

Issues of growth—concerns in remediating Illinois unpaid debt

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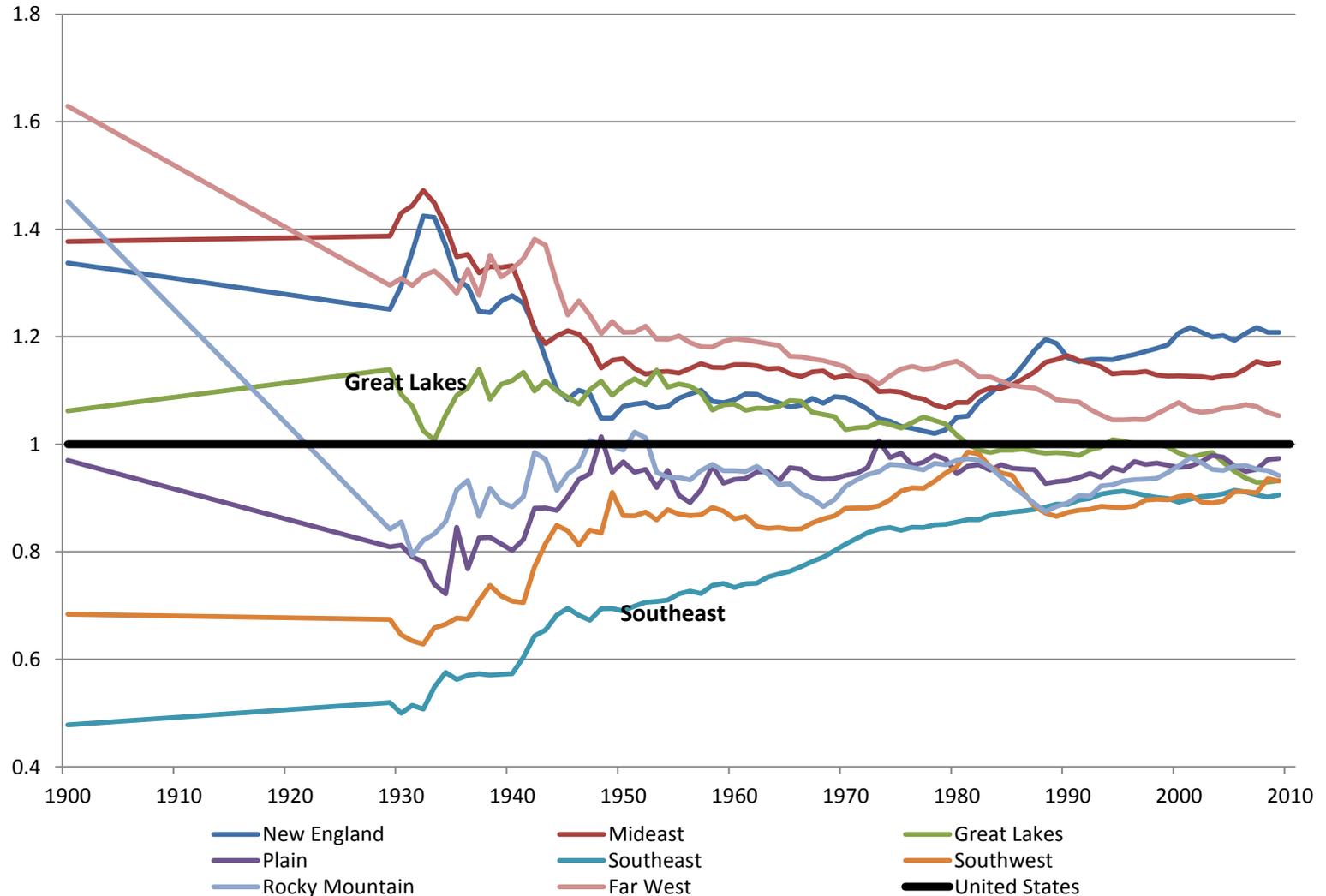
April 4, 2013

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

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

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

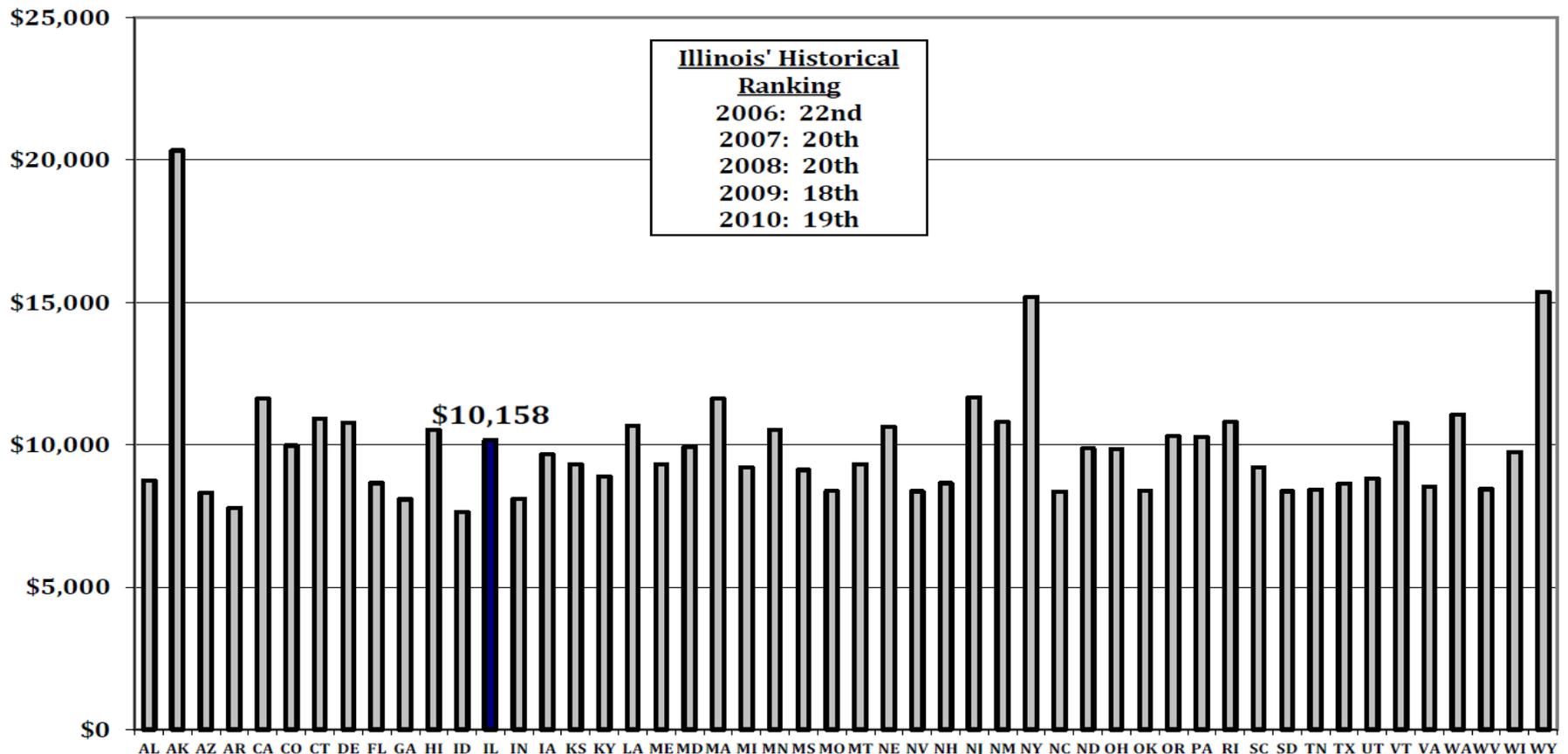
Source: Timothy J. Bartik, "Who Benefits from State and Local Economic Development Policies?", Upjohn Institute.

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

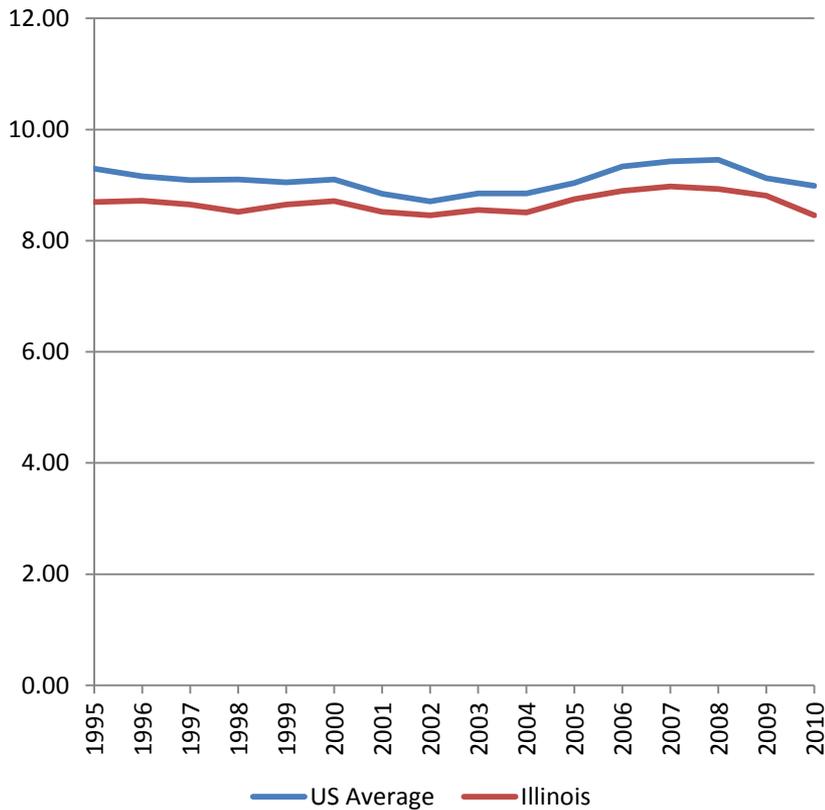
**CHART 27: Per-Capita State and Local Government Total Expenditures in 2010
(National Per Capita = \$10,070)**



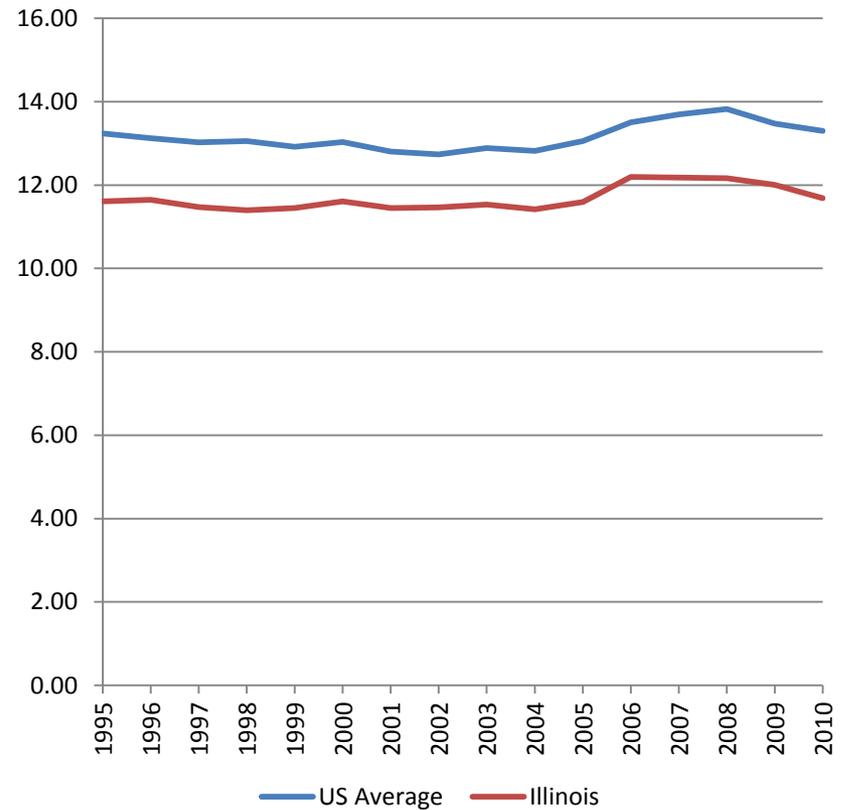
Source: U.S. Census Bureau, 2011 Annual Survey of State Government Tax Collections, 2010 Annual Surveys of State and Local Government Finances.

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

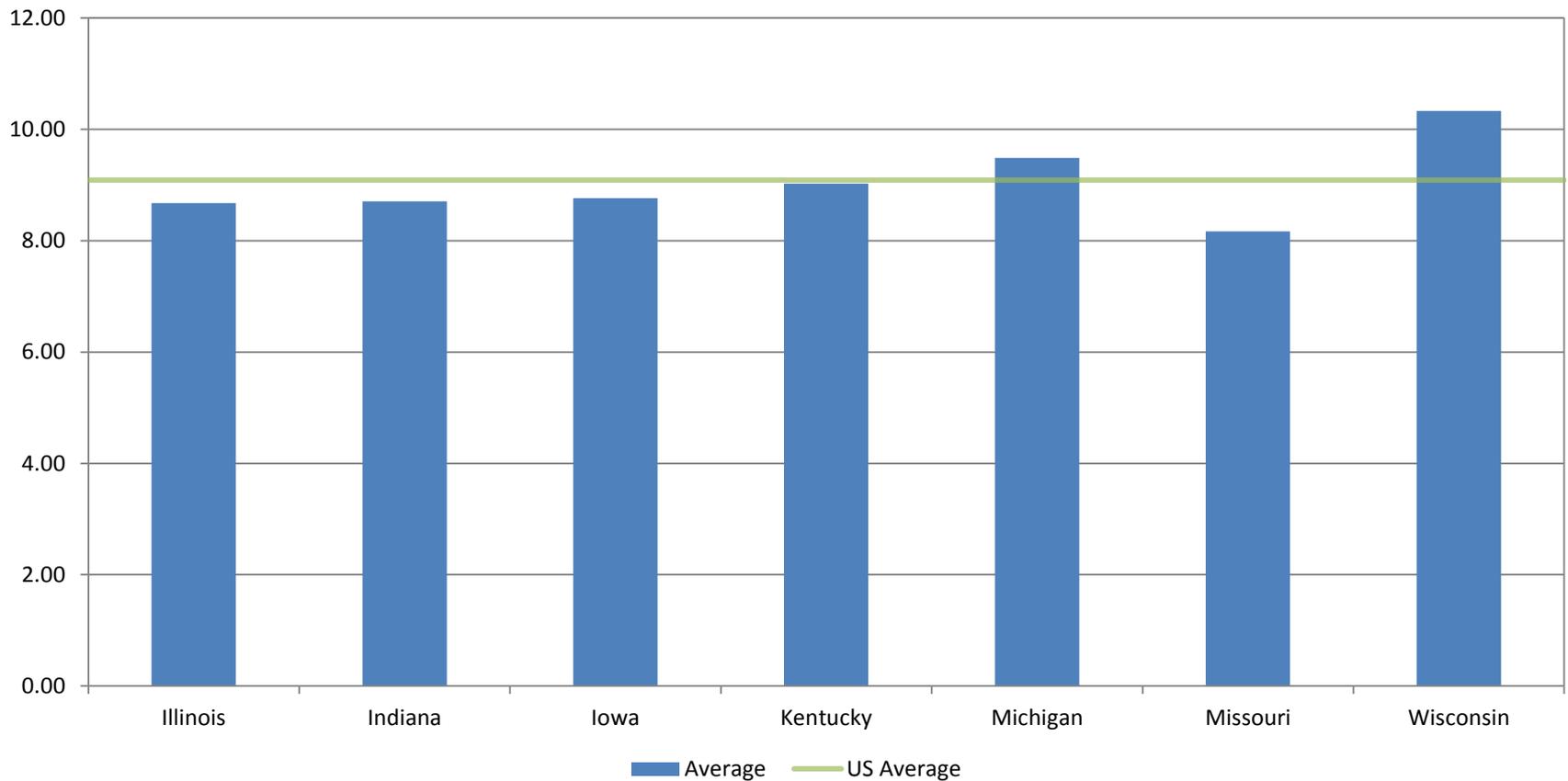


State and local own source revenue as a percent of
GDP FY1995-FY2010



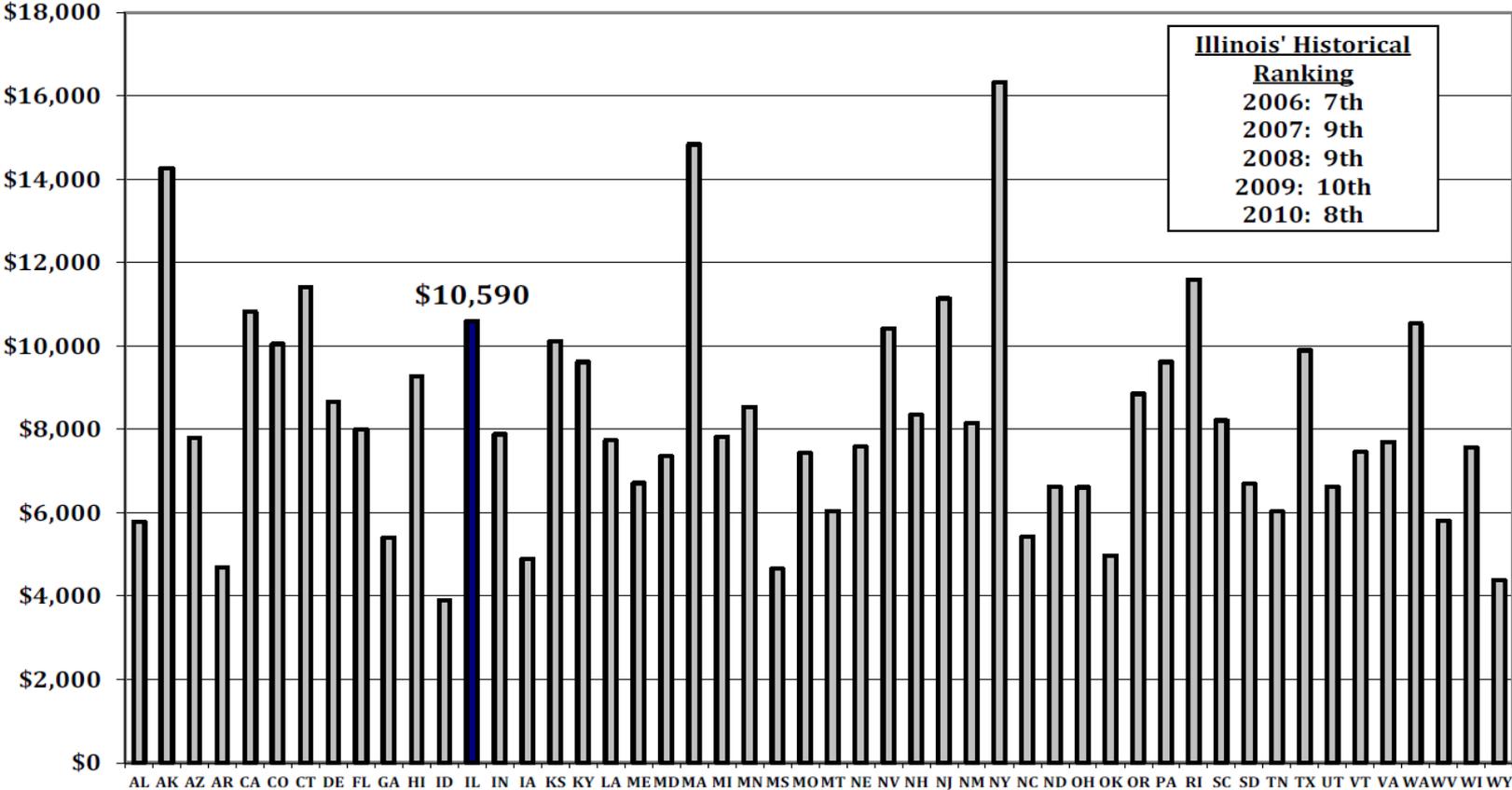
Tax rates by neighboring states—all were within .5 % pt. of U.S. average except Wisconsin

Tax Revenues as a Percentage of GDP FY1995-FY2010



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.

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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) ?

Illinois Fiscal Futures Model Projections (\$Billions)

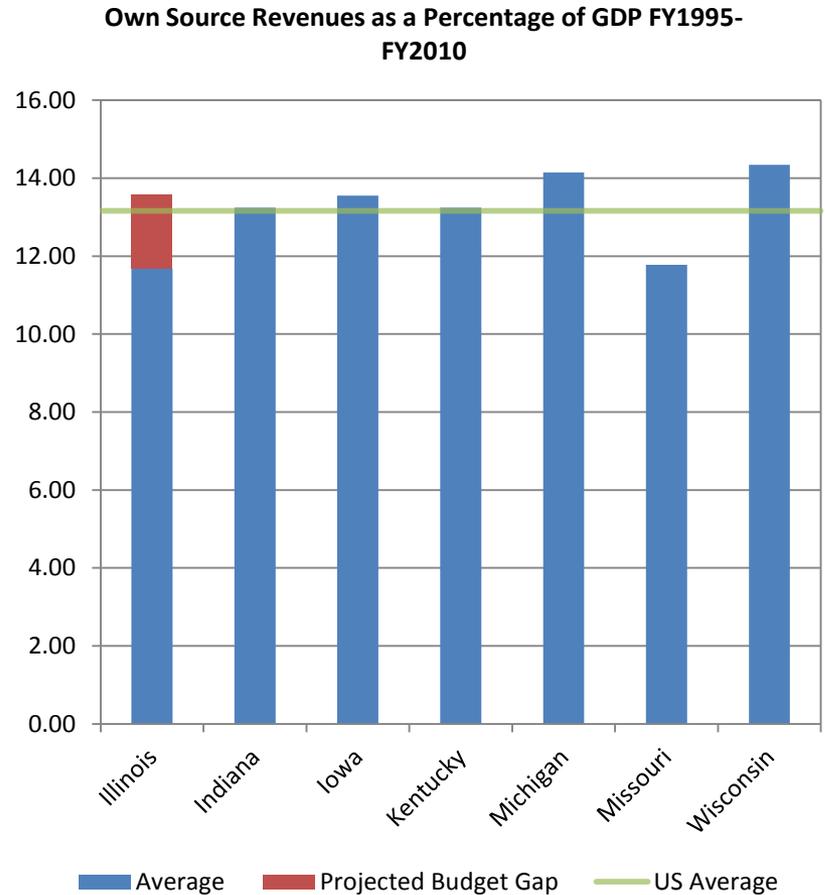
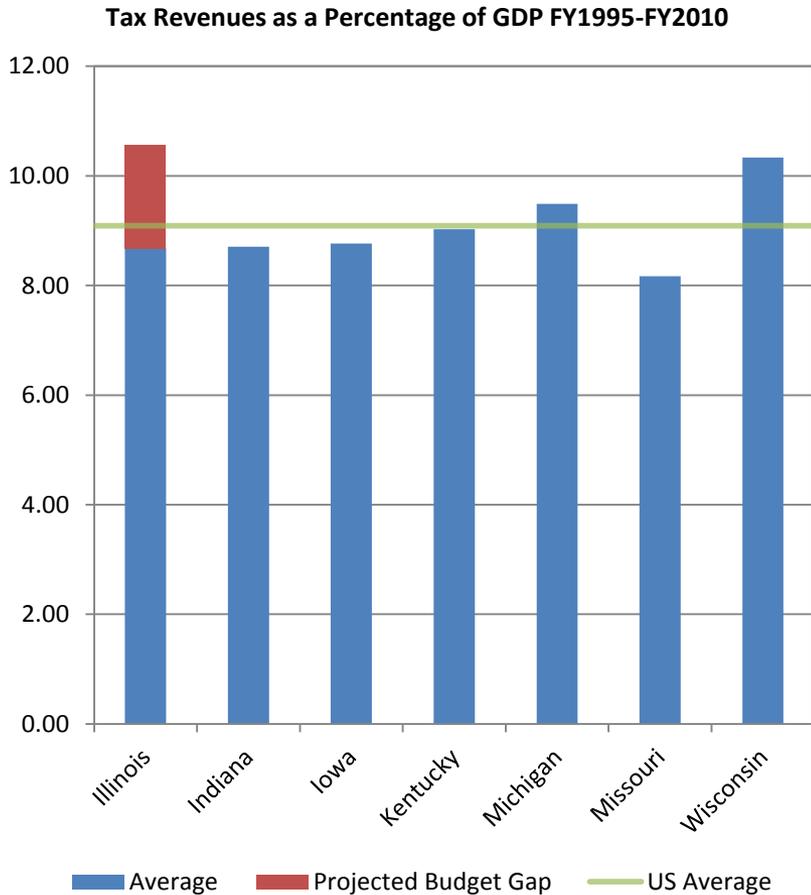
	Baseline gap	Without tax increase	No increase and paying the ARC
2011	7.0	10.1	10.1
2012	6.2	13.2	13.2
2013	4.9	12.0	12.0
2014	1.6	8.9	12.4
2015	4.1	9.1	12.6
2016	6.0	8.7	11.9
2017	6.5	9.3	12.3
2018	6.8	9.7	12.4
2019	7.0	10.0	12.4
2020	6.4	9.5	11.6
2021	6.7	9.9	11.7
2022	7.1	10.5	11.8
2023	7.5	11.0	12.0
Average	6.0	10.1	12.0
% of FY2010 GDP	0.9	1.6	1.9



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

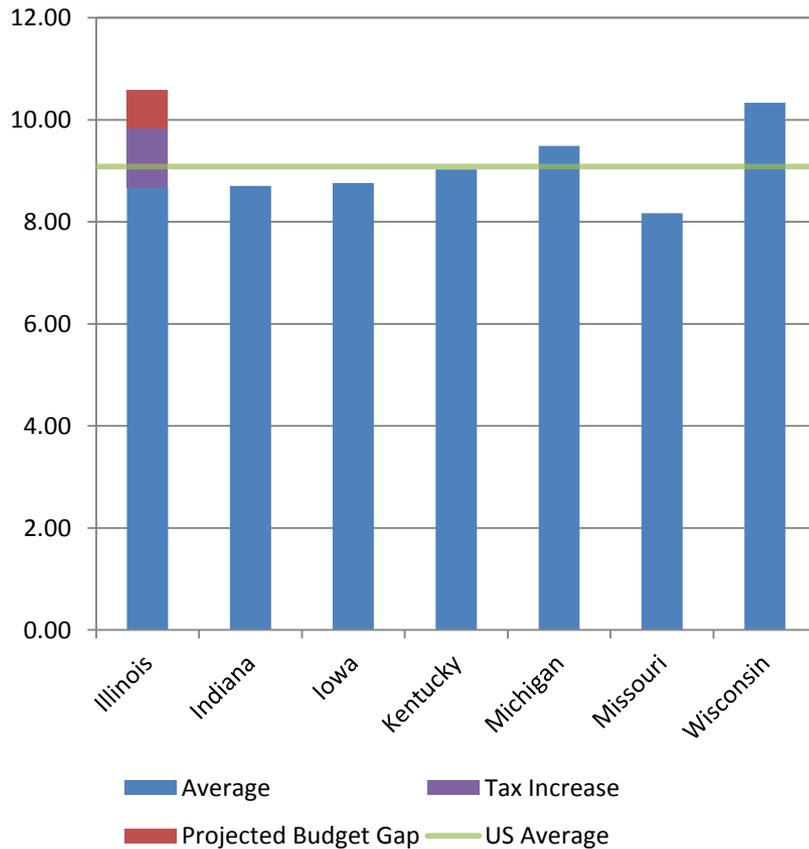
<http://igpa.uillinois.edu/fiscalfutures>

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.)

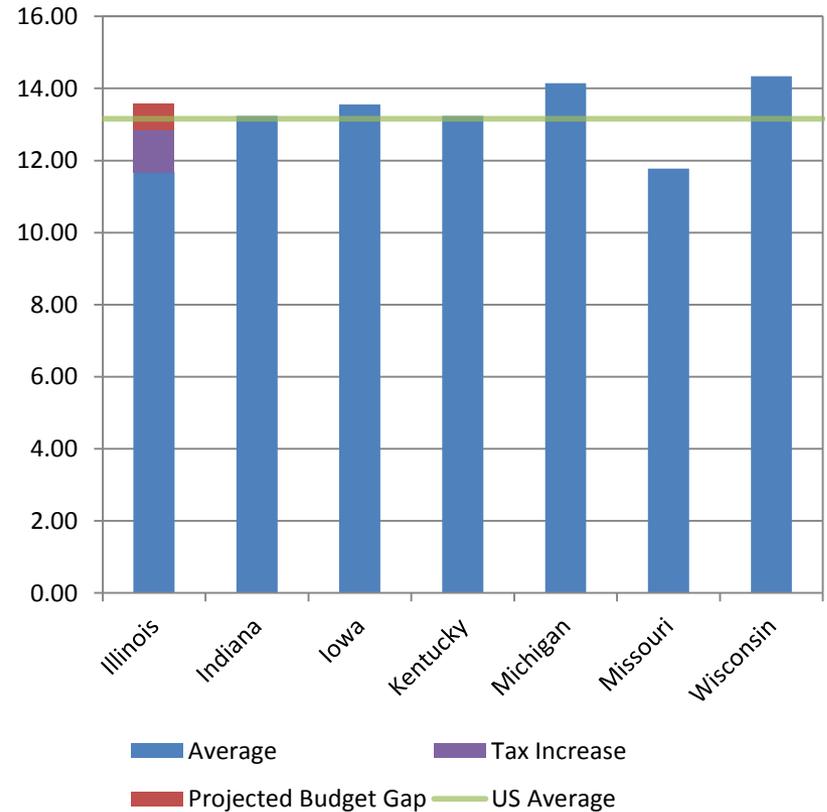


The recent Illinois tax rate hikes on personal and corporate income would not have covered this shortfall

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?)

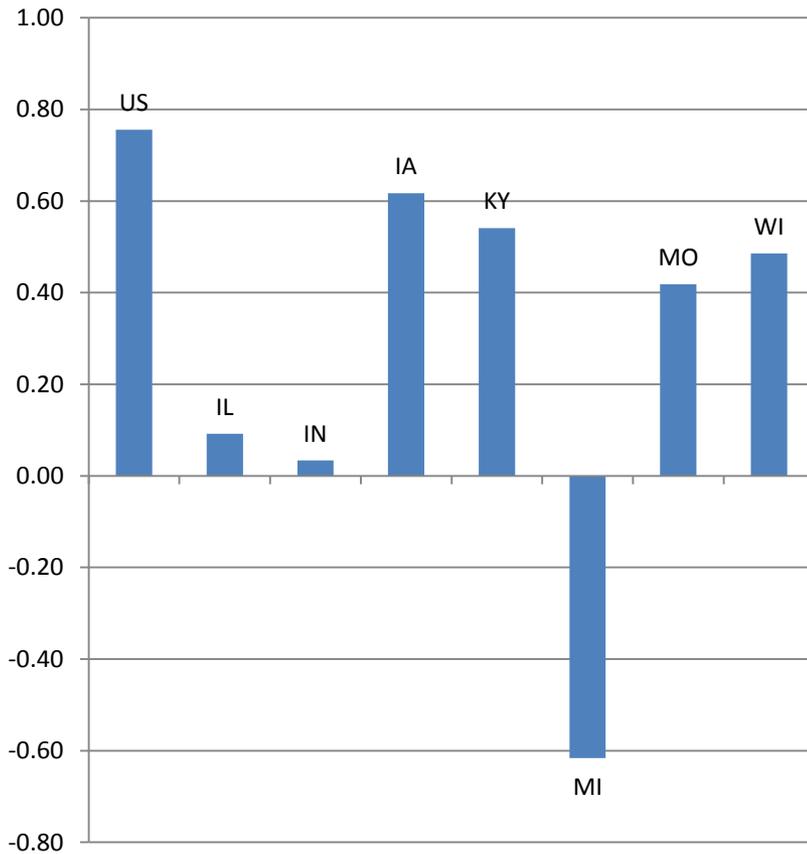
At the outside, might we consider .5 elasticity X 40 pct. pts. tax rate (\$200b) = 20% deleterious impact on growth?

Concluding thoughts and issues

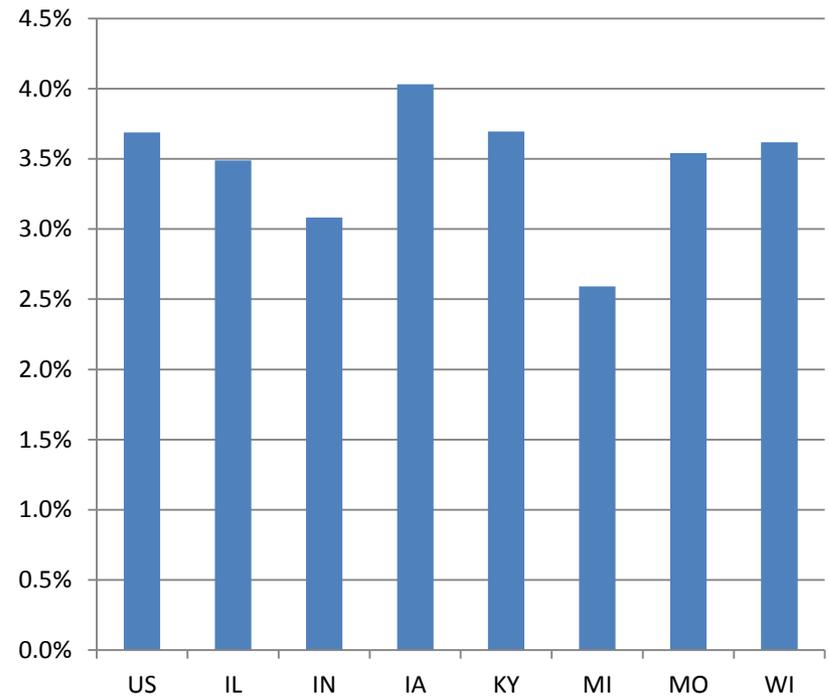
- Illinois had been conservative on spending side, but likely underfunded service expenditures
 - As a result, debt obligations are very high
 - State-local tax burdens not found overwhelming impact on growth...BUT
 - In Illinois, Tax adjustment could be large
 - Borders are close, so flight could be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

