

Kentucky's Budget Outlook



November 15, 2019

Recap of the Current Two-Year Budget

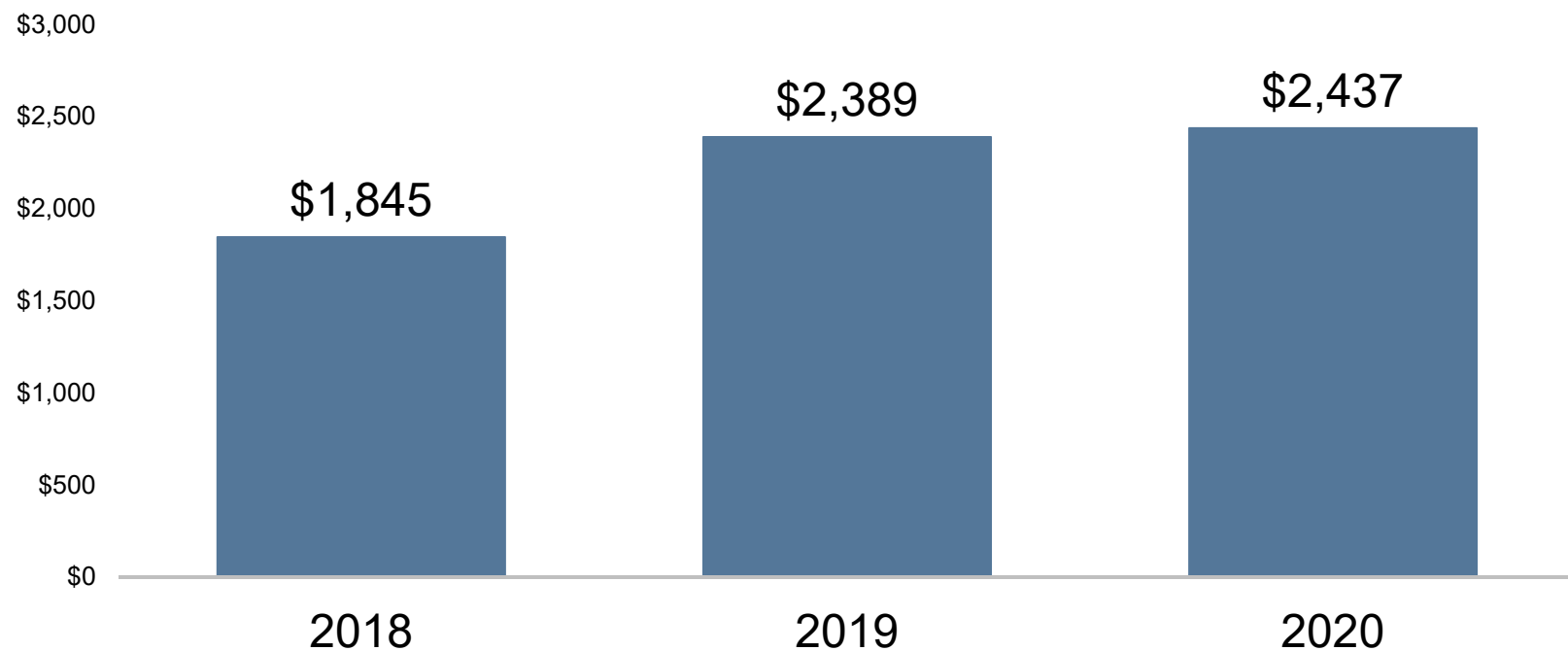
Cut services and moved money to the pension systems



- Increased pension contributions by over \$500 million annually
- 6.25% cuts to many agencies, other cuts
- Plugged budget with >\$300 million/year in one-time monies, mostly from public employee health fund
- Temporary revenue increase through a tax shift

Pension Funding Went Up Due to Assumption Changes

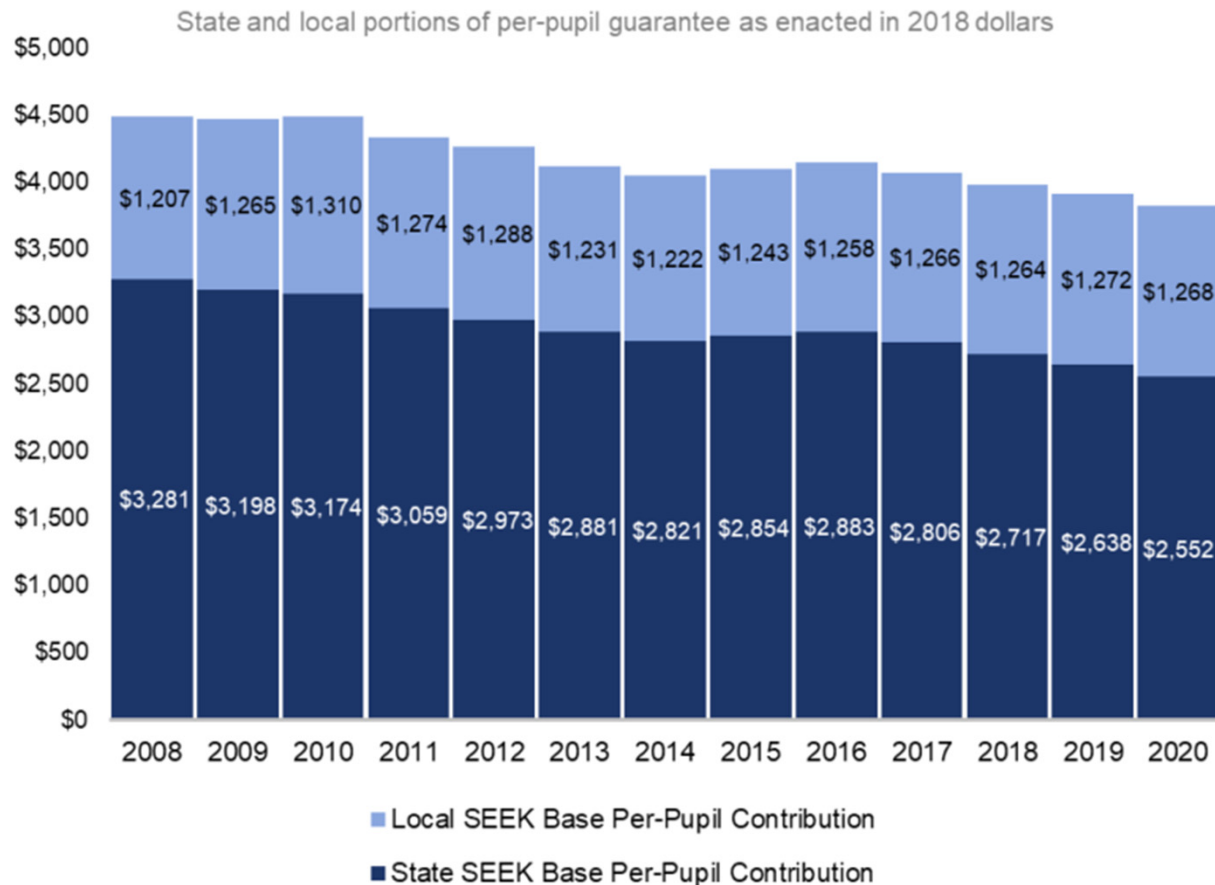
Employer Contributions to State Retirement Systems (Millions of dollars)



Source: KCEP estimates based on analysis of retirement system data for TRS, KERS, SPRS, JFRS, Office of the State Budget Director. Funding is from all sources, not just General Fund.

SEEK Base Funding Is Shifting to Local Level and Eroding with Inflation

SEEK Per-Pupil Guarantee Declining in Real Dollars



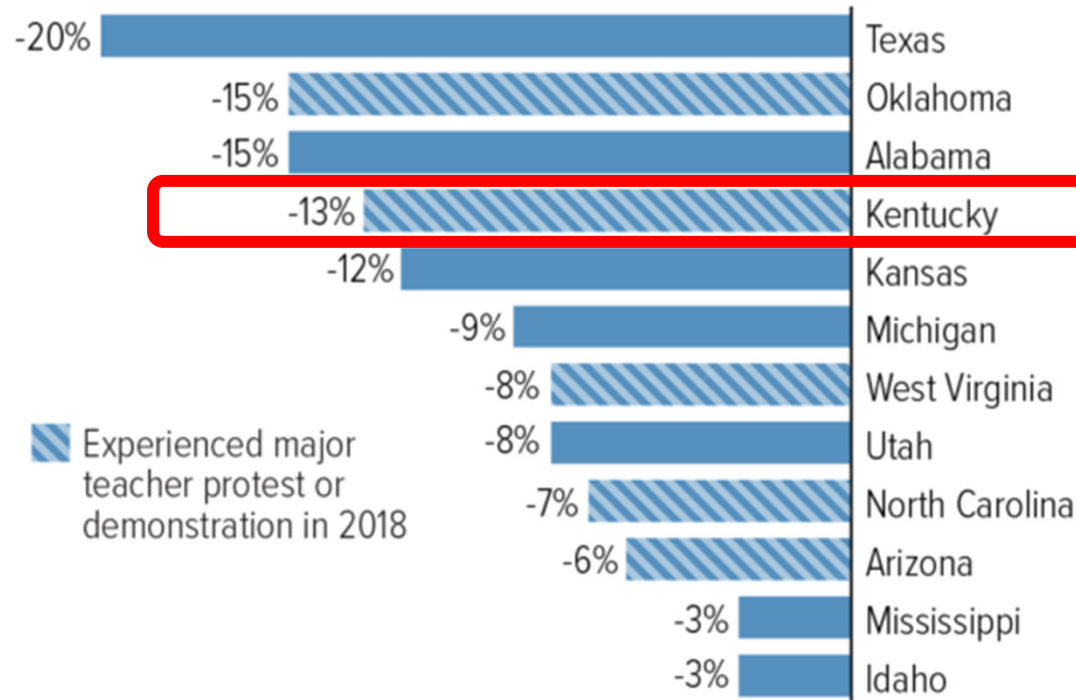
Source: KCEP analysis of Office of the State Budget Director data as enacted.

Note: This analysis assumes the share of funding contributed by the state versus local sources to the per-pupil guarantee each year is their share of all base SEEK funding including SEEK add-ons as well as the per-pupil guarantee. Add-ons include additional funds for students eligible for free lunches and for students with disabilities.

Core Formula Funding (SEEK) Cuts Are Among Worst in Country

Despite 2018 Funding Boosts, Some States Remain Far Below Pre-Recession Funding Levels

Percent change in state formula funding* per student, inflation adjusted, fiscal years 2008-2019



**4th worst cut
among states**

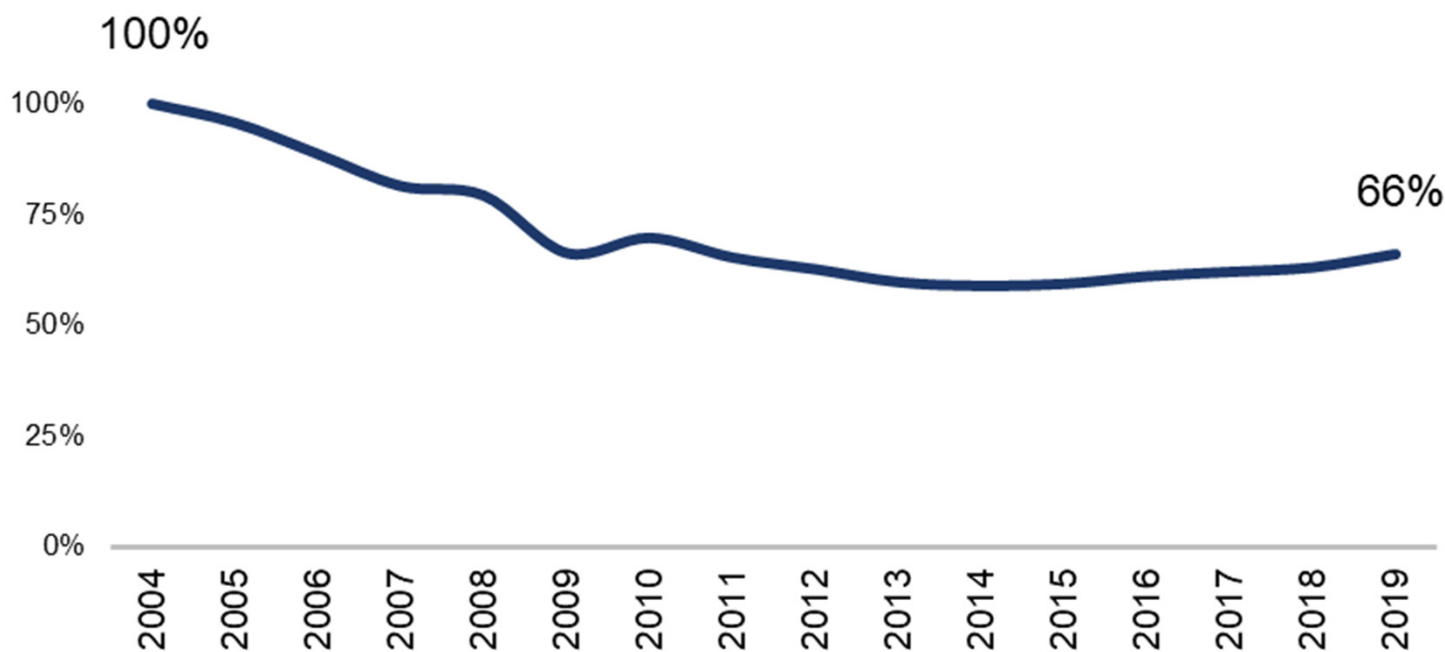
*General or formula funding is the primary form of state K-12 funding. States also typically provide revenue for other, more specific purposes, such as bus transportation and contributions to school employee pension plans.

Source: CBPP budget and enrollment analysis

School Transportation Funding Remains Below Statutory Requirement

State Continues Trend of Underfunding Transportation

Percent of state funding compared to share required under SEEK formula.



Source: Kentucky Department of Education. Calculation of state funding compared to share required under SEEK formula.

Other Key K-12 Programs Were Cut In Current Budget

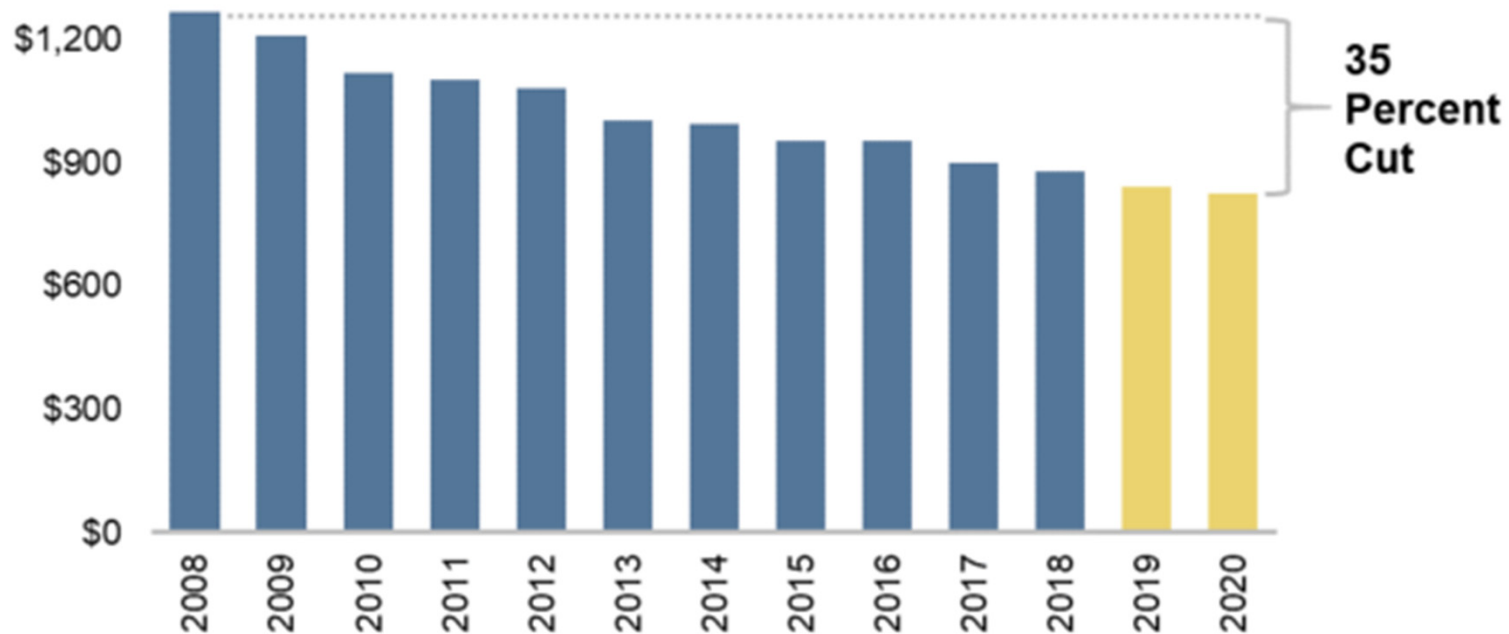


- \$0 for textbooks
- \$0 for teacher professional development
- Extended school services cut by 6.25%
- Preschool cut by 6.25%
- Money added to FRYSCs (though still below 2008 level)

Higher Education Was Cut 6%

Cuts to Kentucky's Public Colleges & Universities Continue

Funding in 2018 dollars, including performance fund pool (in millions)



Source: KCEP analysis of OSBD data.

Examples of Other Areas that Received Cuts

- Cuts of up to 6.25% including:
 - Aging and Independent Living
 - Property Valuation Administrators
 - Behavioral Health & Intellectual Disabilities
- No funding provided for:
 - Across-the-board raises for state employees
 - Commission on Women
 - University Press of Kentucky
 - Kentucky Teacher Internship Program

Selected areas received more funding (examples)

- Lottery scholarships (& more with surplus)
- Supports for Community Living reimbursements
- Hired new social workers and some raises
- More slots in Acquired Brain Injury care
- Public Advocacy, Commonwealth/County Attorneys

Challenges Facing the Next Two-Year Budget

Weak revenue growth with rising costs & structural deficit



- Forecast of just 2%, 1.7% revenue growth
- One-time money will have to be replaced
- Cost increases expected in pensions, Medicaid, corrections
- Funding crises in certain areas
- New spending and reinvestment

Pension Contributions Rise Again Next Budget

- KERS non-hazardous contribution rate will increase from **83% to 93%** of pay*
 - Cost equal to a 10% pay raise for most state employees
 - Result of change in mortality assumptions, declining payroll due to budget cuts & outsourcing, and only 49% contributed for quasis in '19 and '20
 - Will budget provide support for quasis that cannot afford full ARC but want to stay in system?
- Used surplus to fund employer part of under-65 retired teachers' health insurance in '20—would cost \$70 million/year to put back in budget

*Draft recommendation from actuary

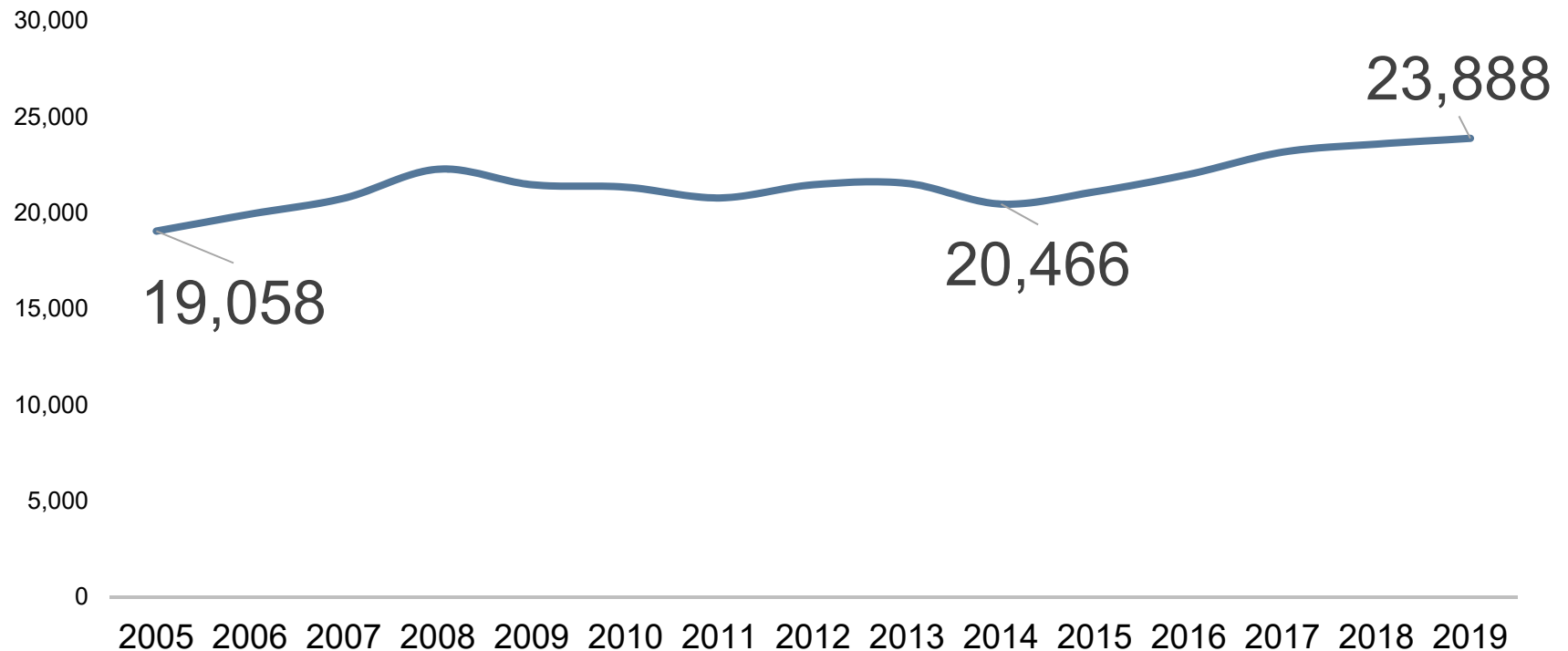
Medicaid Expansion Is a Great Deal, But New Dollars Needed For One More Year Increase in Match

- Increase from '20 to '21 will cost approximately \$50 million
- But still drawing down \$9 for every \$1 we put in

	Federal	State
2016	100%	0%
2017	97.5%	2.5%
2018	94.5%	5.5%
2019	93.5%	6.5%
2020	91.5%	8.5%
2021	90.0%	10.0%
2022	90.0%	10.0%

Prison Population Continues to Grow

Average Daily Population of Individuals Incarcerated for Felony Convictions



Source: Kentucky Department of Corrections.

Other Pressures & Proposals in Next Budget

- Monies for HB 1: School Safety
- Social worker caseloads & child welfare crisis, kinship care (HB 2)
- Reopening of Floyd Co Prison: +\$16 million/year
- \$50 million bond U of L/Jewish Hospital
- Teacher raises
- No across-the-board raises for state employees in 8 of last 10 years

2018 Tax Bill Was a Tax Shift



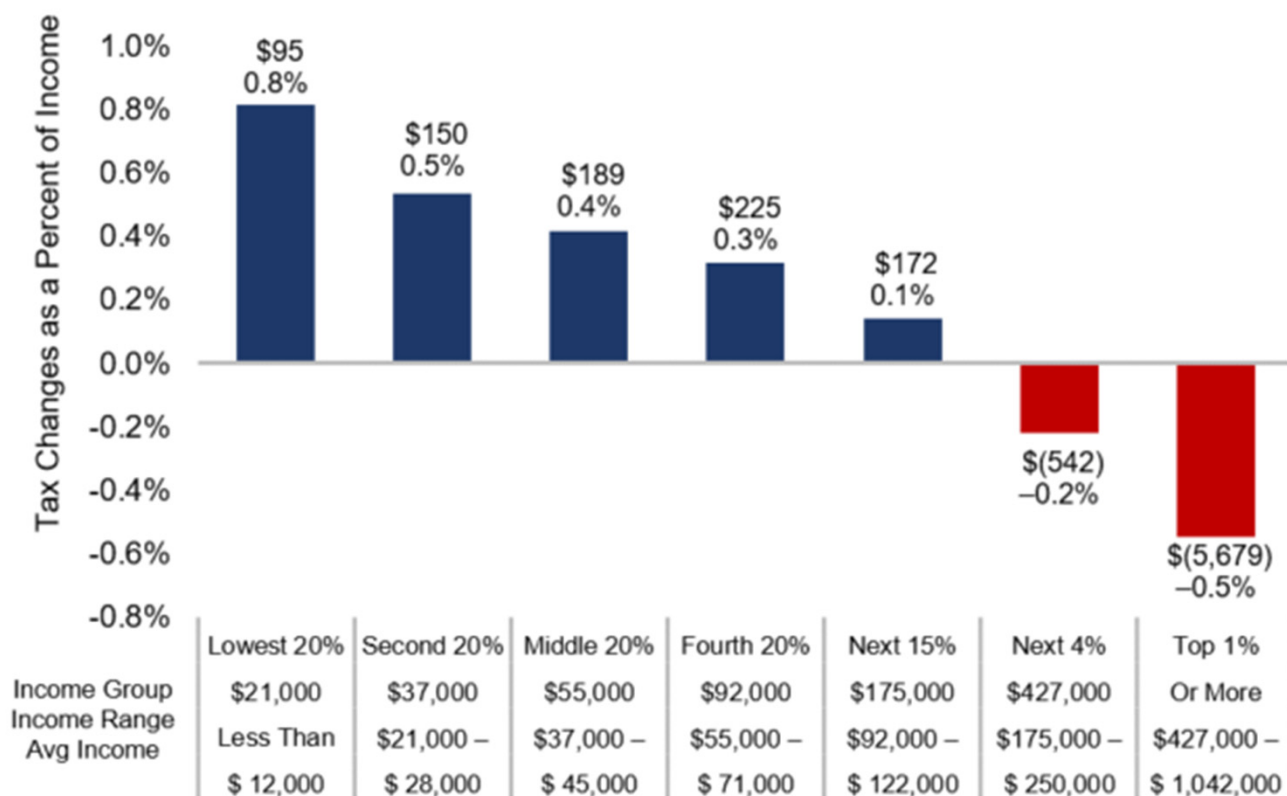
- *Raised nearly \$200 million a year (temporarily)*
- *Shifted taxes from wealthy to everyone else*

- Flat 5% income tax rate rather than graduated 2%-6%
- Flat 5% corporate tax rate rather than 4%-6%
- Expand sales tax to car repair, landscaping, pet vet & grooming, dry cleaning, bowling, fitness centers and other
- Raise cigarette tax by 50 cents
- Lowered retirement income exclusion to \$31,110

2018 Tax Bill Was a Tax Shift

New Kentucky Tax Law a Shift From Those at the Top to Everyone Else

Change in amount and share of family income paid in total state and local taxes

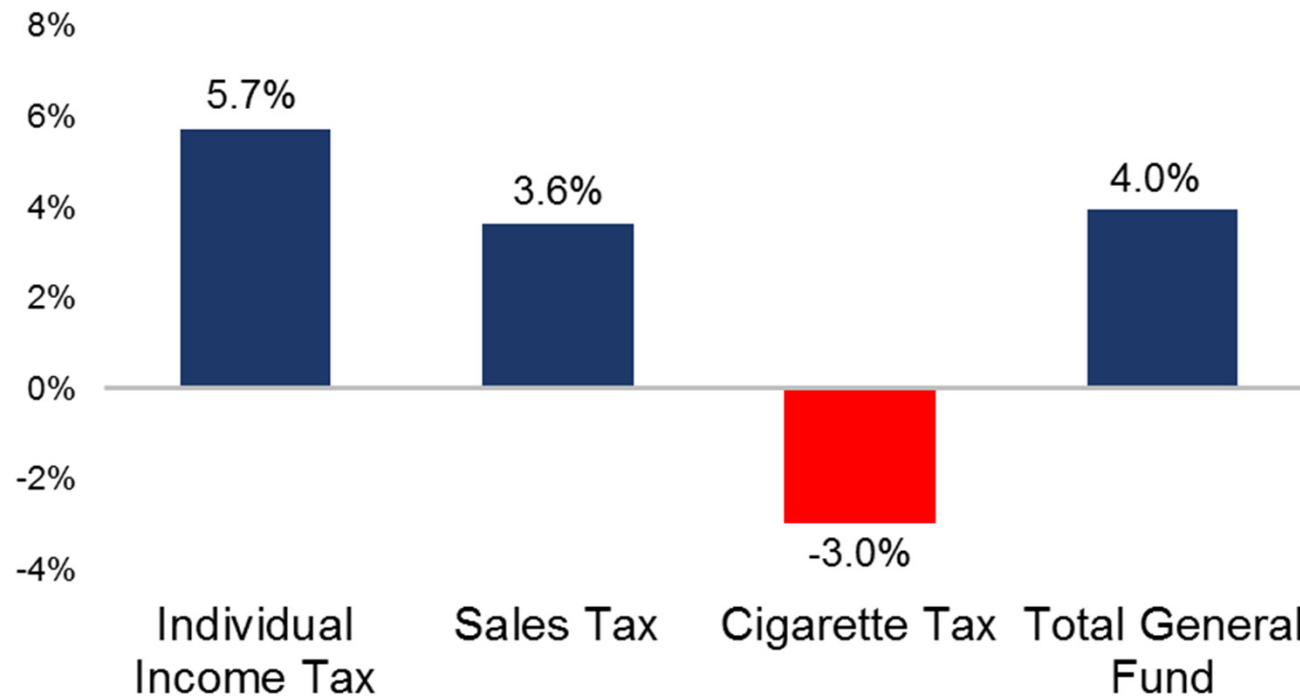


Source: Institute on Taxation and Economic Policy.

Shift from Income tax to Consumption Taxes Slows Revenue Growth

Income Tax Strongest Revenue Source We Have

Average annual growth 2010 to 2018



Source: KCEP analysis of OSBD data.

2019 Tax Bills Result in Major Lost Revenue

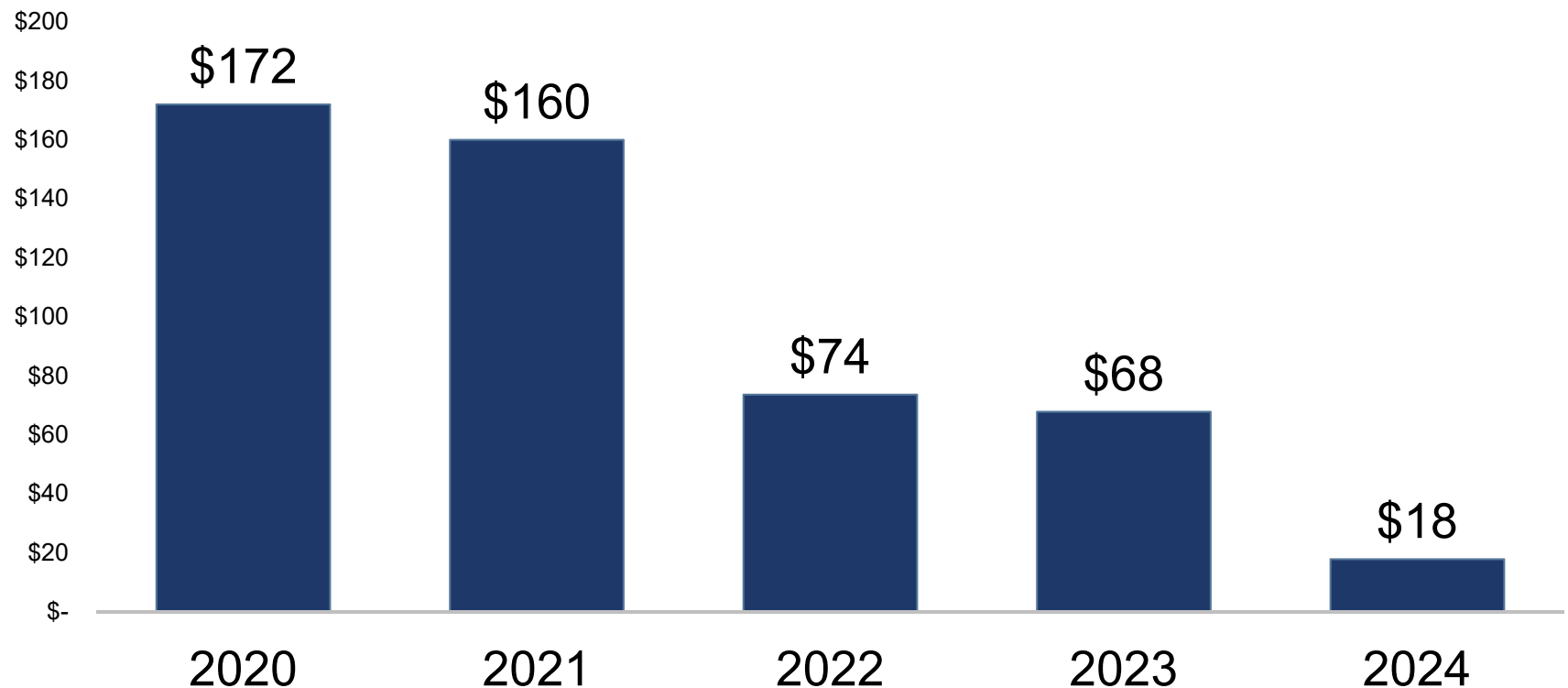
*HB 354 and HB 458 will cost
\$110M a year (& \$159M by 2024)*

- Repealed bank franchise tax, switched banks to corporate income tax
- Loosened rules to allow use of corporate tax havens, other tax avoidance
- Deferred tax relief for large multistate corporations
- Reduced property taxes for heavy equipment leasing companies
- Increased property that can be immediately expensed in corporate tax
- Exempted nonprofit admissions from sales tax
- Breaks for house flipping, large gambling losses, fishing tournaments, boat docking, others

Result Is Revenue Raised by 2018 Tax Bill Will Disappear

Net Revenue from 2018 and 2019 Tax Changes

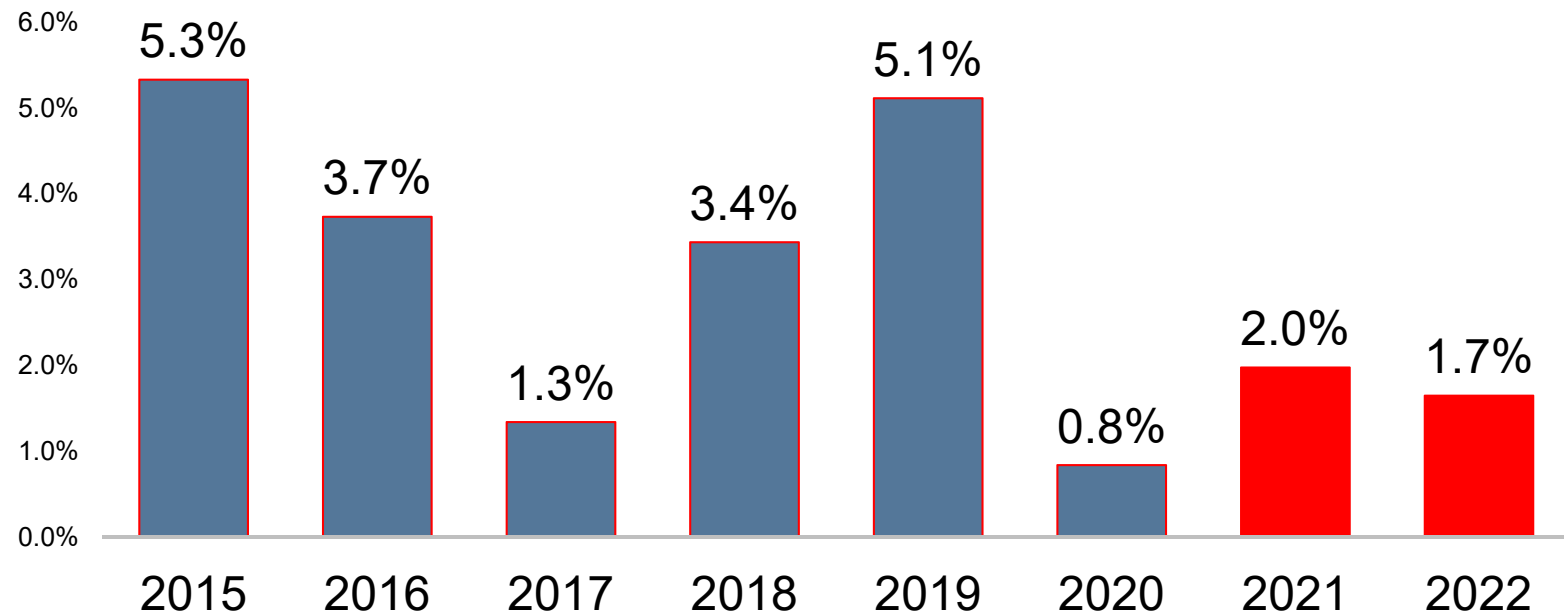
Millions of dollars



Source: Office of the State Budget Director.

Makes Revenue Forecast Weak for Next Biennium

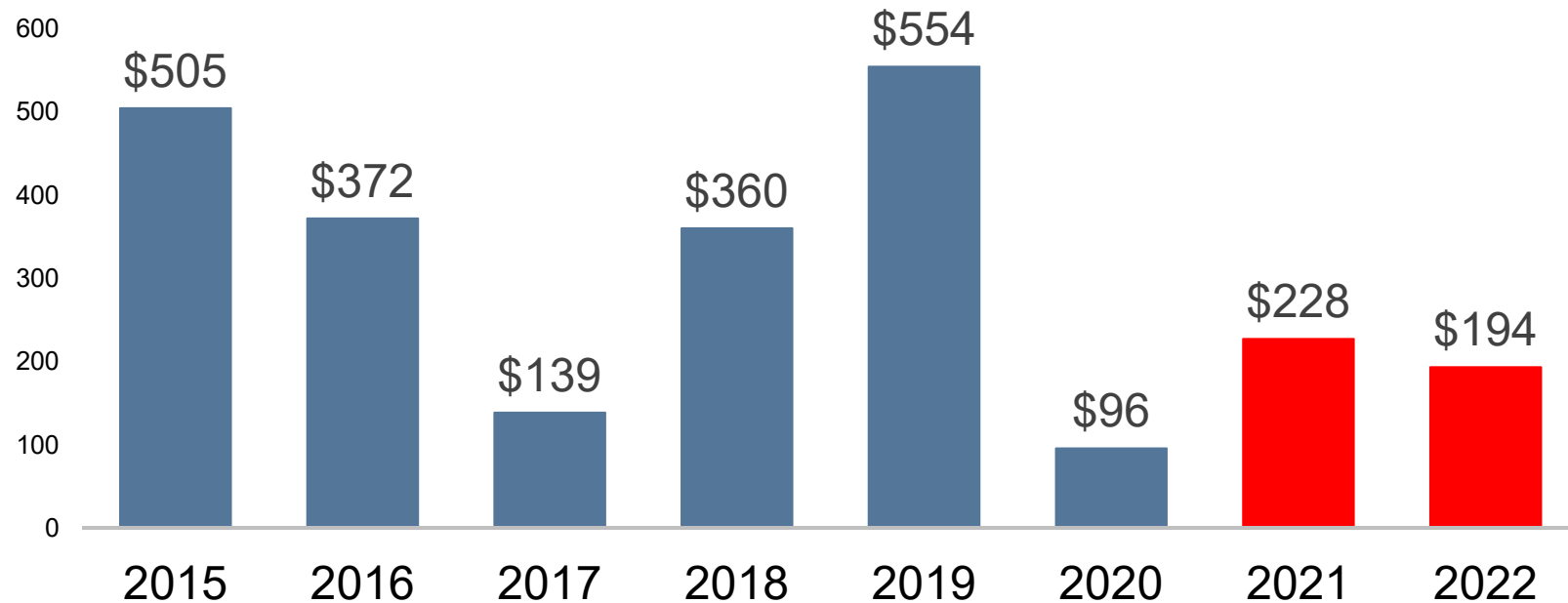
Preliminary Forecast General Fund



Source: Consensus Forecasting Group

Revenue Forecast Is Weak for Next Biennium

Preliminary Forecast General Fund (Millions of Dollars)



Source: Consensus Forecasting Group.

One Time Monies Will Have to Be Replaced

(Numbers in Millions of Dollars)

	2019	2020
Public Employee Health Insurance Trust Fund	\$135	\$175
"Permanent" Pension Fund	\$75	\$75
Public Protection Cabinet funds	\$23	\$23
School Facilities Construction Commission	\$26	\$0
Petroleum Storage Tank Fund	\$12	\$12
Other Transfers	\$33	\$31
Total	\$304	\$316

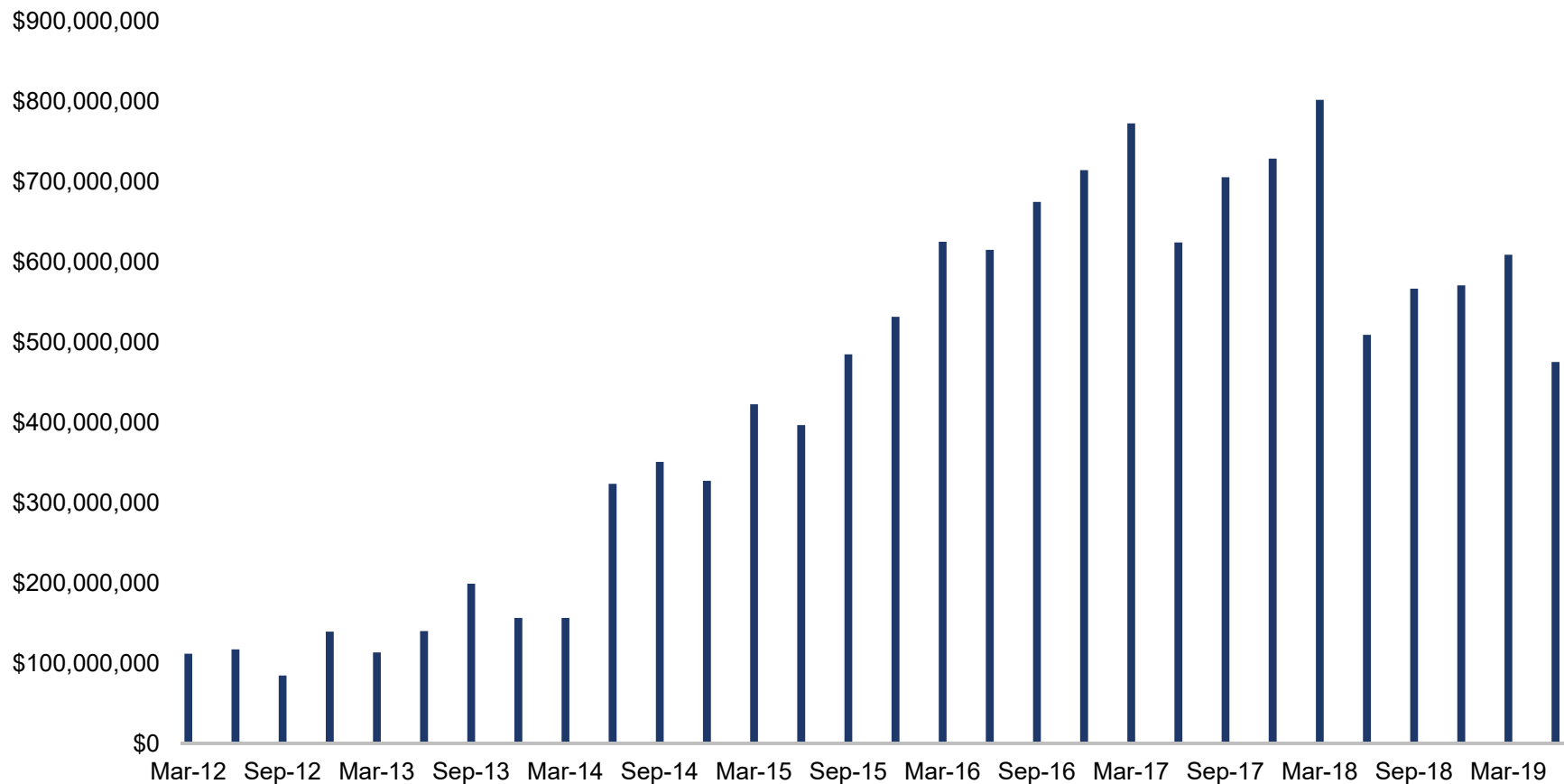
One-Time Monies Will Have to Be Replaced

- After \$150 million withdrawal, Permanent Pension Fund is now empty
- State has drawn repeated transfers from Public Employee Health Insurance Trust Fund; monies were there because claims were falling for a couple of years—now claims are rising.
- \$177 million is scheduled to be added to rainy day fund this year, though that only brings it to 2.7% of budget—experts recommend 5% to prepare for recessions

Extra Funds in Employee Health Fund Dwindling

\$175 Million Still to Be Withdrawn

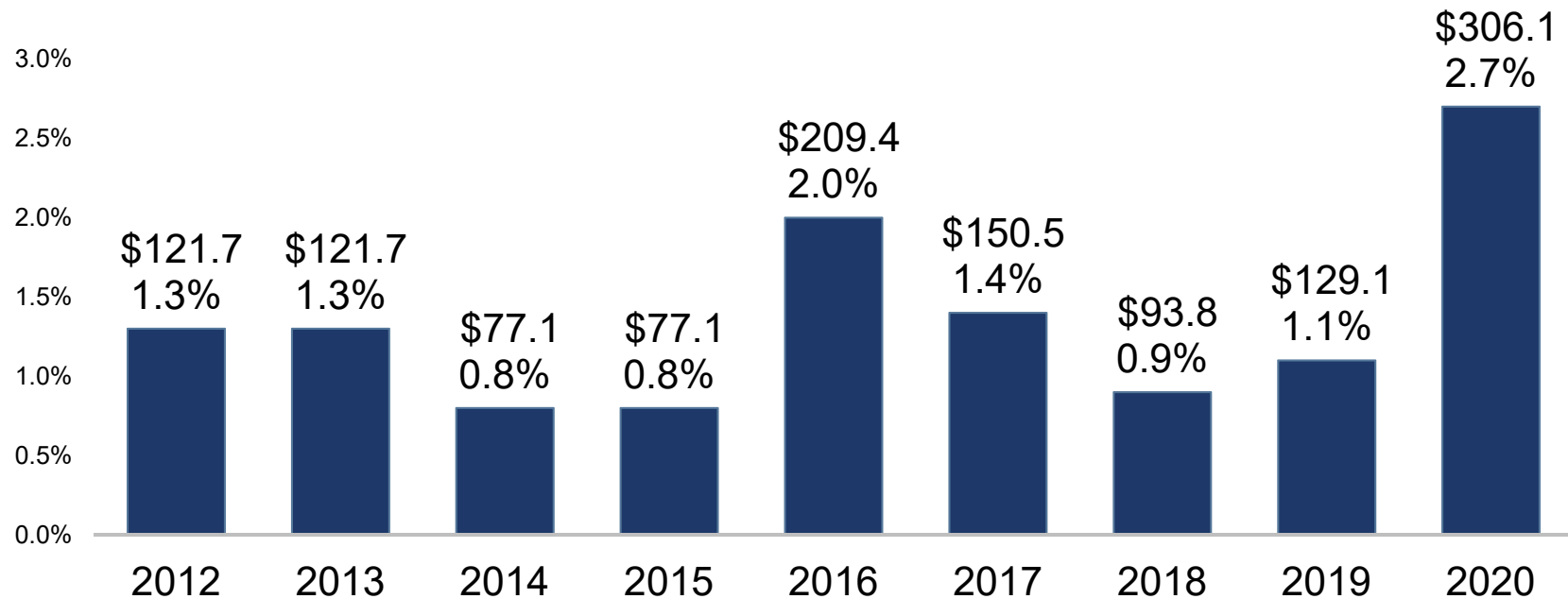
Balance of Public Employee Health Trust Fund



Source: Kentucky Employees' Health Plan.

The Rainy Day Fund Has Limited Resources

Kentucky's Rainy Day Fund: Dollar Amount and as a Share of General Fund Revenue



Source: Office of the State Budget Director.

New Revenue Should Be Generated, But Must Be Strategies that Work

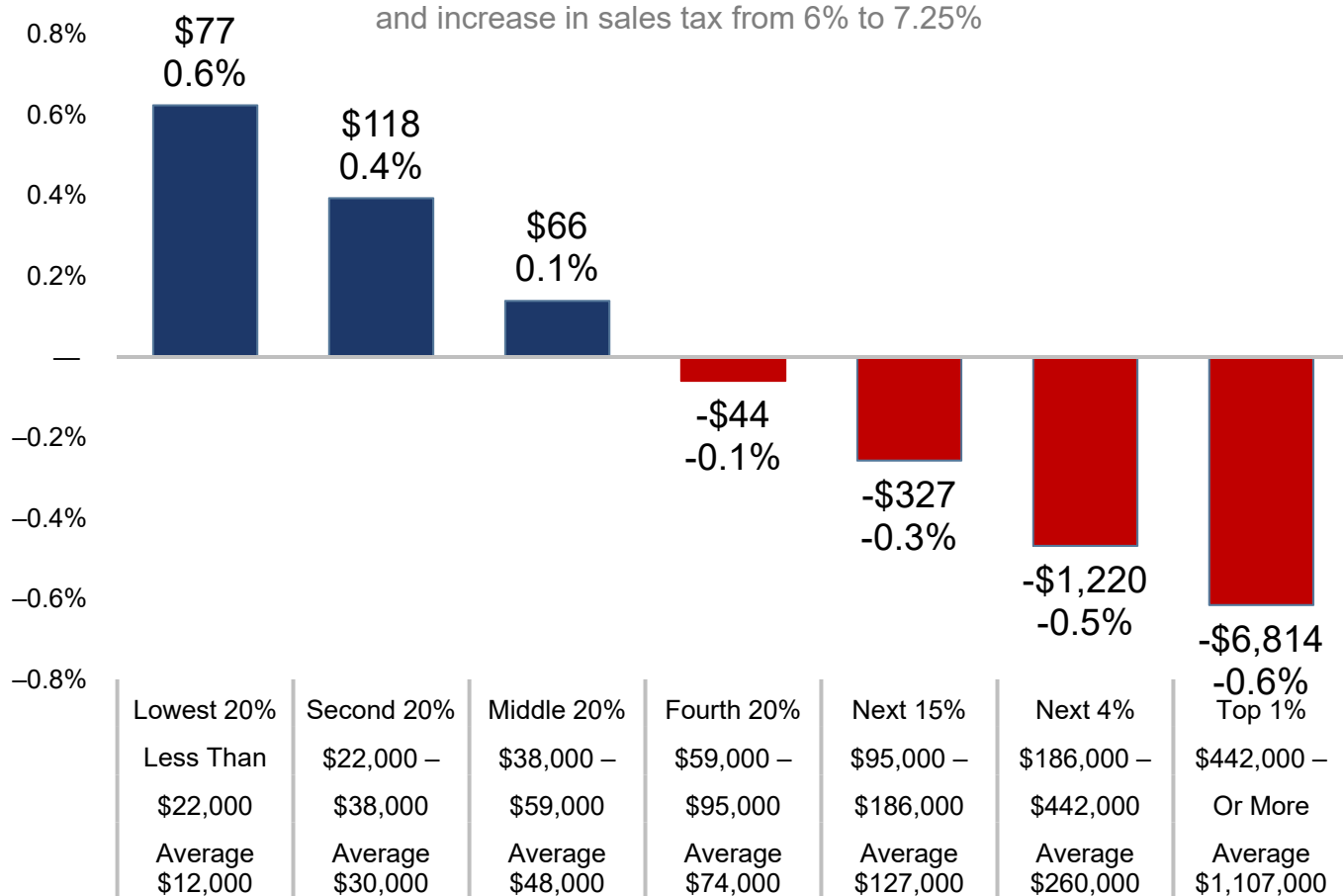
Another shift from income to consumption taxes is not the answer.

- Cost of going from 5% to 4% income tax is \$934 million
- Would cut taxes for wealthy, shift them over to middle-income and poor and slow future revenue growth—worsening budget problems

What Would Another Tax Shift in 2020 Look Like?

Continuing Shift to Sales Taxes Would be a Tax Cut for the Wealthy

Tax change as a share of income and dollar amount from a decrease in the income tax from 5% to 4% and increase in sales tax from 6% to 7.25%



Funding for Road Construction a Challenge



- Drop in the state gas tax
- Increased fuel efficiency
- Failure to increase federal gas tax since 1993
- State trade-in credit on new car purchases hurt
- Expiration of toll credits coming, creating annual gap of \$120 million



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