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Budget Overview: Fiscal Years 2005 – 2006

Governor Fletcher is committed to increasing economic opportunity for Kentuckians. To achieve that goal, he has placed several funding priorities on education, economic development, Medicaid and the efficient operation of state government to ensure more progress for our families and a greater purpose for our Commonwealth.

The Commonwealth is starting this budget process with an additional \$823 million – most from revised revenue forecasts, some from additional fund transfers and the rest from a budget stability initiative undertaken by the Administration. Of the newly identified funds, 57 percent is dedicated to education, 30 percent to Medicaid, 11 percent to state employees and retirees as a result of House Bill 1, and 2 percent to Corrections.

But the additional revenues forecasted by the Consensus Forecasting Group are only a 2.9 percent increase, and the Commonwealth has many needs. The budget for fiscal years 2005 and 2006 reflects cautious, limited appropriations. Just as families can't appropriately budget for their needs if they are uncertain about their future paychecks, government also can't risk burdening taxpayers with commitments that are unaffordable and unsustainable.

As a result, until comprehensive tax modernization is passed, Kentucky's unstable revenue stream will be unable to bear the cost of additional projects for schools and universities, tourism and significant new construction projects – even though they are vital to the future growth of Kentucky.

Education

Elementary and Secondary

- There are four important improvements to education in Governor's budget:
 1. **A Flexible Compensation Fund** that dedicates almost \$26 million in fiscal year 2006 to recruit and retain teachers in critical shortage areas; provide incentives for teachers to serve in difficult assignments; reduce the numbers of emergency certified teachers; provide voluntary career advancement opportunities; and reward teachers who increase their knowledge, skills and instructional leadership.
 2. **A School Learning Performance Fund** that invests \$8 million in fiscal year 2006 in new General Fund (coal severance) support to advance the learning progress of students in schools located within coal-producing counties. It will identify gaps in student preparation and develop skills needed to perform more effectively in postsecondary education, in the workforce and in the emerging knowledge-based economy. Emphasis will be placed on improving the high school learning experience in schools with high at-risk student populations.
 3. **Early reading initiatives** will receive \$3.1 million in fiscal year 2005 and approximately \$7.1 million in fiscal year 2006 for the Read To Achieve program. These funds -- including \$4 million in existing General Fund support each fiscal year for Early Reading Incentive Grants and federal Reading First grants -- will

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strengthen Kentucky's capacity to have all students reading at grade level or above by the time they enter fourth grade. In addition, \$500,000 in fiscal year 2006 is provided to expand the adult and family literacy efforts of the Governor's Early Reading Initiative.

4. Additional SEEK funding to accommodate the increased number of projected students.

- For fiscal year 2005, the recommended budget provides a 2 percent pay increase for the full school year for all local school district employees as well as an additional 1 percent pay increase effective January 1, 2005. Local districts will absorb the first 1.5 percent of the 2 percent pay increase for certified classroom teachers and classified employees in fiscal year 2005. State funds will cover the remainder of the raises.

In fiscal year 2006, the recommended budget provides state funding for the recurring cost of the pay raises mandated for fiscal year 2005 as well as additional mandated **pay increases of 2 percent for certified and classified local school district personnel.**

- \$4,031,800 in debt service for fiscal year 2005 and \$15,623,700 in fiscal year will help local school districts fund projects, such as **local school construction** and renovation for schools that have been ranked as urgent because of their disrepair.
- The **Governor's Scholars Program** will receive \$1,897,300 for fiscal year 2005 and \$1,939,400 in fiscal year 2006 – representing an increase of \$282,700 in fiscal year 2005 and \$324,300 in fiscal year 2006 over fiscal year 2004 levels.

Postsecondary

- \$41 million in one-time funds was transferred to the General Fund as a result of a budget shortfall, and this recommended budget provides **\$20 million in additional General Fund** in fiscal year 2005 to the universities and KCTCS to be used for targeted programs. In fiscal year 2006, an additional **\$11.7 million is provided to restore half of the recurring budget reductions** from fiscal year 2004. The funds are distributed back to the institutions in the same proportion as the original fund transfers and reductions.
- \$11,146,200 is provided in fiscal year 2006 for the costs associated with the maintenance and operations of 29 new facilities and 8 expanded facilities.
- \$3 million in fiscal year 2006 to expand the capacity of the KCTCS system to **train skilled employees** in the mining industry.
- \$1 million in fiscal year 2006 from Tobacco Settlement – Phase I funds to provide salary bonuses for **University of Kentucky County Extension Agents.**

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- As our troops return from active duty, the **Kentucky National Guard Tuition Award** Program will receive \$3,558,100 in restricted funds for fiscal year 2005 and \$4,358,100 million in fiscal year 2006 -- an increase of \$957,800 and \$1,757,800, respectively, over fiscal year 2004 levels.

Health and Family Services

- \$93.5 million in General Fund increases in **Medicaid** and \$214,065,800 in Federal Funds for fiscal year 2005. In fiscal year 2006, \$160 million in General Fund and \$364,285,500 million in Federal Funds will be committed. Governor Fletcher is increasing state funding for the Medicaid program more in a single biennium than any other governor in Kentucky's history.
- Kentucky is one of only five states that conducts **newborn metabolic screenings** for only four disorders. Through an investment of \$2,106,000 in Restricted Funds in fiscal year 2006, two new mass spectrometers will be purchased to expand to 30 tests.
- \$33 million in **capital projects will be invested in technology** to help the Commonwealth better protect its most vulnerable citizens, improve efficiency and help detect fraud and abuse in Medicaid and other social services.

Economic Development, Commerce and Agriculture Policy

- \$15 million in additional **economic development bond funds** will serve as incentives for the attraction and retention of industries to Kentucky -- \$5 million of this total will be dedicated to knowledge-based economy projects.
- Planning funds are provided to attract a federal research lab to Kentucky, and \$22 million in funding is provided to support the continued development of the **New Economy**.
- \$ 2 million in fiscal year 2006 will be provided for seed money to position Kentucky to compete for a billion-dollar federal **pilot clean-coal plant**.
- \$200,000 in fiscal year 2006 will establish a **China office** and expand Kentucky's economic development presence in that region of the world.
- \$17 million is restored to the **Kentucky Agricultural Finance Corporation** and \$898,000 in General Fund debt service for fiscal year 2006.

Transportation

- Despite achieving numerous efficiencies, significant challenges exist for funding important road projects. In January, the Consensus Forecasting Group issued a lower Road Fund revenue estimate than it had given in its January 2004 estimates --

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approximately \$21.7 million less in fiscal year 2005 and \$35.4 million less in fiscal year 2006.

- To add needed resources to an otherwise declining revenue stream, policy initiatives contained in the budget recommendation include:
 - The issuance of \$150 million in **Grant Anticipation Revenue Vehicle** (GARVEE) bonds to support reconstruction and major widening of interstate I-64, I-65, and I-75;
 - The usage of Toll Credits for matching federal highway funds;
 - The issuance of **Turnpike Authority bonds** totaling \$350 million;
 - A **Road Fund Revenue Initiative** that will freeze the penny on the motor fuels tax, collect motor vehicle usage tax at titling instead of registration, which limits the opportunity for tax avoidance; standardize the motor vehicle usage tax so purchased and leased cars are treated the same; and price the drivers' licenses fee at \$20 to cover the cost of issuance. It is estimated to generate about \$53 million in fiscal year 2006.

Justice, Public Safety and Drug Control

- \$1.5 million in total funds in fiscal year 2005 is designated for the newly created **Office of Drug Control Policy**.
- An additional \$2 million in total funds in fiscal year 2006 will establish **regional drug courts** in coal-producing counties.
- **Other anti-drug initiatives** include \$1 million in fiscal year 2006 to fund treatment programs for non-violent offenders in county jails and \$500,000 for education programs for Eastern Kentucky school children.
- A new **Corrections** estimate of 19,069 inmates for fiscal 2005 exceeds last year's estimates by more than 1,600 prisoners. It is expected to rise to 20,200 in fiscal year 2006. To address that need, additional General Fund resources will go to:
 - **Local jails**, \$9.5 million in fiscal year 2005 and \$8.3 million in fiscal year 2006 at the current per diem rate of \$27.31;
 - **State-owned correctional facilities**, \$3,701,000 in fiscal year 2005 and \$13,639,000 million in fiscal year 2006; and
 - **Regional Juvenile Detention Centers**, \$1.9 million in fiscal year 2005 and \$2.8 million in fiscal year 2006.

Capital Projects

- Total bonds recommended for capital construction activities are \$622,521,000, including \$272,521,000 for state construction or information technology investments and \$350,000,000 for an economic development road bond issue.
- New bond authorizations included in the recommendation have been kept to a very moderate level consistent with the Commonwealth's revenue and budget environment. Even compared with the Executive Budget recommended one year ago, this plan is lean, reflecting a policy emphasis of newly realized and/or estimated General Fund revenues to other immediate budget priorities such as Medicaid, public employee health insurance, criminal justice/corrections, and school and public employee compensation.
- Individual project construction costs are estimated to be 10 percent higher than they were when the General Assembly considered them in 2004. The cost of construction materials – especially, but not exclusively steel – has risen substantially.

Salary and Compensation

- The Executive Budget incorporates the appropriations and policy decisions of **House Bill 1**, which was adopted during the 2004 Extraordinary Session of the General Assembly in October. Increased funds for school and state employees' health insurance for calendar year 2005, an additional 1 percent salary increase effective Jan. 1, 2005 for school and state employees, a cost-of-living adjustment for retired teachers and funding for SEEK were made at that time and are now incorporated into the Executive Budget.
- In addition to the 2 percent cost-of-living policy provided for state employees effective on their anniversary date retroactive to July 1, 2004, House Bill 1 provided an additional 1 percent base salary adjustment to be effective on January 1, 2005, for all eligible employees. This 1 percent additional increase had also been recommended by the Governor.

To cover the cost of the pay increases, House Bill 1 appropriated additional General Fund to agencies supported by General Fund totaling \$7.1 million in fiscal year 2005. In fiscal year 2006, the Executive Budget recommendation provides a 2 percent cost-of-living adjustment for state employee pay and includes General Fund support totaling \$9.1 million for state agencies whose primary financial resources consist of the General Fund.