



The Tax That Keeps on Taking

The hidden costs of Governor Quinn's income tax increase

The Problem

In life, there are many gifts that keep on giving. Magazine subscriptions. Cooking classes. Wine-of-the-month clubs. In Illinois, however, where the economy is on life support, Governor Quinn wants to give struggling working families something that keeps on taking: a massive income tax hike.

Governor Quinn's Fiscal Year 2010 budget proposal includes numerous tax hikes, but for most Illinoisans, the largest tax pain will stem from the increase in the personal income tax. The plan calls for increasing the tax rate by a whopping 50 percent—from 3 to 4.5 percent.

It's critical to remember that there is an unseen cost of taxation, known as what economists call "deadweight loss." In short, the very process of transferring resources from the private to the public sector results in a permanent loss of current and future economic output. This means fewer jobs and lower incomes for all Illinoisans.

In present value terms, the total deadweight loss from Gov. Quinn's income tax hike to Illinois's economy is a staggering \$8.6 billion. This is three times larger than the \$2.8 billion tax hike itself.

To put this massive sum into perspective, the hidden cost of Governor Quinn's tax hike is the economic equivalent of taking all the tax revenue for FY 2008, from the sales tax (\$7.2 billion), cigarette tax (\$350 million), liquor tax (\$158 million), inheritance tax (\$373 million), corporate franchise tax and fees (\$225 million) and insurance taxes and fees (\$298 million) and dumping that money into Lake Michigan.

In effect, Quinn's tax hike has created a hole in Illinois's economy. Without the deadweight loss, private companies would have filled this hole with streams of output. Instead, all we're left with is a loss.

Our Solution

The lesson for policy makers is current revenue estimates are too high because the economic models used to generate them do not account for the economic effect of higher taxes. In this case, deadweight losses will mean lower income, sales and property taxes moving forward.

Instead, the Governor and the General Assembly should focus on reducing spending, which has increased 45 percent per capita since 1998. This is the only sustainable way to balance the budget and lower taxes, and it would put us on the path to economic recovery.

Why this Works

Some may dismiss deadweight loss calculations as too abstract to matter in reality. Indeed, some pro-government ideologues insist that "government spending" is really "government investment." However, this reasoning implies that government spending has a surplus benefit above and beyond the taxes raised and the resulting economic carnage.

Unfortunately, Quinn's one-sided marketing campaign is only the latest example in the battle of easily seen benefits versus the unseen costs of government spending. After all, how does one count a business or job never created? Entrepreneurs displaced by high taxes should not be dismissed when debating tax hikes.

Overall, Gov. Quinn is not being honest with taxpayers. The economic concept of deadweight loss has been a recognized cost of taxation by economists for decades, if not longer. An income tax hike will truly be the tax that keeps on taking—from families, from individuals, and the state's general prosperity.

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