, he resigned his seat, acknowledging that he is under investigation. Rumors of impending federal indictment for campaign-finance violations continue to swirl at time of writing.

Figure 1

Normal Vote Distributions of Illinois US House Districts, Before and After the 2011 Redistricting



Source: Relevant data retrieved from sources identified in note 2.

having been developed by one Republican and one Democratic U.S. Representative, Dennis Hastert and William Lipinski. One prime goal was to avoid depriving Chicago of a seat. Moreover, "Hastert had been generous in using his powers as Speaker to aid (Chicago Mayor Richard M.) Daley, Lipinski and other Chicago Democrats on Chicago issues and projects (so)…(m)aintaining a Republican majority that would keep Hastert in the speakership was in the interest of Chicago Democrats," according to *The Almanac of American Politics 2012*.[4] Democrats in the state legislature deferred to their federal colleagues, evidently placing more priority on the maps for the General Assembly.

[4] Michael Barone and Chuck McCutcheon, 2011, *The Almanac of American Politics 2012*. Chicago, IL: National Journal, p. 512.

So while neither the old nor the new U.S. House maps can be said to have been created blind to political interests, the purposes were distinct. What happens when a bipartisan, pro-incumbent map is replaced by one intended to help Democrats and harm Republicans? If the mapmakers know their business, seats change hands. Illinois Democrats won 12 of 18 seats (67 percent) in 2012, a gain of more than 14 percentage points over their average during the five elections held on the old map (10 of 19, or 53 percent). This calculation can be regarded as only a preliminary estimate of the effect of redistricting, insofar as there are four more election cycles to come before the current map

"What happens when a bipartisan, pro-incumbent map is replaced by one intended to help Democrats and harm Republicans? If the mapmakers know their business, seats change hands."

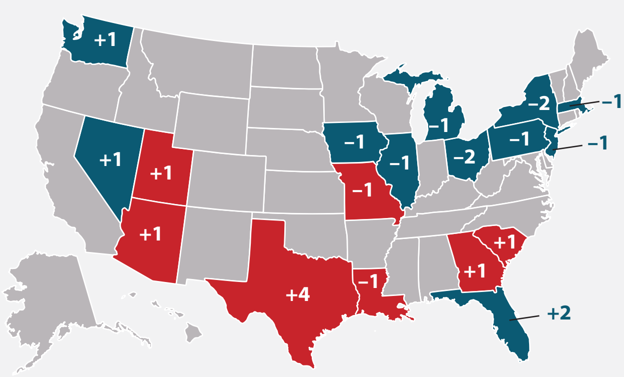
will be replaced. The best result for Democrats in the last decade came in 2008, when they won 12 of 19 seats (63 percent), so if 2012 ultimately turns out to be the Democrats' best year under the new map, later analysts might ultimately conclude that the 2002-10 and 2012-20 district lines were not actually much different in partisan lean. That prospect, however, seems quite unlikely. It also seems improbable that the fairly simple analysis above is mistakenly attributing to the map effects that are actually due to presidential coattails, differentials in retirement, personal scandals, or some other factors. We readily acknowledge that we have not attempted a comprehensive statistical decomposition of all forces involved in the recent U.S. House races in Illinois, but the patterns are so dramatic that we have little doubt that they are genuine.

"How could Democrats win the White House and augment their majority in the U.S. Senate while failing to make larger gains against the Republican majority in the U.S. House?"

Redistricting U.S. House Seats Nationwide

Of course, Illinois is not the only state whose 2012 election results were shaped by new maps. In response to the 2010 census, every state was required to redraw its state legislative maps; the 43 states with more than one congressional district had to redraw them, as well. Adopting a nationwide view offers additional insight into the impact of redistricting on legislative elections because at least two of its dimensions vary among the states: the institution controlling redistricting and, if a partisan process, the party controlling it. In some states, control of the process even differed between U.S. House and state legislative districts. A nationwide view also gives some insight into a puzzle of the 2012 election results. How could Democrats win the White House and augment their majority in the U.S. Senate while failing to make larger gains against the Republican majority in the U.S. House (where they gained only eight seats, falling far short of taking control)? Redistricting is certainly not the only explanation for this divergence, but it is clearly part of the story.

Figure 2
2010 Apportionment and the 2012 Presidential Election



Apportionment

Even before the first legislative districts were drawn in 2011, the 2010 census had helped the Republican cause. The first step in the congressional redistricting process is reapportionment, that is, the reallocation of U.S. House seats among states in response to population shifts. Following a decades-long trend, the 2011 apportionment saw the upper Midwest and Northeast lose congressional representation to the South and Southwest. The two exceptions to this pattern were Louisiana's loss of a seat due to the exodus caused by Hurricanes Katrina and Rita and the state of Washington's gain of a seat as its population continued to boom, swollen in part by an exodus from California, which failed to gain any U.S. House seats for the first time since it joined the union in 1850.

Figure 2 shows the 18 states that gained or lost House seats in 2011, with the change in congressional delegation size indicated for each of them. Most of these states gained or lost a single seat, but Ohio and New York each lost two seats, while Florida gained two seats and the Texas delegation increased by four. This map also denotes which of these states Obama (blue) and Romney (red) won in 2012. Although Obama won more electoral votes than Romney (332 to 206), the 26 states (and the

District of Columbia) that he won had lost six electors to Romney's 24 states after the 2010 census. To forecast House elections, one needs to know what regions of each state were growing comparatively quickly (or slowly), but with red states having outpaced blue states in growth, a good first guess is that Republicans should have been poised to gain.

Who Controlled Redistricting in 2011?

Next, consider redistricting itself. Although Illinoisans understand this process to be highly partisan, with both parties fighting for raw political advantage, it is not done this way in every state. Of course, politicians throughout the country have a great personal and partisan stake in the drawing of legislative maps, but many states have institutions or particular situations that took the partisan edge off the process in 2011. Some states establish nonpartisan or bipartisan commissions to draw their legislative maps, presumably reducing the motivation and opportunity to conduct a partisan gerrymander—although an incumbent protection gerrymander is a strong possibility in such a situation.[5]

19 *States including Illinois gave complete control to one party or the other in 2011 U.S. House redistricting.*

Likewise, when the two parties have split control over the redistricting process, they can be expected to abandon a partisan-motivated gerrymander for an incumbent-protection-motivated gerrymander. In other states, the statutory redistricting process broke down in some way, resulting in no maps that the court system accepted as fair. In those states, the courts themselves drew the maps used in 2012, although in several of these states, the expectation is that the regular process will be tried again before 2014. Each of these—nonpartisan or bipartisan commission, or court-imposed districting, which we classify as "nonpartisan" for simplicity hereafter—provides little opportunity for partisan advantage in the process, although we might expect to find incumbents of both parties to be advantaged by them.

On the other hand, 19 states including Illinois gave complete control to one party or the other in 2011 U.S. House redistricting. As can be seen in Table 1, the partisan advantage was not equally distributed: Republicans controlled redistricting in 14 states having 164 seats, while Democrats did so in only five states having a mere 42 seats. Why this great imbalance?

The 2010 off-year election occurred during a weak economy, so we would expect the party of the president to fare poorly in legislative races that year.[6] And it did.[7] The GOP gained 63 seats in the U.S. House—the biggest single-election seat gain by either party since 1948—winning a substantial 49-seat majority. Such success in congressional elections in 2010 could have bidden ill for the GOP in 2012.

14 VS. 5 *Republicans controlled redistricting in 14 states (164 seats), while Democrats did so in only 5 states (42 seats).*

When parties enjoy large surges, they tend to win many marginal seats, leading them to have vulnerable freshmen in the following presidential election. Furthermore, because these freshmen would have to run in new districts in 2012, before they had a chance to establish themselves with their constituents, they would likely be especially vulnerable. We have already noted that only two of the five GOP freshmen congressmen from Illinois survived the election of 2012, one by knocking off another Republican incumbent in the primary.

Of course, state gubernatorial and legislative elections have an even greater impact on redistricting, since state officials craft all legislative maps in most

5 Michael P. McDonald. 2004. "A Comparative Analysis of Redistricting Institutions in the United States, 2001-02." *State Politics and Policy Quarterly* 4(4):371-95.

6 Gary Jacobson, *The Politics of Congressional Elections*, 8th Edition. Boston, MA: Pearson. Chapter 6.

7 James E. Campbell. 2010. "The Midterm Landslide of 2010: A Triple Wave Election." *The Forum* 8(4):3.

states. And the 2010 elections at the state level were every bit as successful for the GOP as were the congressional elections. Of the 6,125 state legislative seats on the ballot that year, Republicans had a net gain of 680 additional seats, leaving them with more seats nationwide than at any time since the 1920s.[8] Even more significantly, 20 state legislative chambers flipped from a Democrat to a Republican majority in 2010. Republicans did equally well in the 37 gubernatorial races in 2010, with a net gain of six for a total of 29 governorships. The 2010 GOP sweep thus helps explain the imbalance in party control over redistricting the following year. Thus, in addition to the leg up they got through reapportionment, the Republicans had this clear advantage going into the map-drawing process.

The Impact of Redistricting on the 2012 Legislative Elections

Table 1 shows who drew the new maps in place in 2012 and also who drew the maps in effect for the prior decade (see table notes for details on the anomalous cases of states that had multiple U.S. House maps in use over the 2002-10 period). Even though Republicans had to protect more incumbents in marginal districts as a result of the 2010 elections, their control of the redistricting process seems to have shielded them from normal surge-and-decline losses. In particular, the bottom rows of the table show the average proportions of U.S. House seats held by Democrats in the states according to who drew the 2012 maps.

Starting on the left of the table, Republican-controlled states saw almost three-fourths of their U.S. House seats won by Republicans, whereas Democratic-controlled states saw about 60 percent of their seats won by the Democratic candidates. Those numbers alone are suggestive, but somewhat difficult to interpret, given that control of state government is never randomly assigned by a political scientist undertaking an experiment. Naturally, states in which one party is strong in state legislative races will often exhibit the same partisan lean in subsequent U.S. House races. To try to adjust for state-to-state variation in partisan lean, we divided the proportion of 2012 U.S. House races won by the Democrats by 2012 Obama vote share. These values are shown in the bottom row, and a score near 1 indicates that the U.S. House shares were about on par with the presidential vote performance. The states with Republican-drawn maps saw a large discrepancy—the Democratic House candidates badly under-performed compared to their presidential candidate. In the five states with Democratic maps, by contrast, the Democratic presidential-vote and House-seat shares are about the same.

The remaining columns, however, complicate that simple contrast. Maps drawn by Republicans and Democrats together were markedly better for Democratic House candidates than those created by ostensibly nonpartisan actors. However, both sets of states produced scores fairly close to 1 in their average ratio of Democratic success in House races to Obama share, so this gap could be a fluke of which states fell into each category rather than an indication of systematically more pro-Democratic maps resulting from bipartisan rather than nonpartisan process. However, the seven states that did not feature any redistricting, because they have only one seat, resemble the states controlled by Republicans in terms of both of the measures we computed, casting some doubt on the straight-forward interpretation that the latter demonstrate partisan gerrymandering.

In short, while there is some sign that the large GOP edge in mapmaking power translated into a seat advantage, simple across-state averages are very crude measures. It is difficult to adjust for a state's partisan lean when ceiling effects apply (e.g. Massachusetts elected 10 Democrats and no Republicans in 2010 and nine Democrats and no Republicans in 2012). Moreover, the effect of map-drawing power is likely to be smaller in states with relatively few seats (say, two to five).

To complement the examination of Illinois above, therefore, we selected a few cases of fairly large states where Republicans drew the 2012 map, not

8 Jeremy P. Jacobs, "Devastation: GOP Picks up 680 State Legislative Seats," *The National Journal*, 8 November 2010.

Table 1

Who Drew the Maps? Redistricting Control, 2001 and 2011, and 2012 Outcomes

		2012-2020 United States House Map					
		Republicans	**Democrats**	**Bipartisan**	**Nonpartisan**	**AL (n/a)**	**Total**
2002 – 2010 United States House Map	**Republicans**	5 FL, GA*, MI, PA, VA	-	-	3 KS, TX*, UT	-	8
	Democrats	4 AL, IN, NC, TN	3 AR, MD, MA	-	2 CA, UT	-	9
	Bipartisan	5 LA, OH, OK, SC, WI	2 IL, WV	10 CT, KY, ME, MO, NH, NJ, NV, OR, RI, WA	3 CO, ID, NY	-	20
	Nonpartisan	-	-	1 MS	5 AZ, IA, MN NE, NM	-	6
	At Large (n/a)	-	-	-	-	7 AK, DE, MT, ND, SD, VT, WY	7
	Total	14	5	11	13	7	50
Average % U.S. House Seats to Democrats, 2012		26.5 % (164)	57.5 % (42)	64.2 % (60)	48.8 % (162)	28.6 % (7)	
Average % U.S. House Seats to Democrats/Obama %, 2012		0.56	1.01	1.15	0.94	0.45	

Source: Classifications based on Justin Levitt, "All about Redistricting," Loyola University (Los Angeles) Law School (http://redistricting.lls.edu/), accessed November 15, 2012, and *Almanac of American Politics 2012*.

Note: The category "Bipartisan" includes cases of divided government as well as commissions or other bodies that included equal numbers of partisan officials. The "non-partisan" category includes all cases of maps drawn by courts, regardless of whether the judges were associated with parties.

* In Texas, the 2002 map was drawn by 2 Democratic judges and 1 Republican judge, but the 2004-2010 map was drawn by Republicans only. In Georgia, the 2002 map was drawn by Democrats, the 2004 map was drawn by a court, and the 2006-10 map was drawn by Republicans.

having had control of the lines for the prior decade. Do we find evidence of the new maps having assisted the GOP, mirroring the case of Illinois described earlier? First, consider North Carolina. The 2002-10 elections, fought on a map designed by Democrats, produced six Democrats and seven Republicans three times (in 2002, 2004, and 2006), eight Democrats and five Republicans once (in 2008), and seven Democrats and six Republicans once (in 2010). On average, the map produced a 51 percent Democratic seat share. In 2012, the new Republican-drawn map resulted in nine Republicans and four Democrats. That 31 percent Democratic share represents a 20 percentage point decline.

Ohio went from a bipartisan map in the 2002-10 period to a Republican gerrymander in 2012. Although the state tends to be exceptionally closely fought in presidential races, it has fairly consistently leaned toward the Republicans in U.S. House races. Even so, Republicans were able to squeeze more advantage out of the state with their new lines. The 2002-10 races produced six Democrats and 12 Republicans in 2002 and 2004, seven Democrats and 11 Republicans in 2006, 10 Democrats and eight Republicans in 2008, and five Democrats and 13 Republicans in 2010. In 2012, the new map elected four Democrats and 12 Republicans, so the Democratic seat share dropped 13 percentage points, from 38 percent to 25 percent.

Conclusion

Precise estimates of the impact of particular gerrymanders are beyond the scope of this chapter. We purposely ignored state legislative maps here only to keep our task simple. Careful analysis of those maps should be informative. We have refrained from estimating complicated vote-seat functions mainly because even simple comparisons can suffice to establish the basic point that electoral maps matter. Where one party drew the new U.S. House map following the 2010 census, that party did comparatively well in 2012. Parties that *gained* control of redistricting in 2011, not having had it in 2001, seem to have engineered large swings in their own favor, as Illinois, North Carolina, and Ohio demonstrate. Control over redistricting is not always a guarantee of electoral success. Sometimes parties forgo the opportunity to try to maximize seat totals. Moreover, finely drawn partisan gerrymanders can backfire when there is a large swing against the mapmaking party, because such a map features fairly small advantages for the favored party, by definition. It is certainly possible to target only select incumbents when altering lines to break up personal votes.

"Smart politicians armed with the power to fix election results will find the temptation very hard to resist."

Despite all of these potential complications, the analysis above sheds some light on how the GOP could lose the presidency and suffer losses in almost all of the "toss-up" Senate races in 2012 while simultaneously limiting U.S. House losses, and thus retaining control of the House. Leaders of both parties fully understood the importance of the 2010 state legislative and gubernatorial races for redistricting. Republicans made an extraordinary national effort to win as many of these races as possible, and probably profited from the "good fortune" of having lost the 2008 presidential race.[9] Having now withstood a fairly poor year in 2012, the party could be poised for more gains in 2014, when Democrats can expect the usual "midterm loss." Long-term forecasts are always risky, but current members will now have two years to settle into their new districts to improve their popularity and boost name recognition, so barring major national trends, the GOP majority control of the U.S. House could be safe at least until the next redistricting election in 2022.

One could argue that the 2012 election results illustrate the upside of partisan control of redistricting. The Founders created a separation-of-powers system in part to prevent large waves of enthusiasm from being too quickly translated into policy. They feared excessive volatility and valued deliberation. The House Republican majority in Congress will presumably require a Democratic president and a Democratic Senate to negotiate and compromise on policy. We take this argument seriously, and our purpose in this chapter is not to denounce Democratic control of the Illinois U.S. House delegation or Republican control of the U.S. House. But as we emphasized at the outset, it is, in the end, difficult to defend electoral maps that are expressly designed to exaggerate partisan advantages and insulate elected officials from public sentiment. Any electoral system involving single-member districts will have some redistricting effects. But these can be small when the lines are not driven almost exclusively by partisan considerations. In turn, partisan control of the process of drawing districts should be regarded with suspicion by anyone who is genuinely disinterested in regard to the fates of the parties, but keen on competitive races and responsive elections. Smart politicians armed with the power to fix election results will find the temptation very hard to resist.

The survey results with which we began this chapter show that ordinary citizens, while not particularly informed about the redistricting process, nevertheless believe that redistricting matters and should be done in a nonpartisan manner, with compactness and competitiveness as prevailing criteria. By the standards of the general public, partisan gerrymandering is undesirable and unfair. The current Illinois map is shrewd, and it demonstrates the skill of its Democratic designers, but that is not what the people of the state deserve. The process for redrawing electoral boundaries in Illinois should be revised. ■

9 Republican State Leadership Committee, "About the Republican Legislative Campaign Committee" (http://rslc.com/about-the-rlcc). Accessed November 16, 2012.

ABOUT IGPA

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Institute of Government & Public Affairs

Chicago
815 W. Van Buren, Suite 525
Chicago, IL 60607 MC-191
Phone: (312) 996-6188
Fax: (312) 996-1404

Springfield
520 S. 2nd Street, Suite 2-300
Springfield, IL 62701
Phone: (217) 206-7080
Fax: (217) 206-7093

Urbana-Champaign
1007 W. Nevada Street, MC-037
Urbana, IL 61801
Phone: (217) 333-3340
Fax: (217) 244-4817

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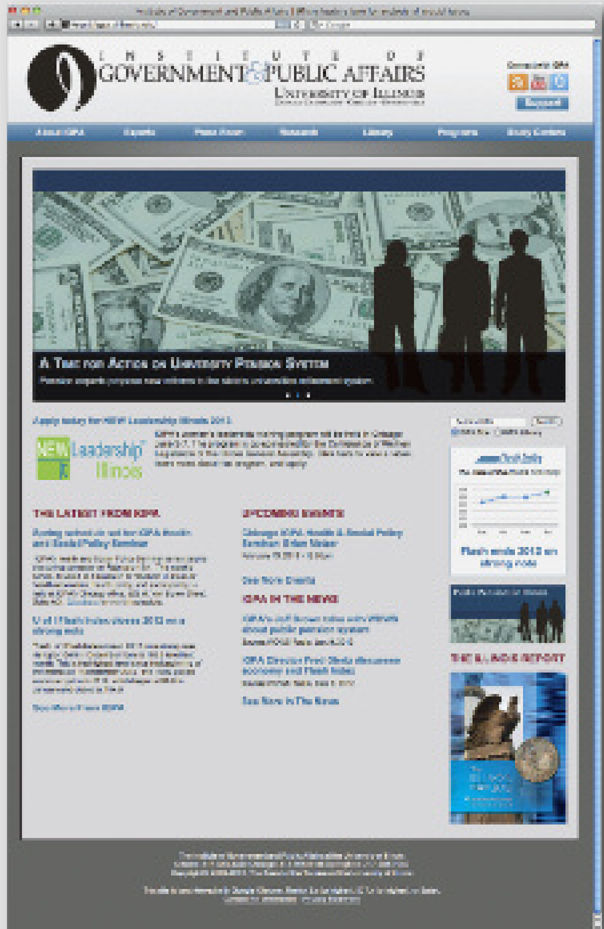

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