

# CENTER FOR TAX AND BUDGET ACCOUNTABILITY

## Funding a Quality Education Requires Fiscal Reform

Providing a quality public education to our children is essential. It also is expensive. The way the state currently funds education guarantees that many school districts will not have the financial wherewithal to fund and deliver a quality education. The reason for this is simple. Illinois is over-reliant on property taxes as a revenue source for funding education. Property taxes are local rather than state-based revenues. That means education funding - and to a large extent quality - are tied directly to resources available in the local tax base. Local property tax wealth per student in school districts across Illinois varies from a low of around \$11,000 to a high of well over \$1.9 million. Low property tax wealth school districts simply cannot raise enough revenue to provide their students a quality education. Where a child lives should not determine whether she has access to a good school.

The only way to ensure all children receive a quality public education is to require the state to shoulder more of the funding burden. As currently constructed, the Illinois fiscal system is not capable of capturing enough revenue to assume this burden. Existing state-based revenue streams must therefore be enhanced, and a portion of the new state-based revenue must then be used to abate a portion of the local property taxes that fund education. This abatement should guarantee minimum relief to each district while maintaining the flexibility to provide additional relief to low property wealth schools.

1. **Shift more of the school funding burden to the state.** Imposing the primary obligation to fund education on the state rather than local taxing authorities will alleviate many of the inequities under the existing system. It will also bring Illinois more in line with the rest of the country. The national average for state-based revenue used to fund education is 50%. Illinois is at only 30%, ranking 50<sup>th</sup> nationally. This will require using state-based revenue to abate a portion, 25%, of the local property tax revenue used to fund education. The abatement should guarantee that every school district receive a minimum amount of relief, while maintaining the flexibility to provide even greater relief to impoverished and rural communities that need it most. To ensure an accountable, transparent, easy to administer school funding program is maintained over the long-term, the Cook County classification system must be substantially conformed to the rest of the state.
2. **How much state-based revenue is needed?** In the past, bipartisan reform commissions have recommended that new state-based revenues be used to replace at least 25% of the property tax revenue currently used to fund education. This would require increasing Illinois state revenues by roughly \$2.5 billion. Increasing the foundation level to \$6,675, the amount identified as the minimum necessary to provide an adequate education, will cost an additional \$1.8 billion. The total demand for new state revenue to fund education reform is just over \$4 billion annually.

However, this does not complete the state's new revenue needs, because Illinois also suffers from a structural deficit. That means the state's current mix of revenue sources will not be able to continue supporting its current spending on services into the future, adjusting solely for inflation and population growth. If the state doesn't enhance revenue to the point of eliminating the structural deficit, gains made in education funding today will be eroded tomorrow. To create the financial capacity necessary to fund an adequate education and eliminate the structural deficit, the state has to enhance its income and sales tax revenue, and realize cost savings from implementing administrative reforms.

3. **Income tax enhancements.** Enhancing the state's income tax has the most revenue generating potential of all available alternatives. It is also one of the most appropriate revenue sources to be used, for a number of reasons. Illinois' maximum combined state and local income tax rate is the lowest in the country, and the state's overall tax burden ranks 48th when all state and local taxes, charges and user fees are considered. Because the tax is based on income, a taxpayer's individual burden corresponds to his or her means, increasing or decreasing with income. Moreover, state income taxes can be deducted from federal income tax obligations.

- a. **Increase the individual income tax rate.** Increasing the current personal income tax rate from 3.0% to 5.0% would generate \$5.9 billion in new revenue.

Revenue generated: \$5.9 billion

- b. Increase the corporate income tax rate.** Businesses will be one of the primary beneficiaries of property tax relief. Moreover, business income tax revenues are significantly less in Illinois than individual income tax revenues. Nationally, corporate tax revenues are at their second lowest level in the last 60 years. It therefore makes sense to increase the corporate income tax as well. Under the Illinois constitution, the maximum corporate income tax rate that may be assessed is limited to 8/5 of the personal income tax rate. That would mean increasing the corporate rate from its existing level of 4.8% to 8.0%.

Revenue generated: \$980 million

- 4. Expand the state sales tax base.** Back in the 1930's when sales taxes were being designed, services were a relatively insignificant portion of the economy. Today, services are by far the largest sector of the Illinois state economy. In spite of this, Illinois exempts most services from sales tax. Ignoring the largest and most rapidly growing sector of the state's economy is poor fiscal policy. Expanding the sales tax base to include, at a minimum, consumer services is essential to structuring a fiscal system that could support funding education.

Revenue generated: \$2.2 to \$3.0 billion

- 5. Protecting low-income families.** In addition to its structural problems, the Illinois tax system is regressive. That means it imposes a higher tax burden on low- and moderate-income families than on affluent families, when tax burden is measured as a percentage of annual income. This is both unfair and counterproductive. To ensure that the various revenue enhancements needed to support education funding do not worsen the regressivity of the state's system, a comprehensive tax credit for low-income taxpayers should be incorporated into the overall reform. To maximize the support any such tax credit provides, it should be refundable. "Refundability" simply means the full tax credit is paid to a taxpayer even if that taxpayer's income tax burden is less than the dollar value of the credit. This recognizes the burden imposed on low-income families by sales and property taxes, in addition to the income tax. A refundable credit would cost approximately \$900 million.
- 6. Administrative reforms.** The state should review all its internal processes for purchasing, contracting and otherwise expending taxpayer dollars. Obtaining economies of scale and otherwise reforming its purchase practices have the potential to save the state significant amounts of revenue annually. Last year, the state implemented a partial reform of its methodology for purchasing prescription drugs. Similar reforms should be pursued in appropriate areas.

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