



Policy Brief

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Contact:
Greg Blankenship
217.544.4759
greg@illinoispolicyinstitute.org

AUDIT REPORT; STATE REVENUE DECLINES SHOW BUDGET REFORMS ARE DESPARATELY NEEDED

(Springfield, Ill.) Nothing more clearly illustrates the peril faced by the State of Illinois than this week's reports on Illinois short term fiscal challenges as well as the long term inability to modernize state government.

Reports from Commission on Government Forecasting and Accountability (COGFA) and Comptroller Dan Hyne's office showing near term revenue shortfalls coupled with a new Auditor General's report stating that Illinois does not know how many programs it has presents compelling evidence that by mid-year Illinois could find itself in another perfect fiscal storm not unlike fiscal year 2002 – where in the midst of a recession state government shrank when ostensibly government services were in high demand.

According to news reports, “It (COGFA) found that for the first three months of the state's new budget year – July, August, and September – sales tax receipts are down by \$55 million from a year ago, a 3 percent drop.”¹

Similarly, in the Illinois State Comptroller's Quarterly we find that:

At the end of the first quarter of fiscal year 2008, the state's cash flow position compared to last year had deteriorated by \$885 million. At the end of September, payables in the Comptroller's Office stood at \$1.393 billion, while last year payables in the office totaled \$508 million...

“...Revenues from the state sales tax and corporate income tax fell in the first quarter. Transfers in were also down for the quarter.

These declines were offset by increases in individual income taxes and by federal revenues that were up sharply due to a phenomenal surge in Medicaid grant spending.”²

Sales tax declines can be seen as an earlier indicator that the economy is slowing down even though overall revenues, including personal income tax revenues still continue to rise.³ This marks the eighth time in nine months that this is occurred.⁴ With tightening credit market caused by the bust in the housing balloon this could portend trouble in deed for state budget come mid-fiscal year.

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Next is the Auditor General's recently released Inventory of State Programs. **In a report released late last week, Auditor General William Holland found that what Illinois state government does remains a mystery to Illinois state government.**

Holland's office surveyed state agencies and found about 1,750 programs. On November 1 he reported that, "Our study concluded that the State does not have a comprehensive, consistent inventory of State programs." In fact, according to the report, "The actual number of programs is likely higher given that some agencies reported programs to us at an aggregate level. In comparison, 69 agencies reported 252 broad **categories {emphasis his}** of programs (e.g., human services, education, public safety) for the comptroller's Public Accountability Report which is prepared for a different purpose."⁵

Moreover, the report did not even address duplicative services within agencies, "This study examined programs that could be duplicative between two or more agencies."⁶

Holland also examined 50 programs that his office believed could be consolidated. In almost every case, officials insisted their program was special and could not be combined with any others. Three agencies volunteered that maybe one of their programs could mix with a similar program offered elsewhere. But in each case, the other agency involved claimed it wouldn't work.

Common reasons cited for a lack of consolidation revolved around different roles and missions. Technical assistance versus financial assistance or one agency had a consultative role versus a potential mate with a regulatory role were offered as justifications for a failure to consolidate.⁷ Republican Rich Brauer of Petersburg dismissed such justifications, "It's called job preservation," he said.⁸

Say No to Taxes

As often the case with declining revenues and the potential for real budgetary pain, the easy approach to solving such problems as well as papering over long term modernization issues is to simply raise taxes. But in Illinois this solution has become both economically and politically difficult.

Illinois continues to lag the nation in both economic growth and in employment. In a September, 2007 report from the Legislative Commission on Government Forecasting and Accountability we find that the Illinois economy is a below average performer:

"Analyzing these data in ten year increments reinforces the view that Illinois' economy has been lagging. In none of the three time periods analyzed (1977 to 1986, 1987 to 1996, and 1997 to 2006) did Illinois rank in the top half of average annual growth. The best Illinois did was 31st during the 1987 to 1996 time period. From 1977 to 1986, Illinois averaged GDP growth of 7.6% per year which was 1.8% lower than the country as a whole. As such, Illinois ranked 40th during this time period. Over the next ten years, Illinois improved to 31st by averaging growth of 5.6% per year which was just under the U.S. average of 5.8% per year. From 1997 to 2006, Illinois fell in ranking to 43rd. Illinois averaged growth of 4.5% per year, which was one percent per year less than the country as a whole."⁹

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Taxes take resources from the productive private sector and give the money to un-productive public sector that simply redistributes the resources to favored groups with no regard to growing the economic pie. Therefore, from an economic growth perspective, hiking taxes will do more harm than good.

In his first year in office, Governor Blagojevich did hike taxes by \$110 million. In his 2007 budget he offered an additional \$130 million in new taxes on businesses and it was rejected. In his Fiscal Year 2008 Budget the governor proposed a whopping \$7.6 billion gross receipts tax with an additional pay roll taxes to pay for his universal health plan. In addition, taxes have been rejected as recently as this month as a solution to staving off a Chicago Transit Authority “doomsday scenario” in which included significant rate fare increases and cuts in services.

Attempts to revive the property tax reduction – income tax hike (the tax swap proposal known as HB750) were also rejected this year and in 2005. Modest increases in sales taxes and income taxes were rejected as not viable this year. Efforts to hike taxes in Cook County and Chicago have been met with strong resistance from taxpayers as well.

With higher taxes being both economically and politically unviable, policymakers need to embrace ideas that can bring down the cost of governing while bringing services to taxpayers in a more cost efficient manner. Furthering the transparency movement and engaging in smart spending policies are two ways in which policymakers can achieve these goals.

Transparency and Smart Spending

With higher taxes being harmful to the economy, the question becomes how do we squeeze more efficiency out of state government without cutting back on services? The answer lies in transparency and innovation. By creating incentives for innovation and efficiency and by better aligning the incentives of state employees with the public they serve, Illinois can provide the kinds of services citizens would like to have without harming economic growth. Two ways of doing this are making greater use of transparency and smart spending.

Taxpayers in at least six states have or will soon be able to track their tax dollars on a comprehensive website detailing a broad range of government expenditures. Thanks to legislation passed and, in the case of Missouri an executive order signed by Governor Matt Blunt (R), state governments are becoming far more transparent. The Missouri website is already up and running at www.mapyourtaxes.mo.gov and was implemented within existing revenues, at no extra cost to taxpayers. The web site has received over 1,000,000 visitors.

Not only will these websites bring more accountability into state government finance, they also have the potential of bringing about massive cost savings for taxpayers, since more public scrutiny will help weed out unnecessary and wasteful spending.

One case in point is Texas, where several hundreds of thousands of dollars in savings were identified when a taxpayer pointed out a better way to manage the agency’s phone system after logging onto Comptroller Combs’s expenditure website.

For any market to work, actors in it must have accurate information on both prices and services in which they can then base their decision making upon. Transparency also acts as a dis-incentive for corruption because the price mechanism will put downward pressure on waste, fraud and abuse of the system. Contractors, program managers and policymakers will all face pressure to deliver higher quality services at lower prices squeezing out the opportunities for corrupt and inefficient practices.

Short Term Ways to Saving Money

In meeting the short term challenges posed by declining revenues as the economy potentially slows down, policy makers have tools at their disposal that can still deliver services without significantly hindering their delivery. Many of the short term ways of saving funds are not optimal solutions because they make no distinctions between successful and failing programs, or duplicative measures. Yet, they are still preferable to hiking taxes during a period of slower growth.

Reduce workforce costs by eliminating positions and cutting costs for current workers and retirees. This may not be the smartest way of reducing costs, but it is sometimes easiest way. Early-retirement incentives and contract concessions from state workers are two approaches. Other examples of workforce savings include smaller cost-of-living adjustments and higher health insurance premiums for state retirees.

Apply across-the-board spending cuts. While this approach is administratively simple, it has one major drawback. It treats good-performing and poorly-performing units of government the same. It would be better to make targeted cuts, based on unit effectiveness and importance.

Repeal the prevailing wage requirement for taxpayer-funded construction. The prevailing wage requirement raises the price of public projects, and pays no attention to work quality.

Long Term Strategies

Long term strategies to save funds would address the challenges to Illinois State Government posed by the Auditor General's findings regarding his Inventory of State Programs. Ways in which these challenges can be addressed are:

Reform health care and other entitlements. Florida's market based reforms are being widely accepted and the originally budget neutral proposal is 15% under projection and Temporary Assistance for Needy Family costs are 23% less than anticipated.

Sell or lease government assets and enterprises. Indiana and Chicago have recently privatized respective road ways that has brought in much needed short-term revenues. Other states examining toll road leasing or development are Virginia, Pennsylvania, Delaware and New Jersey. Governor Blagojevich, while not opposing the idea, hasn't pushed aggressively enough on this front.¹⁰

Make government workers compete for state jobs. In the state of Florida:

- Toll booth operations were outsourced saving \$30 million under contract
- State prison food services outsourced saving \$66 million
- Health services in state prisons were outsourced, saving \$49 million the first year.¹¹

Public employee unions, when treated like partners, can play a positive role in the process. While fear of change and turf protection is a significant hurdle to outsourcing, state and local governments comprised of effective and dynamic policymakers, procurement experts and contract managers can and will deliver better services for less money by letting the private sector do the bulk of the work.

Eliminate poorly performing programs. Activity-based accounting can help identify effective methods of business, which can then be used to change or eliminate ways of doing business. Performance based budgeting that offers metrics not just on the number of services provided or those served, but measure the quality of services provided is a very useful tool that allows policy makers to better prioritize and allocate resources.

Make greater use of incentive programs for government employees. This can include enhanced suggestion programs, merit pay, and performance-based contracts. State employees who find ways to save taxpayer dollars should receive a financial reward for their efforts. Program funding should be tied to that program's success at meeting its intended goals. Programs that don't measure up should be cut. The state of Florida has made large strides in this area.

Eliminate overlap of administration. The Auditor General's report cited above clearly states that Illinois has a long way to go on this front. Legislators should push for a "Grace Commission" to closely examine the state's 1,750 plus programs. The John Locke Foundation, for example, found that North Carolina could save more than \$60 million by doing away with duplicative programs and departments.

Use web-based technology. Florida, again, saved \$115 million over a four year period by moving from a store front model to a self service model in the area of welfare. A consumer self-service model means expanded access, reduced errors, faster customer service and smaller government.¹²

Create a competition council. Since 1993 Charlotte, North Carolina has saved \$10,000 million. "The current five-year competition plan lists 31 projects (competition, outsourcing, optimization, and benchmarking) from 10 of the City's 14 KBU's [key business units], involving 848 employees, and \$87 million in services."¹³ States such as Florida and Virginia have used these tools, as well.

The Bottom Line

State government continues to face both short-term and long-term challenges. Taking steps to ensure that Illinois has a transparent government and moving to make Illinois a government innovator through smart spending reforms is one way of reducing the overall burden of state government without negatively affecting popular and effective programs.

Stopping tax increases, and in fact, lowering the tax burden on Illinoisans would be one of way of making Illinois more economically competitive while forcing policymakers to make the necessary reforms to the state's overspending. Both greater transparency and aggressive efforts to innovate through smart spending initiatives promise to deliver high quality governments services in a cost efficient manner.

¹ Doug Finke. "Reports Predict Budget Shortfalls." *State Journal-Register*. Nov 5, 2007 pg 1.

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- ² Daniel W. Hynes, Comptroller. “The Illinois State Comptroller’s Quarterly.” Edition 25, October 2007 pg 1.
- ³ Joan Gralla. “U.S. state sales taxes flash recession warning.” Reuters. 9:11 a.m. October 11, 2007
<http://www.signonsandiego.com/news/nation/20071011-0911-states-recession-.html>
- ⁴ Commission on Government Forecasting and Accountability. Monthly Briefing, October, 2007 pp. 3
- ⁵ William Holland, Auditor General. Inventory of State Programs. Released: October 2007 pp. V
- ⁶ Ibid. pp.1
- ⁷ Ibid. pp. 6
- ⁸ Christopher Wills, Associated Press. “Much of what state does remains a mystery to auditor.” *State Journal-Register* Thursday, November 01, 2007. pp. 1
- ⁹ Varner, Benjamin. “A Comparative Study of the Illinois Economy.” Legislative Commission on Forecasting and Government Accountability. September, 2007 pp. 3
- ¹⁰ Robert W. Poole, Jr. “Democrats and Public-Private Partnerships Toll Roads” found in *Innovators in Action*, Geoffrey Segal, ed. Reason Foundation, 2007. pp. 31 – 34.
- ¹¹ Hon. Jeb Bush. “Improvement Requires Willingness to Change” found in *Innovators in Action*, Geoffrey Segal ed. Reason Foundation, 2007 pp. 3-5.
- ¹² Ibid. 4.
- ¹³ David Elmore “City of Charlotte’s Privatization and Competition Advisory Committee” found in *Innovators in Action*, Geoffrey Segal ed. Reason Foundation, 2007 pp. 30.

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