



2006-2008 Executive

Budget Overview

For the Senate
Appropriations and
Revenue Committee

Bradford L. Cowgill

State Budget Director
February 7, 2006



Office of State Budget Director

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Recent Publications

Governor Fletcher's 2006-2008 Biennial [Executive Budget](#) recommendation presented January 17, 2006

Study on [Impact of Right-To-Work](#) Legislation

[Quarterly Economic and Revenue Report](#) Second Quarter - Budget Year 2006

[Official Revenue Estimate](#) - December 2005
(PDF Format - 516 KB)

[Economic Briefs](#) for the week of January 27, 2006
(PDF Format - 48 KB)

[Tax Receipts](#) for December 2005
(PDF Format - 17 KB)

Most Recent [Economic Indicators](#) November 2005
(PDF Format - 74 KB)

Interim Joint Committee on Appropriations and Revenue Meeting - 9-22-2005 - Presentations

- [Status of Capital Projects and Bonding](#) (PDF Format 29 KB)
- [Impact of Gasoline on Revenues and Expenditures](#) (PDF Format 23 KB)

[2006-2008 Branch Budget Request Manual](#) (PDF Format - 4,551 KB)

[SCOPE Presentation](#) - September 18 2005 (PDF Format - 3,176 KB)

See Also...

[Current Budget Documents](#)[Governor's Office for Policy and Management](#)[Governor's Office for Policy Research](#)[Governor's Office for Economic Analysis](#)

Budget System Users Page

Following this link for Fiscal Year 2006-2008 Biennial Budget Request Documentation - [BRASS](#)

Related Content

Publications are provided in Adobe Acrobat's Portable Document Format and will require a PDF file viewer such as Adobe's Acrobat Reader to view and/or print the documents.

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www.osbd.ky.gov

A good budget is . . .

. . . an **efficient** budget

- ✓ Builds on work of the Budget Stability Initiative and creates new resources by reductions to base budgets within the biennium
- ✓ Lives within our means; makes no promises it can't keep; imposes no new or higher taxes; doesn't drain the rainy date fund; preserves the traditional policy on debt capacity

. . . a **progressive** budget

- ✓ Funds progressive education and economic development initiatives as main engines of progress
- ✓ Provides major new funding for teacher compensation, early learning and technology; makes major investments in new economy and global outreach initiatives; funds programs and tax relief for small business

. . . a **responsible** budget

- ✓ Fulfills the state's commitments in Medicaid, pension plans and state health insurance

Competing priorities: have to's and want to's

Commitments and obligations are costly to fulfill

- ✓ Healthcare costs are the root of the problem with Medicaid, state health insurance and pension plans
- ✓ Commitments must be fulfilled, even when the cost is unexpectedly high
- ✓ These are national problems; Kentucky is not unique

Policy initiatives are essential to state's progress

- ✓ Education and economic development are the main engines of the state's progress
- ✓ Improvements in P12 and higher education require funding
- ✓ Selection of capital projects requires tough choices

We can fulfill **both objectives because . . .**

- ✓ **We saved money in FY05, contributing to \$214 million surplus that we haven't spent**
- ✓ **We recognized the cost pressures early and began a \$142 savings initiative**
- ✓ **We are controlling Medicaid costs by reducing utilization and tailoring benefits to specific eligible populations**
- ✓ **We have streamlined our health insurance program through self-insurance**
- ✓ **We have been strengthening the Kentucky economy**

Where will **new** money (\$1.4 billion) be used?

Commitments

- ✓ Medicaid
- ✓ Employee benefits
- ✓ Others

\$995 million (70%)

Policy initiatives

- ✓ Education
- ✓ Economic Dev
- ✓ Others

\$420 million (30%)

Where is the \$1.4 billion coming from?

Growth revenue

- ✓ New FY07 - FY08 rev
- ✓ Increased FY06 rev
- ✓ Transfers, other rev

\$978 million (69%)

Efficiency savings

- ✓ Saved FY05 surplus
- ✓ Budget stability
- ✓ Cuts to base funding

\$436 million (31%)

Growth revenue

- ✓ New FY07 - FY08 rev
- ✓ Increased FY06 rev
- ✓ Transfers, other rev

\$978 million (69%)

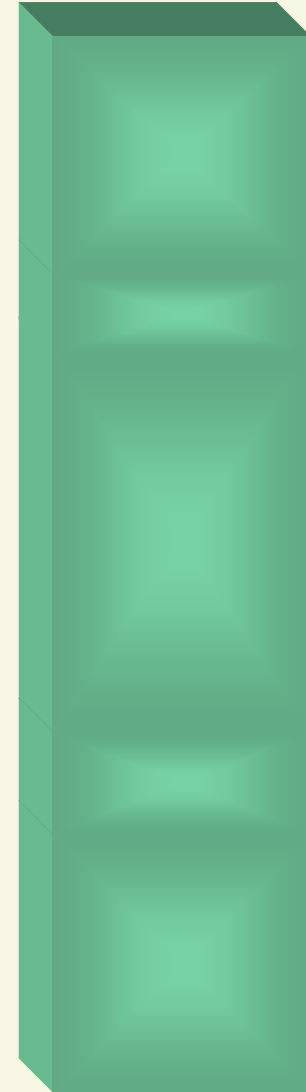
**FY07/08 restricted
fund transfers \$169 m**

**FY07/08 other
resources \$77 m**

**New FY08 revenue
\$335 m**

**New FY07 revenue
\$125 m**

**Excess of new FY06 revenue over current year
appropriations \$273 (\$392 m - \$118 m)**



Commitments

- ✓ Medicaid
- ✓ Employee benefits
- ✓ Others

\$995 million (70%)

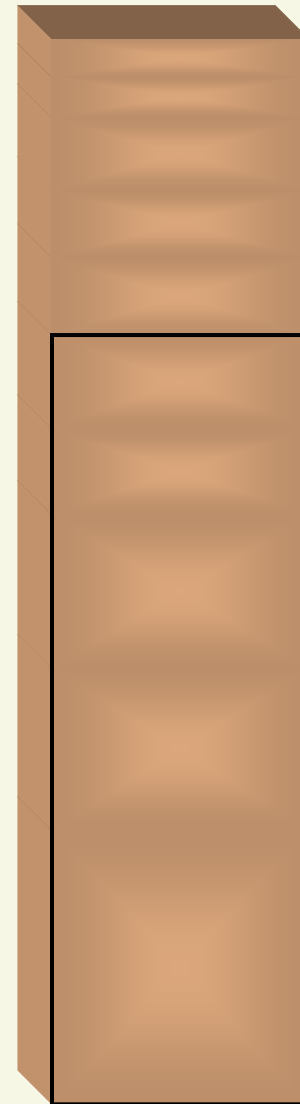
Other \$31 m
Increase in student ADA \$24 m
MHMR/Comm Based Svc \$66 m
Corrections \$60 m
Dedicated revenues \$60 m
State employee increment \$32 m

Pension funds \$93 m

State health insurance \$165 m

2% Salaries, school district \$205 m

Medicaid \$259 m



Efficiency savings

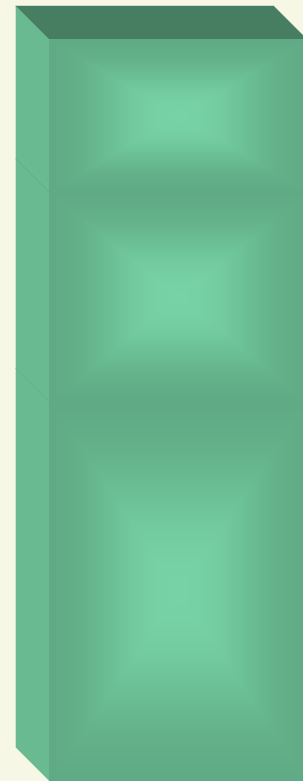
- ✓ Saved FY05 surplus
- ✓ Budget stability
- ✓ Cuts to base funding

\$436 million (31%)

Remaining
FY05 Surplus \$124 m

FY06 Budget
Stability Initiative \$142 m

FY07/08 reductions
to base \$170 m



Policy initiatives

- ✓ Education
- ✓ Economic Dev
- ✓ Others

\$420 million (30%)

Public Advocacy \$6 m

State Police \$12 m

New debt serv (ex SFC) \$33 m

Small business AMC relief \$13 m

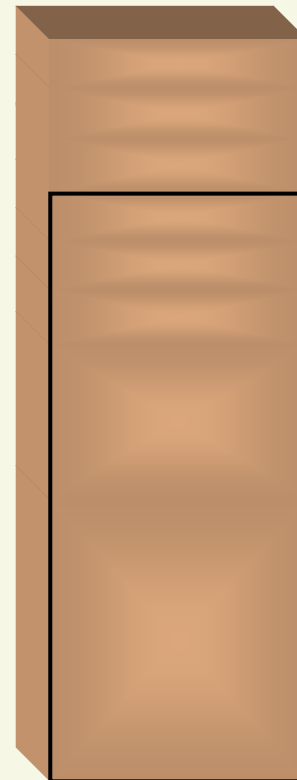
Small business health ins \$20 m

Economic Development \$25 m

Postsecondary education \$140 m

P-12 initiatives \$171 m

Including teacher compensation
(excluding 2% base increase)



Budget stability initiative

- ✓ **Began planning after last budget adopted, anticipating increased costs of commitments**
- ✓ **Generates \$142.5 m in FY06, with schools, universities and Medicaid exempted**
- ✓ **\$83.2 m will result from General Fund lapse (including debt service lapse)**
- ✓ **\$59.3 m will result from restricted fund transfers**

Advice from the rating agencies

- ✓ **Enact a biennial budget**
- ✓ **Minimize structural imbalance**
- ✓ **Don't exceed our traditional debt capacity**
- ✓ **Strengthen the Kentucky economy**
- ✓ **Maintain and build the rainy day fund**

Structural imbalance points

- ✓ **We are carrying forward a large cash balance**
- ✓ **We will be transferring a lot of money from restricted funds to the General Fund**
- ✓ **Healthcare expenses are rising faster than the revenue base**

Structural imbalance points

But . . .

- ✓ **Tax modernization will be fully implemented within the budgeted biennium**
- ✓ **A portion of the restricted fund transfers are recurring**
- ✓ **We are bringing healthcare costs under control**

Don't drain the rainy day fund

- ✓ **We have a significant structural imbalance**
- ✓ **Our bond rating has been on a negative watch**
- ✓ **We are routinely borrowing to the limit of our debt capacity**
- ✓ **Incremental shifts in bond rating result in higher interest rates and millions of dollars in additional expense**
- ✓ **Current balance (\$119 million) is inadequate**
- ✓ **\$77 million needed to achieve national average**

A progressive budget: top view numbers

General Fund Appropriations

Fiscal Year 2006	(Revised)	\$8,401,719,400
Fiscal Year 2007		\$8,770,400,200
Fiscal Year 2008		\$9,190,502,400

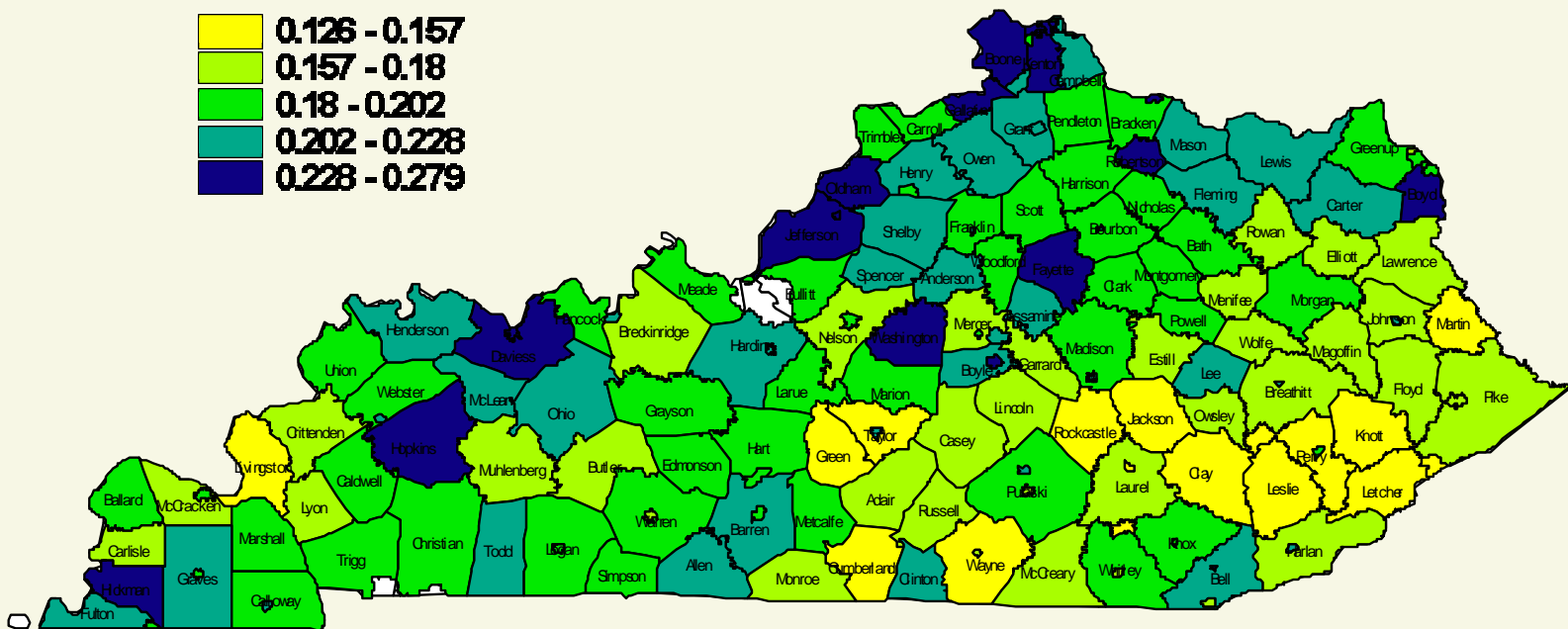
Recommended Bond Projects \$939.2 million

Themes of funded P12 initiatives

- ✓ It's about the kids: higher test scores and student achievement
- ✓ Not how much we **spent** but how much we **bought**
- ✓ Focus on teacher **compensation**, not just salaries
- ✓ Remarkable disparities in teacher compensation

Variation in teacher salaries is remarkable

Salary variation 2004 (standard deviation in salaries divided by mean salary)



Teacher compensation: \$232.8 million new funding

Additional days in the school calendar

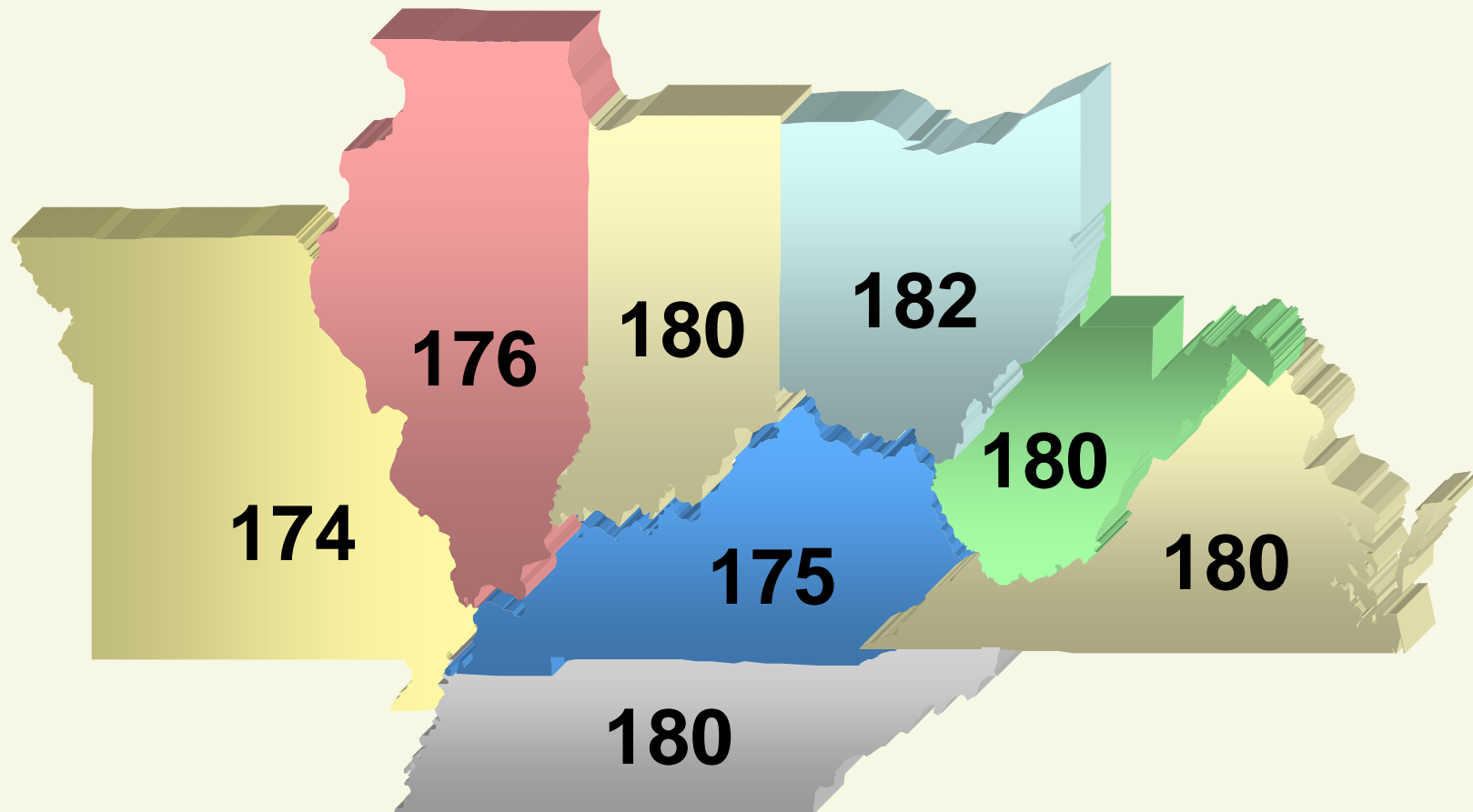
- ✓ **One professional development day in FY07**
- ✓ **Two instructional days in FY08 (current Kentucky average is 175; national average is 180)**

Base increase of 2% each year

Enhanced professional compensation (\$20m)

- ✓ **Addresses critical needs and shortages**
- ✓ **Creates opportunities for professional advancement**

Instructional days in neighboring states



Criteria for differentiated compensation plans

- ✓ **Address critical shortage areas**
- ✓ **Emergency certified teachers**
- ✓ **Difficult assignments and hard-to-fill positions;**
- ✓ **Voluntary career advancement opportunities for classroom teachers who voluntarily wish to participate to reward teachers for increasing their skills and knowledge;**
- ✓ **Instructional leadership**

Other education initiatives

- ✓ **Preschool program - \$46m**
- ✓ **Kentucky Education Network - \$37m**
- ✓ **Ready, Set Success - \$1m additional**
- ✓ **Read to Achieve - \$8m additional**
- ✓ **Technology in coal counties - \$10m**
- ✓ **Opening vocational and technical schools - \$4.6m**
- ✓ **School Construction - \$100m**

Funding for higher education

- ✓ **Funding moved strongly in the last budget; many achievements in recent years; study shows college education is generally affordable, but there are gaps**
- ✓ **Base funding increases through benchmark process - \$50m; this is affordable and sustainable**
- ✓ **Respectful of CPE's jurisdiction re: distribution of operating funds through benchmark formula**
- ✓ **No funds will be taken from the institutions for the BSI**

Postsecondary education

Significant investment in capital projects - \$465m

Heavy investment in research; infrastructure investments

Research support at UK & UL - \$10.5m

Regional stewardship - \$4.8m

Adult education and literacy - \$4m

Workforce development through KCTCS - \$1.5m

Performance funding - \$1m

Principal leadership - \$1m

Student financial aid

Need and merit-based programs - \$22.2m

Additional need-based aid in coal counties - \$10m

National Guard Tuition Assistance – full funding

Mining engineering scholarships - \$.4m

Postsecondary education capital investments

UK – Biological/Pharmaceutical; Hospital

**UL – Health Sciences Research; Center for Predictive
Medicine**

KCTCS

- **Advanced manufacturing – Gateway**
- **Emerging Technology – West Kentucky**
- **Allied Health / Technical Ed. – Somerset @ Laurel
Campus**

Postsecondary education capital investments

WKU: Academic/Athletic Complex renovation;
Materials Characterization Center;
Science campus renovation

KSU: Hathaway Hall renovation

NKU: Student union and Science building
renovations

Murray: New student housing project

EKU: New student housing project;
Dairy research facility

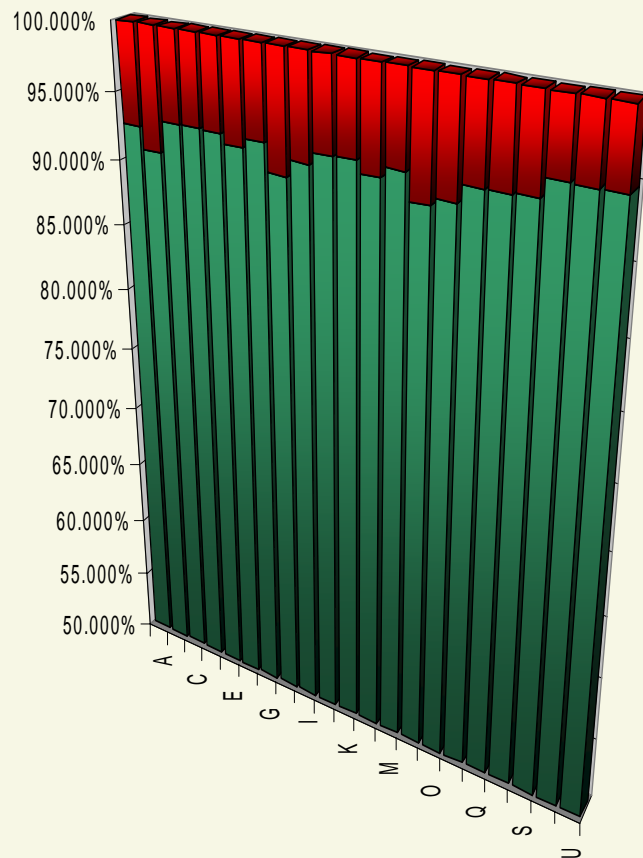
Morehead: Center for Health, Education and Research

System-wide: capital renewal pool

Capital projects

- ✓ **Preserving traditional 6% debt capacity policy**
- ✓ **Heavily invested in education – 64%**
- ✓ **Investments in infrastructure and technology**
- ✓ **Detailed analysis performed showed \$39m in reduced construction costs on new projects through repeal of prevailing wage law**
- ✓ **Savings permits additional construction within existing bond capacity**

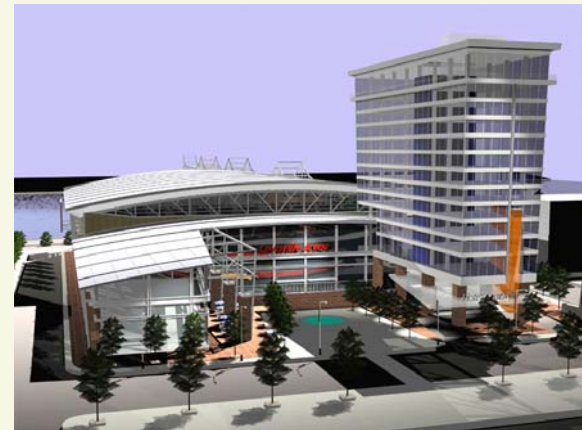
% construction cost savings for listed projects



- A Data Center Readiness
- B Renovate Lonnie Watson Building-Ky Correctional Inst for Women
- C Capital Renewal & Maintenance Pool
- D New Student Housing
- E EKV-UK Dairy Research Project (Meadowbrook Farm)
- F Renovate Ky State Office Building
- G New Indoor Arena
- H Emerging Technology Center. West Ky Community & Technical College
- I Advanced Manufacturing Technology Facility-Gateway Community & Tech. College
- J Allied Health/Technology Education Building -Laurel Campus of Somerset CC
- K Replace Pavilion Roof
- L Renovate Hathaway Hall Phase III
- M Oakwood Mental Retardation Facility-Replace Chillers, Heating & Cooling Lines
- N New Residential College, Murray State University
- O Renovate Old Science Building
- P Patient Care Facility Phase II - Hospital
- Q Biological/Pharmaceutical Complex - Phase II
- R Health Sciences Center Research Facility-Phase IV
- S Renovate Academic/Athletic #2 Complex
- T Renovate Science Campus Phase III
- U Construct Materials Characterization/ICSET Phase II

Economic development initiatives

- ✓ **Small and minority business development - \$.6m**
- ✓ **New economy capital investments - \$20m**
- ✓ **Economic development bond pool - \$10m**
- ✓ **Wildlife Elk Interpretive Center - \$3m**
- ✓ **Downtown Louisville arena - \$75m**
- ✓ **Opening of China office - \$.2m**
- ✓ **New economy initiatives - \$20m**
- ✓ **Parks renovations - \$8m**



Funding for business programs

- ✓ **Large investment in new economy initiatives**
- ✓ **ICARE: Insurance Coverage Affordability and Relief to Employers**
 - ✓ **\$20m pilot program**
 - ✓ **Provides monthly subsidies to small employers with less than 25 employees**
 - ✓ **Provides access to the previously uninsured and those with high cost conditions**
- ✓ **AMC tax relief for small businesses**

Developing our economy

- ✓ Expanding global connections
- ✓ Showcasing Kentucky worldwide
- ✓ New economy investments
- ✓ Tax relief for small businesses



AMC tax relief for small businesses

AMC Objectives

- ✓ **Fairness to Ky-only companies by ensuring payments by multi-state nonresident companies**
- ✓ **Increase stability of revenue stream**
- ✓ **Offset repealed taxes and rate reductions**
- ✓ **Fairness to profitable companies**

Incidence of taxation is highly concentrated

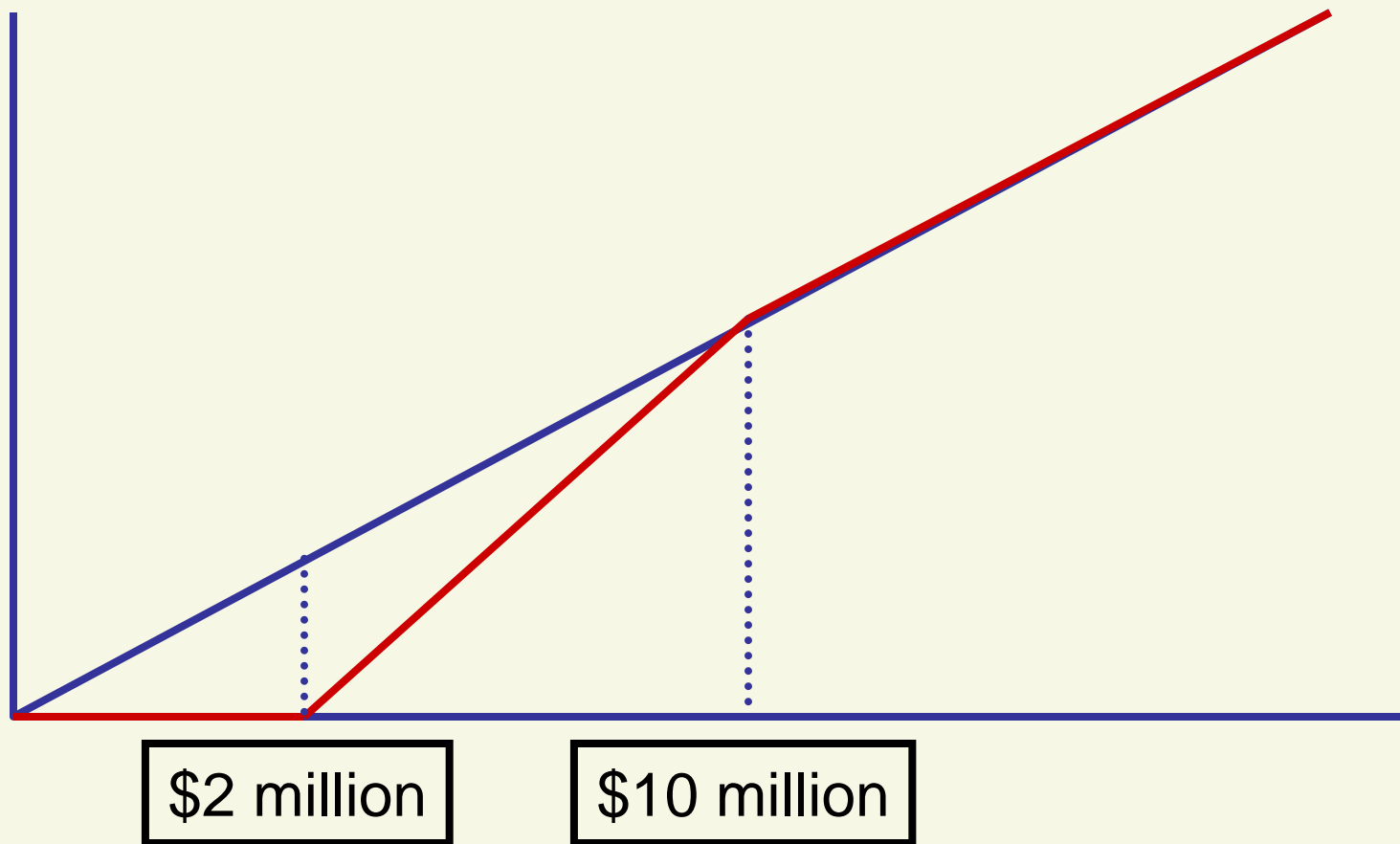
AMC tax relief for small businesses

- ✓ **No business with gross receipts of \$2 million or less will pay AMC on its gross receipts**
- ✓ **Businesses with gross receipts between \$2 million and \$10 million will get a proportionate credit against AMC calculation on gross receipts**
- ✓ **Retains the stabilizing effect of AMC while reducing tax burden on small business**
- ✓ **Friendly to start-up businesses that are not yet profitable but have gross receipts under \$10 million**
- ✓ **All companies will still pay the greater of the income factor, the AMC, or the minimum tax of \$175**

AMC tax relief for small businesses

- ✓ **60,000 businesses (mostly LLE's) will pay no AMC**
- ✓ **An additional 10,000 businesses (with gross receipts between \$2 million and \$10 million) will receive reduction of AMC obligation**
- ✓ **Fiscal impact:**
 - FY07: \$3.2 million**
 - FY08: \$9.7 million**

Depiction of AMC relief for small business



A responsible budget: fulfilling commitments

- ✓ **Medicaid**
- ✓ **State health insurance**
- ✓ **Employee salary increment**
- ✓ **Pension plan funding**
- ✓ **Justice Cabinet initiatives**
- ✓ **Transportation programs**

FY06 Medicaid shortfall

- ✓ **Decreased leveraging opportunities as a result of federal policy / rule changes**
- ✓ **Increasing expenditures**
- ✓ **Actions to balance**
- ✓ **Current year appropriation of \$85m**

Change in Direction: KyHealth Choices

- ✓ **1115 Waiver request**
- ✓ **Stretch resources to most appropriately meet the needs of recipients**
- ✓ **Encourage Medicaid members to be personally responsible for their own healthcare**
- ✓ **Expect to begin phase-in January 2006**
- ✓ **Additional funding over biennium of \$258.5m**

Other Health and Families Services priorities

Community Based Services - \$29.4m

Mental Health / Mental Retardation - \$30.7m

Workers' Information System (TWIST) - \$6.2m

Aging Services - \$1.5m

Governor's Council on Wellness and Physical Activity - \$2.5m

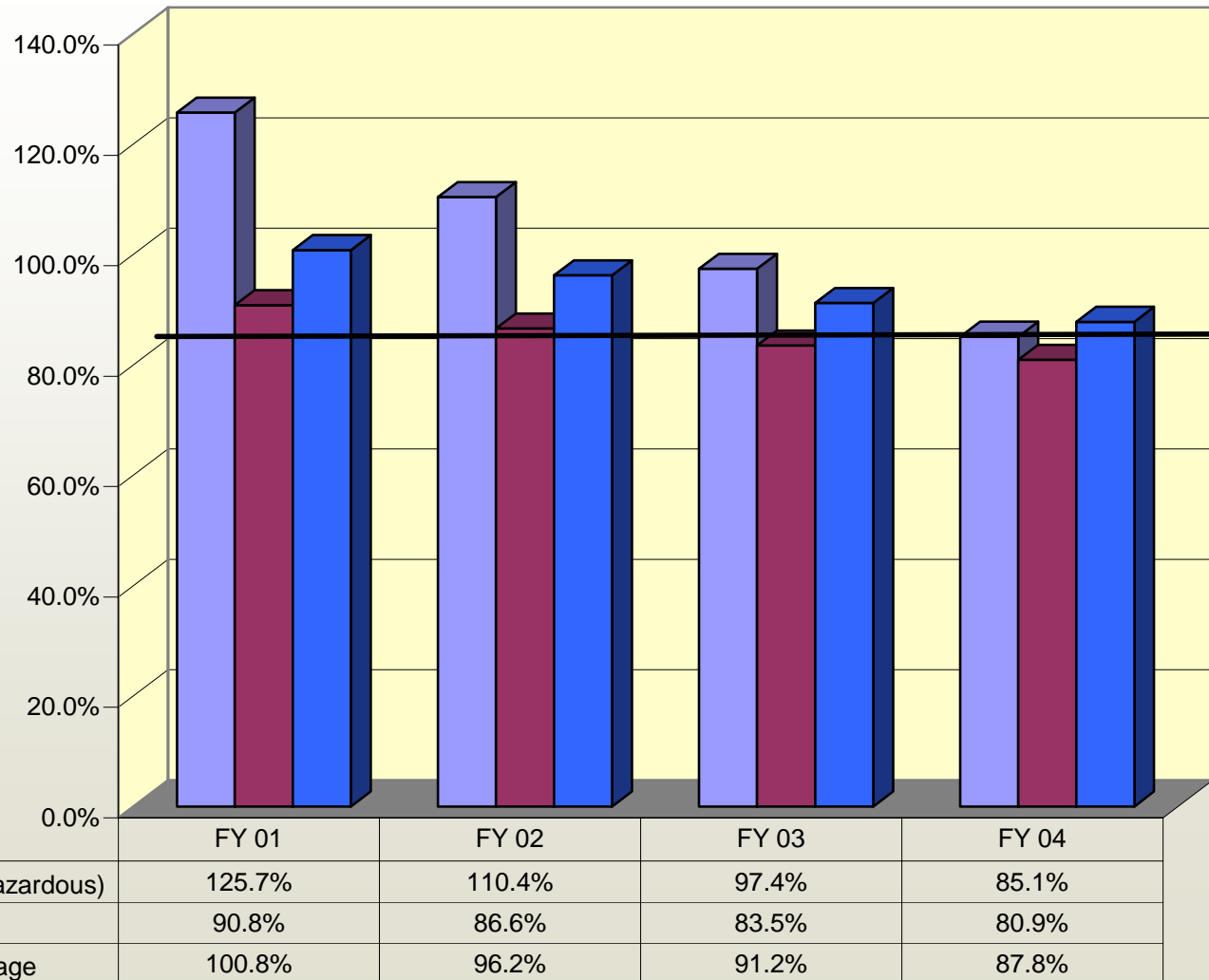
Public employee health insurance

- ✓ **Maintains current program in 2007 with minor adjustments**
- ✓ **Ability to maintain due to savings from self-insurance state-wide**
- ✓ **Many Blue Ribbon Committee recommendations incorporated**
- ✓ **9% increase in costs in FY 07**
- ✓ **Another 9% increase in costs in FY 08**

State salary and compensation policy

- ✓ **Graduated scale beginning at \$1000 per year at lower salaries**
- ✓ **Reduced to \$200 per year for employees over \$60,000 per year**
- ✓ **Intended to reduce turnover among lower paid employees and to provide funds to address health needs**

KY Pension Funding Levels are Close to National Averages (not including medical funds)



Source: KERS and KTRS annual reports and NASRA September 2005 Report

Pensions

- ✓ **Took a while to get here; will take a while to get out**
- ✓ **Our situation is not unlike other states**
- ✓ **Governor wants to make a good faith effort to address the problem; undertake a professional study of long term solutions**
- ✓ **Benefits to state employees are guaranteed under the inviolable contract doctrine**
- ✓ **KRS employer contribution for non-hazardous service is increased 24% in FY07 and 11% in FY08**
- ✓ **KTRS funding will permit continuation of health benefits to retirees**

Transportation

GARVEE bonds for federal highway projects - \$290m

Economic Development Highway bonds - \$75m for local road aid projects

State Resurfacing program - \$33m

Minority Scholarship program - \$.4m

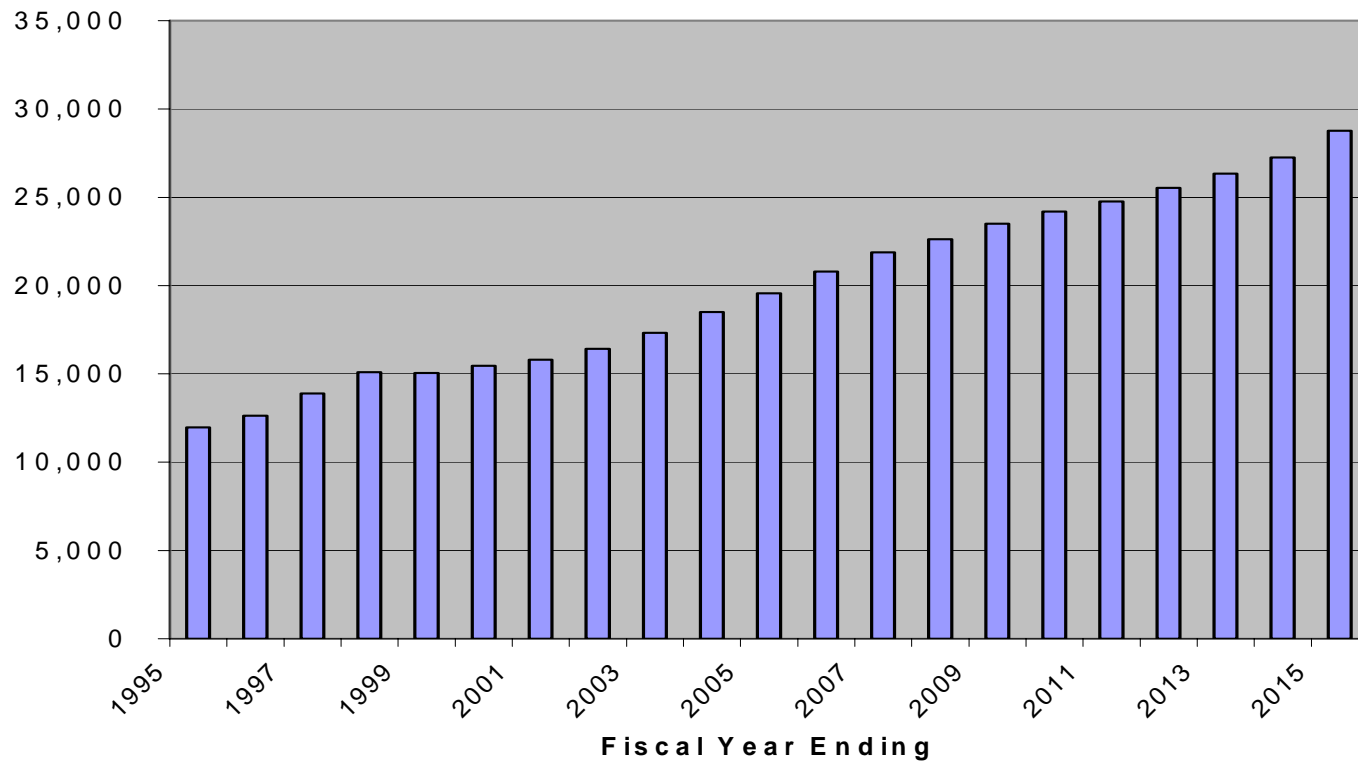
Justice, Public Safety and Drug Control

Department for Public Advocacy - \$6.2m for decreasing caseloads and a pilot program with social workers

Kentucky State Police - \$8.5m for overtime payments; additional funding for overtime results in the equivalent of 50 new troopers

Corrections

Kentucky Prison Population 1995 - 2015



Justice, Public Safety and Drug Control

Department of Corrections

- ✓ **\$4.3m for additional parole and probation officers**
- ✓ **\$15m for increased inmate medical costs**
- ✓ **\$2m for additional beds at Otter Creek**
- ✓ **\$16.7m for additional local jail payments**
- ✓ **\$2m to expand home incarceration program**
- ✓ **\$6.6m for additional half-way house beds**
- ✓ **\$1.2m for new beds at Recovery Kentucky drug and substance abuse treatment centers**
- ✓ **\$4m for regional drug courts in coal counties**
- ✓ **\$2m for drug and substance abuse treatment in local jails**

MSA assessment fee

- ✓ **Payments by Kentucky smokers are subsidizing other states**
- ✓ **Time has come for a Kentucky assessment directly on tobacco manufacturers**
- ✓ **Manufacturer's assessment would bring in additional \$150 million each year**
- ✓ **Funds would be used for higher education, small business tax relief and strengthening pension programs**



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