Testimony of Frank Manzo IV
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At a Hearing on the Possibility of a Progressive Income Tax in Illinois

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Introduction

Good afternoon, Mr. Chairman and Members of the Committee. My name is Frank Manzo IV. I am the Policy Director of the Illinois Economic Policy Institute, a nonprofit research organization that provides candid and dynamic analyses on major subjects affecting the Illinois economy– specializing in the construction industry. ILEPI focuses on "high-road economic development" policies that promote quality jobs, productive investment, and economic growth.

Policies that Improve a State's Economic Performance

In 2017, the Illinois Economic Policy Institute and the Project for Middle Class Renewal at the University of Illinois at Urbana-Champaign conducted an evidence-based review of public policies that grow state economies. Academic research finds that investing in public education and investing in infrastructure are the most effective public policies at achieving broad-based economic prosperity. Fiscal sustainability through balanced budgets also allows governments to fund these investments and boosts business confidence. The finding that investments in the future are the key drivers of economic growth are well-documented in the research, including studies on developed countries as well as the 50 U.S. states (Bruno & Manzo, 2017).

The most successful function of government in fostering economic development has been in educating the populace. Research has found that boosting spending on public education significantly increases employment and reduces poverty in a state (Blomquist et al., 2009; Jackson et al., 2015). A well-educated workforce raises median wages and builds a foundation for shared prosperity in a state (Berger & Fisher, 2013). Additionally, economic simulations reveal that physical capital infrastructure investment enhances economic growth. For every dollar increase in infrastructure spending, the economy improves by about $1.57 (Zandi, 2010). This is a larger economic impact than nearly all other policy changes aimed at stimulating the economy– including tax cuts and credits. A recent 2015 analysis of 24 state-level policies and economic phenomena corroborates the conclusion that public education, infrastructure investments, and budget surpluses improve economic outcomes. On the other hand, higher average personal income tax rates did not have a statistical effect on the employment rate of U.S. states (Manzo & Bruno, 2015).

For years, the State of Illinois has underinvested in public education, underinvested in public infrastructure, and operated without budget stability– causing the state's economy to grow slower than the national average. The lack of state support has produced financial distress for school districts and forced local governments to rely heavily on property taxes (Manzo et al., 2017). State funding for public colleges and universities has declined over the past decade, resulting in higher tuition costs and students choosing to attend cheaper, out-of-state schools (Manzo & Bruno, 2017). Illinois residents have become accustomed to pothole-filled roads, deteriorating transit systems, run-down school buildings, and unsafe veterans' homes (Craighead, 2018). Illinois needs to generate additional revenue to balance the budget and increase public investments.

Illinois Can Cut Taxes for Middle-Class Families, Reduce the Budget Deficit, and Increase Public Investment by Enacting a Graduated Income Tax

Replacing the flat income tax with a graduated income tax, if done correctly, could generate additional revenue balance the budget and stimulate the economy while cutting taxes for the vast majority of Illinois taxpayers. In 2018, the Center for Tax and Budget Accountability proposed the following graduated income tax rate system for Illinois:

- The state would reduce the income tax to 4.5 percent for all net income below $100,000,
- keep the 4.95 percent rate for net income between $100,000 and $300,000, and
- implement three marginal income tax rates between 8.0 percent and 9.85 percent for incomes above $300,000.

This proposal would cut taxes for 98 percent of Illinois taxpayers, raise them on the richest 2 percent of Illinois tax filers earning $314,000 or more, and generate **about $2 billion** in revenue to help close the state's structural deficit (Martire & Hertz, 2018). This proposal would stimulate consumer spending by raising taxes on the rich and lowering them on the bottom 98 percent, who spend a higher portion of their incomes back in the economy.

The Center for Tax and Budget Accountability proposal would help make Illinois' tax system fairer. Illinois, which is one of only eight states that has a flat income tax, currently has the 5th-most "regressive" tax code in the country, according to the progressive-leaning Institute on Taxation and Economic Policy. The poorest Illinois households contribute 13 percent of their annual incomes to state and local taxes and the middle class contributes 11 percent. Meanwhile, the Top 1 Percent in the state contributes just 5 percent of their incomes to state and local taxes in Illinois (Davis et al., 2015). The absence of a progressive income tax, which is prohibited in the Illinois Constitution, contributes to the lack of fairness. Instead of a progressive income tax, Illinois relies heavily on regressive forms of taxation– such as sales tax revenues and local property tax revenues– to pay for public education, public infrastructure, public health, police and fire protection, and other government functions.

Alternatively, Illinois could adopt a graduated income tax structure which lowers the first marginal rate on the working class to a level below the flat taxes in Indiana (3.23 percent) and Michigan (4.25 percent) and makes the top marginal rate comparable to that in Iowa (8.98 percent) and Minnesota (9.85 percent) (Scarboro, 2018). This would mean that working-class Illinois residents would have lower income taxes than their counterparts in neighboring states while the wealthy would pay significantly more– but not more than neighboring states. A sound graduated tax plan would also cap income taxes on "pass-through" businesses (i.e., partnerships and S corporations) to effectively hold small business harmless.

The Illinois Economic Policy Institute and the Project for Middle Class Renewal at the University of Illinois at Urbana-Champaign are currently working together to study different plans for a possible graduated income tax in Illinois. We are evaluating the proposals based on a number of metrics. These include: whether the progressive tax proposal could cut taxes for at least three-quarters of Illinois households and raise them on the rich, whether the proposal would hold businesses harmless and boost economic growth, whether the proposal would allow for increased investment in education and infrastructure, and whether the proposal would allow the state to cut property taxes through a transfer to local governments. Preliminary analysis shows that a well-designed graduated income tax could achieve all of these goals. Illinois can cut taxes for working-class and middle-class families, raise taxes on the wealthy, produce budget stability to restore investor confidence, increase public investment, and provide property tax relief for homeowners through a progressive income tax.

Opponents of Graduated Income Tax Systems Often Present Unsound Arguments

The arguments posed in opposition to switching to a graduated income tax system in Illinois are generally very weak. Economists have widely discredited "trickle-down" economic theories. Time and again, tax cuts that disproportionately benefit upper-class households have failed to deliver the jobs and economic growth promised by those enacting the cuts, while worsening budget deficits for governments. Nevertheless, opponents of graduated income taxes continue to use the principles of trickle-down economics to argue that Illinois would have slower economic growth if it switched to a graduated income tax system (Miller, 2018).

However, a 2017 analysis of the economic performance of the nine states with the highest top income tax rates and the nine states with no income taxes found that the higher-tax states had a better track record over the last decade. From 2006 to 2016, states levying the highest top personal income tax rates (averaging 10 percent) experienced GDP growth that was 1.7 percentage-points faster, GDP growth per person that was 8.4 percentage-points faster, and personal income growth that was 2.2 percentage-points faster (Davis & Buffie, 2017). These findings cast serious doubt on claims that a progressive income tax would negatively impact the Illinois economy.

Furthermore, trickle-down commentators cannot explain the recent failure of the experiment in Kansas. Kansas, which has a progressive income tax, "flattened" its top tax rate by lowering it from 6.4 percent to 4.9 percent. This tax cut was enacted because lawmakers, adhering to trickle-down theories, said that it would stimulate business and job growth– generating enough economic activity that the tax cuts would pay for themselves. However, the tax cuts reduced state revenue by 8 percent (more than $700 million per year), caused budget instability, and did not stimulate the economy (Tankersley, 2017). According to data from the *Current Employment Statistics* by the U.S. Department of Labor Bureau of Labor Statistics, from January 2012 to January 2018, employment in Kansas increased by just 4.4 percent (+59,300 jobs) while it grew by 10.9 percent nationally (+14.5 million jobs). Job growth was even higher in Illinois, which experienced a growth of 6.4 percent over that time (+363,100 jobs) (BLS, 2018). The unsuccessful experiment in Kansas shows how trickle-down arguments can lead to flawed public policy.

Finally, it is worth noting that a 2016 survey of over 110 economics and policy professors at accredited universities and colleges in Illinois found that they were largely in favor of instituting a progressive income tax in Illinois. When asked which statement came closest to their view on the state budget, 51 percent said that "the State of Illinois should approve a constitutional amendment to allow a progressive income tax and raise taxes on the rich" and another 28 percent said that "the State of Illinois should reinstate the 5.0% income tax for individuals" from the 3.75 percent rate at the time. Only 12 percent said that "the State of Illinois should not raise the income tax at all to help balance the budget." (Manzo, 2016). The majority of Illinois' top economics and public policy experts reject the arguments posed by the trickle-down opponents of a graduated income tax.

Illinois Should Consider a Constitutional Amendment to Enact a Graduated Income Tax

Lawmakers and taxpayers in Illinois should support an amendment to the Illinois Constitution that would permit a graduated income tax system. A graduated income tax system can make the state's tax code fairer, can fund essential public services, and can protect public sector jobs. If done correctly, a graduated income tax could accomplish five goals in Illinois: 1.) cut taxes for working-class and middle-class families, 2.) raise taxes on wealthy families, 3.) increase revenues to reduce the state's budget deficit, 4.) provide property tax relief for Illinois homeowners, and 5.) grow the Illinois economy.

I thank you for allowing me the opportunity to submit my testimony.

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