Issues of growth—concerns in remedying Illinois unpaid debt

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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

Per Capita Personal Income by BEA Region
Index = 1.00 (U.S. Average)
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

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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)

Illinois' Historical Ranking
2006: 22nd
2007: 20th
2008: 20th
2009: 18th
2010: 19th

Illinois’ tax rates had been modestly below average—we either underfund services or underspend.

[Graph showing State and local taxes as a percent of GDP FY1995-FY2010 and State and local own source revenue as a percent of GDP FY1995-FY2010 with data from 1995 to 2010 for US Average and Illinois.]
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)

$10,590

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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) ?

<table>
<thead>
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<th>Year</th>
<th>Baseline gap</th>
<th>Without tax increase</th>
<th>No increase and paying the ARC</th>
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<tr>
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<tr>
<td>2013</td>
<td>4.9</td>
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<tr>
<td>2023</td>
<td>7.5</td>
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</table>

Average: 6.0 10.1 12.0

% of FY2010 GDP: 0.9 1.6 1.9

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.
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:

-- 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?)

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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?

Illinois Unemployment rate premium over U.S.

12-month MovingAverage

Source: Haver Analytics