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A Fiscal Fix for Illinois

By Jim Nowlan

Illinois can fix its fiscal problems without raising tax *rates*, but not without pain. This can be done by eliminating questionable exemptions and expanding the sales tax to services that other states tax.

For years Illinois has been spending and obligating about $3-4 billion a year more than the state has been taking in from its base revenue structure. This difference has been masked by one-time revenues (such as selling our future tobacco settlement revenues this past year for one up-front payment), borrowing, avoidance of pension payments, and delaying payments to vendors and non-governmental social service agencies.

As a result, today we have a state deficit of about $14 billion, which is more than half of annual general funds revenues.

The options for eliminating the deficit include further cuts in the budget, more revenue and of course a combination of the two.

Illinois has been cutting its budget for years now. State employment has fallen from 80,000 at the beginning of the last decade to 68,000 today. Higher education receives less today than a decade ago, and receives it months late. The hours at parks I frequent have been cut back.

More can always be done. The Civic Committee of the Commercial Club, a business group, would like to see additional cuts to the state employees' pension programs. That may be warranted, but don't expect much change now that the unions have been given so much credit for Gov. Quinn's re-election.

Gov. Quinn has called for an increase of the income tax rate by 1 percent, which would yield about $3 billion a year. At present, Illinois has a flat rate of 3 percent, which is lowest among states that have an income tax. I believe we can both avoid an increase in that rate and also avoid increasing the corporate income tax, which is important to our state's business climate.

Here are some options to rate increases. They are painful but I believe less so than tax rate increases.

Almost alone among the states, Illinois exempts all retirement income from the state income tax; millionaires with fat pensions pay nothing on their retirement income. If Illinois were to tax retirement income as the federal government does, the state could gain about $750 million in revenue. We also provide a 5 percent tax credit against our state income tax for property taxes paid; few people think of that as property tax relief. The revenue lost is about half a billion dollars.

The state sales tax has over the years become riddled with exemptions. The biggest is for food for home consumption and drugs. If we eliminated the exemption on food for home consumption we would generate almost a billion dollars in annual revenue. The exemption for food was thought to be fairer to poor people, who pay more of their income for food than do those better off. Yet most poor people take advantage of food stamps, which are not taxed anyway, so there is no benefit to the poor on food stamp purchases.

Sales to non-profit organizations are exempt and cost the state another half billion dollars. If these and other exemptions were eliminated, we would generate a total of about $3 billion in sales tax revenue annually.

Finally, the sales tax in Illinois is levied primarily against tangible goods and not against services. Illinois taxes the sales on 17 services, mostly in the utilities category. Neighboring Iowa taxes 94 services; Washington State and New Mexico each tax 158 services. These include personal services such as barbers and beauticians, admissions to amusements like movies, and repair services.

Depending upon what mix of services is included, revenues generated could be as high as $1-2 billion annually in Illinois.

I propose that Illinois borrow to pay off the accumulated deficit, use the sales taxes on services to pay off the debt in 5-10 years, and then reduce the overall sales tax rate by one cent once the debt is paid off. The increases in revenue from the elimination of exemptions would be applied to the general state budget to cover the longstanding mismatch between revenue and spending.

This is all painful, to businesses covered by sales taxes for the first time and to taxpayers, of course. Overall, I think the proposals here are fairer to taxpayers and would create a more rational, more responsive public finance system than would increasing the rate of the income and/or sales taxes.