Only tax increase can cure Illinois budget woes, study says

18 November 2009

Tax increases are the only solution to a widening budget crisis that a new study says has landed Illinois among the nation's most financially troubled states, a soon-to-be-released report by a team of University of Illinois economists warns.

Illinois is among nine states spiraling toward an economic disaster that could rival California, where a $24 billion budget shortfall has netted IOUs, widespread layoffs and forced furloughs, according to a study released last week by the Pew Center on the States, a nonpartisan think tank.

With a roughly $11 billion budget gap of its own, Illinois can only duck a similar meltdown by raising taxes, says Daniel McMillen, an economist with the U. of I. Institute of Government and Public Affairs who co-wrote an analysis of the state's fiscal crisis for an upcoming report on critical issues facing Illinois.

"In the end, I think we have to face up to the fact that Illinois has to have higher taxes," he said. "Budget cuts can't close a gap this wide and worsening. It's just not possible with major expenses like pension and Medicaid obligations that you simply can't reduce."

The best solution is a two-pronged plan that would boost sagging revenue by raising the state income tax and expanding sales-tax receipts through a new tax on services such as haircuts, plumbing repairs and health clubs, according to the report, co-written by IGPA economist Richard Dye and research assistant Nancy Hudspeth.

An income-tax increase, rejected by lawmakers last summer, would also ease the state's over reliance on sales tax, which lags during recessions and has seen its base narrow as Illinois' economy has shifted toward services, McMillen said.

"It's better to have a mix of taxes rather than to rely on any one tax too heavily," he said. "We have a relatively low income-tax rate and we have a sales tax that is not very broad based, so it's really hurting state government."

A sales tax on services could generate more than $7 billion annually, according to a report by a commission that provides financial forecasts for the General Assembly. A proposed 50 percent income-tax increase rejected in May would have netted $4 billion a year.

McMillen says tax increases are long overdue in Illinois, where budget shortfalls have been mounting for nearly a decade.

"It really should have been done 10 years ago, when the economy wasn't in bad shape," he said. "But even though the recession is a bad time to raise taxes, I still think they need to do it right away."

McMillen hopes the Pew Center's dire forecast builds new support for tax increases, among legislators and the public.

"Illinois has traditionally been in the middle of the pack in reports on states' financial stability," he said. "To be pushed down to the bottom 10 and to be compared with California could be a wake-up call."

Without tax increases, the state's budget woes will continue to haunt future generations, according to an analysis that will appear the IGPA's Illinois Report 2010, which will be released in February to refocus legislators on key issues.

"We're bridging the gap now by borrowing, with a bad bond rating that drives up interest rates," McMillen said. "So people in the future will be paying for the fact that we aren't fixing the problem today."

Source: University of Illinois at Urbana-Champaign

(news : web)