

Kentucky Tax & Budget Initiative

Taxes & the State Budget

101





Overview:

Tax & Budget 101

- Public Structures
- The Budget Process
- Funding Public Services
- The Budget in Recent Years
- Guiding Principles

Public Structures:

The role of government and taxes

- Government creates and maintains a system of public structures that *benefit* all of us. Tax revenue makes this possible.
 - Physical Infrastructure
 - E.g. Roads, highways, and internet access.
 - Organizational Systems
 - E.g. Courts, schools, and health departments.

- These *structures* provide services that increase our collective quality of life: safety, efficiency, education, stability

The Budget Process

First, a Few Budget Basics

- A balanced budget
 - The Kentucky Constitution requires that expenditures be balanced with expected revenues.

- A biennial fiscal year budget
 - Every other year Kentucky passes a two-year budget.
 - Each fiscal year runs from July 1 – June 30.

- Two main budgets
 - Operating Budget – programs and services
 - Capital Budget – buildings and infrastructure

The Process Starts with a Revenue Forecast

- A nonpartisan group of financial and economic experts, the **Consensus Forecasting Group**, convenes to provide estimates of state revenues for use by the governor and the legislature.
- Average difference in the first 14 years between forecasts and actual revenues was 0.8%

A consensus-based system moves away from a system of political influence and contributes to unbiased revenue estimates

The Executive Branch Budget

- ❑ Or, the Governor's budget, is based on the revenue forecast prepared by the CFG.
- ❑ The budget is prepared by the Office of the State Budget Director.
- ❑ The Governor's budget is submitted to the legislature as a recommendation.
- ❑ The budget recommendation includes input from state officials and Cabinet Secretaries.

The Legislative Branch Budget

- The budget starts in the House of Representatives
- The budget is assigned to the Appropriations and Revenue committee where it is amended to align with House priorities.
 - The budget is then given three readings by the full House and finally an approval vote by a majority of the members (51 Representatives)
- The budget then arrives in the Senate
 - Follows the same procedure as in the House; is amended and approved by a majority vote (20 Senators)

Conference Committee

House & Senate Budgets Don't Match

- A joint committee is appointed by the House Speaker and Senate President
 - Compromises are agreed to by committee members
 - The compromised budget bill is returned to both the House and the Senate for a vote – no amendments are allowed at this point.
- When both Chambers pass the budget, it is sent to the Governor.

Governor's Veto Power

- Upon receipt of the approved budget bill the governor can:
 - Sign the bill,
 - Allow the bill to become law without his signature, or
 - Eliminate items from the budget.
 - Kentucky's governor has line-item veto power.

- If the budget, or parts, are vetoed the General Assembly can override the veto with a majority vote of both Chambers.

Budget Implementation

- The budget is implemented in line with the appropriations made by the Governor and the General Assembly over the course of the following two fiscal years.

- Recall, the budget was based on a revenue estimate – should there be a shortfall in projected revenues, laws define the course of action for budget reductions.
 - Currently, law allows the Governor to adjust the budget without the General Assembly's input when the shortfall is within 5% of General Fund revenues.

The Budget Reserve Trust Fund

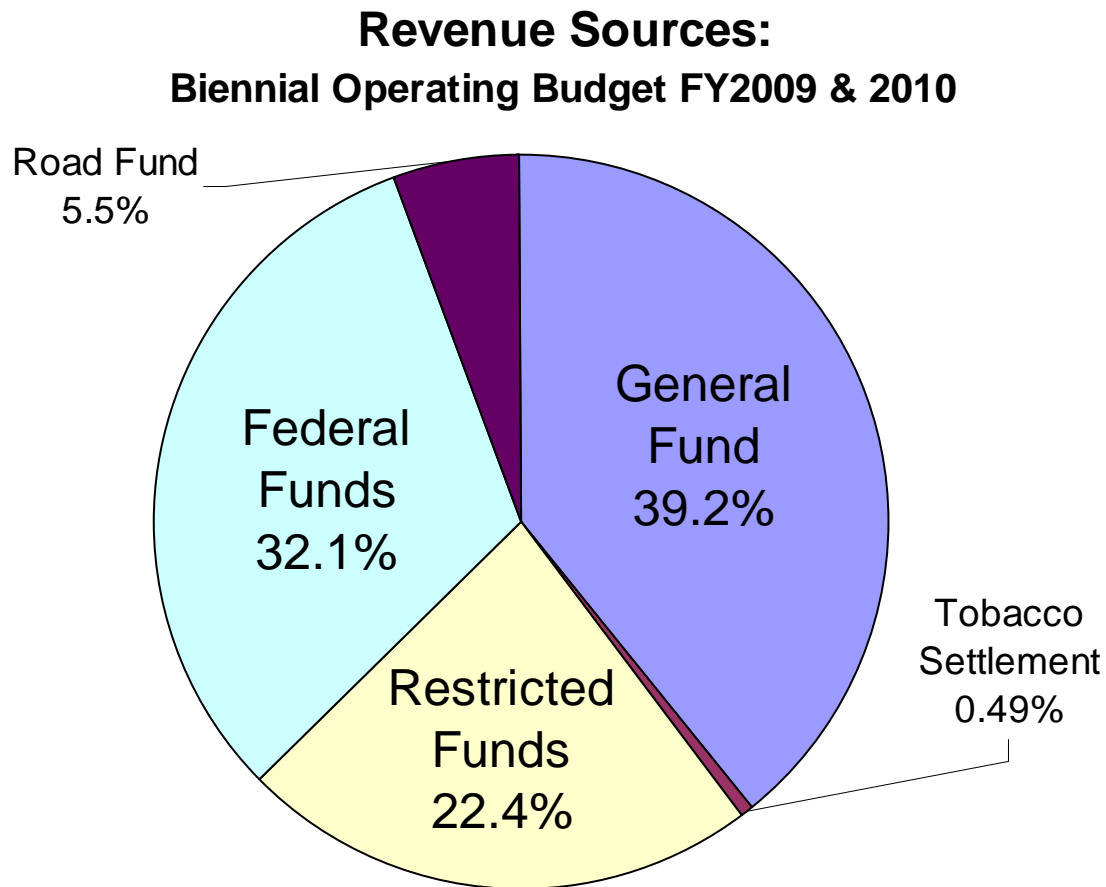
- Also known as the “rainy day fund,” it is basically a state savings account to be used when tax revenues are less than projected.

- The BRTF was established in 1988 with a \$2 million appropriation.
 - The fund can accumulate up to 5% of annual General Fund Revenues
 - Since 1999 withdraws and deposits from the fund have been nearly equal.
 - Current balance in the fund is \$0. Approximately \$226 million was used to fill recent shortfalls.

Kentucky's Revenues

Funding Public Services:

The largest share of revenue comes from General Fund

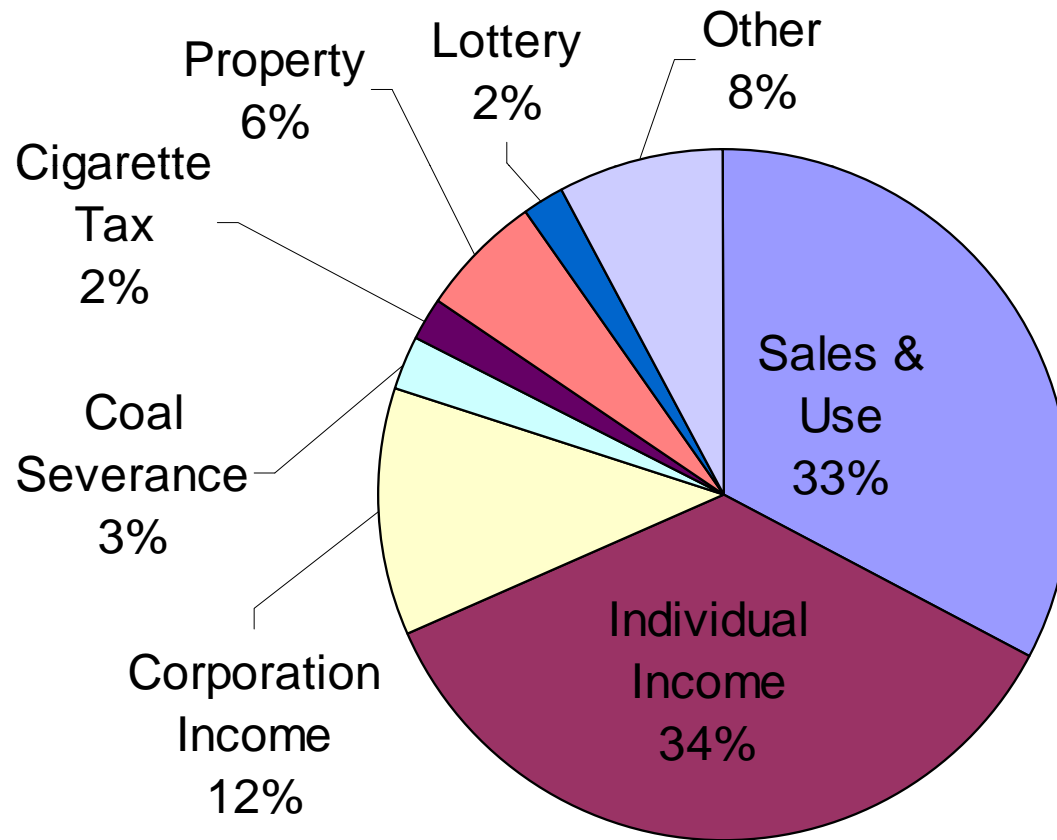


Source: Biennial Budget 2008-2010

Funding Public Services:

As income and sales go, so goes the General Fund.

Proportion of General Fund Revenues



Source: Biennial Budget FY 2008-2010
Office of the State Budget Director

Funding Public Services:

Kentucky's tax revenues are lower than most states.

Kentucky's Taxes & Revenues Relative to Other States (2006)

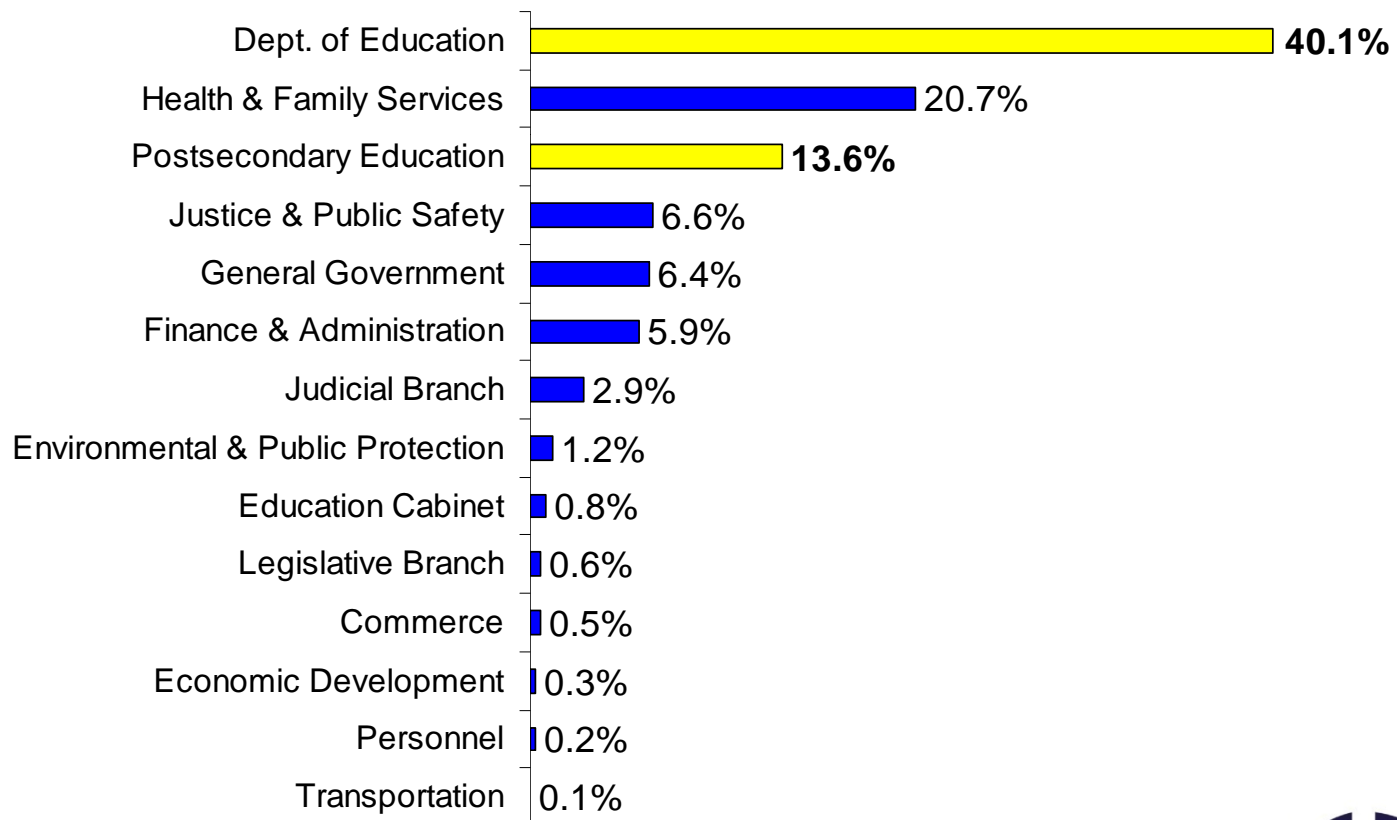
		Rank
State and Local Taxes as a Percent of Personal Income	11.1%	23
Federal Revenue as Percent of Personal Income	5.5%	14
Total Revenue as Percent of Personal Income	25.6%	29
State and Local Taxes Per Capita	\$3,225	39
Federal Revenue Per Capita	\$1,604	16
Total Revenue Per Capita	\$7,409	46

Source: Census Bureau and Bureau of Economic Analysis 2006

Funding Public Services:

Education is 54% of the budget, followed by...

General Fund Expenditures by Cabinet: FY 2008-2010



Source: Biennial Budget 2008-2010

The Budget in Recent Years

Overview of recent budget reductions

- **FY 2008** - Revenue shortfall of **\$432 million**.
 - Budget balanced with across the board spending cuts and transfers from restricted funds.

- **FY 2009** - Revenue shortfall of **\$519 million**.
 - Budget balanced with a mix of spending cuts, use of one-time money – including reliance on “rainy day” fund, and limited new revenue.
 - Medicaid dollars of \$63.2 million used to balance the budget at year end.

- **FY 2010** – Revenue shortfall of **\$1 billion**.
 - No money left in the “rainy day” fund.
 - Budget was balanced by cutting \$248.5 million and using \$787.5 million in ARRA – or federal stimulus dollars.

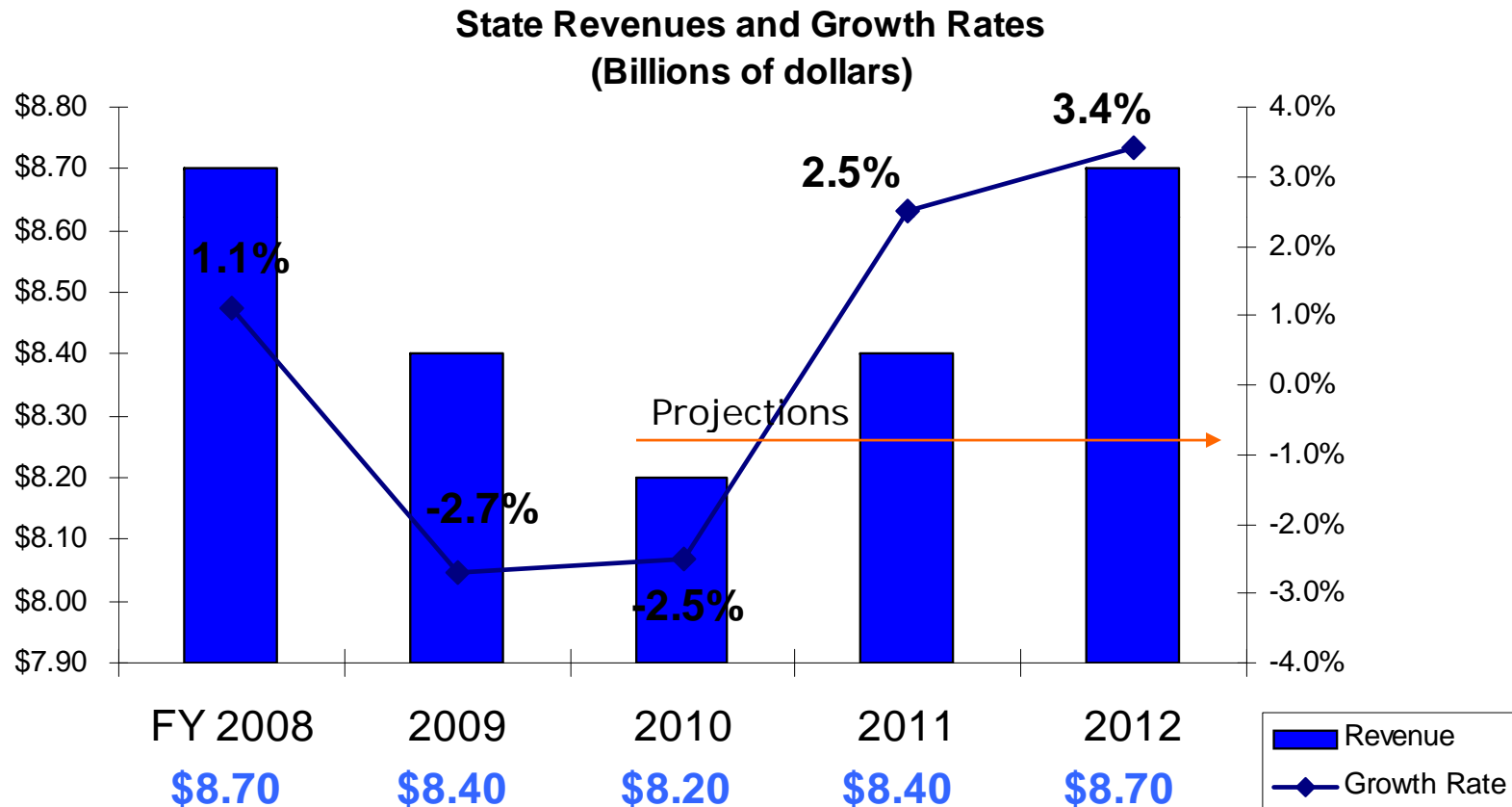
American Recovery & Reinvestment Act

- Flexible funds are available to help with budget shortfalls through 2011.
 - \$787.5 million used to balance budget in 2010
 - Approximately \$300 million left to help in 2011

- Targeted revenues provide additional assistance to specific programs.
 - E.g. Food Stamps, Child Care Assistance

- Tax credits for individuals and small businesses that help provide a stimulus for the economy.

Kentucky's Financial Woes Far From Over



Source: Consensus Forecast Group; 8/2009

Economic Cycles

In times of plenty, save for a rainy day.

- Economic downturns are a part of normal business cycles.

- We also have a structural deficit – a built in shortfall.
 - Revenues aren't keeping pace with the economy.
 - Tax structure has not been adjusted to reflect economic changes.

- Again, the importance of the “rainy day” fund.

Guiding Principles:

For a state tax & budget system

❑ ADEQUATE

Revenue must be sufficient to cover needs.

❑ SUSTAINABLE

Revenue must maintain over time; keeping the future in mind.

❑ RESPONSIBLE

The state has an obligation to not shift costs to local governments.

❑ TRANSPARENT

Information about taxes and state budget must be readily available

❑ FAIR

Our tax system should be based on ability to pay.

You can make a difference.

- Contact your legislators and let them know what you think.
- Help us document the impact of public investment and of spending cuts.
- Write letters to the editor and op-eds.

Let us know how we can help you.

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