

## **Sustainable State Budgeting**

Now is not the time for the state to raise taxes, the Northwestern editorialized the other day. Well, I beg to differ – now is exactly the right time to raise taxes.

Yes, I know, a tax increase during a recession is a terrible idea, cutting people's spending power and exacerbating the downturn. But cutting state spending through layoffs or furloughs or whatever is equally bad. The state should do neither, but, given the \$6.6 billion hole it's gotten itself into, it has to do one or the other, or both.

Of course, the best way to get yourself out of a \$6.6 billion hole is to never get into it in the first place. So the best way to get out of the hole now would be the way that makes us least likely to ever fall back in. And that involves, in part, a tax increase.

A little historical review: the state has been having difficulty balancing its budget for about 8 years now. That's because back in 1999-2000, when the state's economy was unusually strong (with per capita real income about 2.5% above the long term trend), the legislature, with the immense lack of foresight that legislatures are blessed with, decided to enact a massive tax cut that reduced tax revenues by one tenth. Easy to do when the state economy is unusually strong, and you're awash in tax revenue, but not a smart long run decision.

In the relatively normal economic times that followed, the state's finances were as a result merely precarious. But of course normal economic times are never a permanent phenomenon. So when the inevitable happened, and we had a downturn, voila, \$6.6 billion in the hole.

A smart, foresightful legislature would've never let that happen. It would have amassed a surplus back in 1999-2000, put those funds in some safe AAA bond fund, and had a nice rainy day account to dip into to avoid all this mess. Since smart, foresightful legislatures don't exist, we'll have to trick our less astute, myopic legislature into acting as if it were smart. And the first step is to have it undo, in part, the tax cuts of 1999-2000.

And right now, with a \$6.6 billion hole staring them in the face, is pretty much the only time the legislature will find the gumption to raise taxes. The current budget proposal, that increases taxes and fees by \$2.1 billion, is probably close enough to what that smart legislature would have done to be acceptable.

But we shouldn't let them stop there. As part of our submitting to this tax increase, we should demand that they do the other thing a smart legislature would do: plan on saving its excess revenues, once times get good again, rather than frittering them away as myopic legislatures are wont to do.

That is, we should demand that they enact a rule that limits state spending to no more than "long term trend" revenue, i.e. the revenue the state would bring in if state income were exactly on its long term trend. In good years, when revenue is above trend, the excess, every last penny of it, would have to go into a rainy day fund. In bad years, that fund could then be tapped, so the state could avoid both tax hikes and spending cuts during recessionary times.

Now is the time for the tax hike. And now is the time, while the experience of being deep in the hole is fresh, to enact a spending limit rule. So that maybe, just maybe, we'll never have to find ourselves in a fiscal mess like this again.