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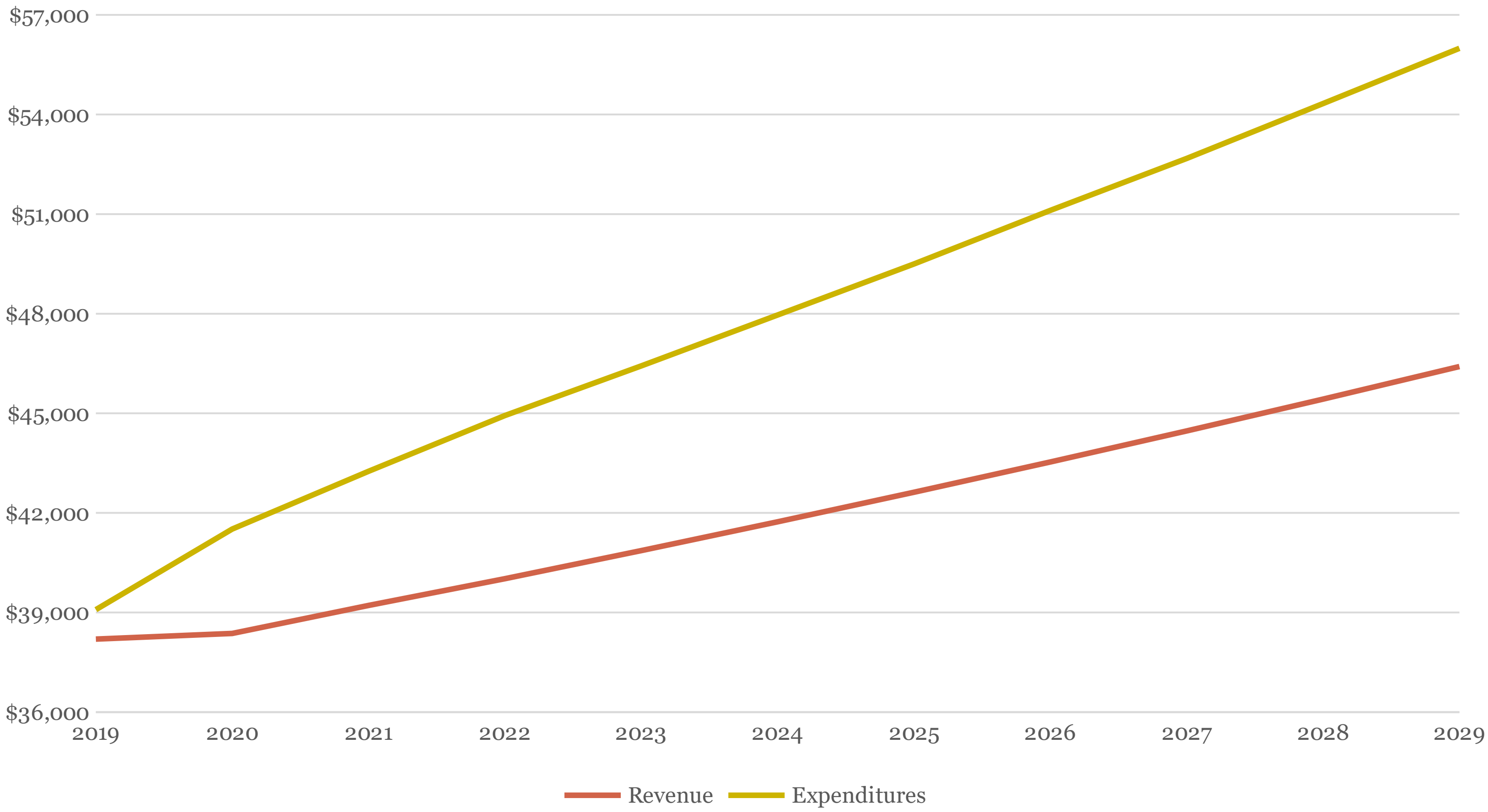
The Fair Tax Proposal In Context of the Illinois General Fund

THURSDAY, JANUARY 30, 2020; 12:00 PM
ADLAI STEVENSON CENTER ON DEMOCRACY
ROOSEVELT UNIVERSITY
430 S. MICHIGAN AVENUE — IDA B. WELLS LOUNGE
CHICAGO, ILLINOIS

Presented by:
Ralph M. Martire, Executive Director, Center for Tax and Budget Accountability and Arthur Rubloff Endowed Professor of Public Policy at Roosevelt University

The Problem Remains: Illinois has a Structural Deficit (Full Funding of EBF)



Source: CTBA analysis of COGFA figures. Assumes expenditures keep pace with inflation and funding of the Evidence Based Formula as required under P.A. 100-0465, a total increase of $7.4 billion (on a fully inflation-adjusted basis in FY2018 dollars) by FY2029 (which totals $9.17 billion in FY2029); assumes revenues grow at historic rates, and assumes no change in law.

FY2020 General Fund Budget

Category	Appropriation
1. Net General Fund Appropriations — After Unspent	**$40,116**
2. Total Hard Costs	$13,048
Debt Service (Pension & Capital Bonds)	$2,201
Pension Contributions	$8,370
Other Statutory Transfers Out	$449
Group Health Insurance	$2,028
3. General Fund Service Appropriations (Gross)	**$28,041**
Healthcare (including Medicaid)	$7,619
Early Childhood Education	$544
K-12 Education	$8,883
Higher Education	$1,943
Human Services	$6,268
Public Safety	$1,977
Other	$807
Unspent Appropriations	($973)
4. Net General Fund Service Appropriations	**$27,068**

97%

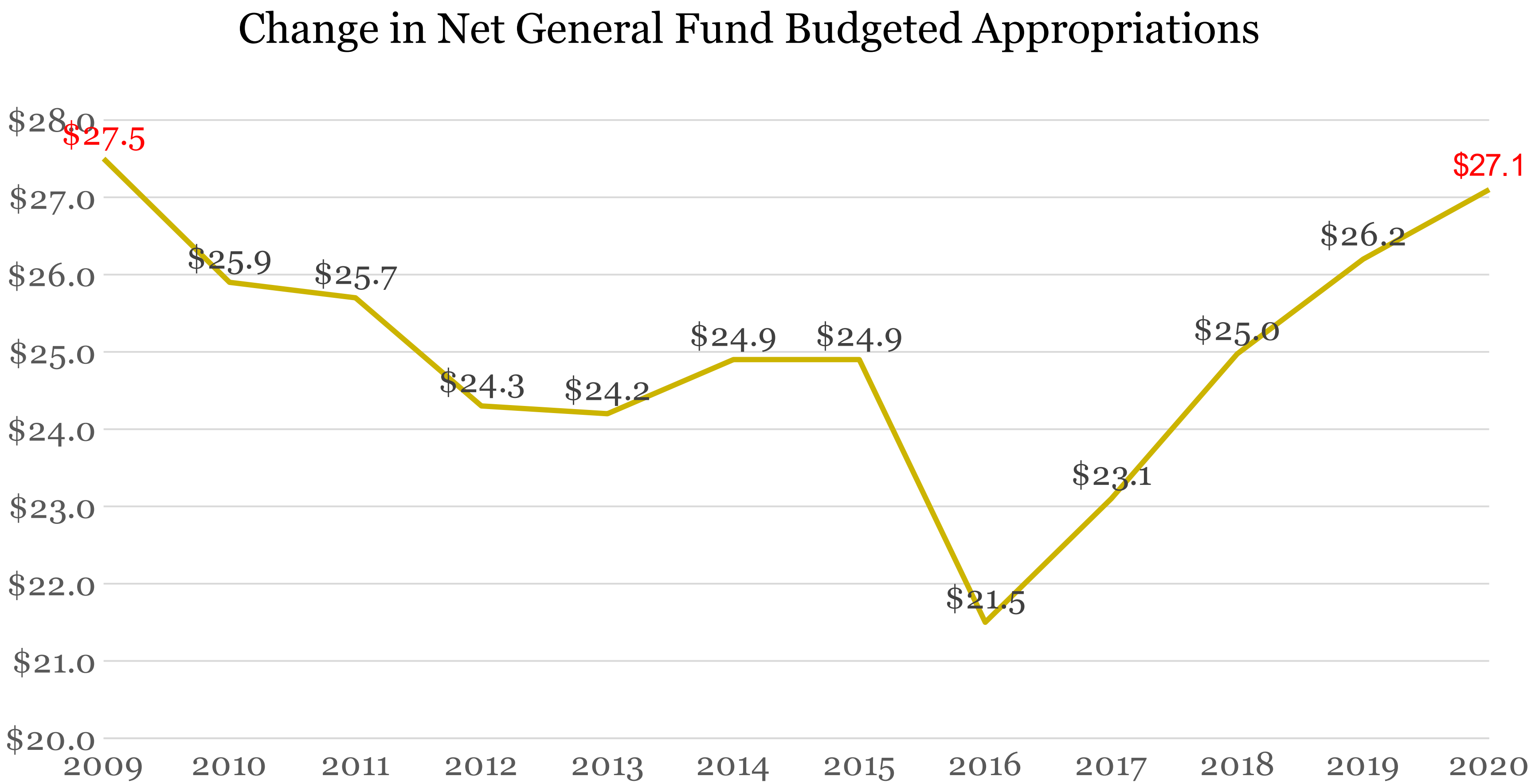
Sources: CTBA analysis of Senate Dems Budget Walk Up and General Fund Spending; subject to change

FY2020 Estimated Accumulated Deficit

Step	Revenue	$ Millions	Spending	$ Millions	Remaining Revenue (Revenue – Spending)
(i)	FY2020 Revenue	$40,287	FY2020 Hard Costs	$13,048	$27,239
(ii)	Revenue After Hard Costs	$27,239	Accumulated Deficit Carry Forward from FY2019	($7,760)	$19,479
(iii)	Projected Net FY2020 General Fund Revenue Available for Services	$19,479	Projected Net General Fund Service Appropriations after Unspent Appropriations	$27,068	($7,589)
			Surplus/Deficit Remaining after General Fund Service Spending		($7,589)
Projected Accumulated FY2020 General Fund Deficit		**($7,589)**			
Projected Deficit as a Percentage of General Fund Service Appropriations		**-28%**			

Source: GOMB, FY2020 Operating Budget Book and FY18 Q4 Comptroller Quarterly Report. Does not include revenues or expenditures from interfund borrowing or Treasurer's investment borrowing.

Service Spending Did Not Create the Structural Deficit



Source: CTBA analysis of P.A. 100-0586 and COGFA data.

General Fund Spending on Current Services, FY2000 Compared to FY2020 ($ Millions)

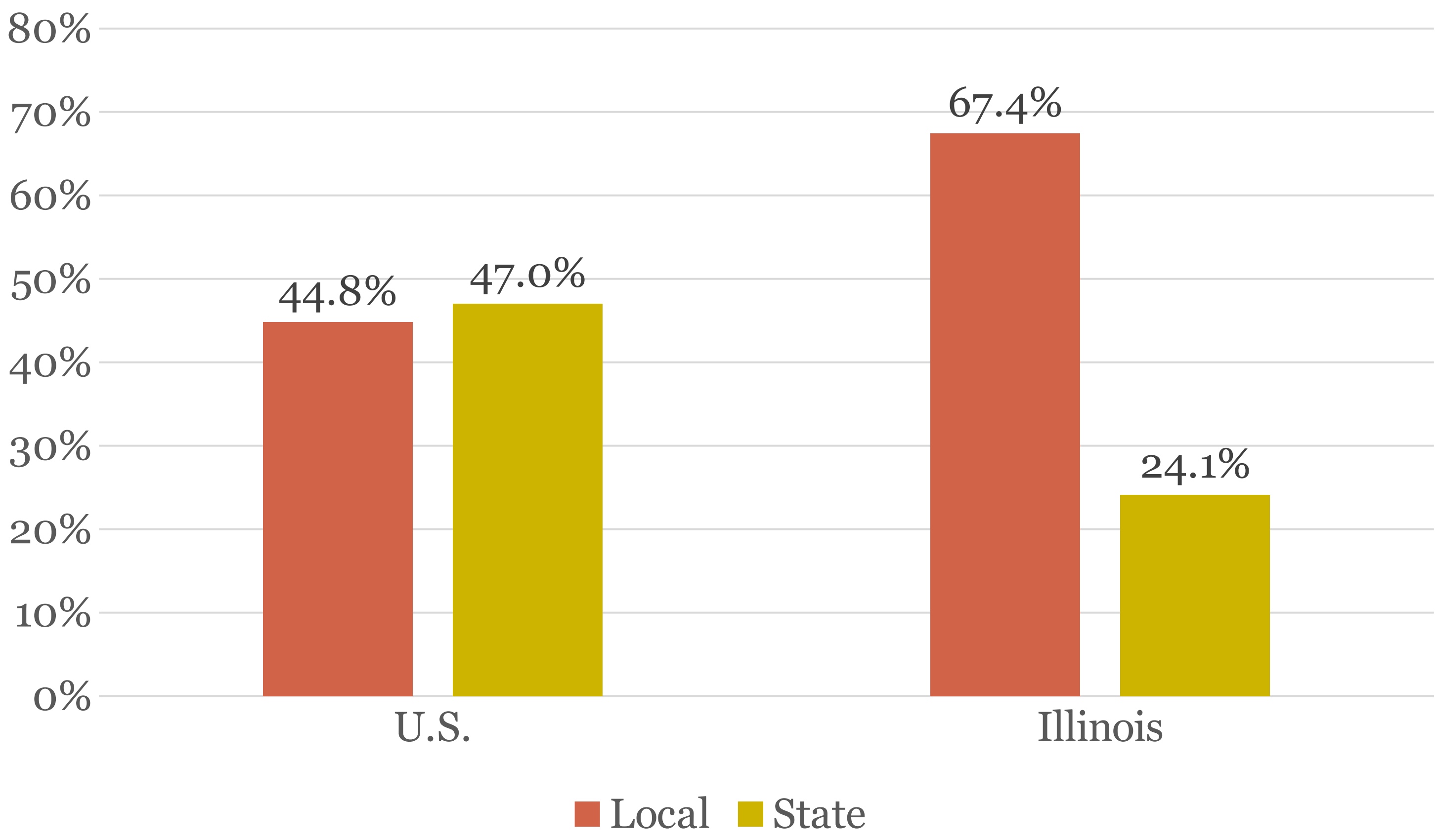
Category	FY2000 Enacted General Fund Budget (Nominal)	FY2000 Enacted General Fund Budget (Adj for Inflation & Population)	FY2020 Enacted General Fund Budget	$ Difference (ECI and Pop Growth Adjusted)	% Change
K-12 Education	$4,673	$8,232	$8,883	$651	7.90%
Early Childhood Education	$170	$299	$544	$245	81.65%
Higher Education	$2,152	$3,791	$1,943	($1,848)	-48.75%
Healthcare	$5,022	$8,847	$7,619	($1,228)	-13.88%
Human Services	$4,599	$8,102	$6,268	($1,834)	-22.64%
Public Safety	$1,350	$2,378	$1,977	($401)	-16.87%
Gross General Fund Service Appropriations	$17,967	$31,652	$28,041	($3,611)	-11.41%

Future Fiscal Pressure Under the EBF

$ Statutory Requirement #1	K-12 funding has to increase on a year-to-year basis by $300 M - $350M
$ Statuary Requirement #2	EBF has to be fully funded by FY2028 (10 years from implementation)

$ Problem #1	At $350 M per year, it will take until FY2047 to fund fully (that's 29 years—*oops*)
$ Problem #2	To make the FY2028 timetable, the EBF year-to-year funding increase has to be $843 M (at least), or $493 million (that's almost half of a billion $) more than the current $350 million target

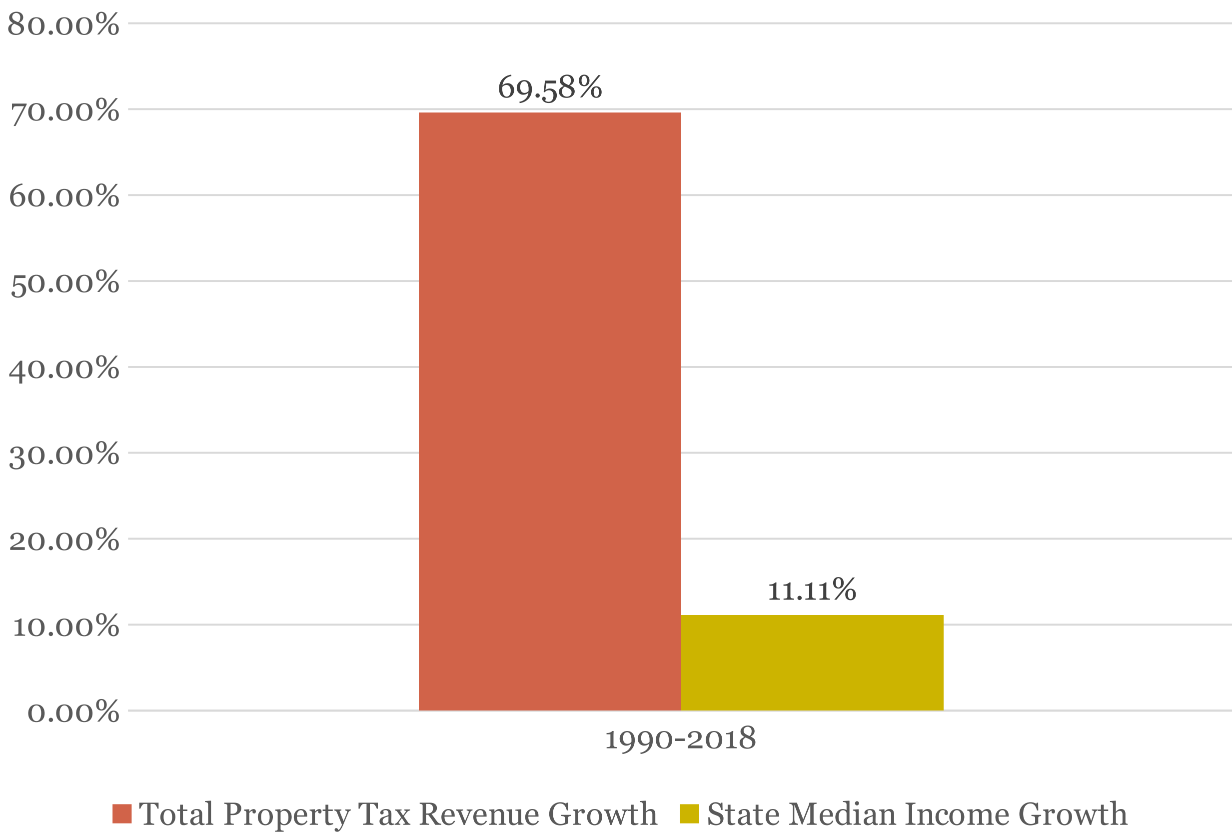
Local and State Share of Education Funding Spending, FY2016



Source: NCES Digest of Education Statistics, Table 235. 20

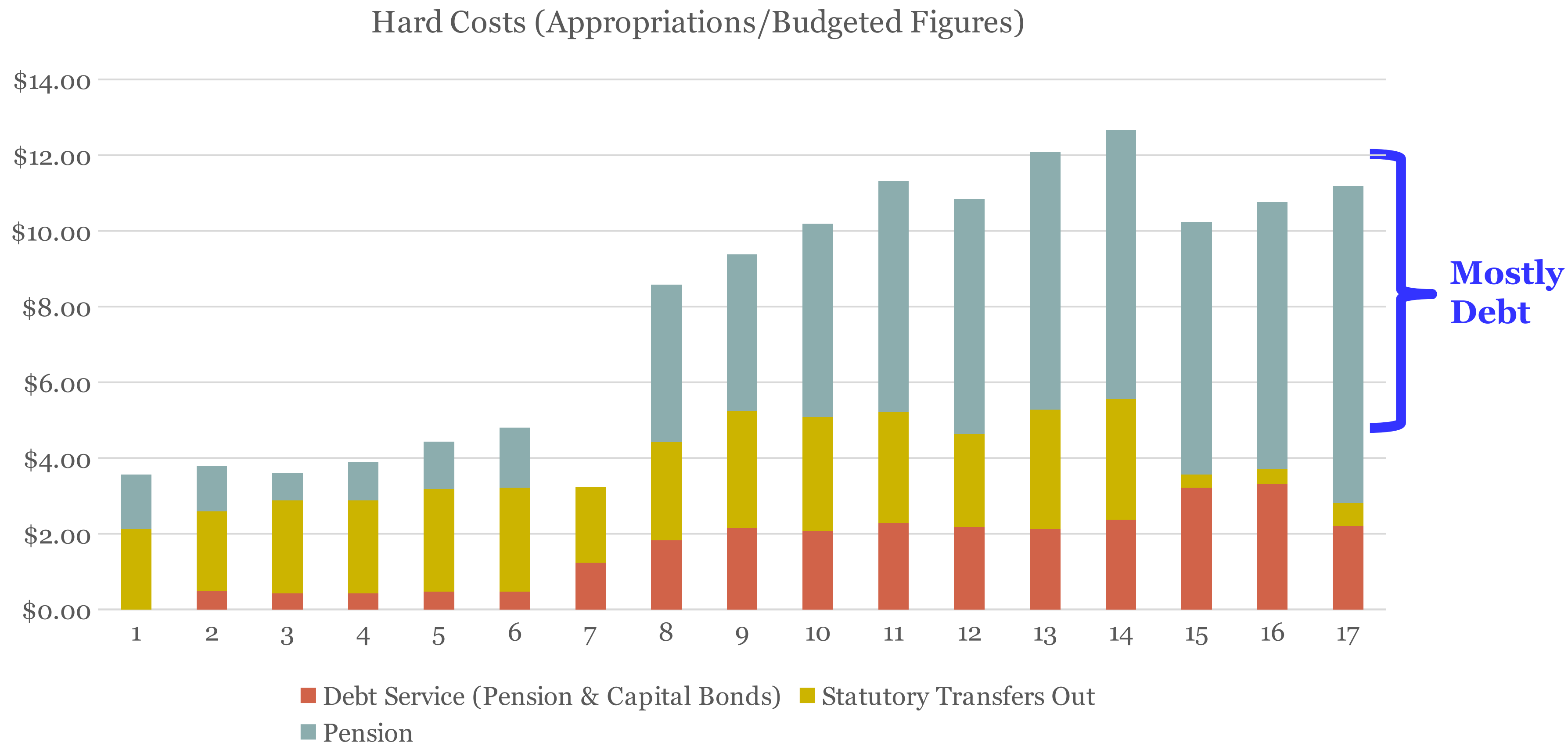
THAT'S BAD FOR TAXPAYERS AND LOCAL GOVERNMENTS!

Illinois Total Property Tax Revenue Growth vs. State Median Income Growth



All data inflation adjusted to 2018 using CPI-U-RS
Income Data: US Department of Census, Current Population Survey
Property Tax Data: Illinois Department of Revenue

Growth in Hard Costs, However: Primarily for Pension Debt Service

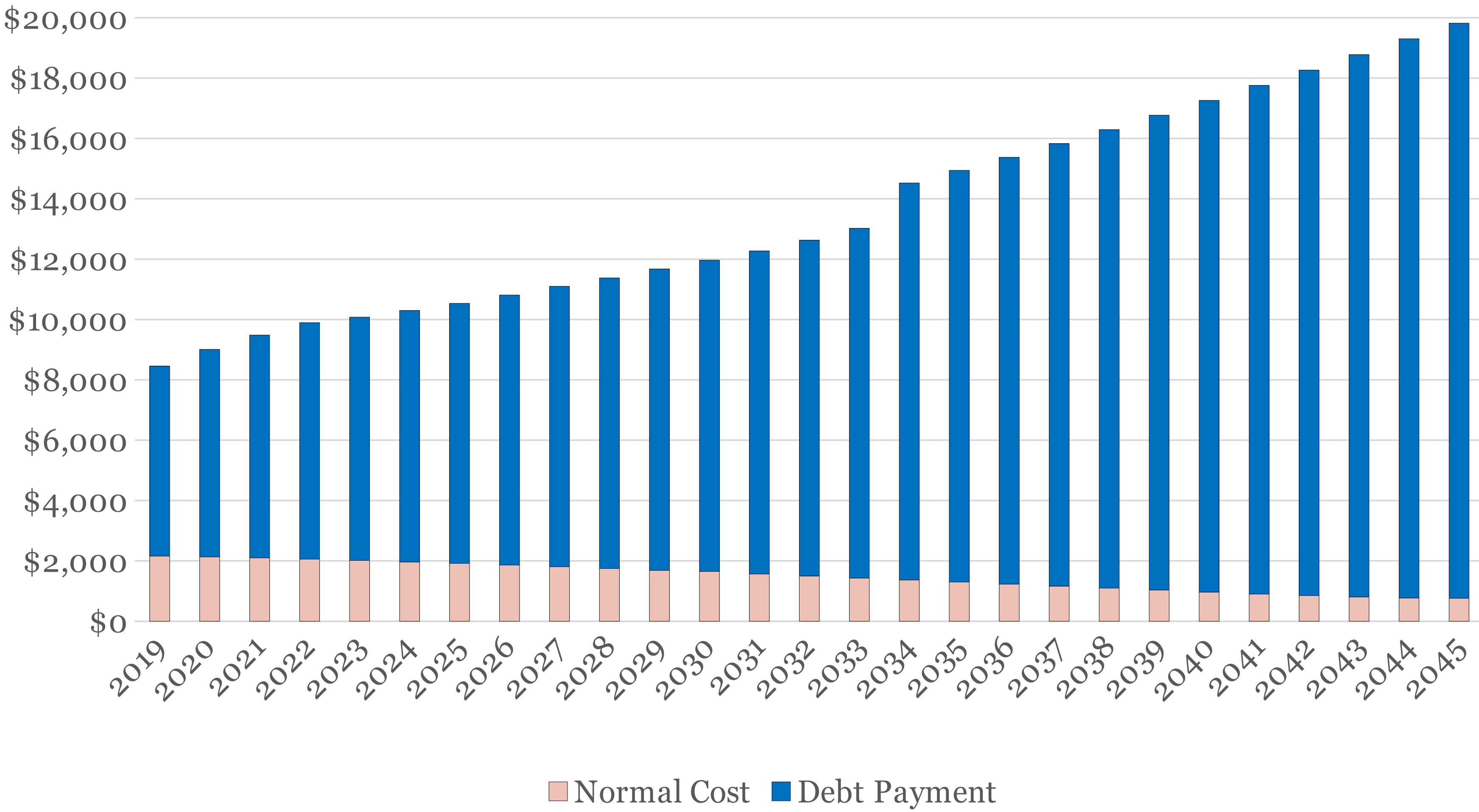


Notes:

- Legislation passed in 2005 cut the state's pension contributions for fiscal years 2006 and 2007
- In 2010 the state used Pension Obligation Bonds to pay its pension contribution
- In 2011, the state also used Pension Obligation Bonds. AS such, while the state budgeted for $4.2 billion in General Fund pension contributions the *actual* General Fund pension contribution in 2011 was $0
- 2015 statutory transfer is artificially low because it exclude $600 million Healthcare Provider Relief Fund transfer, which took place in 2014 instead (that $600 million IS NOT reflected in the 2014 figure)
- 2016 statutory transfer does NOT reflect the $650 million repayment of inter-fund borrowing that will take place in 2015

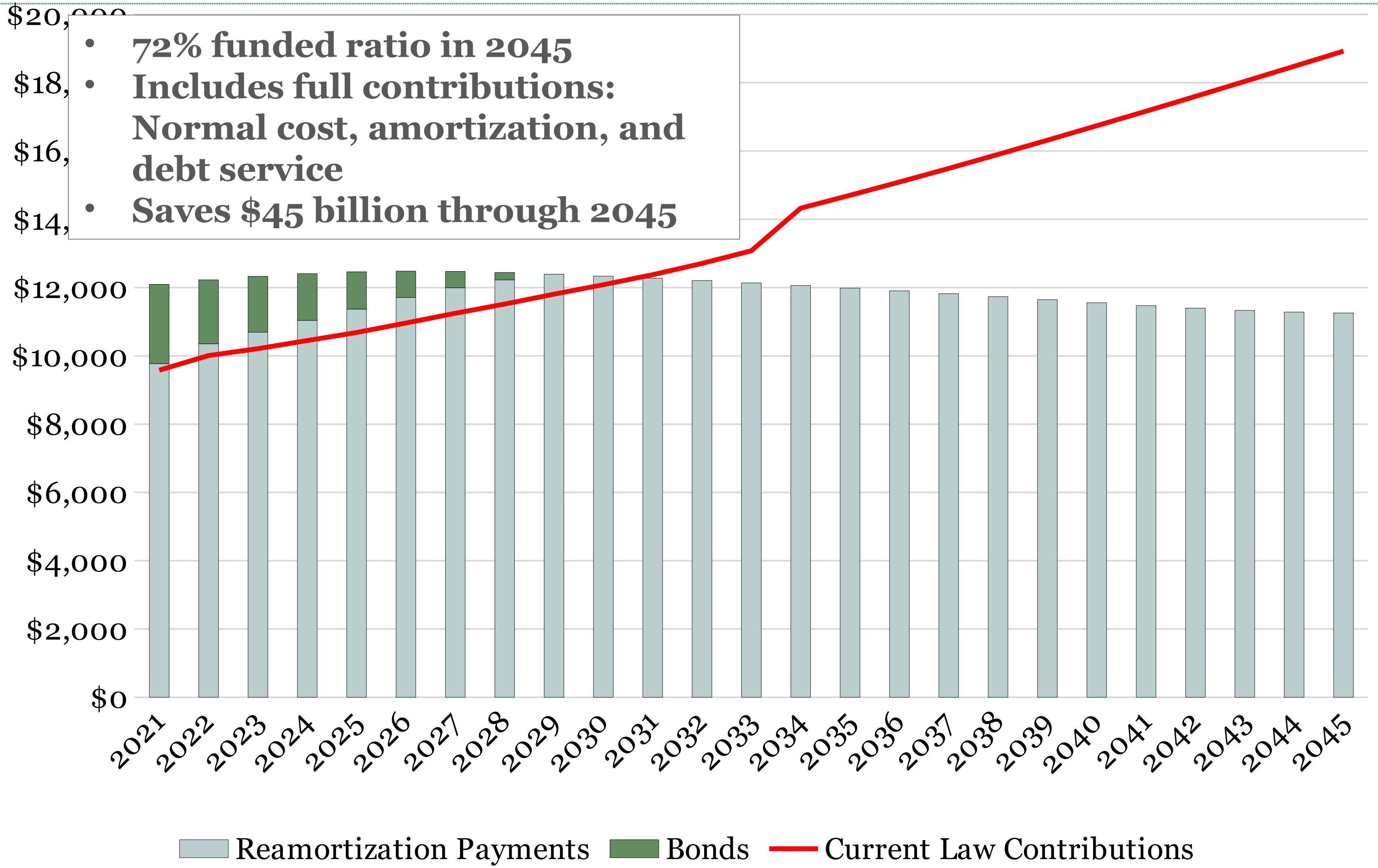
THE BOTTOM LINE: The Ramp Is a Debt Structure Problem: Normal Cost of Benefits Not the Driver

($ Billions)



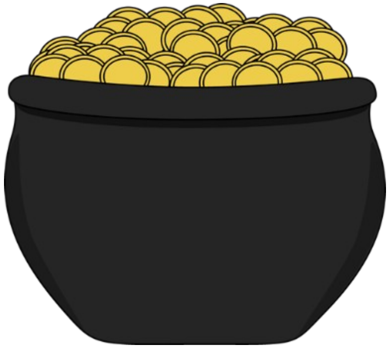
Source: State pension funds actuarial valuations

The Rational Way to Solve Problems is to Re-Amortize Pension Debt ($ Billions)



OF COURSE, WHEN A STRUCTURAL DEFICIT EXISTS—TAX INCREASES - ARE GENERALLY NEEDED TO SOLVE THE PROBLEM LONG TERM—ESPECIALLY WHEN OVER-SPENDING IS CLEARLY NOT THE ISSUE

Which Implicates Tax Policy Issue No. 1:



Where needs are greatest

Resources are least

Adam Smith, the father of capitalism, contended that for a tax system to be fair it has to be progressive

- According to Smith:

"The subjects of every state ought to contribute toward the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state ….[As Henry Home (Lorde Kames) has written, a goal of taxation should be to] 'remedy inequality of riches as much as possible, by relieving the poor and burdening the rich.'"

A Snapshot of Income Inequality

The long-term trends in income distribution in America demonstrate growing disparity.

Change in Average US Income Accounted For By Income Group

Income Group	1947— 1979
Top 10%	34.1%
Bottom 90%	65.9%

Change in Average US Income Accounted For By Income Group

Income Group	1979 — 2015
Top 10%	108.4%
Bottom 90%	-8.4%

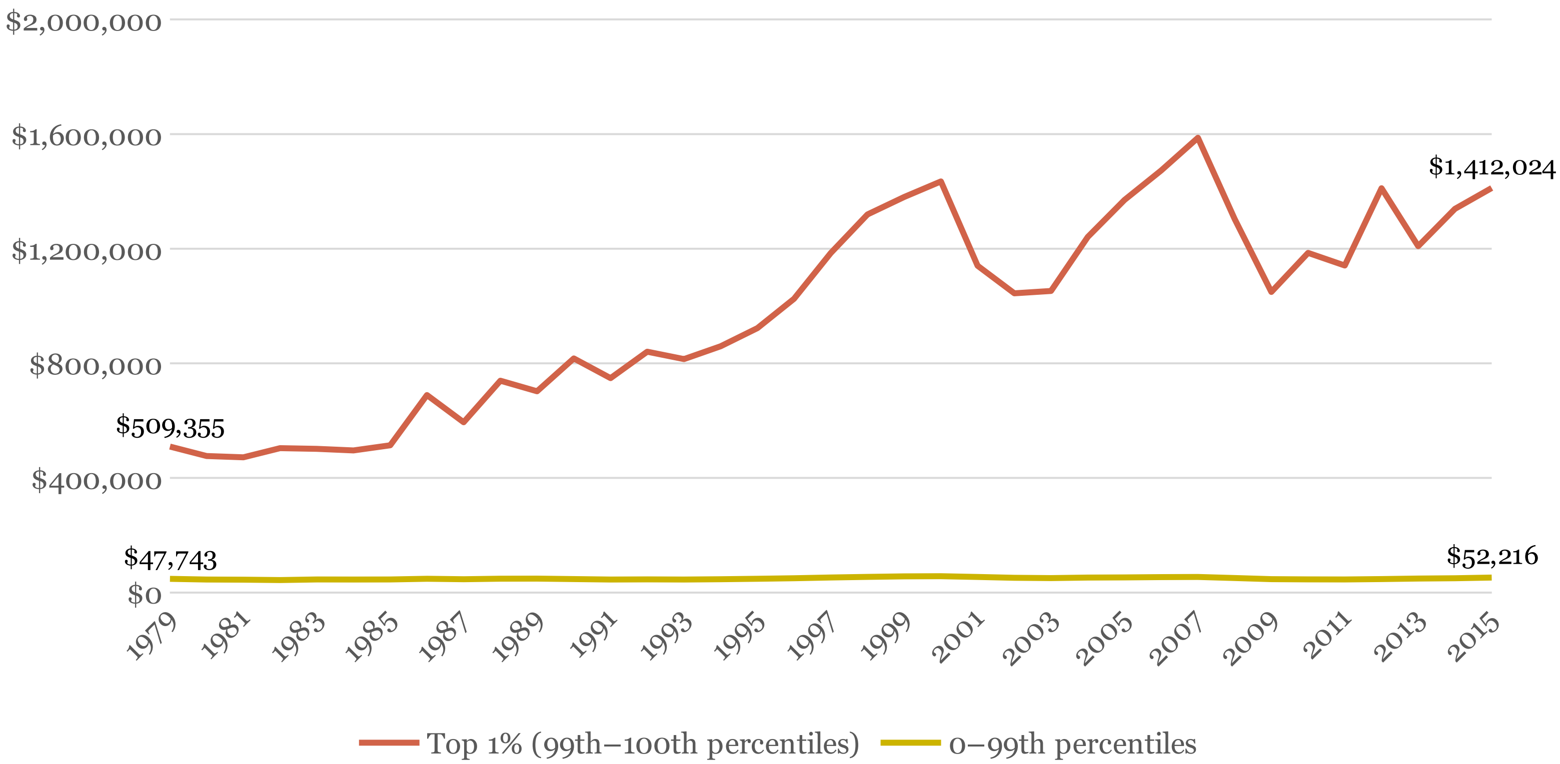
Source: Economic Policy Institute's website: http://stateofworkingamerica.org/who-gains/ Data used is from Piketty and Saez, "Income Inequality in the United States, 1913-1998", *Quarterly Journal of Economics*, 118(1), 2003, 1-39 (Tables and Figures Updated to 2015 in Excel format, January 2013), http://eml.berkeley.edu/~saez/ .

Percentage of Total Change in Average Illinois Income

Income Group	1979 – 2015
Top 10%	108%
Bottom 90%	-8%

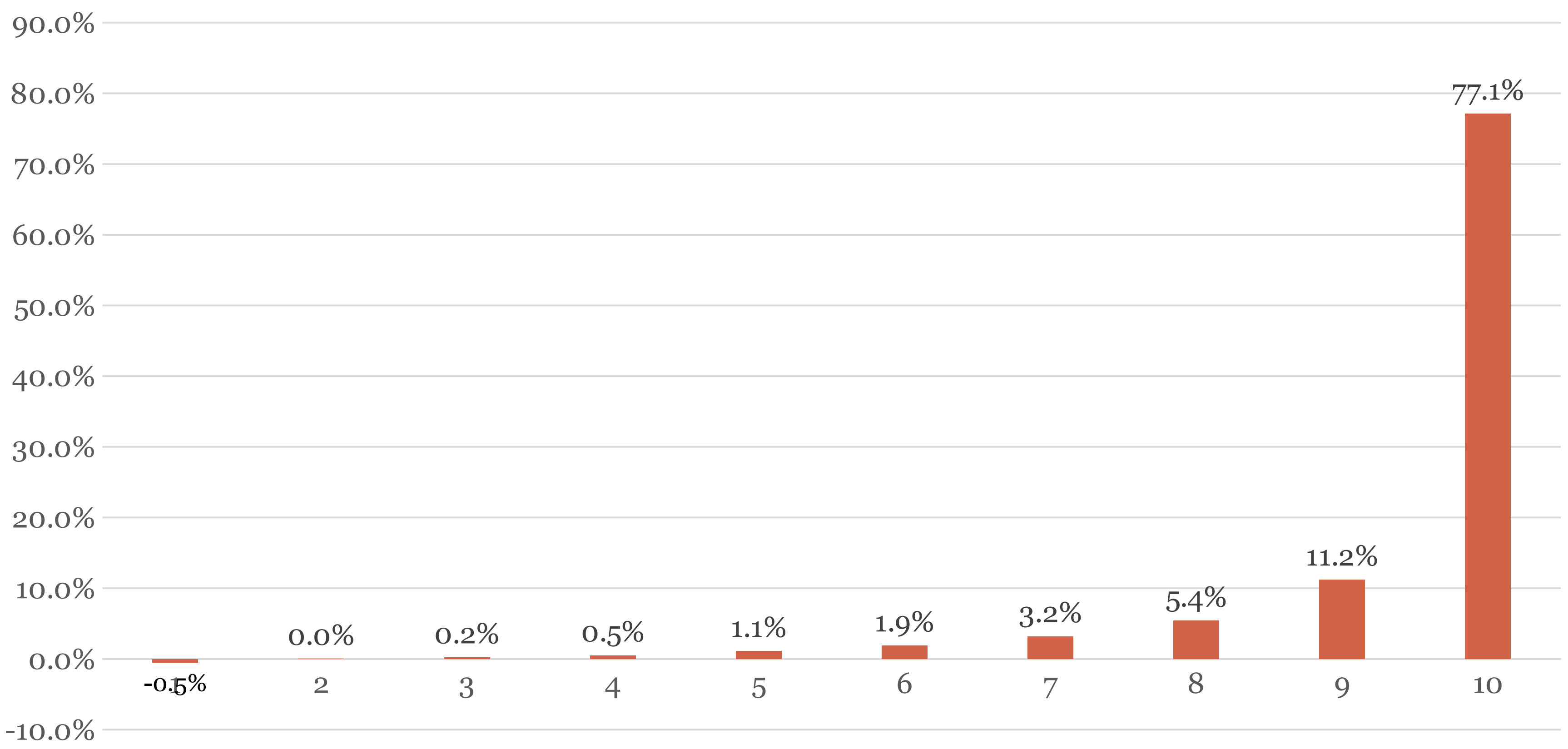
Source: CTBA Analysis of data from Estelle Sommeiller and Mark Price. "The New Gilded Age." Economic Policy Institute, July 19, 2018

Incomes of Top 1% and Bottom 99% in Illinois, in 2015 Dollars, 1979-2015



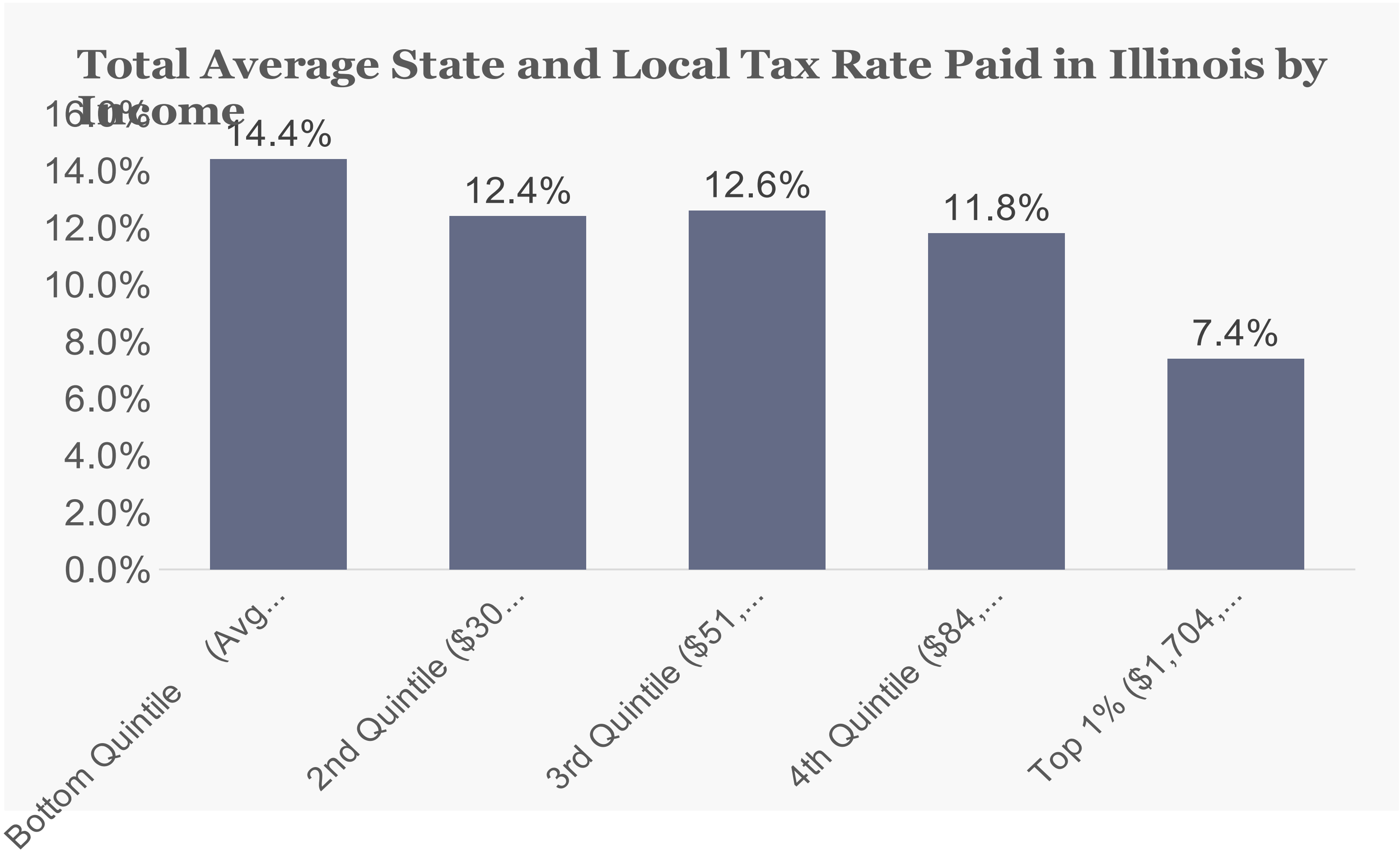
Source: CTBA Analysis of Economic Policy Institute “Unequal States of America” 2018 Data.

National Wealth Held by Income Decile



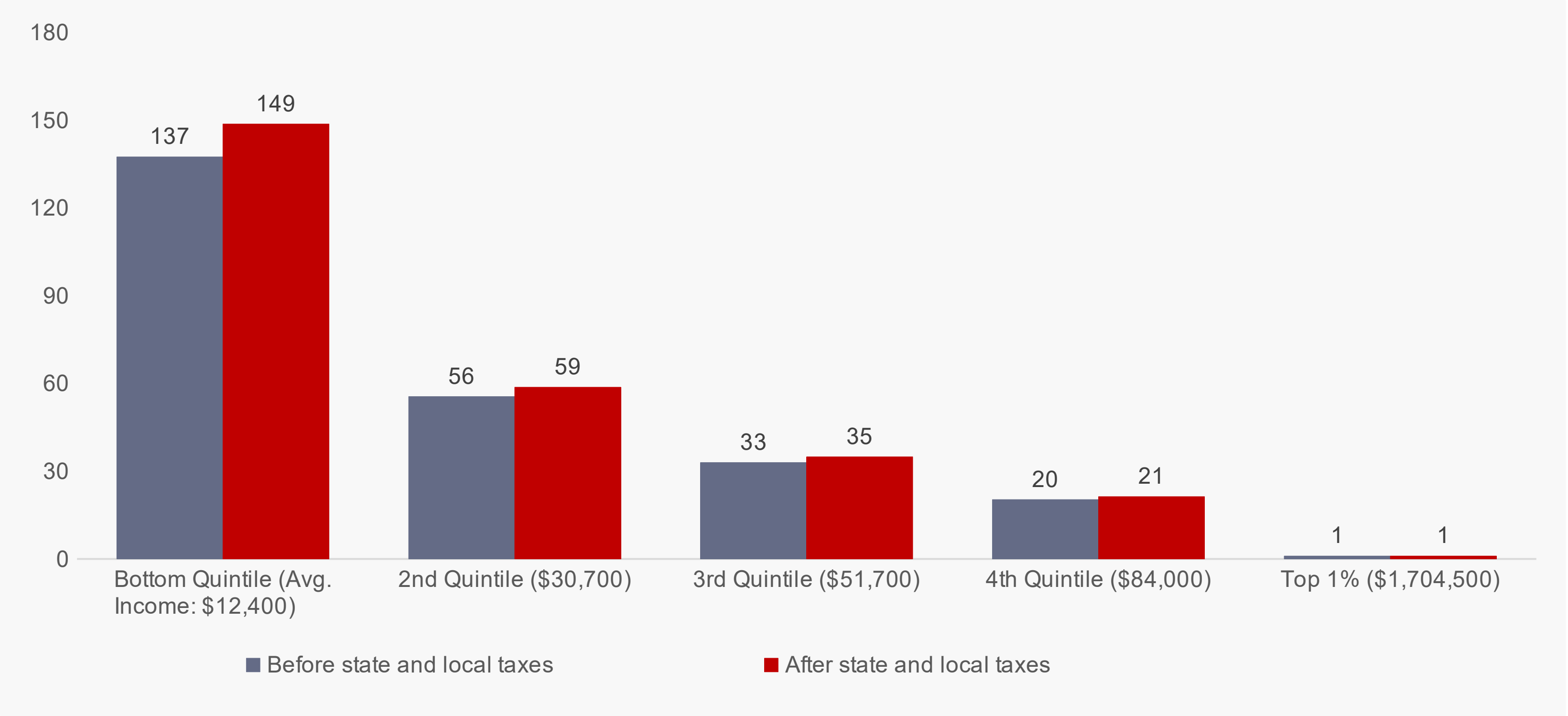
Source: Survey of Consumer Finances

The Illinois Tax System is Currently the Opposite of Progressive



Source: ITEP, "Who Pays?"

Ratio of Income of Richest One Percent to Other Income Groups in Illinois, before and after state and local taxes, 2016



Source: CTBA analysis of ITEP, "Who Pays?" 6th edition, 2018.

Fair Tax Details

Income Above (Single)	Income Above (Joint)	Marginal Rate	Percent of Taxpayers
$0	$0	4.75%	27.2%
$10,00	$10,000	4.90%	58.9%
$100,00	$100,000	4.95%	11.1%
$250,00	$250,000	7.75%	1.9%
$350,000	$500,000	7.85%	0.6%
$750,000	$1,000,000	7.99%*	0.3%

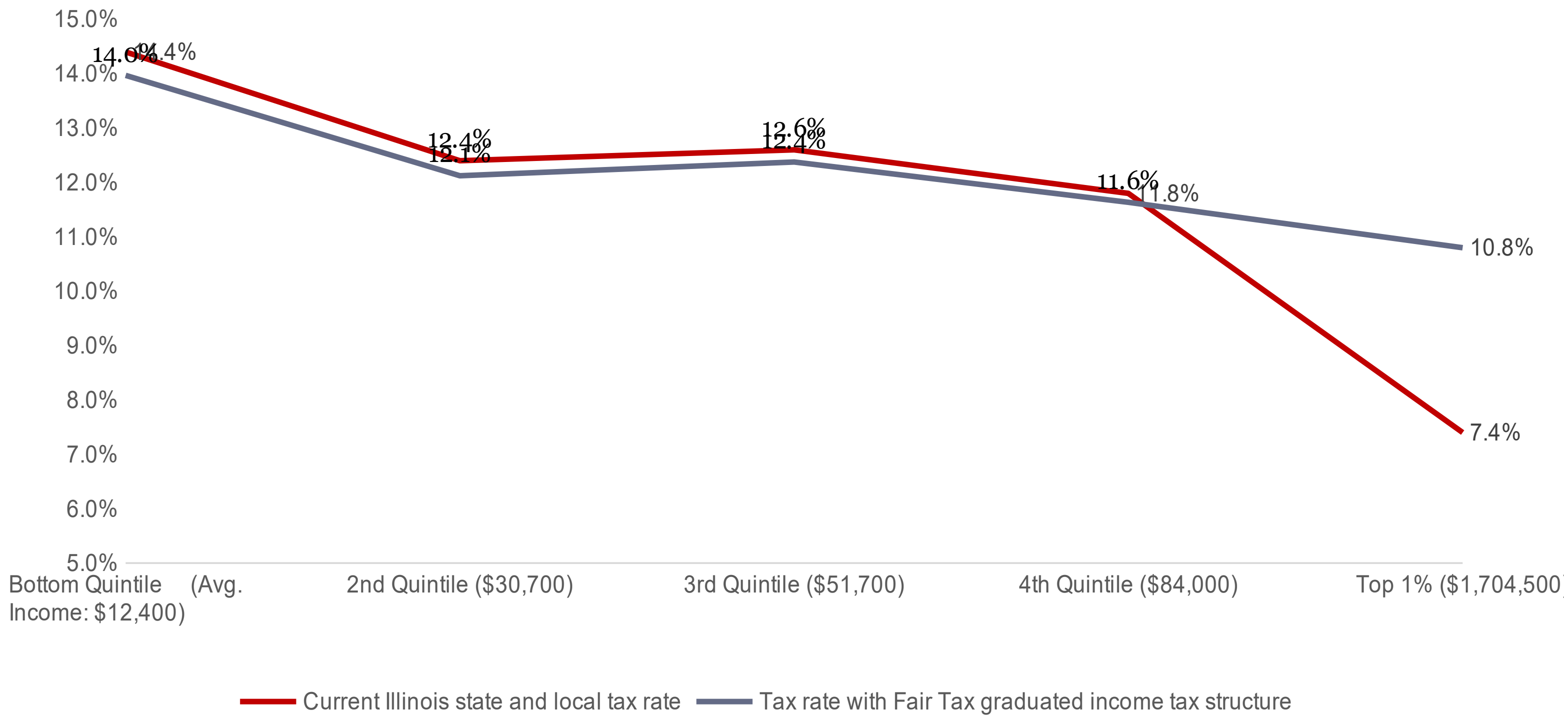
*Income over $750K (single) and $1M(joint), rate applied to total income

The Proposed "Fair Tax" Generates Needed Revenue, Shifts Tax Burden to the Top and has Rates within Midwest Range

- The Fair Tax Proposal:
  - Cuts taxes for 97 percent of taxpayers—only the top 3 percent see an increase
  - Raises $3.6 billion
  - Has a top rate of 7.99%—compared to
    - Minnesota —9.85% @ $163,890
    - Iowa — 8.53% @ $71,910
    - Wisconsin — 7.65% @ $258,950

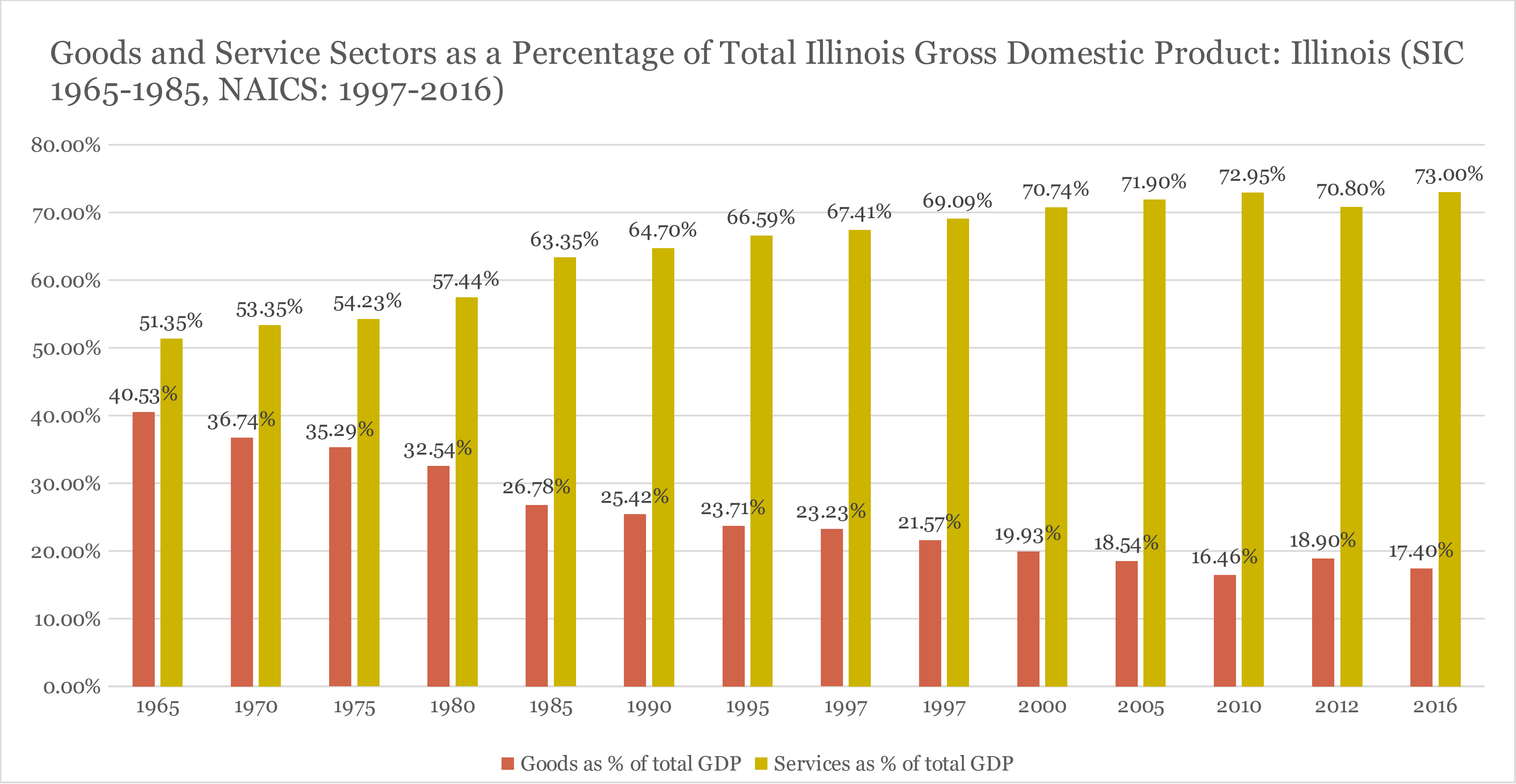
Total Effective State and Local Tax Rate by Income Category

Current Law v. Proposed Fair Tax Graduated Income Tax Structure



Source: ITEP, "Who Pays?" 2018 and CTBA analysis

For State-Level Stability: A Broad-Based Sales Tax is Needed



Source: Bureau of Economic Analysis

BUT WAIT…..

WON'T TAX INCREASES KILL THE ECONOMY?

NOPE:

Economic Growth

- A rigorous 2012 study commissioned by the U.S. Small Business Administration (SBA) found:

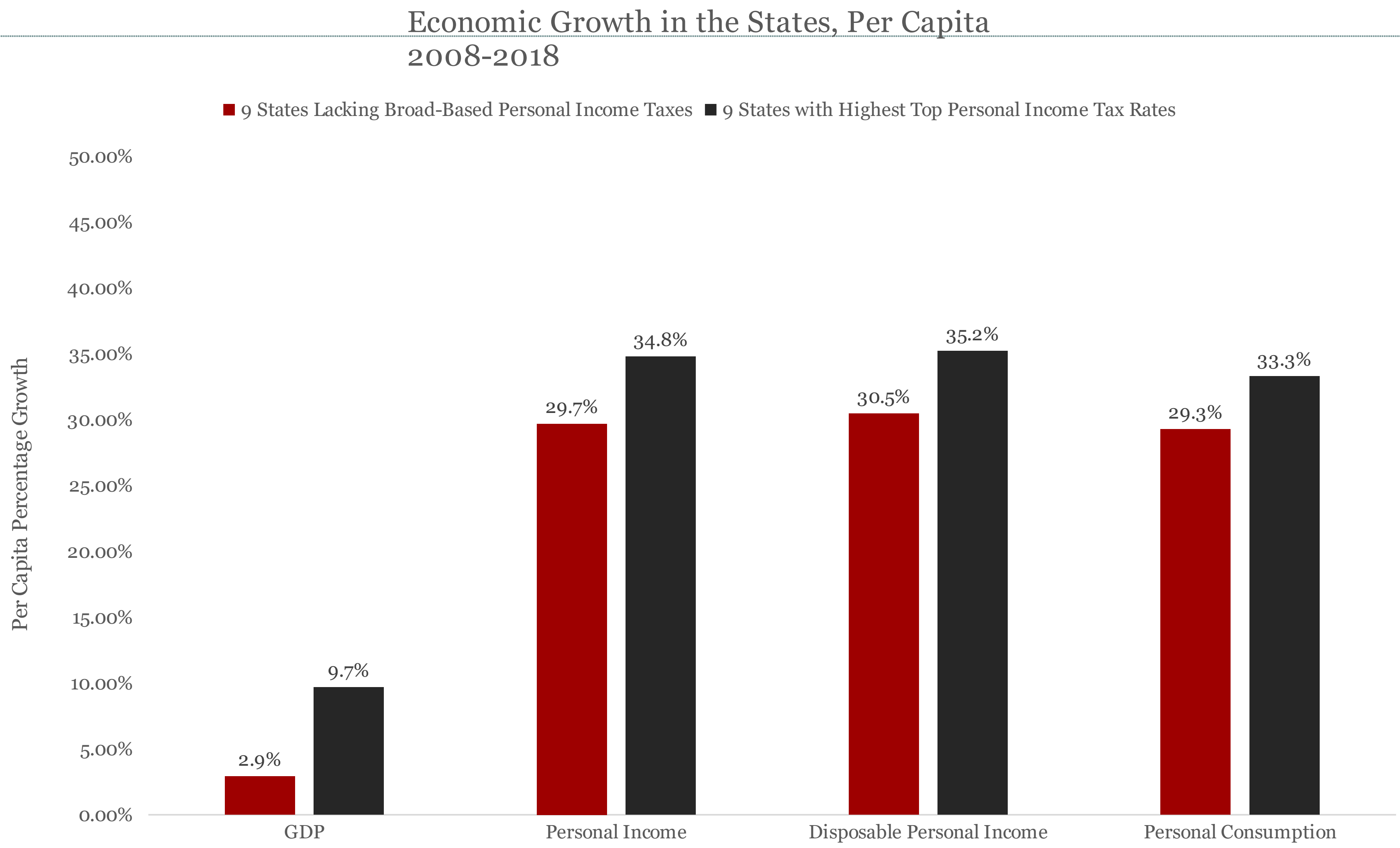
  - " No evidence of an economically significant effect of state tax portfolios on entrepreneurial activity."
    Can State Tax Policy be Used to Promote Entrepreneurial Activity, Small Business Economics, 2012.
  - The Harry S. Truman Institute @ University of Missouri found that when benefit of a tax break is measured against the economic loss generated by spending cuts—there is always a NET ECONOMIC LOSS.
  - The CBO found no correlation between tax policy & job creation. . . . Private sector demand is what counts.

Two Recent Examples:

- Kansas
  - Cut top personal income tax rate from 6% to 4.5% in 2012
  - Projected to reduce revenue by $920 million in FY2017
  - Income tax as share of state revenue fell from 50% to 40%

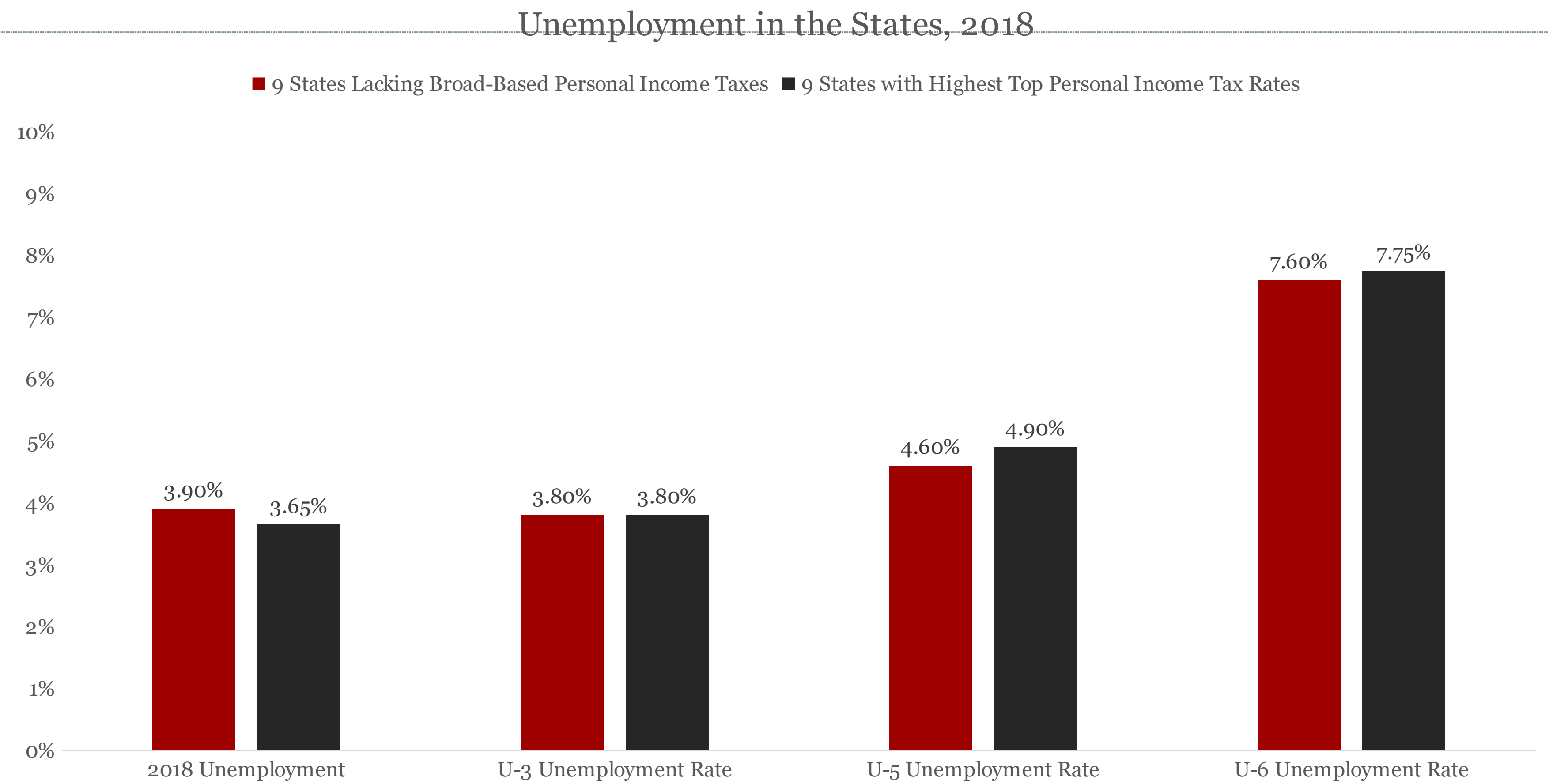
- Minnesota
  - Mark Dayton inherited a
    - $6.2 billion deficit
    - 7% unemployment
    - Only 4,000 new jobs prior 7 years
  - So he raised top income tax rate from 7.85% to 9.85%, and 4 years later
    - 172,000 new jobs
    - 3.9% unemployment
    - $1.2 B surplus

High Income Taxes and the Economy



Source: Bureau of Economic Analysis Data

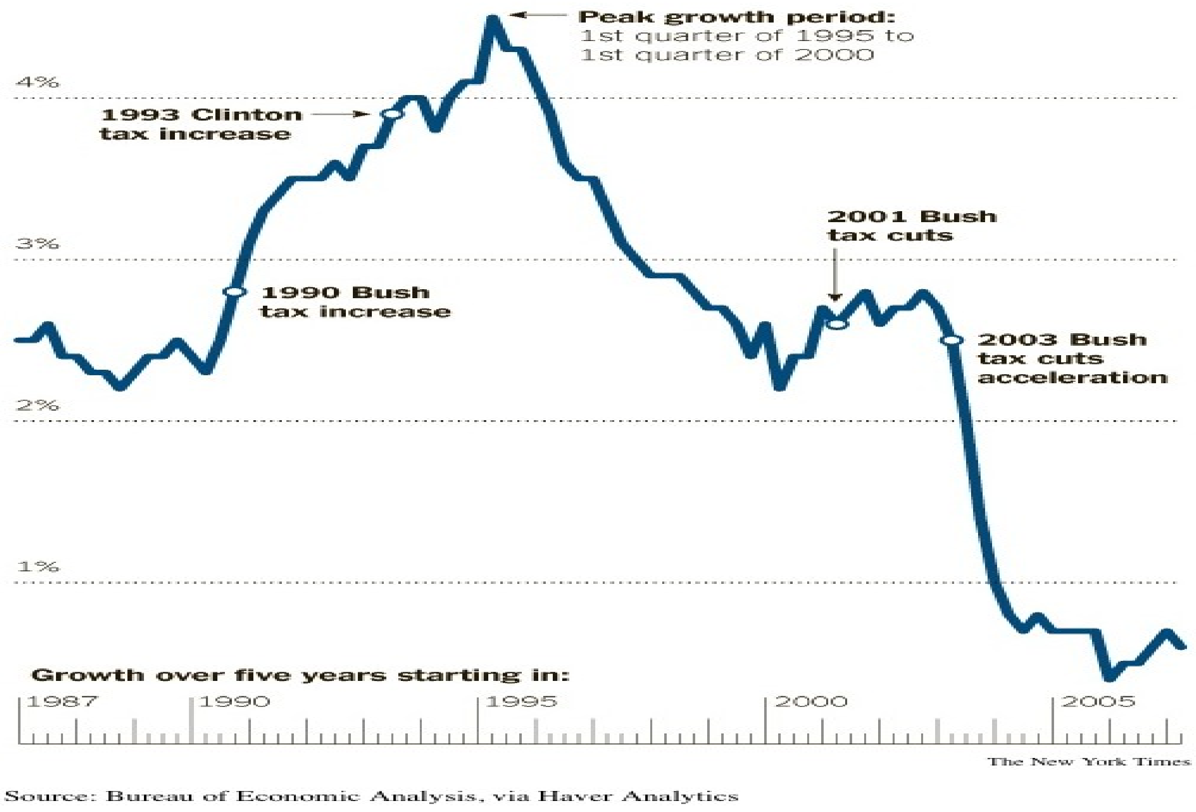
Unemployment in the States, 2018



Source: Bureau of Labor Statistics

Even Nationally: Economic Growth Isn't Necessarily Stymied by a Progressive Income Tax Rate Increase

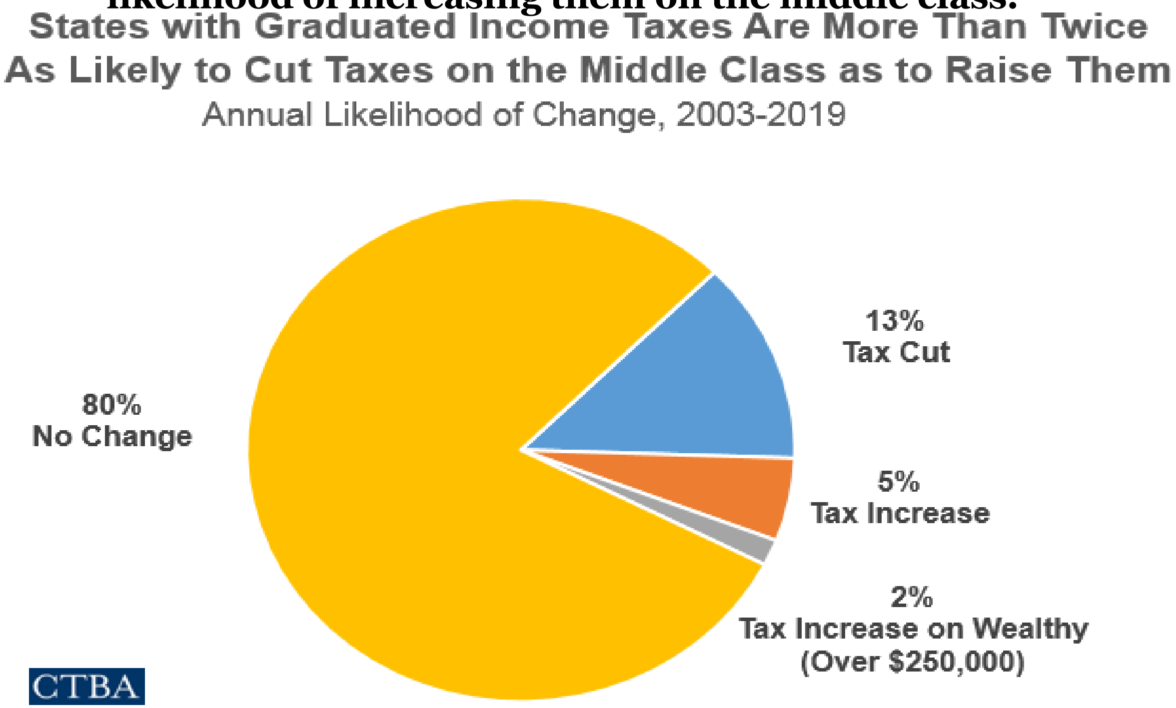
Economic Growth Rates Following Periods of Tax Increases and Tax Cuts



Henry Blodget, Bombshell: New Study Destroys Theory That Tax Cuts Spur Growth, September 21, 2012 http://www.businessinsider.com/study-tax-cuts-dont-lead-to-growth-2012-9

States with Graduate Rate Income Tax Structures are Less Likely to Increase Taxes on the Middle Class

Since 2003, states with GRIT had a roughly 13 percent likelihood of cutting taxes — versus just a five percent likelihood of increasing them on the middle class.



Oh, & When Illinois Raises Taxes

- People won't run screaming out of the state:
  - Since 1925, IL has had net outmigration every year except one
  - Illinois' outmigration rate actually declined in 2011, the first year of the temporary tax increase
  - A greater % of the populations of IN and WI moved into IL since the temporary tax increase, than vice-versa

For More Information

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