

# Issues of growth—concerns in remedying Illinois unpaid debt

Bill Testa

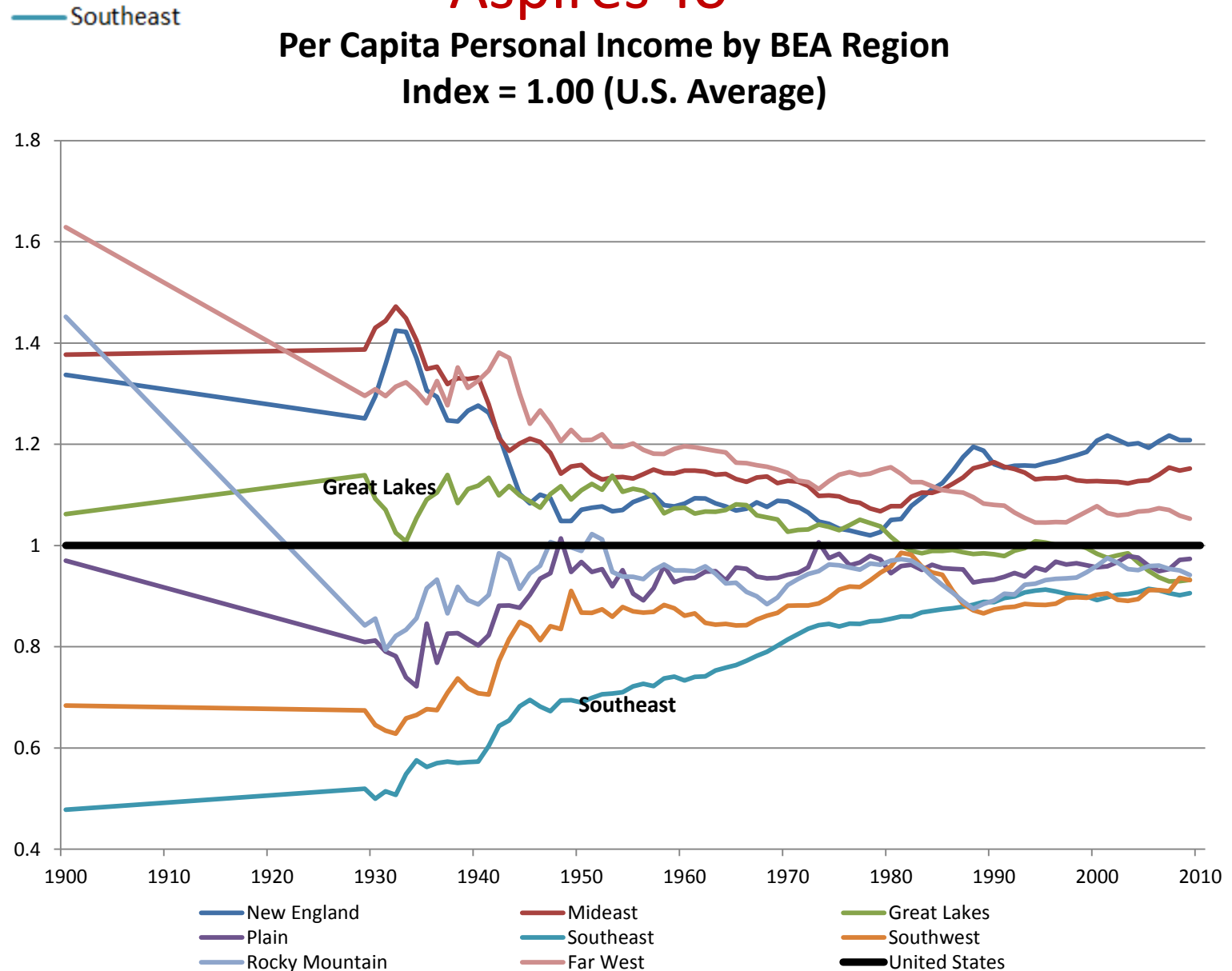
Federal Reserve Bank of Chicago

April 4, 2013

# Outline

- Do (*can*) Tax Differences Matter to Growth?
- Have Illinois taxes historically been out of line (no)?
- What might be future tax rates, and should we be concerned?

# U.S. Regions have Accomplished What the EU Aspires To



# Do taxes matter? The presumption is yes, but how much is important

## Finding effects of tax rate differences is not easy: WHY?

- State-local taxes not biggest part of business tax bills; and what is a business tax?
- States have not allowed tax burdens to get out of line (J. Shannon “convoy”)
  - Deskins & Hill: convergence 1985 to 2003 total state tax per capita; std dev 6.3% to 2.8% (ditto as measured % of Personal Income)
- State spending (service levels and mix) matters (e.g. Jay Helms); “Tax hills” (e.g. Bania and Stone)
- Tax structure, too
- No “output” measures of services provided, only \$s
- Bottom line: Many other factors obfuscate any effect (i.e. labor, location, natural advantage, industry mix, climate)

# Studies find limited impacts as compared to other factors

- Marginal (small) impact (elasticities) of state-local tax burden across states and MSAs found to be modest (e.g.  $-.1$  to  $-.3$ )
  - (e.g. “meta-analyses) T. Bartik, 1991 to Phillips & Goss, SEJ, 1995, Wasylenko 1997 NEJ)
- *Intra-area (i.e. local)* impacts much larger ( $-1.0$  +)

*Inter-area* studies find small marginal impacts of state-local tax burden differences on growth; *intra-area* much larger

Table 2.3  
Summary of Econometric Studies of Tax Effects on Business Location

|  | Percentage of Studies<br>With At Least One<br>Statistically<br>Significant<br>Negative Tax Effect | Mean Elasticity of<br>Business Activity<br>With Respect<br>to Taxes [Range] | Trimmed<br>Mean<br>Elasticity           | Median<br>Elasticity |
|--|---|---|---|----------------------|
|  | (1)   | (2)   | (3)                                     | (4)                  |
| Inter-area studies   | 70%<br>(57 studies)   | -.25 (s.e. = .05)<br>[-1.40 to .76]<br>(48 studies)                         | -.22<br>[-.73 to .04]<br>(38 studies)   | -.15                 |
| Inter-area studies<br>with controls for<br>"fixed effects" | 92%<br>(12 studies)   | -.44 (s.e. = .11)<br>[-1.02 to 0]<br>(11 studies)                           | -.43<br>[-.88 to -.07]<br>(7 studies)   | -.35                 |
| Inter-area studies<br>with public<br>service controls      | 80%<br>(30 studies)   | -.33 (s.e. = .09)<br>[-1.40 to .76]<br>(25 studies)                         | -.33<br>[-.77 to 0]<br>(19 studies)     | -.27                 |
| Intra-area studies   | 57%<br>(14 studies)   | -1.48 (s.e. = .54)<br>[-4.43 to .62]<br>(9 studies)                         | -1.36<br>[-2.70 to 0]<br>(7 studies)    | -1.59                |
| Intra-area studies<br>using specific<br>community data     | 70%<br>(10 studies)   | -1.91 (s.e. = .60)<br>[-4.43 to .62]<br>(7 studies)                         | -1.91<br>[-2.70 to -.79]<br>(5 studies) | -1.95                |

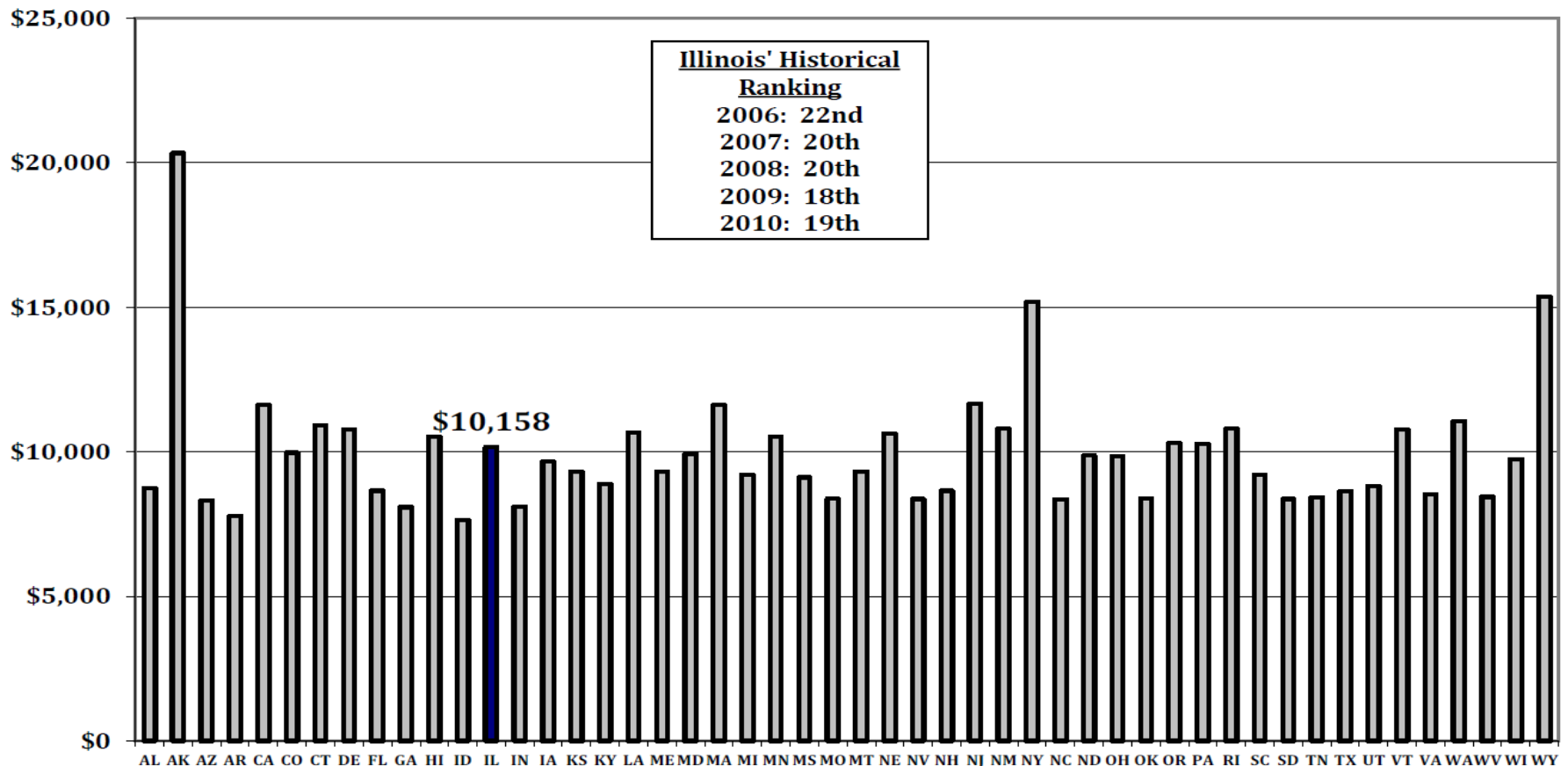
Source: Timothy J. Bartik, "Who Benefits from State and Local Economic Development Policies?", Upjohn Institute.

# Outline

- Do Tax Differences Matter to Growth?
- Have Illinois taxes historically been out of line?  
(and why?)
- What might be future tax rates, and should we be concerned?

# Overall government spending in Illinois has been average (however it is financed)

**CHART 27: Per-Capita State and Local Government Total Expenditures in 2010  
(National Per Capita = \$10,070)**

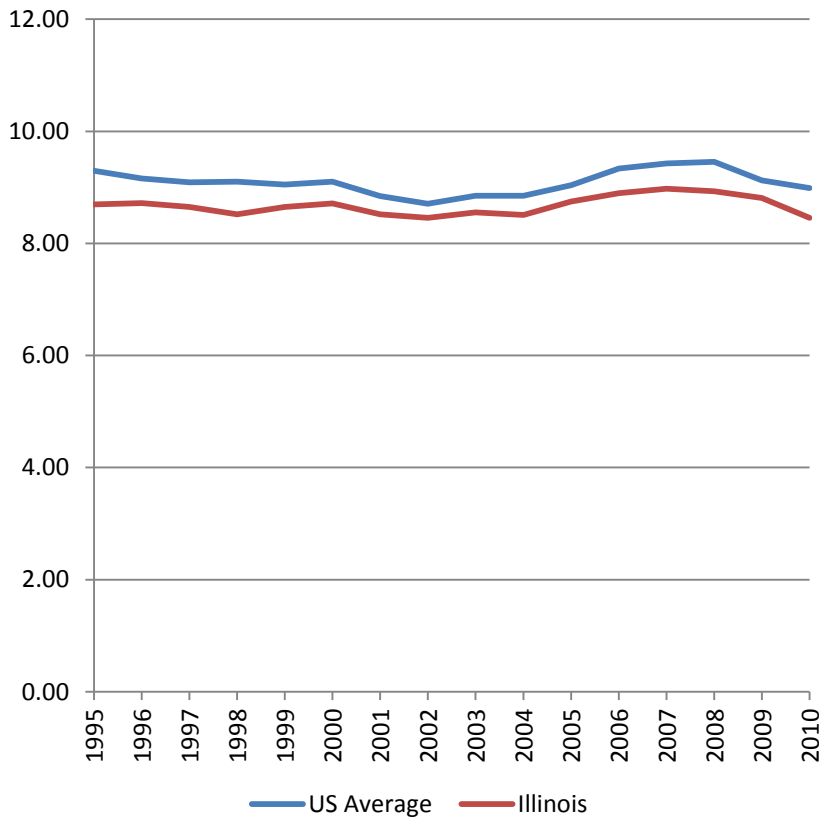


Source: U.S. Census Bureau, 2011 Annual Survey of State Government Tax Collections, 2010 Annual Surveys of State and Local Government Finances.

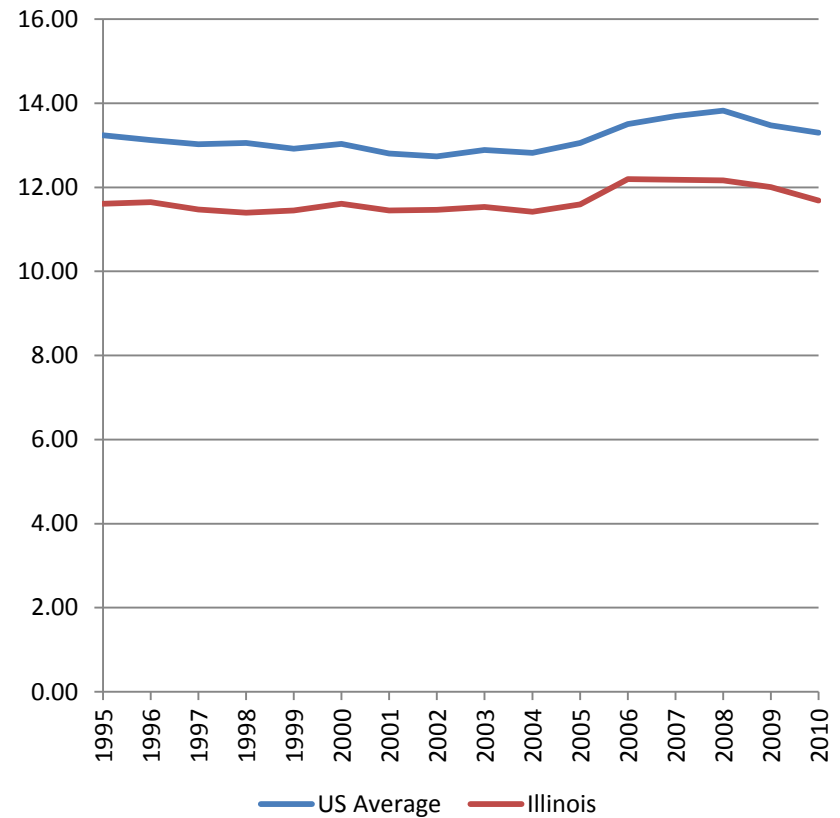


# Illinois' tax rates had been modestly below average—we either underfund services or underspend

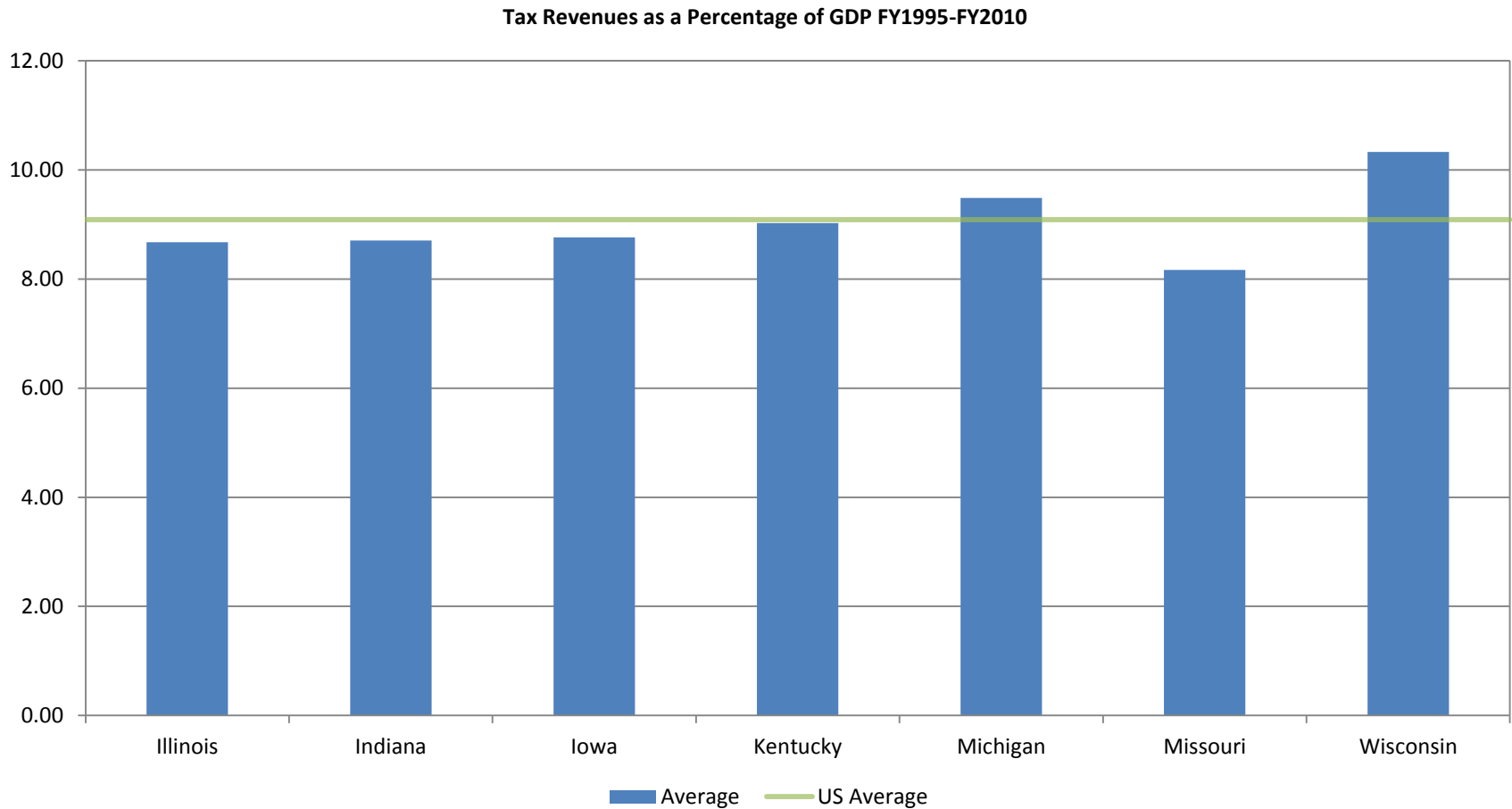
State and local taxes as a percent of GDP FY1995-FY2010



State and local own source revenue as a percent of GDP FY1995-FY2010

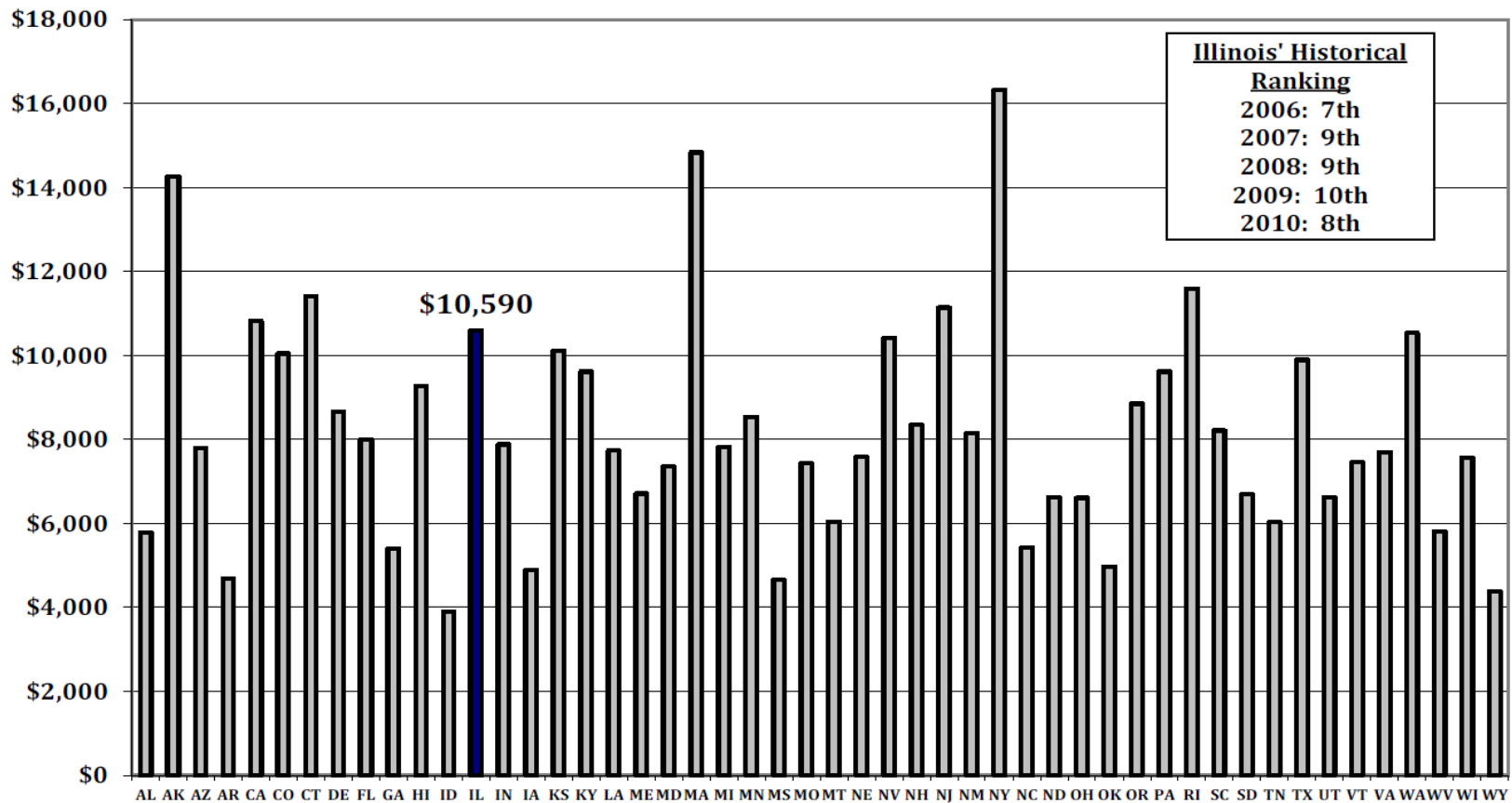


# Tax rates by neighboring states—all were within .5 % pt. of U.S. average except Wisconsin



It appears that Illinois has been borrowing against the future to provide services: State-local debt outstanding ranks high (per capita), here shown aside from pension obligations

**CHART 46: Per Capita State and Local Government Debt Outstanding in 2010**  
(National Per Capita = \$9,146)



Source: U.S. Census Bureau, 2011 Annual Survey of State Government Tax Collections, 2010 Annual Surveys of State and Local Government Finances.

# Outline

- Do Tax Differences Matter to Growth?
- Have Illinois taxes historically been out of line? (and why?)
- What might be future tax rates, and should we be concerned?

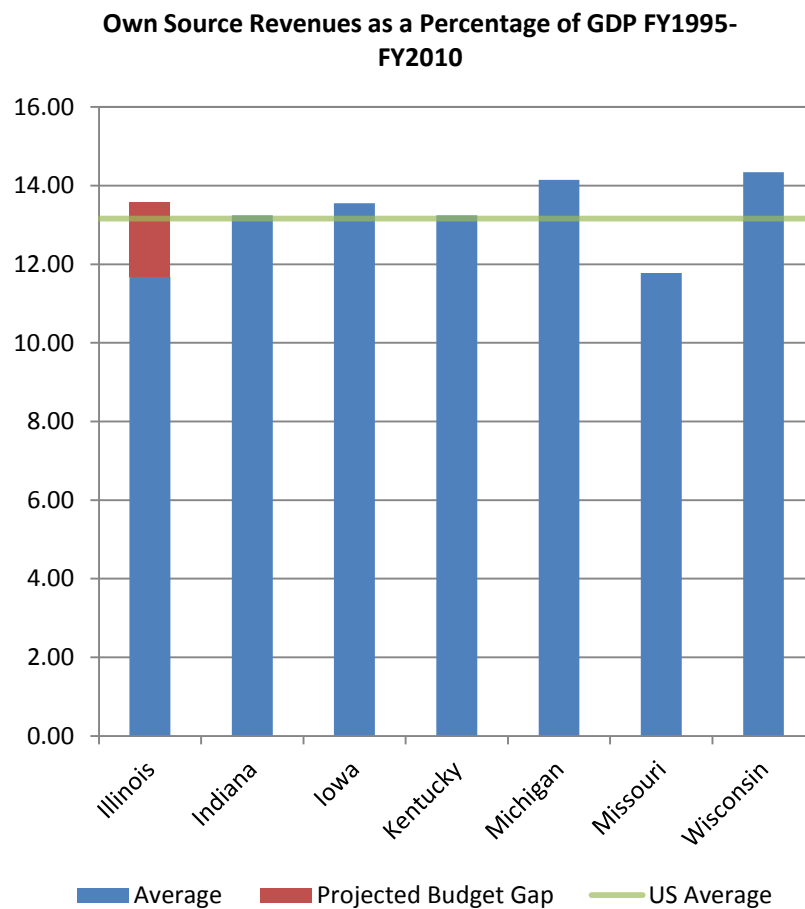
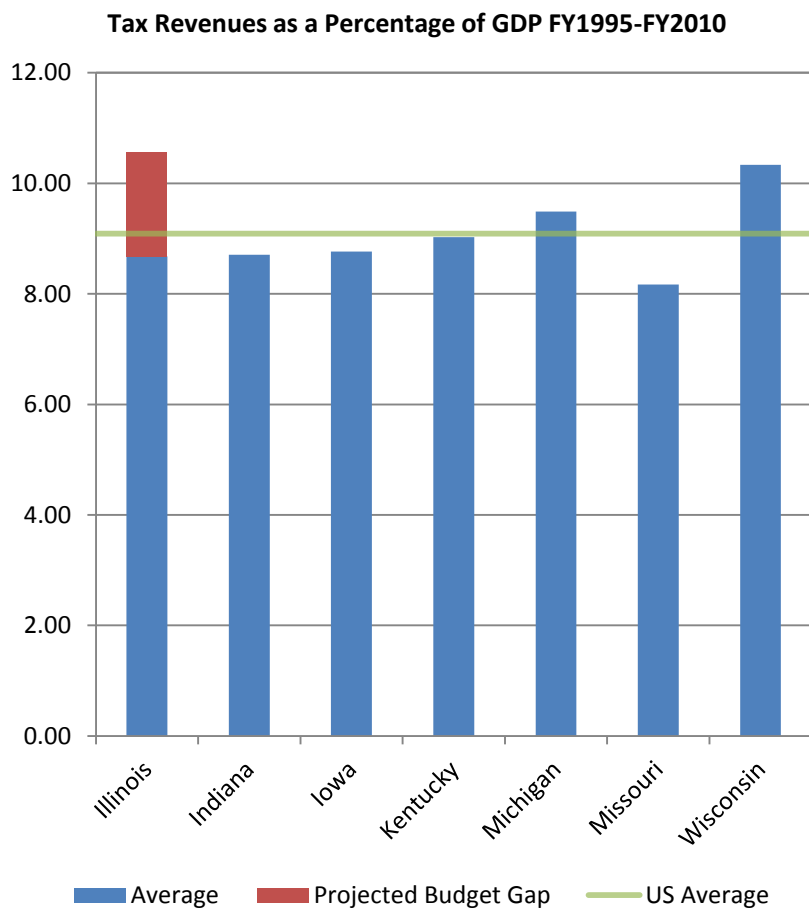
Exercise: What do Illinois state budget gaps (all funds) look like going forward (if pensions paid on 30-year ARC, without any income or other tax increases) ?

| Illinois Fiscal Futures Model Projections (\$Billions) |              |                      |                                |
|--|--------------|----------------------|--------------------------------|
|  | Baseline gap | Without tax increase | No increase and paying the ARC |
| 2011   | 7.0          | 10.1                 | 10.1                           |
| 2012   | 6.2          | 13.2                 | 13.2                           |
| 2013   | 4.9          | 12.0                 | 12.0                           |
| 2014   | 1.6          | 8.9                  | 12.4                           |
| 2015   | 4.1          | 9.1                  | 12.6                           |
| 2016   | 6.0          | 8.7                  | 11.9                           |
| 2017   | 6.5          | 9.3                  | 12.3                           |
| 2018   | 6.8          | 9.7                  | 12.4                           |
| 2019   | 7.0          | 10.0                 | 12.4                           |
| 2020   | 6.4          | 9.5                  | 11.6                           |
| 2021   | 6.7          | 9.9                  | 11.7                           |
| 2022   | 7.1          | 10.5                 | 11.8                           |
| 2023   | 7.5          | 11.0                 | 12.0                           |
| Average  | 6.0          | 10.1                 | <b>12.0</b>                    |
| % of FY2010 GDP  | 0.9          | 1.6                  | <b>1.9</b>                     |

Source: University of Illinois Institute of Government and Public Affairs Fiscal Futures Model.

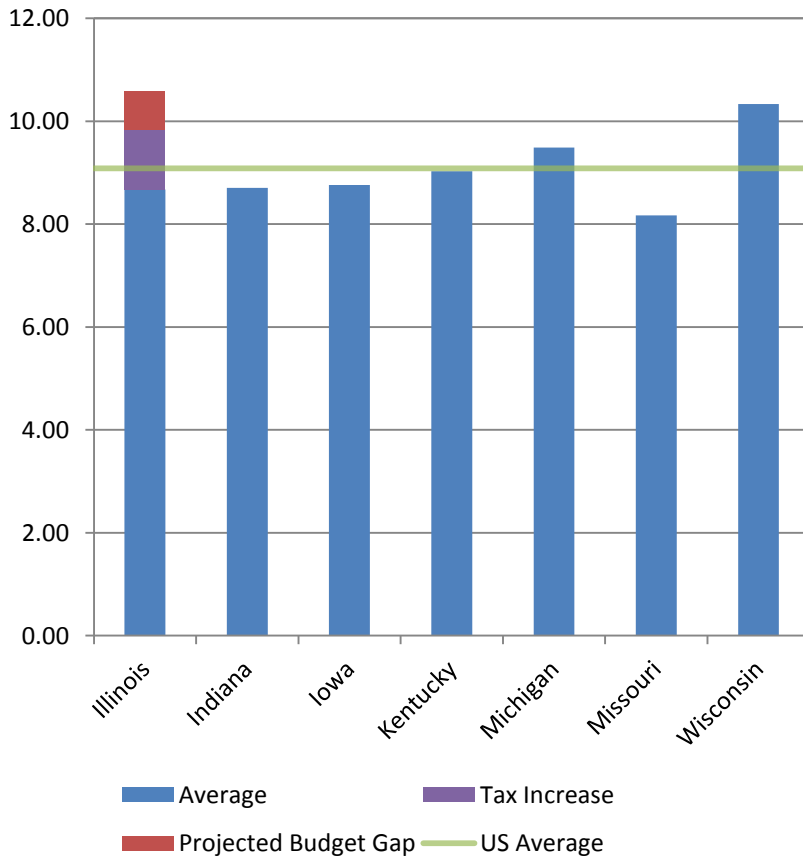
<http://igpa.uillinois.edu/fiscalfutures>

And what if.... A 1.9 percent of GDP budget gap had been added to Illinois' tax rates of the past 15 years? ( e.g. a 22 percent greater tax rate; 15 percent > national avg.)

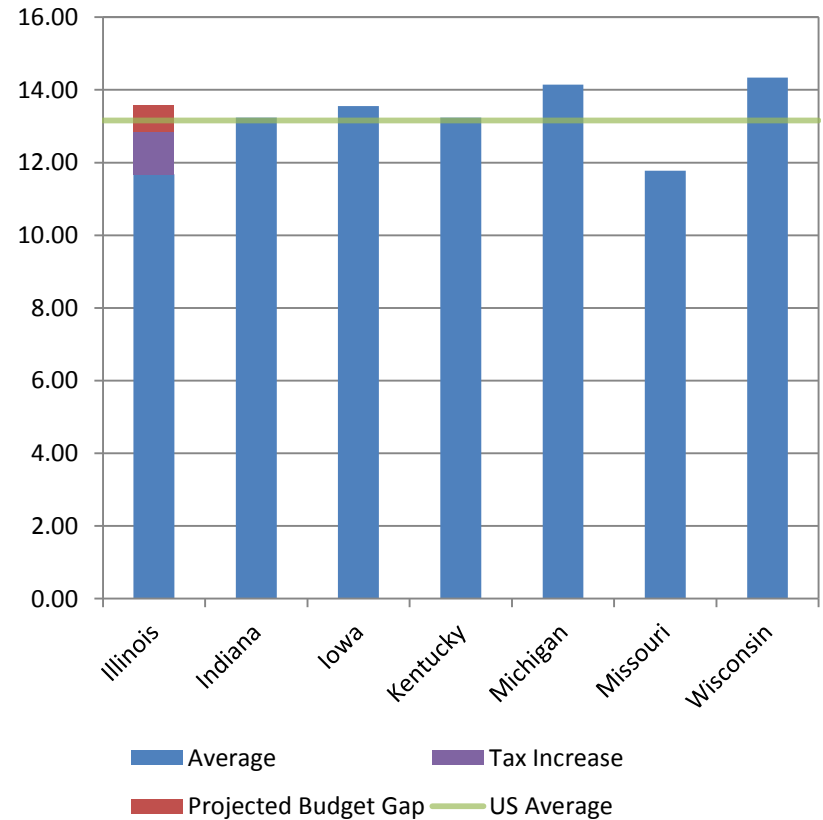


# The recent Illinois tax rate hikes on personal and corporate income would not have covered this shortfall

Tax Revenues as a Percentage of GDP FY1995-FY2010



Own Source Revenues as a Percentage of GDP FY1995-FY2010



# Neighboring states also carry unfunded pension-type debt, though Illinois debt problems go well beyond state government alone

Unfunded local government debt in Illinois may also be problematic;

| Per Capita Unfunded Liability FY2010 |         |                    |       |
|--------------------------------------|---------|--------------------|-------|
|                                      | Pension | Retiree Healthcare | Total |
| Illinois                             | 5,955   | 3,421              | 9,376 |
| Indiana                              | 2,108   | 59                 | 2,167 |
| Iowa                                 | 1,693   | 164                | 1,857 |
| Kentucky                             | 3,929   | 1,727              | 5,655 |
| Michigan                             | 2,203   | 4,509              | 6,712 |
| Missouri                             | 2,201   | 519                | 2,720 |
| Wisconsin                            | 0       | 273                | 273   |

Source: Pew Center for the States, 2012.

- State retiree health care (\$40B+)
- City of Chicago pension unfunded liability (\$27B, w. CPS, police and municipal workers highest).
- \$6 billion Cook County
- many uncounted (undercounted) local gov't funds in Ill.
- total estimates of \$200 billion not unreasonable (and 8% discount rate on unfunded pension debt extremely generous)



# Findings of statistical studies, implications for Illinois

- Marginal (small) impact (elasticities) of state-local tax burden found to be modest (e.g. -.1 to -.3 )
  - However, conservatively, aggregate tax rates alone might need to rise by 15-22 percentage points over national average, over a medium term to balance budgets and pay down existing debt
- *Intra-area (i.e. local)*, impacts much larger (-1.0 +)
  - ? How much of Illinois economy faces a border situation?
    - 2/3 of Illinois economy within Chicago MSA (plus fringe in Rockford, Quad Cities, E. St. Louis, etc....3/4?)

-----  
At the outside, might we consider .5 elasticity X 40 pct. pts. tax rate (\$200b) = 20% deleterious impact on growth?

# Concluding thoughts and issues

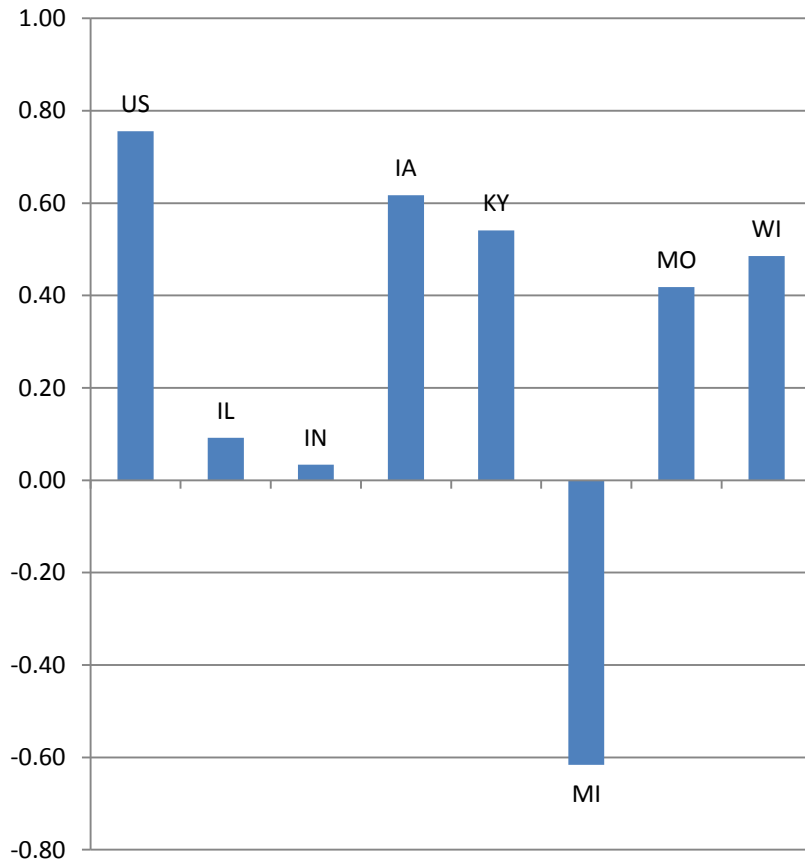
- Illinois had been conservative on spending side, but likely underfunded service expenditures
- As a result, debt obligations are very high
- State-local tax burdens not found overwhelming impact on growth...BUT
  - In Illinois, Tax adjustment could be large
  - Borders are close, so flight could be sensitive

**SHOULD WE BE CONCERNED TO THE EXTENT TO NOT HONOR ALL LIABILITIES?**

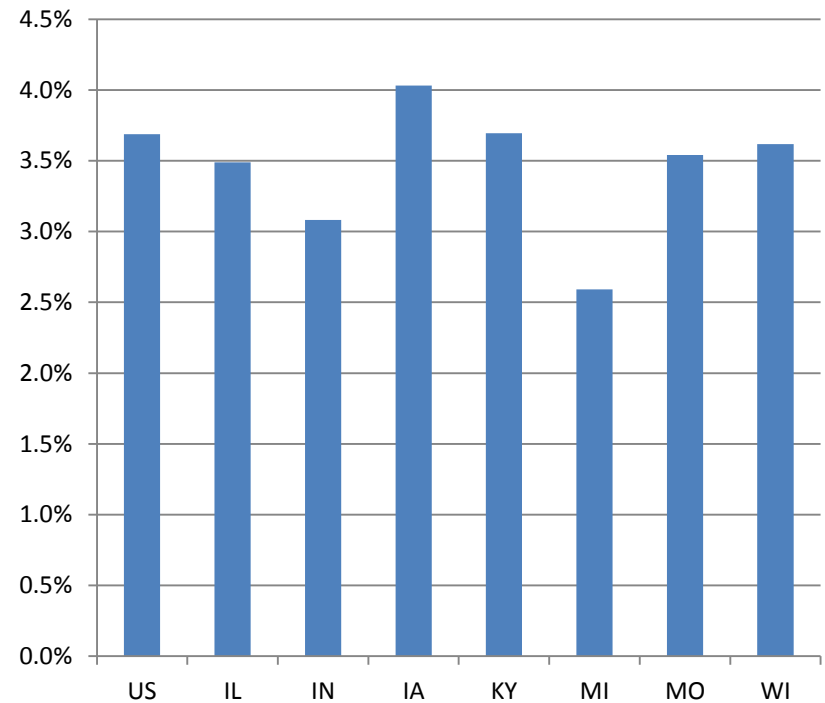
**I am concerned....**it is different to say that, generally speaking “taxes matter little” from “taxes **CAN** matter”

# Illinois growth has not been robust

Payroll Employment CAGR FY1995-FY2010



PCY CAGR FY 1995-2010



# Are uncertainty or recent tax hikes slowing Illinois' economy of late?

