

A GRADUATED INCOME TAX FOR A SUSTAINABLE BALANCED BUDGET IN ILLINOIS

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December 2018

Most of the states that border Illinois have progressive graduated income taxes, and their highest-earning residents pay income-tax rates which are higher than the flat income-tax rate that everybody pays in Illinois. This fact alone should tell Illinois citizens that apocalyptic warnings against a graduated income tax in Illinois have been somewhat exaggerated.

The motivation for Illinois's current constitutional requirement of a flat income-tax rate was apparently to increase the political difficulty of raising income taxes, as every taxpayer must be affected by any rate increase. But it is hard to argue that we live in a country where politicians find it too easy to raise taxes. Even at the federal level, where we have a progressive graduated income tax, a Congress led by self-proclaimed fiscal conservatives could not find the political will to raise taxes; instead they cut taxes and increased the federal deficit at a time of full employment. Everybody hates to pay taxes, and no politician wants to even talk about a tax increase if the subject can be avoided.

But the State of Illinois needs to raise more taxes, largely because for decades we have not been paying the taxes that were needed to fund the pensions that were promised to our public employees. A constitutional amendment to authorize a progressive graduated income tax in Illinois would allow the additional tax burden to be distributed in a way that most people consider more reasonable and fair, as households with greater income can generally afford to pay a larger fraction of their income without suffering severe hardship. For this reason, people in Wisconsin, Iowa, Missouri, and Kentucky have chosen to fund their state governments with graduated income taxes. Why not Illinois?

Opponents of any tax increase may breathlessly warn that higher taxes would drive people out of Illinois to lower-taxed states. But such claims are rarely accompanied by any consideration of how many people would actually move, and what the results would be for the rest of us who stay in Illinois. It is worthwhile to think through this question carefully.

The main reason why Illinois needs to raise taxes is because our failure to tax ourselves enough in the past has created an unfunded pension liability, currently estimated to be \$131.7 billion, which is almost \$28,000 per household. Imagine now what might happen if there were another nearby state that was just like Illinois in its cities and countryside, with all the same

industries and public services, except that the people in this alternative-Illinois made adequate pension-fund contributions for the past twenty years, so that they would have no unfunded pension liabilities. Their tax burden would certainly be lower, but does that mean that we would all move there? If some of us did, home values and rental rates in our (real) Illinois would begin to drop, and home prices in the alternative-Illinois would rise. But when the difference in the average home values got to about \$28,000, the incentive to move would vanish. Living in the real Illinois will require you to pay taxes sufficient to cover your share of a pension-liability debt that would not exist in the alternative-Illinois, but buying a home in the alternative-Illinois would require a larger home-mortgage debt, and your life would be similar, regardless of which debt you pay.

The point of this fable is that having higher taxes than neighboring states would not be a ruinous disaster for our state, although it would have some marginal effect on real-estate prices. Reducing taxes in Illinois, other things being equal, would increase home values in Illinois, which any homeowner here would welcome. But this gain might not be realized if the tax cut was achieved by cutting public services on which people depend. We would not necessarily be attracted to an alternative-Illinois with lower taxes if lower public spending there resulted in worse infrastructure, less public safety, and more desperate people on the street.

The discussion here has been simplified by an assumption that the long-term burden of taxes and provision of public services are predictable and well-understood. But our current unsustainable fiscal situation actually generates substantial uncertainty. When our taxes are not sufficient to pay for the public debt and public services that we have in Illinois today, something has to change. Will taxes increase, or will public services be cut? The answer is probably some of both, but there is great uncertainty about whose taxes will go up, and what services will be cut. Investors who could bring new jobs to Illinois are particularly averse to such uncertainty.

What Illinois needs is more honesty about our public budget, so that people can make well-informed decisions about public services and taxation in our state. Nobody likes paying taxes, but everybody relies on public services, and the state budget shows us how one is necessary for the other. Allowing a progressive graduated income tax in Illinois would give our political leaders more flexibility to pass a sustainable balanced budget which can fund the public services that are valued by the people who live here.

<https://home.uchicago.edu/~rmyerson/research/progressivetax.pdf>