

Taxes and disinvestment

Illinoyed

CHICAGO

Businesses are threatening to leave

THE state finances in Illinois are an ugly mess of deficits, unpaid bills and tax refund backlogs. At the heart of the problem lies a public pension liability estimated at a present value of \$80 billion. The state's pension schemes are only 51% funded, the lowest rate among the 50 states. In January, in an attempt to grapple with its problems, the state raised corporate taxes from 7.3% to 9.5% and personal income tax from 3% to 5%. Although the tax hikes are theoretically temporary—and start to expire in 2015—both the rises and the continued failure of politicians to get to grips with the budget crisis are starting to worry businesses.

Over 17% of the state's operating budget, or about \$5.8 billion this year, goes on meeting public-pension obligations—a burden that will worsen as longevity increases. Many companies, fearing that

Worst of the worst

Percentage of state pension liabilities funded 2009*

Top five:		Bottom five:	
New York	101	Kentucky	58
Washington	99	New Hampshire	58
North Carolina	97	Oklahoma	57
Delaware	94	West Virginia	56
South Dakota	92	Illinois	51

Source: Pew Centre on the States

*Fiscal year

they, and their employees, will ultimately have to pick up the tab, are demanding tax breaks to stay in the state. In May Motorola Mobility was offered \$100m in financial incentives to retain its corporate headquarters in Illinois, in the hope of retaining 3,000 jobs. Last year Navistar, a truck and engine firm, also managed to extract incentives worth \$65m from the state.

Now Sears, a chain of department stores and one of the state's largest employers, is playing the relocation card. It says it will move out unless its current package of tax incentives, due to expire in 2012, is extended. Sears employs 6,000 people at its headquarters in Hoffman Estates, a suburb of Chicago. Two Chicago-based financial exchanges—CME Group and CBOE Holdings—say they will go as well. They argue it is unfair that they are currently obliged to pay Illinois taxes on electronic trades that happen out of state.

The state's general assembly has responded by preparing legislation that offers these companies a deal. Although a final bill has yet to be agreed, legislative approval looks very likely. Tax breaks for Sears could amount to \$15m a year, while one option being considered for the trading exchanges is to tax them on only part of their business. This could reduce government revenues by \$85m a year, but if these companies are serious about leaving, then half or a third of something is a lot better than 100% of nothing.

Although each new individual arrangement may seem justifiable to the politicians, together they further undermine the state's financial position. Laurence Msall, president of the Civic Federation, an independent watchdog, says the current state budget contains more than \$2 billion of promises for which there is no money. In addition, the state has carried over \$5 billion in unpaid bills from previous years. Illinois seems to careen from one crisis to the next. Each corporate demand only underscores the state's perilous position: it cannot afford to lose businesses but it cannot afford the tax breaks to keep them.

The vultures are circling. Ohio has offered Sears \$400m to move to the Buckeye State. Indiana's governor, Mitch Daniels, jokes that having Illinois as a neighbour is like living next door to a dysfunctional

family. Indiana even has an advertising campaign targeted at tempting Illinois businesses across the border by asking them if they were "Illinoyed" by paying higher taxes.

Although Indianapolis lacks the excitement of Chicago, Indiana has a personal taxation rate of 3.4%, and has promised to reduce corporate tax to 6.5% over the next four years. It has also cut property taxes and offers a generous R&D credit. Katelyn Hancock, a spokesperson for the Indiana Economic Development Corporation, says her state has been in competition with Illinois 43 times this year to win new investment—and won 40 times.

As many states have found, incentive schemes can be troublesome if not properly structured. Ms Hancock points out that the way to compete is not through incentives but via lower taxes, a predictable regulatory climate and fiscal stability. Most Illinois companies like Chicago's transport links and its skilled workforce. Loyalty, however, does know some bounds. ■