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MEMORANDUM

To: Brian Lawlor
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From: Terry Steczo
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Re: Legislative Report

Date: July 13, 2017

With all of the activity that occurred in Springfield over the previous two weeks we thought it important to provide this information more immediately than our normally scheduled end of month report. Our next regular report will be provided at the end of August.

The Perfect Storm

The nightmare is over, at least for now and it took a "perfect storm" of issues to provide the spark and sense of urgency that resulted in a bipartisan effort to finally enact a budget for the state of Illinois after two years plus. It was a combination of Comptroller Mendoza's dire warning that the state would run out of enough cash to pay "core" expenses in August, bond houses signaling that "junk bond" status for state debentures was an eye blink away, and then federal Judge Joan Lefkow's decision in late June to require the state to start paying overdue Medicaid bills immediately to the tune of \$300 million per month that caused enough concern that legislative members actually moved the process rather than the leaders. It wasn't quite a revolt, but it was a successful enough of a scuffle to change the dynamic of the whole budget conversation and caused a genuine dose of bipartisanship to come to the fore. The fifteen Republican House members who voted for the initial revenue bill (Senate Bill 9) and the ten who voted to override the Governor's veto exhibited great political courage knowing that their votes could spell the possible end of their careers as elected officials. The Governor and his minions showed great displeasure during the last election cycle when one senator, Sen. Sam McCann, voted in opposition once and found himself with an election opponent, public opposition from the Governor, and millions of dollars spent to defeat him. McCann won his primary election race but there was a very strong message sent from the Governor to cross him at your own peril. This veto override vote made McCann's "indiscretion" look like child's play. The Governor staked his whole tenure on getting to opposition to cave before he would consider any tax increases or expansions. Now that issue has been snatched away and the Governor's negotiating posture, or

whatever there was, has been marginalized or neutralized. He can't be happy and he can be vindictive.

Before the enactment of the budget and revenue the state had at least \$18 billion in unpaid bills and was spending at a rate of \$39 billion per year based on court rulings, continuing appropriations, and the executive decision by the Governor to pay state employees with no actual budget authorization. The newly enacted budget limits spending to \$36.05 billion. Ironically, the Governor's initial budget proposal in February called for \$37.3 billion in spending as did the Senate version of the budget that was approved at the end of May, as well as the GOP "Capital Compromise" plan that was announced in mid-June. In doing so the final budget document created by House Democrats followed the recommendations and suggestions offered by Republicans to cut agencies and programs 5% with a 10% cut for universities, as well as certain pension savings derived from allowing a small portion of Tier 3 state employee pension qualifiers to opt for a 401(k) type of retirement plan.

The final version of Senate Bill 9 does the following:

- Increases the individual income tax to 4.95% and the corporate income tax to 7% and will raise almost \$5 billion for the full fiscal year. The effective date of the tax is July 1. Fiscal impact: \$4.967 billion;
- Closes corporate loopholes by ending the Qualified Production Activities Income Tax Deduction (QPAI), Combines Reporting, and Outer Continental Shelf tax benefits. Fiscal Impact: \$125 million;
- Accelerates the sunset of the sales tax discount on gasohol and biodiesel fuels. Fiscal Impact: \$100 million;
- The Education Expense Credit, Property Tax Credit, and Standard Exemption would no longer be available to high-income earners (individuals earning more than \$250,000 per year, or joint filers earning more than \$500,000 per year). Fiscal Impact: \$96 million;

Senate Bill 9 also includes an increase in the Earned Income Tax Credit as well as a few other deductions and credits. The grand total of anticipated new revenues is \$5.079 billion per year.

Sales taxes on services, satellite and streaming services (direct television, Netflix, etc.) and cable television were not concluded in the final package.

In addition, the budget package allows borrowing of up to \$6 billion to pay backlogged bill that could add up to an additional \$2 billion by paying federal match related billings first. Fund sweeps, inter-fund borrowing and an \$800 million transfer from the state Human Services Fund will help pay arrearages for human service providers.

As July 1 neared it appeared that negotiators and working groups were getting closer on agreements on some of the peripheral, non-budget issues that were the focal point of the Governor but nobody really knows how close they actually were, or are in case the discussions are continuing. One extremely tactical misplay in that regard occurred on Saturday, July 1 when an era of good feeling prevailed in the House floor after an extremely bipartisan effort the day before to adopt an amendment that embodied the new budget. In what was assumed to be the spirit of continuing the negotiations the Speaker attempted to adjourn the House early so that

discussions could continue. House Republican Leader Jim Durkin objected and demanded that agreements be made and votes be taken, on the plethora of issues, that day. Shortly thereafter the Speaker announced that a vote solely on the revenue and budget packages would take place the following day. That certainly was not what Durkin was expecting, and in making the demand he changed the dynamic of the conversation and put the pressure on his members rather than on the Speaker. With continued negotiations and "junk status" pending the pressure would have been on Democrats to give more than they might have wanted to get budget resolved before Moody's made a bond status decision. Instead, by trying to prematurely force Madigan's hand the result was a decision by House Democrats to gauge the support for revenue after the bipartisan support for a budget amendment the day before. The pressure at that point shifted to House Republicans to put votes on the board. The end result was fifteen Republicans voting for increased taxes and no compromises reached on the ancillary issues. Sometimes you have to be careful what you ask for.

Perspectives

For the fifteen Republican legislators who made the decision to disregard their leadership and vote for the passage of Senate Bill 9, the income tax increase, and for the ten Republican legislators who voted to override the Governor's veto, the decision was not an easy one. Some may face election challenges while others may be penalized in other ways. State Rep. Stave Andersson (R-Geneva), for instance, the House GOP floor leader who supported Senate Bill 9 both on final passage and the veto override was removed from his position this week.

Obviously, those who did decide to make the big decision had thought hard and had concluded that the economic harm to the state, their districts, state universities or other institutions warranted their support of the proposed budget and additional revenues to go along with it. Some changed their minds after an onslaught of opposition from their constituents. Others remained steadfast, believing that there was no other path that was acceptable and responsible. Rep. Michael Unes (R-East Peoria) said in debate, "right here, right now, this is the sword I'm willing to die on. And if it costs me my seat, so be it." Other Republican House members as well as Senator Dale Righter (R-Mattoon), the lone Senate Republican to support the override, were very emotional and genuine expressing and explaining their decisions.

State Rep. David Harris (R-Arlington Heights) is a legislative veteran who explained his initial vote for the revenue package by stating that we "wasn't elected as a state legislator to preside over the financial destruction of this great state". However, it was Harris' comments in debate during the override vote that provided an interesting perspective. During his remarks he alluded to the "Capitol Compromise" that was put forth in mid-June by the Governor and the GOP legislative caucuses. In addition to publically providing their "compromise" positions on the non-budgetary issues that were being discussed at the time, they released their own budget document as well as announcing their support for the Senate version of Senate Bill 9 provided it was coupled with a four year sunset and a four year property tax freeze. That specific version of Senate Bill 9 not only contained the same income tax increase as the bill that eventually became law, but also included expanded sales taxes and the institution of various other taxes. In his remarks during the House override vote Harris explained that he had a choice to make, to support the amended version of Senate Bill 9 that was basically an increase in the income tax or to support the GOP's "Capitol Compromise" that included not only the income tax but the plethora of others. It was an easy choice, he said.

Certainly the debate on the issue of raising taxes is never unemotional, especially when there were so many tangentially connected issues under discussion at the time and such a lengthy impasse. One part of any legislative debate, but this one in particular, is to hear the rationale of opponents as they offered their reasons for opposing new revenues. For the most part those arguments were fueled by the fact that most of the other "grand bargain" issues like workers compensation reform and others were lost in the weeds. Those issues weren't resolved so the had decision was to oppose the tax bill. The ironic part of the story is that even if every single ancillary issue was resolved to their complete satisfaction, most who spoke in opposition to the tax bill would still have voted no. That's the nature of the legislative beast. In some cases words are spoken from the heart and in others for the means to justify the end.

Perplexing

One of the most bewildering observations during the waning days of the budget impasse was the unwillingness of the Governor to see the impending fiscal morass as the impetus to find a way to get some satisfactory closure on his non-budgetary issues, declare at least a partial victory, and start on the road to making Illinois fiscally and economically healthy.

What has occurred over the past two plus years in Illinois can best be described as a cage fight to the death, and one that will have serious implications for years to come. It may be that the strategy that the Governor employed from the beginning was flawed because what works in the private sector does not necessarily in the public sector. He truly may have felt that being indignant and immovable while spending millions to negatively define his opposition would allow him to be triumphant. If that was the case he seriously miscalculated. He has said in the past that he wanted to emulate the successes of Governor Scott Walker in Wisconsin. Walker, however, had a Republican legislature to help him. He was given advice by Ohio Governor John Kasich to take small victories because they add up. He declined, opting instead for "all or nothing". So far, he has accomplished the latter.

The old saying about politics and beanbag is true. It's not for the faint of heart, especially these days with social and other media allowing immediate and rapid response. But as the war is being waged there comes a time when a leader looks at both the destruction and prospects for success and figures that it's time to either surrender or take the best deal you can. The Governor is not a surrender kind of guy. Far from it. The second option has been on the table since last December when Senators Cullerton and Radogno started the process that ultimately ended in a budget. Initially, in February, with three months left in the legislative session, when he interjected himself in the process and dissuaded GOP senators from supporting the "grand bargain" proposals it could be somewhat understood in the sense that sometimes the best deal is the one that that comes with the clock nearing midnight. But with midnight on the horizon the Governor became even more unwavering rather than more flexible.

The war was a long one with many unfortunate casualties. But when the Comptroller, and granted she is a political opponent of the Governor, issues a warning about running out of money in just a few weeks it should be time to reassess your position. If not that, then Moody's warning about "junk status" for Illinois issued bonds should certainly be fodder for reassessment. Rep. Steve Andersson (R-Geneva) explained his support of the budget package by noting the impact of a "junk bond" rating. "With a junk rating, most institutions legally cannot buy our bonds. This makes our ability to borrow virtually non-existent which is essential to even keeping minimal state services functioning," he explained. The Governor, as a successful businessman, certainly

should understand the implications. Rather, his reaction to the efforts to override his veto was, "Don't listen to Wall Street, don't listen to a bunch of politicians who want to stay in power like they have been for 35 years," even though he had criticized previous downgrades that occurred during the previous administration. And subsequent to the veto override State Treasurer Michael Frerichs suggested that the Governor travel to New York to personally visit the bond houses and reassure them that Illinois was getting its act together. The Governor, as of now, has declined.

There was time during June and early July, like there had been all year, to find some middle ground. Especially at the end, then things were apparently close on the non-budgetary issues and pressure to hike revenue was mounting, It would be been the time to take the deal and declare a win. The rap on Governor Rauner by the opposition is that it has to be 100% or nothing. The end result of the budget impasse may have shown that observation to be true. Oddly, many of those issues still outstanding may be resolved in the coming weeks or months. But if they do it will be the legislators from the Governor's party who defied him that will secure any victory.

Session Schedule/Deadline Dates

Here are relevant dates for the 2017 legislative session:

- July 1+ - Sessions may resume at the call of the Speaker and Senate President