ITEP

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KENTUCKY FORWARD PRESS CONFERENCE
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As Kentucky grapples with the news of a potential $1 billion budget shortfall, there are good reasons for state lawmakers to turn to progressive tax reform instead of resorting to painful spending cuts.

Kentucky's overall tax structure is currently quite regressive, meaning that low-and middle-income families pay more as a share of their income in taxes than do wealthier Kentuckians. In 2007, the poorest 20 percent of Kentucky residents (those with incomes less than $8,000) paid 7.8 percent of their incomes in state and local taxes. The richest 1 percent—taxpayers with average incomes of $933,100 in 2007—paid 5.8 percent of their income in Kentucky taxes, after accounting for the federal deductibility of such taxes. Changing the state's tax structure in a progressive way would ensure that Kentucky taxes are based on the ability of Kentuckians to pay those taxes.

In choosing to fund public investments via a regressive tax system, Kentucky is essentially trying to raise money from the people who have the least of it. The wealthiest 20 percent of Kentuckians have more income than the poorest 80 percent put together. What's more, between 1988 and 2008 Kentuckians in the top 1 percent saw their inflation-adjusted average incomes rise by 34 percent. Meanwhile, middle-income earnings grew by 5.9 percent, and the poorest 20 percent saw their real incomes rise by just 3.5 percent over this period. In short, balancing a tax system on the backs of the poor simply does not yield much revenue compared to modest taxes on the best-off families.

Increasing taxes in a progressive way isn't simply the fairest way to deal with the Commonwealth's budget deficit. It's also the most economically sound approach, given the ongoing recession. Cutting programs utilized by low and middle income taxpayers results in less consumption and less economic activity, precisely the opposite outcome from which states should now be aiming. In contrast, increasing taxes on high income individuals will likely result in less saving rather than less consumption. Renowned economists Joseph Stiglitz and Peter Orszag (Director of the US Office of Management and Budget) wrote, "tax increases on higher-income families are the least damaging mechanism for closing state fiscal deficits in the short run. Reductions in government spending on goods and services, or reductions in transfer payments to lower-income families, are likely to be more damaging to the economy in the short run than tax increases focused on higher-income families."[1]

The debate over progressive tax reform isn't unique to Kentucky, as state lawmakers across the country have debated – and, in a growing number of cases, adopted – tax increases in recent months. Kentucky legislators would be wise to debate the merits of progressive tax reform as both an avenue for increased tax fairness and an option for solving the state's budget shortfall.

BACKGROUND ON ITEP

Founded in 1980, the Institute on Taxation and Economic Policy (ITEP) is a non-profit, non-partisan research organization, based in Washington, DC, that focuses on federal and state tax policy. ITEP's mission is to inform policymakers and the public of the effects of current and proposed tax policies on tax fairness, government budgets, and sound economic policy. ITEP's full body of research is available at www.itepnet.org.

[1]Peter Orszag and Joseph Stiglitz, "Budget Cuts vs. Tax Increases at the State Level: Is One More Counter-Productive than the Other During a Recession?" Center on Budget and Policy Priorities, revised November 6, 2008 http://www.cbpp.org/archiveSite/10-30-01sfp.pdf