



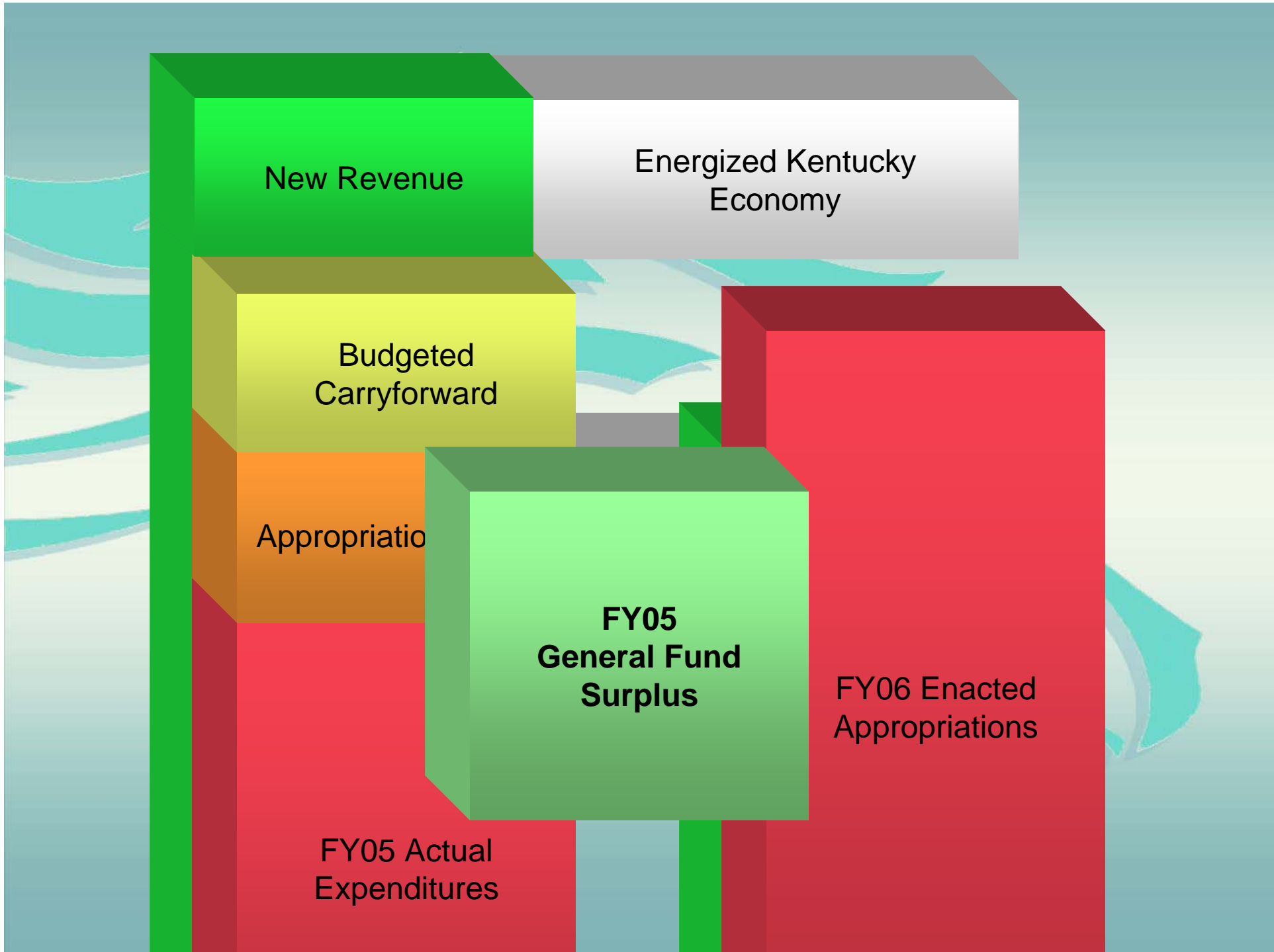
# The Road Ahead

Report to SCOPE

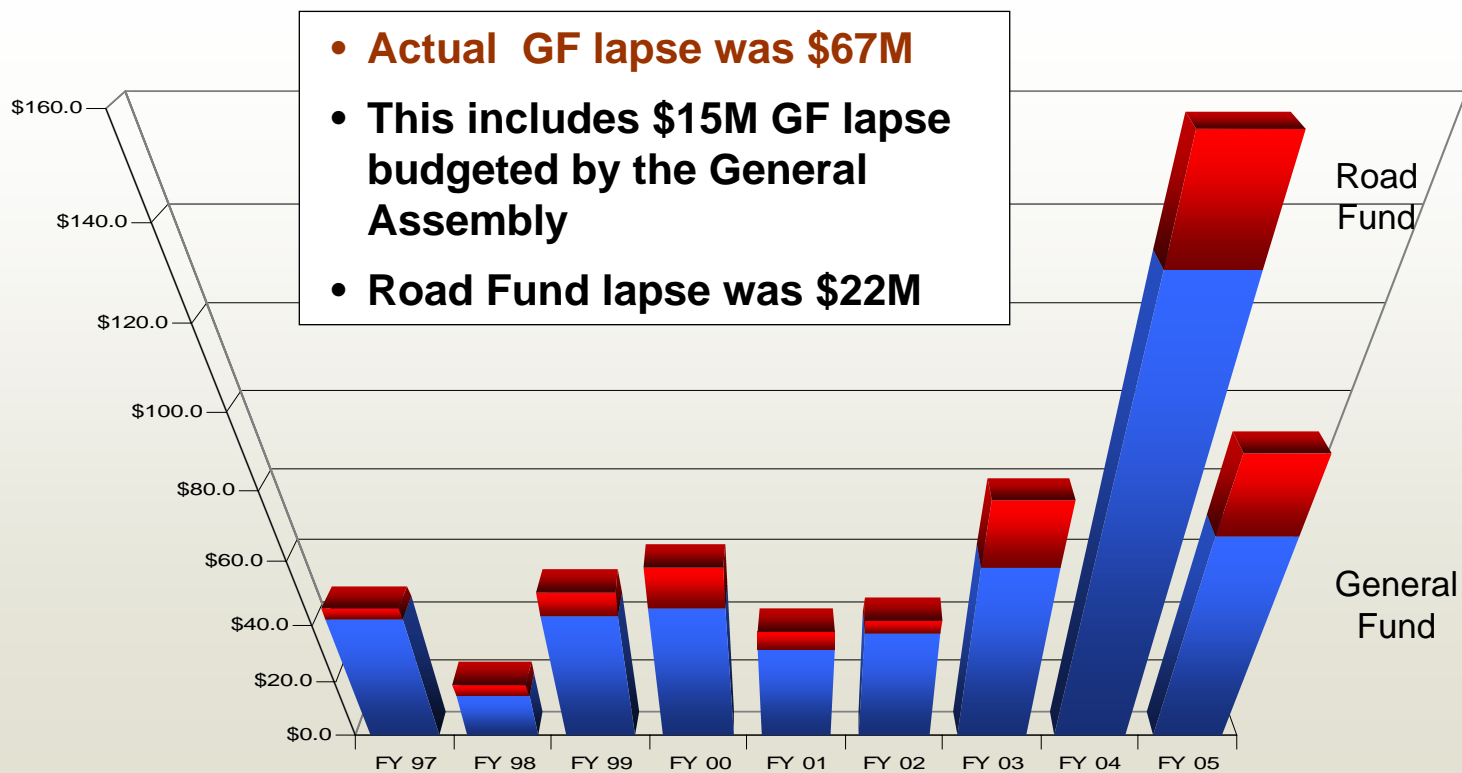
---

**Bradford L. Cowgill**

State Budget Director  
September 18, 2005



# FY05 lapses were remarkably high



## **Road Fund achieved \$29M surplus**

- ✓ **Surplus represents 2.5% of enacted appropriations**
- ✓ **No small achievement when revenues grew less than 1%**
- ✓ **Surplus funds will be directed into the state highway construction program**
- ✓ **Transportation Cabinet saved \$22.5 million in Cabinet activities; funds can now be dedicated to highway construction**

## FY05 GF revenue up \$667M (9.6%) over FY04

	FY05	FY04	Diff	Diff
	(\$Mil)	(\$Mil)	(\$Mil)	(%)
Sales and Use	2,595.0	2,447.6	147.4	6.0
Individual Income	3,036.2	2,796.3	239.9	8.6
Corp. Inc. & License	612.6	427.4	185.2	43.3
Cigarette	33.7	17.1	16.6	97.1
Coal Severance	184.4	147.5	36.9	25.0
Property	472.6	448.8	23.8	5.3
Lottery	161.3	173.8	-12.5	-7.2
Other	582.9	536.2	46.7	8.7
Total	7,645.0	6,977.60	667.4	9.6

## **FY05 GF rose \$195M over projections**

### **Why GF revenue rose faster than expected?**

- ✓ **Stronger uptick in Kentucky economy than predicted**
- ✓ **Consistent with other states, national trends**
- ✓ **Encouraged by business and consumer confidence in Kentucky business and governmental climate**
- ✓ **Business signals sent through tax modernization may have played small role in the strengthening of the economy but implementation has just begun**

## **Did tax modernization affect FY05 receipts?**

**Mostly no, because J4K hasn't fully kicked in yet.**

**But with three qualifications**

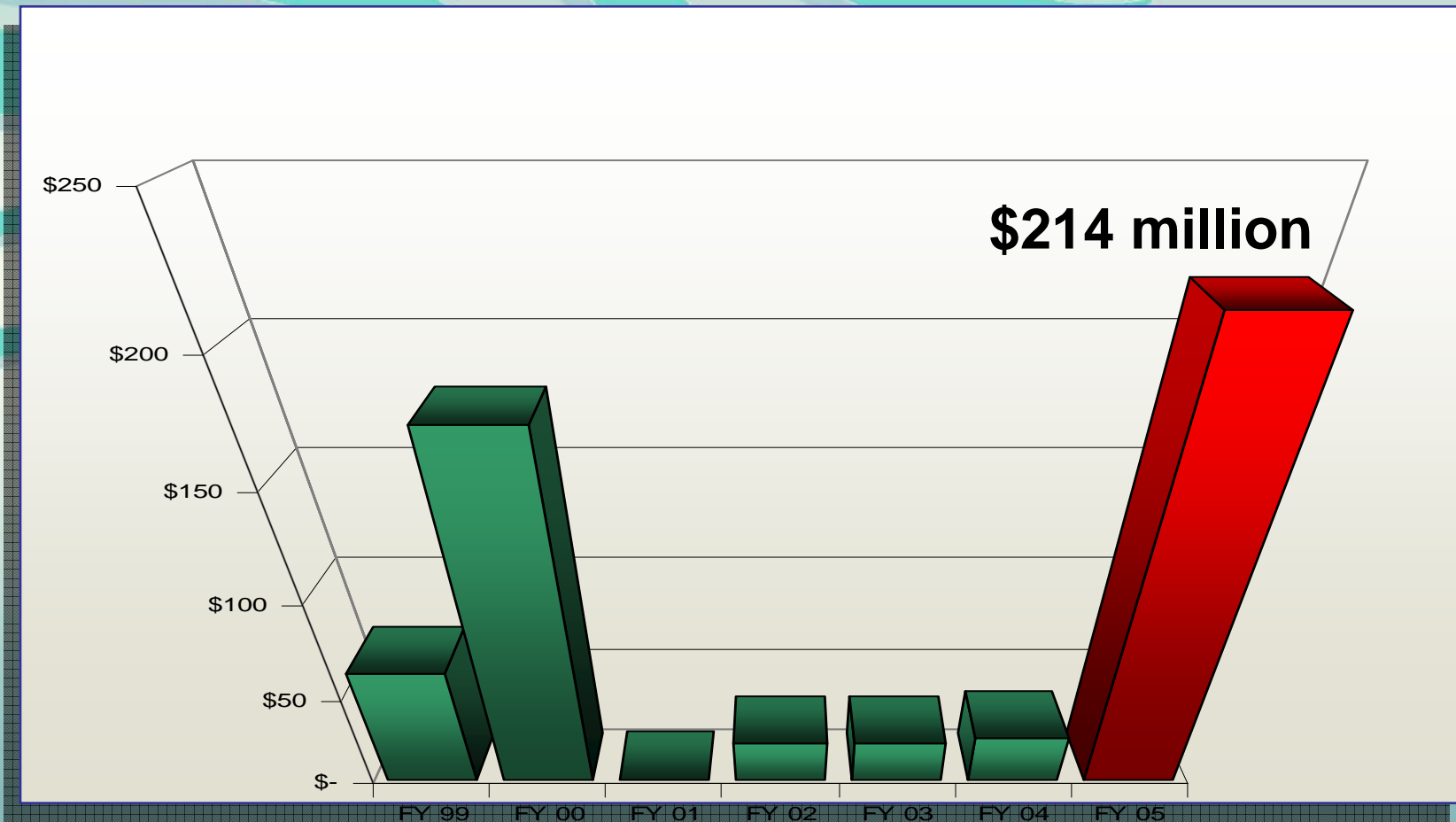
- 1. Yes, new cigarette tax revenue (\$16.6M more, due to cigarette tax changes)**
  - ✓ JOBS for Kentucky (J4K) increased tax from 3c to 30c per pack for one month (June)**
  - ✓ J4K imposed floor stocks tax (to equalize tax on existing inventories)**

## **Did tax modernization affect FY05 receipts?**

- 2. Yes, individual income tax receipts fell in June**
  - ✓ LLE members anticipate credit for business tax
  - ✓ J4K reduced income tax rates
  - ✓ (J4K low income tax credit had not yet affected receipts)
- 3. Mixed, corporate income tax**
  - ✓ Some portion of increase resulted from inclusion of LLE's in corporate income tax
  - ✓ But increased business tax receipts resulted primarily from higher corporate profits (other states also have big boosts)



## FY05 General Fund Surplus was up sharply



## General Fund Surplus on June 30, 2005

	<b>\$ Millions</b>
General Fund Revenues in excess of enacted	\$195
Tobacco Settlement – Phase I payments in excess of enacted	\$3
Fund Transfers less than enacted (due to injunction on KAPT \$13.7m)	(\$5)
Necessary Government Expenses-unbudgeted expenditures	(\$14)
Judgments payments-unbudgeted expenditures	(\$3)
Off-budget expenditures (Abandoned Property Fund/KAPT)	(\$17)
Unbudgeted Lapses (excl. budgeted lapse of \$15)	\$52
Lapse of Continued Appropriation	\$2
<b>General Fund Surplus</b>	<b>\$214</b>

## Budget bill's surplus spending plan

Governor is permitted to choose among five options:

1. **Budget reserve trust fund** (up to 1.5% of projected FY06 GF revenue)
2. **Increased classroom teacher salaries** to the average level of contiguous states
3. **Additional funding to (P-16)** necessary to return base appropriations to the pre-Budget Reduction /Stability Initiative of fiscal year 04
4. **Medicaid** (limited to an amount certified as needed by the secretary of H&FS and approved by the State Budget Director)
5. **Necessary government expenses** (including judgment liabilities not funded by General Assembly)

## **Governor contributed \$90M to trust fund**

<b>Target at 1.5% of FY 06 revenues</b>	<b>\$</b>	<b>119,015,085</b>
<b>BRTF ending balance for FY 05</b>	<b>\$</b>	<b>28,764,829</b>
<b>Maximum Deposit from surplus</b>	<b>\$</b>	<b>90,250,256</b>

- ✓ **\$124 million available for other options**
- ✓ **Governor is currently studying options and evaluating the needs of the Medicaid program**

## **Financial support for higher education**

### **General Fund appropriations for higher education**

- ✓ **\$1,262 million for FY06**
- ✓ **12% increase over FY04**

**Institutional budgets in FY06 increased \$81.6 million  
(average of 9% per institution over FY04)**

### **Student financial aid funding from state funds**

- ✓ **\$195 million in FY06**
- ✓ **17% increase over FY04**

## **Capital projects and cancer research**

**\$625 million in total bond funds for capital projects, including:**

- ✓ **\$395 million in General Fund supported bonds (26 projects)**
- ✓ **\$230 million in agency bonds (18 projects)**

**Cancer research:**

- ✓ **Earmarked one center cigarette surtax for cancer research (split equally between the two research institutions and matched by external funds)**

## **Budget problems have shifted . . .**

**. . . from insufficiency of revenue to unsustainable expenditure patterns**

- ✓ **Revenues are coming in nicely (but don't forget that FY07 slides back from FY06 cash flow "hump").**
- ✓ **The big four (Medicaid, health insurance, pensions and corrections) are competing with everything else in the budget, denying funds for education and economic initiatives**

## **FY06 good news: revenue**

### **Already budgeted:**

- ✓ **JOBES for Kentucky (J4K) was revenue neutral over five year period (FY04-08), but included cash flow “bump” (\$110M) in FY06 (already budgeted)**

### **Not budgeted:**

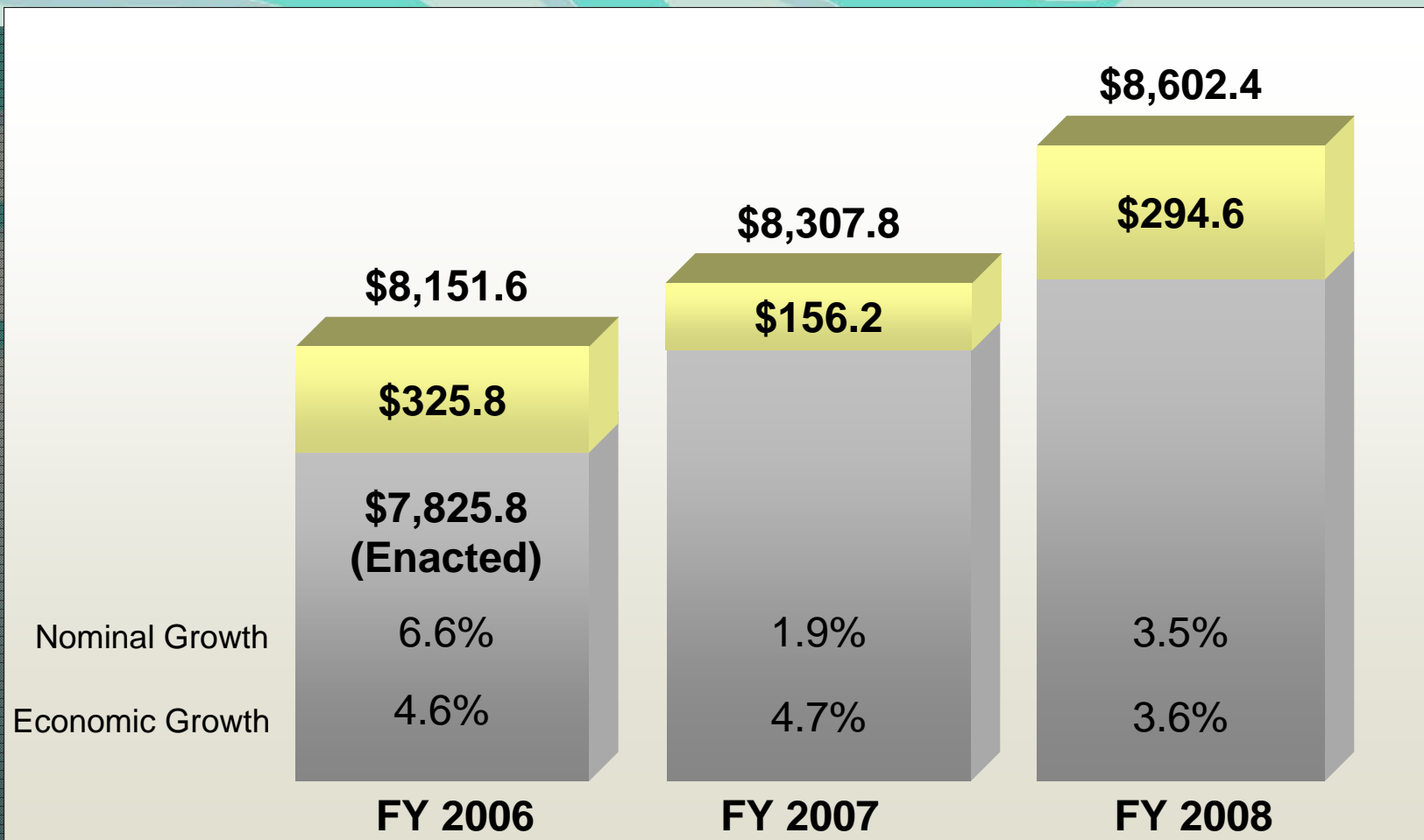
- ✓ **Beginning balance is higher than anticipated due to lapse and stronger revenue in FY05**
- ✓ **CFG forecast for FY06 is \$ \$325.8 more than the enacted budget**



## **FY06 bad news: expenditure pressures**

- ✓ **Medicaid is way out of balance**
- ✓ **Prison population is increasing, but at lower rate**
- ✓ **State employee health insurance costs were budgeted for 20% increase to CY06**

## CFG revenue outlook for General Fund FY06-08



## CFG August GF revenue estimates

	<b>FY06</b>	<b>FY07</b>	<b>FY08</b>	<b>FY09</b>	<b>FY10</b>
	<b>(\$Mil)</b>	<b>(\$Mil)</b>	<b>(\$Mil)</b>	<b>(\$Mil)</b>	<b>(\$Mil)</b>
<b>Sales &amp; Use</b>	2,714.8	2,772.5	2,891.1	3,034.1	3,164.6
<b>Individual Income</b>	2,820.6	3,000.8	3,158.1	3,317.7	3,472.2
<b>Corporation Inc &amp; Lic</b>	974.0	915.2	896.8	896.0	873.1
<b>Coal Severance</b>	199.1	202.9	190.3	180.1	170.3
<b>Cigarette</b>	181.8	169.1	169.1	169.1	169.3
<b>Property</b>	495.7	476.2	501.0	525.9	552.3
<b>Lottery</b>	160.0	165.5	170.5	175.5	180.0
<b>Other</b>	605.6	605.6	625.5	643.7	663.4
<b>Total General Fund</b>	<b>8,151.6</b>	<b>8,307.8</b>	<b>8,602.4</b>	<b>8,942.1</b>	<b>9,245.2</b>
<b>Growth Rates</b>	<b>6.6%</b>	<b>1.9%</b>	<b>3.5%</b>	<b>3.9%</b>	<b>3.4%</b>

## Tax cuts reduced CFG's August forecasts

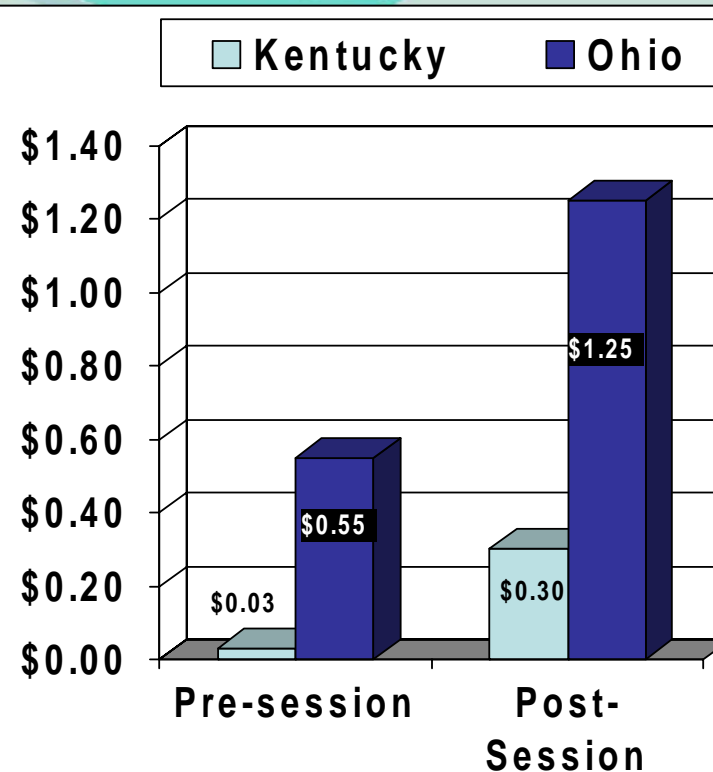
	<u>FY06</u>	<u>FY07</u>	<u>FY08</u>
Individual Income Tax Cuts (LIC and lower rates)	-120	-91	-94
Corporate License Tax Repeal	-61	-202	-206
Corporate Income Tax Reductions	-45	-80	-82
ITW Fix	-47	*	*
Cigarette Tax Increase	+160.3	+149	+149

## **Tobacco tax developments**

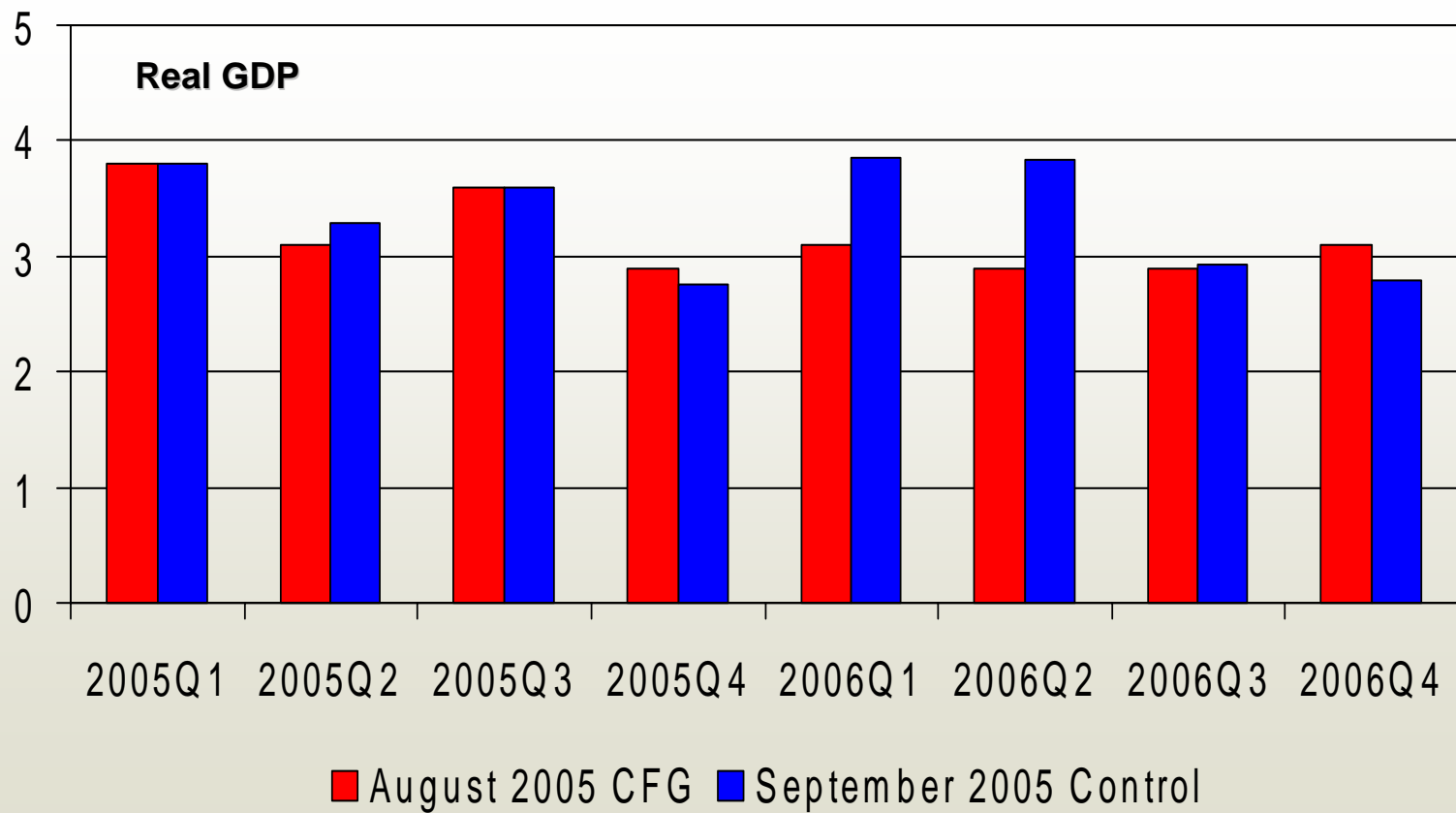
- ✓ **Receipts are coming in consistent with our estimates**
- ✓ **Three installments of the cigarette inventory tax have produced receipts of \$20.8 million**
- ✓ **The new surtax of 26¢ has netted \$37.3 million in receipts since the June 1<sup>st</sup> effective date. (The total tax increase was 27¢, with the extra penny devoted to matching funds for cancer research at UK and U of L).**

## Tobacco tax developments

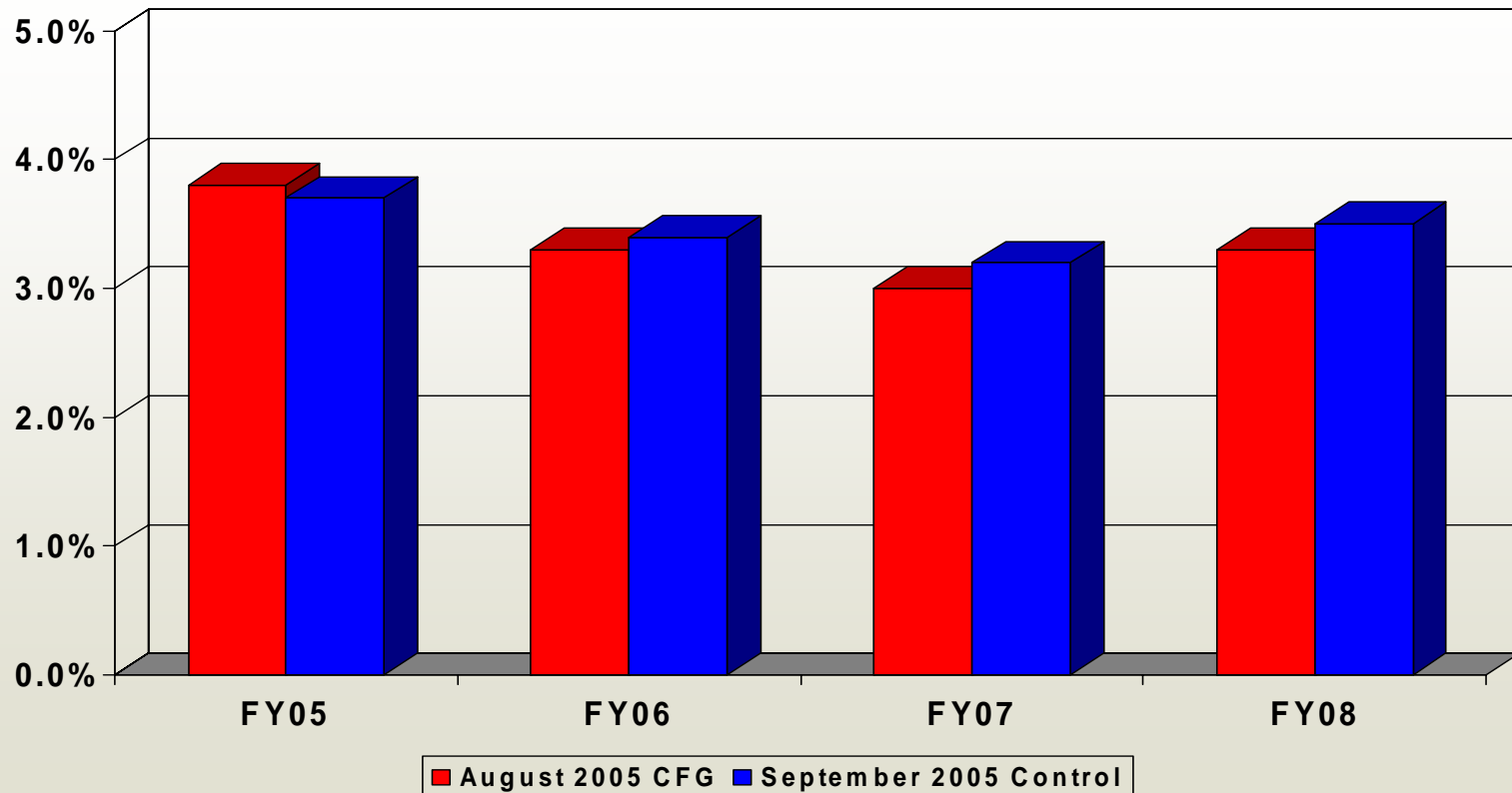
- ✓ Since Tax Modernization, Ohio has increased their tax rate from 55¢ to \$1.25 (effective July 1, 2005)
- ✓ Anecdotal evidence suggests a positive impact on KY sales
- ✓ Ohio's increase has more than restored the pre-session tax gap between Kentucky and Ohio



## Katrina hurts US growth, temporarily

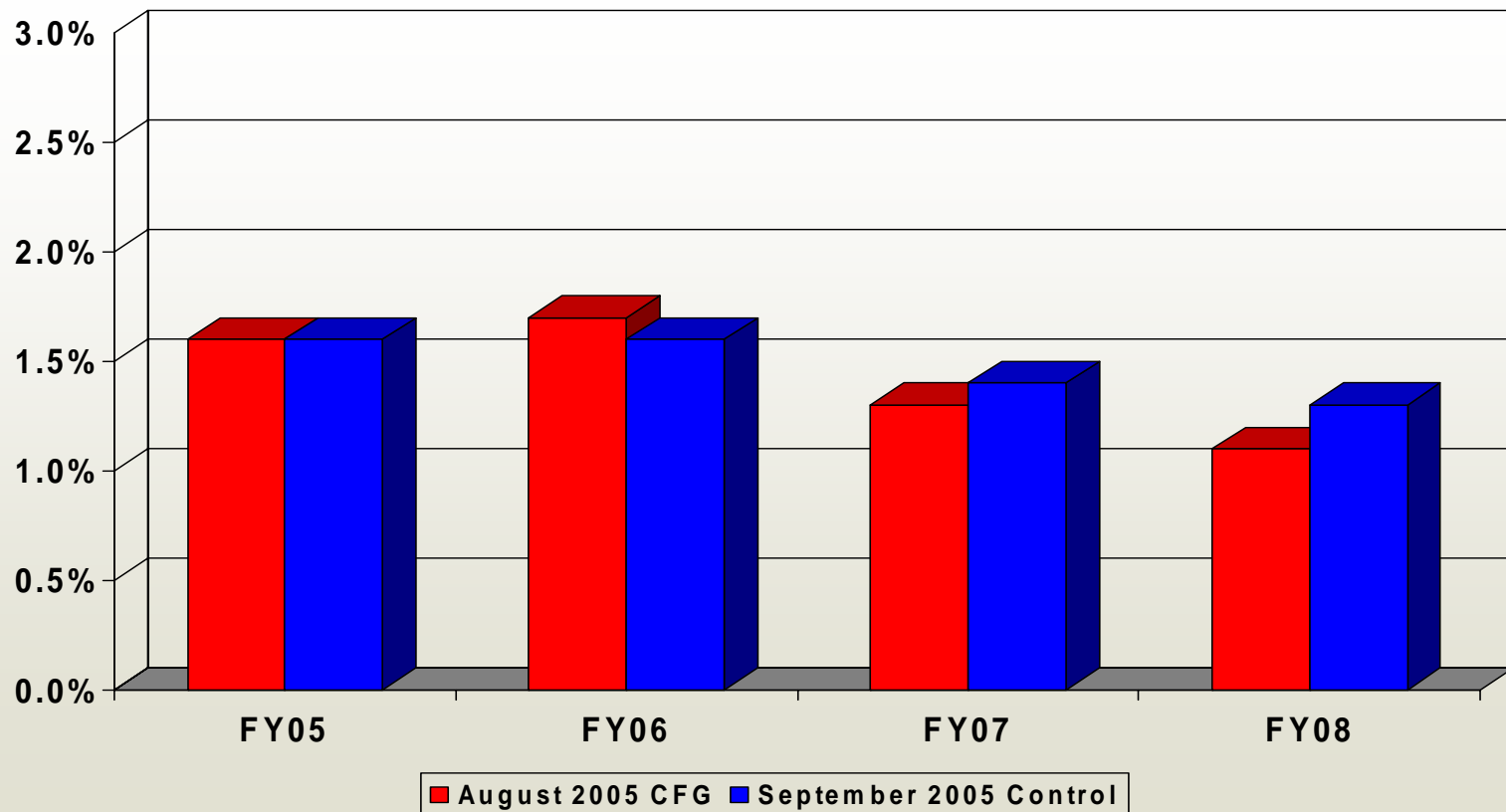


## Real GDP slightly higher over fiscal year





# US nonfarm employment: dip and rebound



## **Possible revenue impacts on Kentucky**

### **Negatives:**

**Gasoline tax receipts due to reduced consumption**

**Sales tax due to reduced disposable income**

**Possible reductions in withholding if certain industries are adversely affected**

### **Positives:**

**Potential for higher coal severance tax receipts**

**Possibly higher sales tax revenues**

# CFG Road Fund August Estimates

	<b>FY06</b>	<b>FY07</b>	<b>FY08</b>	<b>FY09</b>	<b>FY10</b>
	(\$Mil)	(\$Mil)	(\$Mil)	(\$Mil)	(\$Mil)
<b>Motor Fuels</b>	526.2	560.1	557.3	561.5	569.0
<b>Motor Vehicle Usage</b>	422.8	436.1	441.1	447.5	452.4
<b>Motor Vehicle License</b>	93.0	94.0	95.6	97.2	98.8
<b>Motor Vehicle Operators</b>	15.9	17.3	17.5	18.0	18.2
<b>Weight Distance</b>	84.4	86.2	89.3	92.5	95.7
<b>Investment</b>	3.8	4.1	4.3	4.3	4.3
<b>Other</b>	43.5	44.2	41.4	39.6	40.5
<b>Total Road Fund</b>	<b>1,189.6</b>	<b>1,242.0</b>	<b>1,246.5</b>	<b>1,260.6</b>	<b>1,278.9</b>
<b>Growth Rates</b>	<b>5.6%</b>	<b>4.4%</b>	<b>0.4%</b>	<b>1.1%</b>	<b>1.5%</b>

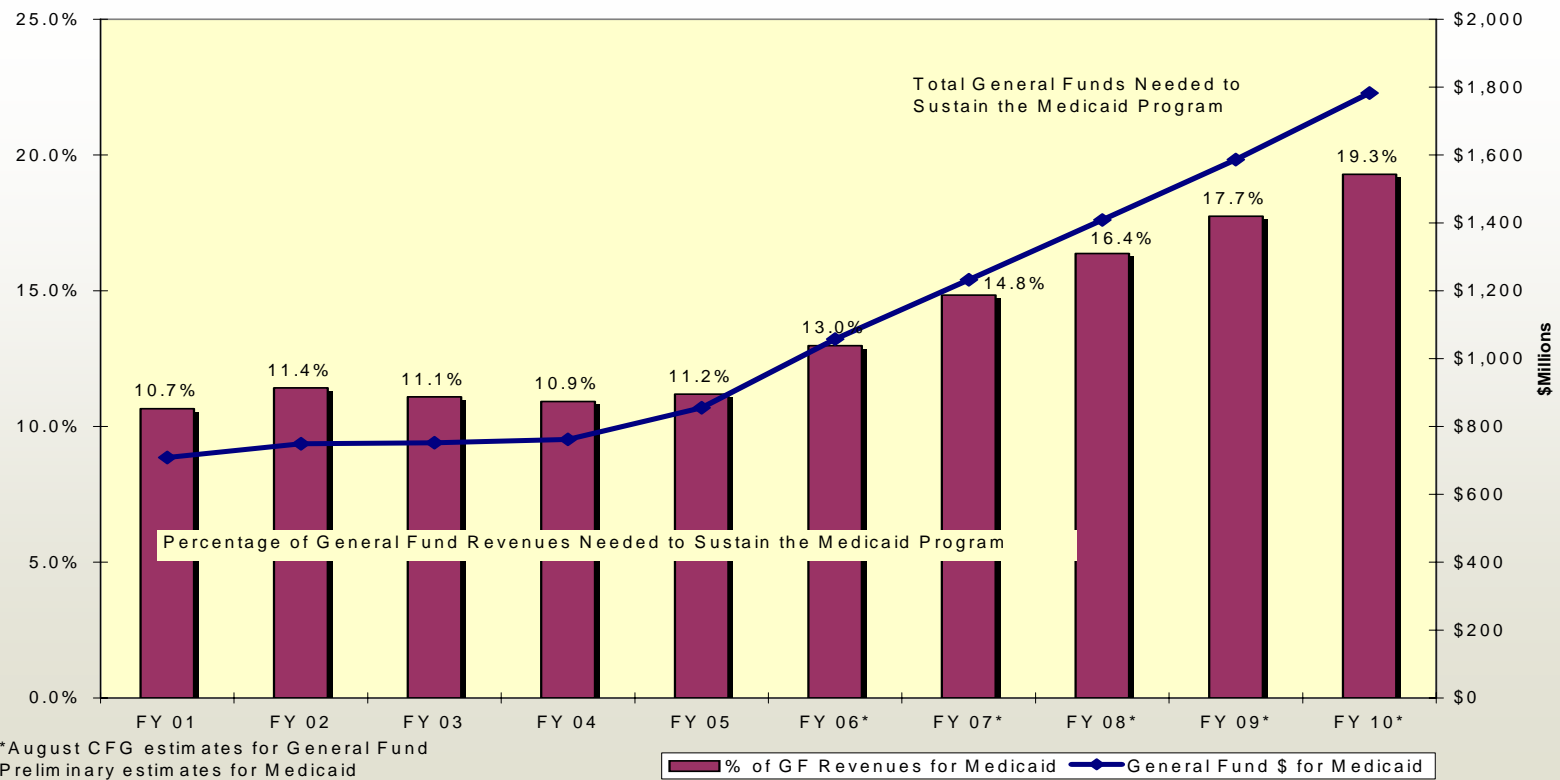
## **Structural imbalance on revenue side**

- ✓ **Structural imbalance = current conditions which cannot feasibly be extended into the future**
- ✓ **On the revenue side:**
  - ✓ **FY07 slides down the back side of J4K “bump” in FY06**
  - ✓ **We are placing heavy reliance on restricted fund transfers**
  - ✓ **The big cash carryforward into FY06 may not be available in FY07, depending on use of anticipated FY06 revenue**

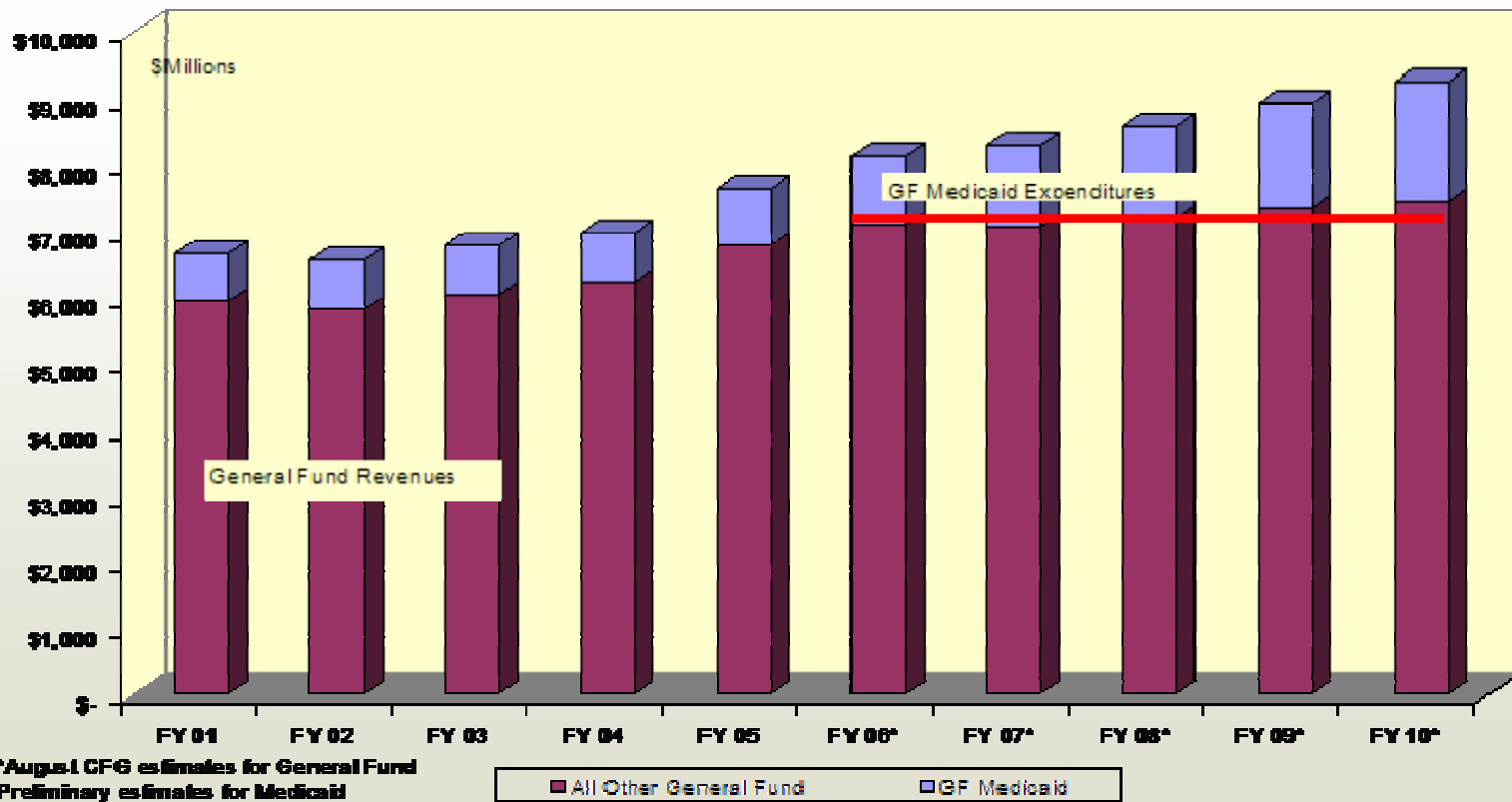
## **Structural imbalance on the **spending side****

- ✓ **Unsustainable rates of increase in cost of Medicaid and state health insurance**
- ✓ **Shift of debt service from half year to full year**
- ✓ **No appropriations for necessary government expense**

# Medicaid's increasing share of General Fund



# Medicaid costs are mushrooming



# Medicaid could absorb revenue gains

Fiscal Year 2006

**\$124**  
balance  
of FY05  
surplus

**\$132**  
Current  
Medicaid  
FY06  
deficit

Fiscal Year 2007

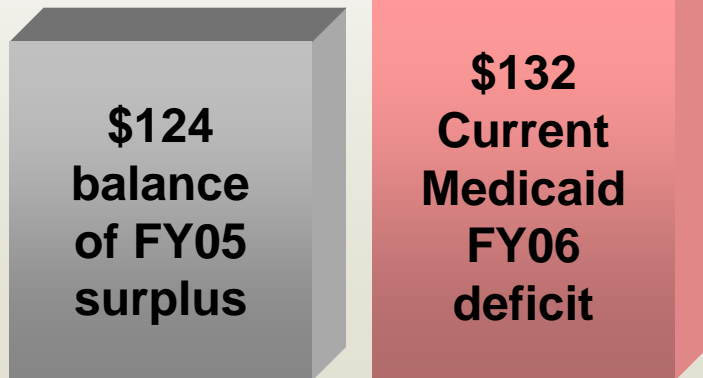
**\$156**  
“new  
money”  
in FY07

**\$175**  
increased  
cost of  
current  
Medicaid  
program  
in FY07

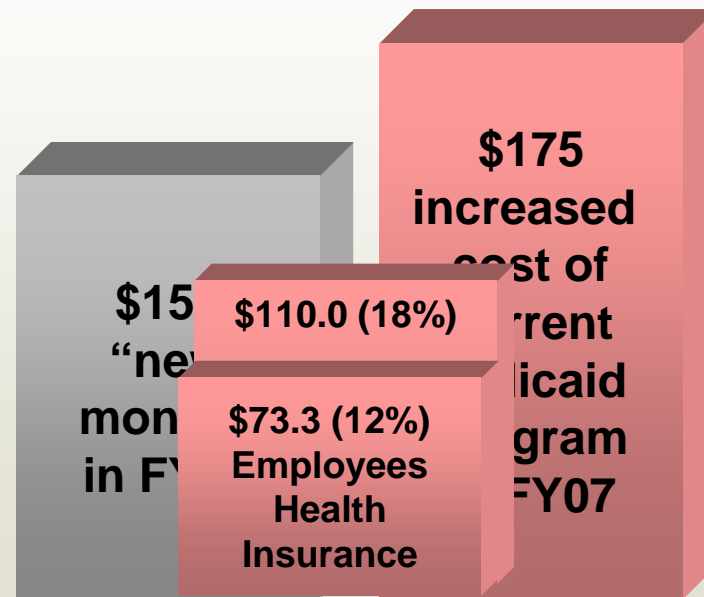


# Medicaid could absorb revenue gains

Fiscal Year 2006



Fiscal Year 2007





# The Road Ahead

Report to SCOPE

---

**Bradford L. Cowgill**

State Budget Director  
September 18, 2005