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ANDERSON ECONOMIC GROUP

Illinois Budget Proposals

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EXECUTIVE SUMMARY

Once again, Illinois faces a budget crisis characterized by a large looming deficit and a stalled decision-making process. Budget negotiations began in March when Governor Rod Blagojevich presented his original budget for fiscal year 2008 to the Illinois General Assembly. Governor Blagojevich proposed $49 billion in state operational expenditures, representing a $3 billion increase over the past fiscal year.

Government revenue in the upcoming fiscal year, however, is expected to fall short of the amount necessary to cover the governor's proposed expenditures. Since Illinois' constitution requires a balanced budget, state legislators have introduced an alternate proposal and several revenue-generating proposals in order to comply with constitutional constraints. These proposals are presented in Table 1 and Table 2.

Illinois House Speaker Michael Madigan, Senate President Emil Jones and Governor Blagojevich failed to meet the original May 31 deadline for adopting a new budget. Therefore, a three-fifths majority in both the House and the Senate is needed to pass a budget by the start of the new fiscal year, or Illinois may face a government shutdown.

TABLE 1. Summary of Budget Proposals

Proposal	Brief Description
Governor's Proposal (SB1086)	A gross receipts tax, the lease of the Illinois Lottery, universal health care, and a billion dollar Capital Budget
Limited Growth Budget (SB1132 and SB1544)	A $800 million spending increase: $500 million in natural growth of state revenue and $300 million in revenue from ending business tax breaks

Source: Anderson Economic Group, LLC

TABLE 2. Summary of Revenue Proposals

Proposals	Brief Description
An Increase in Income Tax/Decrease in Property Tax (House Bill 750)	Increase the income tax from 3% to 5% for individuals and 4% to 8% for corporations and decreases property taxes by the amount granted from the School District Property Tax Relief Fund
Lease of the Illinois Lottery (No Bill)	Cedes operation of the lottery to a private party
Gambling Expansion (HB480)	Allows gambling at race tracks and creates 4 additional riverboat casino licenses

Source: Anderson Economic Group, LLC

BACKGROUND

Illinois' state government uses tax revenue to fund various projects, initiatives, and services. According to both Article VIII Section 2(b) of the Constitution of the State of Illinois and Illinois statute, the Illinois state government cannot appropriate more money than it generates.[1]

In compliance with Article VIII, Section 2 of the Illinois state constitution, Governor Blagojevich prepared and submitted a state budget for the upcoming fiscal year to the General Assembly on March 7, 2007. Then, according to Illinois statutes, the state government had to approve a new budget through majority vote by May 31, 2007 in order for it to be enacted before the start of the new fiscal year (July 1).[2] However, because House Speaker Michael Madigan, Senate President Emil Jones and Governor Blagojevich were not able to reach an agreement, they missed the deadline.

Currently, the Governor and the Illinois General Assembly face a new challenge. According to Illinois statute, a bill passed after May 31st needs the affirmative vote of three-fifths of the House and the Senate in order for the bill to be effective before the start of the new fiscal year.[3] The Democratic party holds a super-majority in the Senate (37). However, the budget needs to earn the vote of 71 representatives in the House and there are only 66 House Democrats.

BUDGET PROPOSALS

State legislators have two proposals with which to begin the negotiating process: Governor Blagojevich's original budget to the General Assembly (SB1086) and a 'limited growth' budget that has been passed by the House and moved to the Senate (SB1132 and SB1544).

1. Chapter 15, Article 20, Section 50-5 of the Illinois Complied Statutes
2. Chapter 5, Article 75, Section 1 of the Illinois Compiled Statutes
3. Chapter 15 of the Illinois Complied Statutes.

The Governor's Original Proposal (Senate Bill 1086)

The state budget is comprised of two components: the operating budget and the capital budget. The operating budget details the operating revenues and appropriations for the fiscal year and the capital budget details funding sources and appropriations that will be received and spent over a longer time period.[4] The Governor's operating budget proposes to appropriate $49 billion, representing a $3 billion increase over fiscal year 2007. His capital budget proposes to appropriate $11 billion in new and re-appropriations.[5] Description of the capital budget is beyond the scope of this paper, however most of the contention surrounding the budget negotiations refers to the operating budget, not the capital budget.

The operating budget has 3 new expenditures: $3.2 billion in additional funding to the P-12 education system over 3 years, a series of programs designed to provide universal health care called "Illinois Covered," and an increase in the funded ratio of state retirement from 60.5% to 83%. The governor plans to fund these expenditures through 3 revenue sources: a gross receipts tax known as the "Tax Fairness Plan," the lease of the lottery (discussed on page 5), and the issue of additional pension obligation bonds.[6]

"Illinois Covered" refers to a series of programs designed to provide universal health care to the state of Illinois. It provides health insurance to families of eligible children at up to 400 percent of the federal poverty level and to those living in poverty but who are ineligible for Medicaid. It also provides rebates for adults with incomes between 100 percent and 400 percent of the federal poverty level. The governor also wants to enter into a public-private partnership with insurance carriers to provide a lower cost, guaranteed issue insurance policy to unemployed residents. The governor estimates that the total cost of all these programs will be approximately $3 billion.[7]

The Tax Fairness Plan consists of a gross receipts tax on Illinois businesses that earn more than $1 million in Illinois receipts. A gross receipts tax is levied on a firm's revenue rather than on a firm's profits, and is often a more stable source of revenue for states. If the governor's plan is enacted, the tax would begin in January 2008 (the second half of fiscal year 2008). According to the Governor, the tax would generate $2.6 billion in revenue for Illinois in FY2008 and $6 billion every subsequent year.[8] However, the Tax Fairness plan was effectively declared dead on May 10, 2007, when the House voted 107-0 to block the gross receipts tax.

4. The FY 2008 Capital Budget, page 1, obtained at www.state.il.us/budget
5. Ibid, 11
6. *Illinois State Budget Book Fiscal Year 2008*, 2-6 obtained at www.state.il.us/budget/
7. Ibid, 2-3, 2-4
8. Ibid, 2-9

Limited Growth Budget (Senate Bill 1132 and Senate Bill1544)

A “limited growth budget” would increase spending by $800 million over the previous year’s budget. The funds to support the increase could come from roughly $500 million from growth in state revenues (caused by population growth, more efficient compliance, etc.) and $300 million from ending a variety of tax breaks for businesses.[9] Senate Bill 1132 addresses the appropriations and Senate Bill 1544 addresses the revenue sources.

Of the $800 million in increased spending proposed by the limited budget, $710 million would be spent on K-12 state education.[10] The plan would raise $300 million in new revenue by closing corporate tax loopholes and streamlining the state’s sales tax collection process. One part of the budget would require rental car companies to pay sales tax on vehicles purchased for their fleets. The House estimates that a change in deductions on federal bonds would generate $19 million.[11]

House Republicans oppose this budget because they believe that the tax increase on businesses would be too high. The Senate President and the Governor oppose this plan because the spending plan is not large enough.[12] However, if the General Assembly cannot come to a new budget agreement by the beginning of the new fiscal year (July 1), the limited growth budget may prove to be the easiest way to keep the government running. The bill has passed the House, and the Senate has enough votes to pass the measure, which would leave the final decision to the Governor. If passed, the General Assembly could operate under that budget until January, when the legislative rules change again.[13]

REVENUE PROPOSALS

There are three major options currently being discussed by budget negotiators in Illinois: an increase in income taxes and a decrease in property taxes (HB750), the lease of the lottery (no bill), and gambling expansion (HB480).

An Increase in Income Tax/Decrease in Property Tax (House Bill 750)

HB750 proposes to simultaneously increase the income tax and lower local property taxes. The plan, if approved, would increase the income tax rate for individuals,

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9. Christopher Wills, “Illinois House Democrats approve limited-growth budget” 31 May 2007. <http://www.thetimesonline.com/articles/2007/05/31/updates/breaking_news/doc465ef028dfa7a238462652.txt> 15 June 2007.
10. Open letter to Senate President Emil Jones from House Speaker Michael Madigan, obtained at http://<www.chicagotribune.com/media/acrobat/2007-06/30516627.pdf>
11. Christopher Wills, “House Dems approve budget” *The Register-Mail Online.* 31 May 2007. <http://www.register-mail.com/stories/053107/MAI_BDCDUSJ7.GID.shtml> 15 June 2007.
12. Christopher Wills, “Illinois House Democrats approve limited-growth budget”.
13. Andy Shaw, “Budget disputes send Illinois legislative session into OT,” obtained at www.abc7chicago.com.

trusts, and estates from 3% to 5% and nearly doubles the income tax rate for corporations (increasing from 4.8% to 8%). It also creates the School District Property Tax Relief Fund and requires that the General Assembly appropriate funds to the Fund. It then decreases property taxes by the amount of the grants made from the newly created Fund to school districts.

HB750 would also create additional funds to help supplement education and create the Family Tax Credit, which is a refundable income tax credit available to taxpayers who report total annual income of $26,847 or less (if filing alone) or who report total annual income of $53,694 or less (if filing as a couple or as head of the household). HB750 also requires that the state set a minimum amount to spend on education, and allows the state to give supplemental aid to rapidly expanding school districts.[14]

Revenue from the individual and corporate income tax go primarily into the General Revenue Fund and into the Education Assistance Fund, which funds Elementary, Secondary, and Higher Education. In FY 2006, 82.2% of the revenue from the individual income tax and 75.1% of the corporate income tax went to the General Revenue Fund, while only 6.6% of the individual income tax and 5.9% of the corporate income tax went to the Education Assistance Fund, suggesting that if these taxes were to be increased, their funds would go mainly to the overall operations of the government and its services and programs. [15] However, with a required minimum expenditure on education, the new tax program could provide the state with the funds for its expanding school system.

Governor Blagojevich has maintained that he would veto any proposal that contains a hike of income or sales taxes.[16] The Illinois House Democrats have also spoken out against the bill, instead favoring gambling expansion.[17]

Lease of the Lottery (No Bill)

Governor Blagojevich first proposed the idea of leasing the lottery as part of his presentation of the state budget to the General Assembly on March 7, 2007. Then,

14. Illinois General Assembly, "Bill Status of HB0750" n.d. <http://www.ilga.gov/legislation/BillStatus.asp?DocNum=750&GAID=9&DocTypeID=HB&LegId=28049&SessionID=51&GA=95> (23 May 2007)
15. Illinois State Comptroller's Office, "In-Depth Analysis of Revenues," obtained at http://www.wh1.ioc.state.il.us/Expert/Rev/ERSummary.cfm
16. Adam Jadhav, "Woes of governor's tax plan in Illinois could doom universal health-care plan". *St. Louis Post-Dispatch Missouri.* 16 May 2007. <http://www.stltoday.com/stltoday/news/stories.nsf/illinoisnews/story/D140382B49BAD747862572DD000DB9FC?OpenDocument> (23 May 2007)
17. For more information, see Dave McKinney's article "Madigan's Dems oppose tax hike" in the Chicago Sun-Times, available at www.suntimes.com/news/politics.

when budget negotiations went into overtime, the Governor proposed the idea again on June 6, 2007 in the second day of budget negotiations.

The administration estimates that it would raise $10 billion through a long-term concession lease.[18] A typical long-term concession lease would require the concessionaire (the private company leasing the lottery from the state) to pay an up front fee for the right to operate the lottery and retain its subsequent proceeds for an amount of time to be determined between the private party and the state. [19]The Governor's Office of Management and Budget has suggested that the lease should last up to 75 years.[20]

If the administration has correctly estimated the amount of revenue the lease would generate for the state and the state spends $642 million a year on education as it did last year, then it would take a little under 15 years for the money from the lease of the lottery to run out. This figure assumes that the money from the sale is used solely for education and that the amount from the lottery fund spent on education is consistent every year. Even if these assumptions are true, eventually the state will have to find a new source of revenue to replace the lottery.

Gambling Expansion (House Bill 480)

Lawmakers have also considered House Bill 480, which 1) amends the Illinois Racing Act of 1975 to allow slot machine gambling at race tracks and 2) amends the Riverboat Gambling Act to create four additional licenses, one of which authorizes gambling in Chicago.[21] The bill originated in the Senate, where it passed and was moved to the House. On June 13, 2007, the House Gaming Committee voted 20-2 to reject the bill. However, some form of a gambling expansion may still be part of a final budget agreement.[22]

The idea to sponsor government-owned casinos and to promote gambling has been a popular one across the country as revenue-strapped states hope to make quick cash. Illinois became the second state in the nation to legalize riverboat gambling in 1990 when it enacted the Riverboat Gambling Act. According to the American Gaming Association, 12 states now have operating commercial casinos, up from

18. *Illinois State Budget Book Fiscal Year 2008*, 4-3
19. Geoffrey Segal, "Several States Consider Privatizing their Lotteries," obtained at www.reason.org.
20. Governor's Office of Management and Budget, State of Illinois. "Request for Concessionaire Qualifications" obtained at: www.state.il.us/budget/
21. Illinois General Assembly, "Bill Status of HB0480" n.d. <http://www.ilga.gov/legislation/BillStatus.asp?DocNum=480&GAID=9&DocTypeID=HB&LegId=27472&SessionID=51&GA=95> (23 May 2007)
22. Doug Finke, "Gambling expansion bill craps out". *The State Journal Register.* 14 June 2007. <http://www.sj-r.com/Sections/News/Stories/116709.asp> 14 June 2007.

only two in 1987 (that doesn't include racetrack casinos and casinos run by Indian tribes). [23]

However, legalizing gambling comes at a cost. Casinos often take business from other entertainment venues, such as theaters or sports bars. As a result, some economists contend that, on average, casinos actually make no net tax contribution. Furthermore, the effect on jobs could actually be negative, because many modern casinos need fewer employees per customer than the businesses they tend to replace.[24]

Some suggest that the presence of a casino increases the rate of crime in the area. For example, Prof. Earl Grinols, a former senior economist on the president's Council of Economic Advisors and economist David Mustard at the University of Georgia estimate that, on average, about 8% of crime in casino counties is attributable to the casinos. Taking all the costs and benefits of casinos into account, they estimate that the introduction of a casino ultimately incurs an average net cost of at least $97 per resident per year. However, other studies have found that the effect of casinos on the rate of crime in an area is minimal at best.[25]

Effects aside, gambling in Illinois no longer seems to be the growth industry the state had hoped it would be: in 2006, state riverboat revenue decreased by $10 million and horse racing revenues decreased by $1 million.[26]

ISSUES AFFECTING BUDGET NEGOTIATIONS

Electric Rate Relief

A last-minute complication in the budget negotiations involves electric rates. Members of both the House and Senate have said that they would not vote for any budget deal until customers of Commonwealth Edison and Ameren are given relief from a 25% rate increase after nine years of no rate increases. Rep. Tom Holbrook took the fight to a new level by using a parliamentary move to block the Senate from considering the limited-growth budget (discussed on page 4) until rate relief is provided. To avoid regulations, Commonwealth Edison and Ameren have offered to provide about $500 million worth of relief over three years. However, the offer was not

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23. Mark Whitehouse, "Bad Odds" *The Wall Street Journal.* 11 June 2007. <http://online.wsj.com/article/SB118114530050026499.html?mod=todays_us_the_journal_report> 14 June 2007.
24. Ibid

    For more information on the effects of gambling expansion on local communities, see "The Economic Impacts of a Proposed Casino Development: Allegan County, Michigan", prepared by Anderson Economic Group, which can be obtained at www.andersoneconomicgroup.com.
25. Ibid

    An executive summary of a study that analyzes the effects of casino gambling on area crime rates can be found at www.unr.edu/gaming/papers/effect.asp
26. Commission on Government Forecasting and Accountability, "Wagering in Illinois: 2006 Update"obtained at www.ilga.gov/commission/cgfa2006/

enough for the legislature. Now, senators are threatening to pass a bill that rolls back electric rates to 2006 levels and freezes them for an additional three years if the utilities don't agree to bolster their offer. The bill has already passed the House and may pass the Senate as well if negotiations fail.[27]

Universal Health care

The governor has insisted that his number one priority for this year's state spending plan is a universal health care package. His plan, which amounts to $2.1 billion in new spending, fell one vote shy in a test vote taken the night of May 31, 2007. The next day, Gov. Blagojevich almost came to blows with Sen. Mike Jacobs after the senator refused to back the plan, threatening to withdraw millions of dollars in funding for a university in Jacobs' district.[28]

27. Ryan Keith, "Lawmakers head into overtime with no electric rate agreement" *Chicago Tribune.*1 June 2007. <http://www.chicagotribune.com/news/local/illinois/chi-ap-il-xgr-electric-rates,0,2236775.story> 14 June 2007.
28. Dave McKinney and Whitney Woodward, "Statehouse eruption" *Chicago Sun-Times*. 2 June 2007. <http://www.suntimes.com/news/politics/411474,cst-nws-leg02.article> 11 June 2007.

ABOUT ANDERSON ECONOMIC GROUP

Anderson Economic Group, LLC (AEG) was started in 1996 and today has offices in Chicago, Dallas, Oklahoma City and East Lansing. AEG is a consulting firm that specializes in economics, public policy, financial valuation, market research, and land use economics. AEG's past clients include:

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