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Needs of Kentuckians Rise during Recession, Balanced Approach Needed to Meet Demand

During a recession, the needs of Kentucky families increase just as the state generates less revenue to provide for them. This is true across the country; state revenues have simply collapsed – the biggest drops in history. Sales tax collections and income tax collections are hit hardest during a recession due to the impacts of unemployment. The worst thing we can do in this situation is cut spending to the point of failing to maintain public services like education and health care that a productive economy needs. That will make it extremely difficult for Kentucky to ever recover from this recession ready to make real progress. It is time legislators look to adopting a balanced approach, one that includes new revenue.

Policymakers recognized the need for a balanced approach that included new revenue in 2009 when tobacco and alcohol taxes were increased. It's even more important now to ensure limited cuts to government services that have already been weakened by previous reductions. A strategy that includes new revenue will allow the state to maintain adequate services in critical areas like education, healthcare, and public safety and position us for future economic growth once the recession ends.

Demand for Services Increasing

As job losses increase through the recession, the needs of Kentucky's families and individuals also increase. The unemployment rate in Kentucky, currently at 10.7 percent, has nearly doubled since the recession began in December 2007, and has consistently remained above the national rate. Underemployment also adds to the need across the state as workers experience a reduction in their weekly hours, temporary layoffs, or furloughs.

In response to increasing need, Kentuckians turn to all types of government services to help support themselves and provide for their families. Unemployment often increases demand for workforce training as workers recognize the need to update their skills to be competitive in the labor market. Job loss can mean the loss of health insurance resulting in the need for Medicaid, KCHIP, or services at the local health department. The loss of

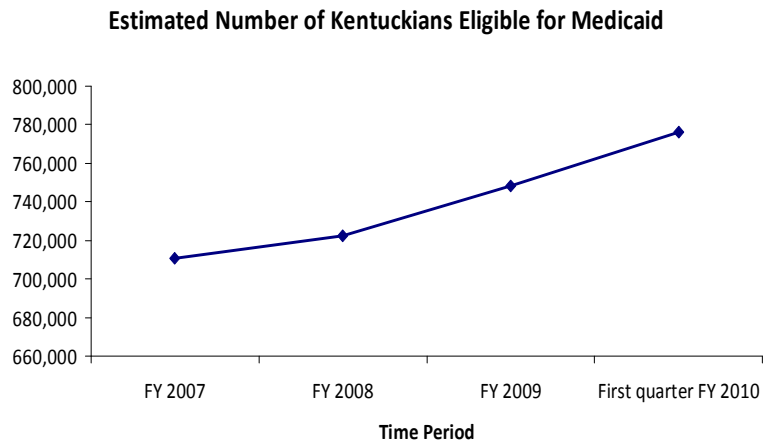
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income, particularly for low-income families, can result in the need for food assistance through food pantries and food stamp benefits. The demand for services is increasing as evidenced by the following:

- Fall 2009 enrollment numbers for Kentucky’s Community and Technical College System (KCTCS) grew by nearly 12 percent with the largest increase in the non-traditional population age 25 and older. More than 100,000 Kentuckians are now seeking additional workforce training.¹

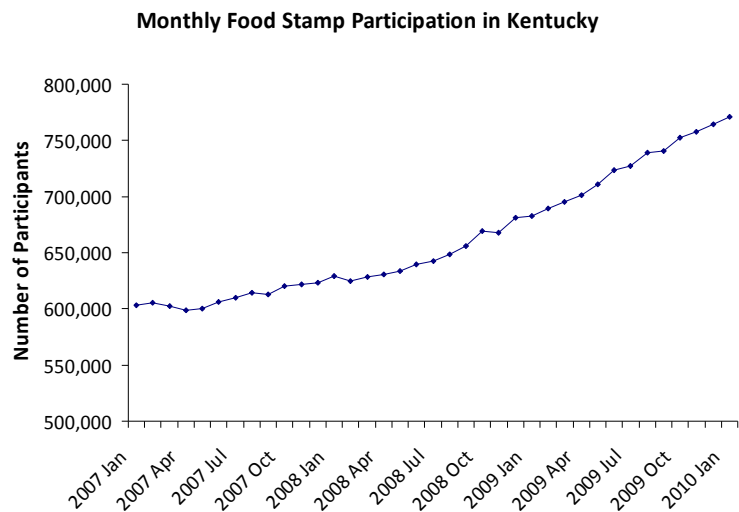
- Since July 2008, the number of people eligible for Medicaid has increased by roughly 3,000 per month; that’s an increase of more than 50,000 people since the recession began. The total number of people eligible as of September 2009 is estimated to be near 780,000 Kentuckians – approximately 20 percent of the state’s population.²



Source: Legislative Research Commission

- Food pantries are noting an increase in demand as well. In central and eastern Kentucky, where some of the state’s poorest counties are, the number of people served by God’s Pantry Food Bank increased from 120,000 in 2002 to 211,300 in 2010. Homelessness is also on the rise.³

- Kentucky’s participation in SNAP (formerly food stamps) increased by nearly 90,000 people between January 2009 and January 2010, marking a 13 percent increase in one year and an increase of 22 percent since the start of the recession. As of January 2010, there are more than 770,000 Kentuckians receiving SNAP benefits.⁴



Source: Cabinet for Health and Family Services

...As State Revenues Decline

The national recession has caused state revenues to decline significantly over the past three years and recovery is expected to be slow. As a result, Kentucky's leaders face a shortfall of \$1.5 billion dollars as they work to balance a budget for fiscal years 2011 and 2012. This comes on the heels of consecutive shortfalls and budget reductions in each of the last three fiscal years. To date the budgets have been balanced with recurring spending cuts, all of the "rainy day" fund, transfers from reserve accounts, and money from the federal Recovery Act. Now the rainy day fund is dry and the state has little recovery act money left; what is left must be used in 2011 – the first year of the two-year budget. It is imperative that legislators agree on a balanced approach to the state's budget that does not rely solely on cuts but includes new revenue.

States Respond with Balanced Approach

Contrary to popular arguments, government spending cuts can harm the economy more than targeted increases in revenue. This argument was forwarded in 2001 by Joseph Stiglitz, Nobel-prize winning economist and Peter Orzag.⁵ It follows that, cutting programs and public services, like education and workforce development slows the state's progress, decreases public sector employment, and prevents investment in the future. Alternatively, targeted tax increases do less harm to working families and less damage to state economies than deep cuts to services.

Other states have recognized the importance of a balanced approach that includes new revenue. In the midst of the current recession nine states raised personal income taxes on the highest-income households, and raised business taxes as well. In 2009, 31 states increased taxes in order to continue to provide government services. In the recession of the early 1990s, about 44 states raised taxes and in the early 2000s, around 30 states did so.⁶ These states understood the futility of relying solely on cuts to needed programs.

Recent state actions to increase revenue:⁷

- Wisconsin enacted a new 7.75 percent income tax bracket on all income over \$300,000 for married couples and \$225,000 for individuals and heads of households.
- Florida, Arkansas, Mississippi, and North Carolina joined Kentucky in increasing excise taxes on tobacco products. A total of 15 states increased taxes on tobacco and alcohol.
- Tennessee extended the sales tax to include software maintenance contracts and limited an exemption on computer software.
- Iowa placed limits on the size of five costly business tax credits, saving the state about \$18 million in fiscal year 2010.
- Kansas suspended film production credits for two years. For dozens of other credits, the state temporarily reduced the amount firms can claim by 10 percent.
- Nevada temporarily increased the state sales tax.
- Oregon⁸ and North Carolina⁹ raised the income tax rate for upper income households and increased the corporate tax rate.

Revenue Options for Kentucky

A balanced approach includes both targeted reductions in government spending and targeted increases in revenue. There are several options available to policymakers to responsibly increase revenue while allowing the state to be well-positioned when economic growth returns. One way or another, action in the current legislative session will impact our continued progress as a state. The following are a few immediate options available to legislators that will provide the revenue necessary to positively impact our progress.

1. Increase Top Income Tax Rate

Increase the marginal tax rate on incomes over \$75,000

Kentucky has a graduated income tax rate structure with rates ranging from 2 percent to 5.8 percent on taxable income of less than \$75,000. Those making more than \$75,000 pay 6 percent on the portion of their income that is above \$75,000. By incrementally increasing the marginal tax rate on incomes above \$75,000, as proposed by Representative Wayne in HB 13, Kentucky would increase revenue by approximately \$250 million annually.¹⁰ Alternatively, adding a new top tax bracket that applied a rate of 7 percent to income above \$250,000 would increase income tax revenue by about \$76 million per year.¹¹

Tax increases on upper income residents are not harmful to the economy like a broad-based increase might be because the money to pay the taxes generally comes from savings and therefore does not reduce economic activity in the state. In addition, the revenues raised would allow the continuation of important services that strengthen the economy.

2. Level the Corporate Tax Playing Field

Enact combined reporting to ensure proper corporate income tax payments

Multistate corporations doing business in Kentucky can easily shift taxable profits earned here onto the books of related companies in other states with lower tax rates. Kentucky can ensure an equitable corporate tax structure by closing these loopholes through a policy called “combined reporting”. It’s estimated that doing so would increase corporate tax revenue by 10 – 20 percent; a range of \$26.8 - \$53.6 million based on 2009 actual receipts.¹²

Ensure business tax breaks result in a net benefit to Kentucky

In 2005, the General Assembly passed legislation to require a study of business tax breaks. A net benefit analysis of Kentucky’s tax expenditures should be performed at regular intervals in addition to the bi-annual tax expenditure analysis issued by the Office of the State Budget Director. Tax breaks not resulting in a clear net benefit to the state should be discontinued.

3. Modernize the Sales Tax

Broaden the sales tax base to reflect a shift in consumption from goods to services.

Modernizing Kentucky's sales tax to include a significant number of services would raise a considerable amount of money. Since the 1970's consumption patterns have been shifting from a majority of purchases on goods to a majority of our purchases on services. Broadening the sales tax to include more services would bring the sales tax structure back in line with growth in the economy.

Of some 40 household services identified in a survey conducted by the Federation of Tax Administrators, Kentucky currently taxes only 6 services compared to the national average of 17. Currently the state is losing up to \$1 billion dollars per year because of the exclusion of services.¹³

Conclusion

The problem presented by the recession is simply too big to solve with only one approach. Spending cuts alone will hurt families who are already struggling to stay afloat. In addition, relying heavily on cuts hurts Kentucky's investments in areas like education, transportation, and workforce development and jeopardizes our future growth as a state. It is time policymakers adopt a balanced approach – one that includes revenue increases – to ease the economic troubles of the Commonwealth.

¹ "KCTCS Enrollment Tops 100,000 Students". December 16, 2009. Kentucky Community and Technical College System. Available at http://www.kctcs.edu/News_and_Events/News_Articles/System_Office/2009_Fall_Enrollment.aspx. Accessed February 2010.

² Data received from the Legislative Research Commission.

³ God's Pantry Food Bank. February 2010. "Hunger in Central and Eastern Kentucky." Available at http://godspantry.org/assets/372/HICEK_2010.pdf. Accessed February 2010.

⁴ KYA calculations based on data provided by the Division of Family Support within the Cabinet for Health and Family Services.

⁵ Orszag, Peter and Joseph Stiglitz. 6 November 2001. "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. Available at <http://www.cbpp.org/cms/index.cfm?fa=view&id=1346>. Accessed February 2010.

⁶ Johnson, Nicholas. 27 January 2010. "Statement: Nicholas Johnson, State Fiscal Project Director, on the Passage of Revenue Measures in Oregon." Available at <http://www.cbpp.org/cms/index.cfm?fa=view&id=3064>

⁷ Unless otherwise noted, this list is from Johnson (2009).

⁸ Marr, Chuck and Leachman, Michael. 16 February 2010. "Oregon Voters' Approval of Tax Increase Noteworthy as Federal Tax Debate Opens". Center on Budget and Policy Priorities. Available at http://www.cbpp.org/cms/index.cfm?fa=view&id=3083#_ftn4. Accessed February 2010.

⁹ Buhl, John. 12 August 2009. "North Carolina Governor Signs Budget with Tax Increases, Budget Cuts" Tax Analysts. August 2009.

¹⁰ "Tax Reform in Kentucky: Serious Problems, Stark Choices". June 2009. Institute on Taxation and Economic Policy. Available at http://www.itepnet.org/Serious_Problems_Stark_Choices.pdf. Accessed February 2010.

¹¹ McNichol, Liz et al. 11 November 2009. "Raising State Income Taxes on High-Income Taxpayers". Center on Budget and Policy Priorities. Available at <http://www.cbpp.org/cms/index.cfm?fa=view&id=2792> . Accessed February 2010.

¹² Mazerov, Michael. 3 April 2009. "A Majority of States Have Now Adopted a Key Corporate Tax Reform — "Combined Reporting"". Center on Budget and Policy Priorities. Available at <http://www.cbpp.org/cms/index.cfm?fa=view&id=246>. Accessed February 2010.

¹³ Mazerov, Michael. 10 August 2009. "Expanding Sales Taxation of Services: Options and Issues." Center on Budget and Policy Priorities. Available at <http://www.cbpp.org/cms/index.cfm?fa=view&id=2888>. Accessed February 2010.

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