FLIP IT TO FIX IT

AN IMMEDIATE, FAIR SOLUTION TO STATE BUDGET SHORTFALLS

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EXECUTIVE SUMMARY

Severe budget deficits now facing the states represent significant hardship and political challenges, but immediate solutions are feasible and readily available. The national recession has produced historic revenue shortfalls marked by the greatest decline in state tax receipts on record, while concurrently increasing the demand for public services.

When the economy is hurting, state governments should be adding jobs and investments, a proven response that keeps money flowing in the economy. Instead, virtually every state has opted to slash vital public investments and layoff public servants. Such moves increase unemployment, harm the nation's infrastructure and educational systems, and dampen our nascent economic recovery. This is not good policy in the short or long term, and—contrary to popular belief—it is entirely unnecessary.

At the core of the budget crises facing states are regressive state tax structures (comprised of the major state and local taxes) that are unfair, unsound, and unsustainable by design. Fortunately, there is a sensible solution: inverting the state's current tax structure.

The inversion exercise takes a state's current distribution of state and local taxes by income quintile (lowest 20 percent, second 20 percent, middle 20 percent, fourth 20 percent, top 20 percent) and flips it at the 50th percentile mark, thereby making a regressive structure progressive.

This resulting progressive tax structure has major benefits to states.

- **It raises significant revenue.** If every state inverted its tax structure, states would raise a combined $490 billion, wiping out deficits with cash to spare to invest in economy-enhancing activities.
- **It is unmatched in its economic efficiency,** which encourages steady and strong economic activity and widespread prosperity over time.
- **It provides commonsense equity,** with wealthy families contributing a greater share of their income in taxes than low- and middle-income families.

To achieve the inverted structure, states must establish, or significantly improve upon, the graduated personal income tax—the backbone of any progressive tax structure. Concurrently, states and localities must significantly reduce their reliance on regressive sales, excise, and property taxes, which fall heavily on low- and middle-income families.

The benefits to inversion are clear and many; there is no rational economic argument against a progressive tax structure for every state. The biggest hurdle in achieving such a model is a lack of political will. State level elected officials simply cannot ignore the fundamental roots of their deficit problems, even if significant legislative or constitutional roadblocks make sensible reform a politically difficult undertaking.

KEY FINDINGS

- Every state has a regressive tax structure that would benefit significantly from a direct inversion into a progressive structure.
- An inverted tax structure for every state would raise a combined $490 billion in new revenue, immediately eliminating state budget deficits.
- A cuts-only approach to state budget deficits is shortsighted—imposing immediate harm on families, while dampening economic recovery and compromising the future competitiveness of the American workforce.
- A progressive tax structure provides commonsense equity, economic efficiency, and adequate revenue to invest in communities and spur economic growth.
- To achieve an inverted, progressive structure, states must establish or improve upon the graduated personal income tax while reducing reliance at the state and local level on regressive sales, property, and excise taxes.