Raising the Bar

Kentucky's Real Budget Report

Fall 2005

Kentucky Economic Justice Alliance
P.O. Box 1450, London, KY 40743 • 606-878-2161 • www.keja.org

The Kentucky Economic Justice Alliance (KEJA) is a partnership of organizations that work together to create progressive social and economic change in Kentucky. We strive for change by building a base of politically conscious, organized people and groups that work to design and win new public policy. We achieve our goals through the strategic interaction of community organizing and leadership development, research and policy analysis, and message development and delivery.

The KEJA partners include:

- **Kentuckians For The Commonwealth**: a statewide, grassroots citizens' organization that uses direct action organizing to educate, motivate, and activate a base of people to work for change. KFTC believes in the power of people—working together—to challenge injustices, right wrongs, and improve the quality of life for all Kentuckians. www.kftc.org

- **Kentucky Youth Advocates**: an independent non-profit children's advocacy organization. KYA represents the interests of all Kentucky children by vigorously promoting positive changes in programs and policies that affect large numbers of children. KYA's strategies include research and analysis, case advocacy, public education, administrative negotiation, legislative monitoring, and, as a last resort, class-action litigation. www.kyyouth.org

- **Appalshop**: a multi-disciplinary arts and education center in the heart of Appalachia producing original films, video, theater, music and spoken-word recordings, radio, photography, multimedia, and books. Appalshop's education and training programs support communities' efforts to solve their own problems in a just and equitable way. www.appalshop.org

A special thanks is given to the KEJA Tax Strategy Team for collaborating on this report. Team members include Lisa Abbott, Steve Boyce, Kat Goodman, Heather Roe Mahoney, Debra Miller, Mimi Pickering, K.A. Owens, and Janet Tucker. Additionally, we extend a thank you to the many allies who contributed ideas and information to the report.

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Raising the Bar: Kentucky's Real Budget Report

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EXECUTIVE SUMMARY

Kentucky is not adequately investing in the programs and services that can propel our state forward, such as public schools, higher education, health care, and more. The chronic under-funding of these critical areas leaves Kentucky in a dire situation. At best, the state is standing still. At worst, we are slipping further behind as other states pass us up. Consider these facts:

- Kentucky ranks 50th in per capita spending on education.
- Kentuckians die at a rate that is 18 percent above the national average.
- Nearly 44,000 Kentuckians experience homelessness in a year's time.

Unfortunately, these and other poor quality of life rankings are part of a reality that we, as Kentuckians, have become accustomed to. It is a reality that is shaped by public policy decisions that starve services of the funds needed to move Kentucky forward. It is a reality that will only continue to deteriorate as long as a "revenue neutral" climate dominates the Kentucky legislature, steering Kentucky in the wrong direction.

This report examines the chronic under-funding of key areas of the state budget and explores what it will take to move ahead. The report documents as much as $1.8 billion in unmet needs. For instance:

- Public schools need $337 million to bring our per pupil spending up to the average of surrounding states. It would take $982 million more annually to rank among the top ten states.
- In the area of health care, $132 million is needed to cover the Medicaid shortfall; $132 million is needed for insurance for teachers and state employees; and at least $25 million is needed for mental health funding.
- County jails housing state prisoners are in need of $100 million in order to avoid running deficits.

Raising the Bar: Kentucky's Real Budget Report is not meant to be a comprehensive analysis of the state budget. It is, however, an important collection of evidence that we are not adequately investing in the programs and services that can move Kentucky forward. The report includes three primary sections:

- *Introduction:* This section examines the tax and budget policy decisions that have led to the chronic under-funding of programs and services.
- *Examination of Budget Areas:* The report examines key areas of the state budget. It provides evidence of under-funding as well as an estimate of the level of funding needed to adequately invest in the area.
- *Conclusion:* This section offers tangible policy options for moving Kentucky forward.

The Kentucky Economic Justice Alliance believes that Kentucky can do better. But creating the kind of state we envision will not be easy. It requires a thoughtful approach, new ideas, and leadership bound with the courage to make tough choices.

The time has come for state elected officials and the public to look at where we are headed as a state if we continue down the current path. It is time to create a better future for Kentucky. To put our state on the path to prosperity, we must invest today.

INTRODUCTION

Kentuckians have grown accustomed to reports that document our generally poor standing in relation to other parts of the country. On any number of critical indicators—including health, education, environmental quality, political participation, economic development, and personal income—we lag far behind the nation. Even so, a recent flood of bad news showing that Kentucky is continuing to slide backwards on many key measurements is alarming. For example, reports released over the summer of 2005 revealed:

- Kentucky's poverty rate increased faster than all but one other state between 2003 and 2004, rising from 14.3 percent to 16 percent, according to the US Census Bureau. Child poverty rose from 22 to 24 percent from 2000 to 2003.

- *Governing Magazine* ranked Kentucky 50th in per capita state spending on education.

- Kentucky fell five spots to 42nd in overall child well-being, the state's worst ranking in the 16 years of the survey by the Annie E. Casey Foundation.

Raising the Bar: Kentucky's Real Budget Report illustrates how public policy decisions—especially choices about taxes and the budget—have contributed to suffering and the deterioration of the quality of life in Kentucky. This report is an effort to provoke and inform public discussions about the inadequate funding for Kentucky's schools and services. In a number of areas we demonstrate the impact of feeble state funding and offer some measurements of the additional investments needed to make real progress as a state. Additionally this report offers policy recommendations, including progressive tax reforms that raise revenue and ways to improve the decision-making process in future tax and budget deliberations.

As the title suggests, this publication seeks to unmask the real meaning and consequences of the state budget. While Kentucky's *Real Budget Report* is not comprehensive or complete, it does gather the growing evidence that our state budget is chronically under-funded in critical areas. It also offers an alternative view to the dominant politics of our time and the threadbare promise of progress through low taxes and minimal public investments.

The groups responsible for this report comprise the Kentucky Economic Justice Alliance, a partnership among Kentuckians For The Commonwealth, Kentucky Youth Advocates, and Appalshop. Together with our allies, we work to promote progressive social and economic change in Kentucky. We achieve our goals by fostering civic participation and leadership development, conducting research and policy analysis, and communicating new ideas.

Vision vs. Reality

Kentuckians—like people in all societies—yearn for a more hopeful, prosperous future. As a state, we are divided by many lines of difference including income, religion, race, political party, and regional identities. But those allegiances and distinctions fade quickly as people describe their vision and hopes for the future.

The three organizations comprising the Kentucky Economic Justice Alliance have 90 years of history working across Kentucky. In countless conversations, focus groups, and public forums, we have come to believe that Kentuckians want to live in caring communities. We want quality schools that nurture our children's development into capable, confident adults. We want our people to have access to good jobs that sustain families. We envision a clean and healthy environment that provides all residents with safe food, water, air and recreation. We want accountable, effective government that serves people regardless of their status or background. We want all people to have access to affordable, safe shelter and quality health care. We want to live in a state that is known for both the determined independence and the compassionate *interdependence* of our people.

Our shared vision is powerful and persistent, even as Kentucky ranks near the basement on many of indicators that measure the quality of life today. The list of our failings as a state is as painful as it is familiar. We are last in the nation in per capita spending on education. We are last in the participation of women in our democracy. We rank first in smoking (among teens and adults) and lung cancer deaths. Kentuckians report more days per month of poor mental health than residents of any other state. We rank 49th in the percentage of adults with a bachelor's degree. In the last two years, Kentucky experienced the second highest increase in poverty in the nation. Our median household income is now the 46th lowest in the nation. Kentucky ranks 42nd in child well-being, according to the Annie E. Casey Foundation.

These numbers—and the many other statistics documented in this report—provide important but insufficient measurements of the quality of life in Kentucky. The full story must be understood in terms of human lives, hopes and suffering. Each person without health care has a name and a story. Each family struggling to keep a job and a home—or to pay for electricity, gas, food, clothes, and medicine—harbors dreams of a better life along with fears for the future. As authors and readers of this report, it is our responsibility to see and feel the lives represented by each number or fact on the page.

Kentucky's Looming Budget Crisis

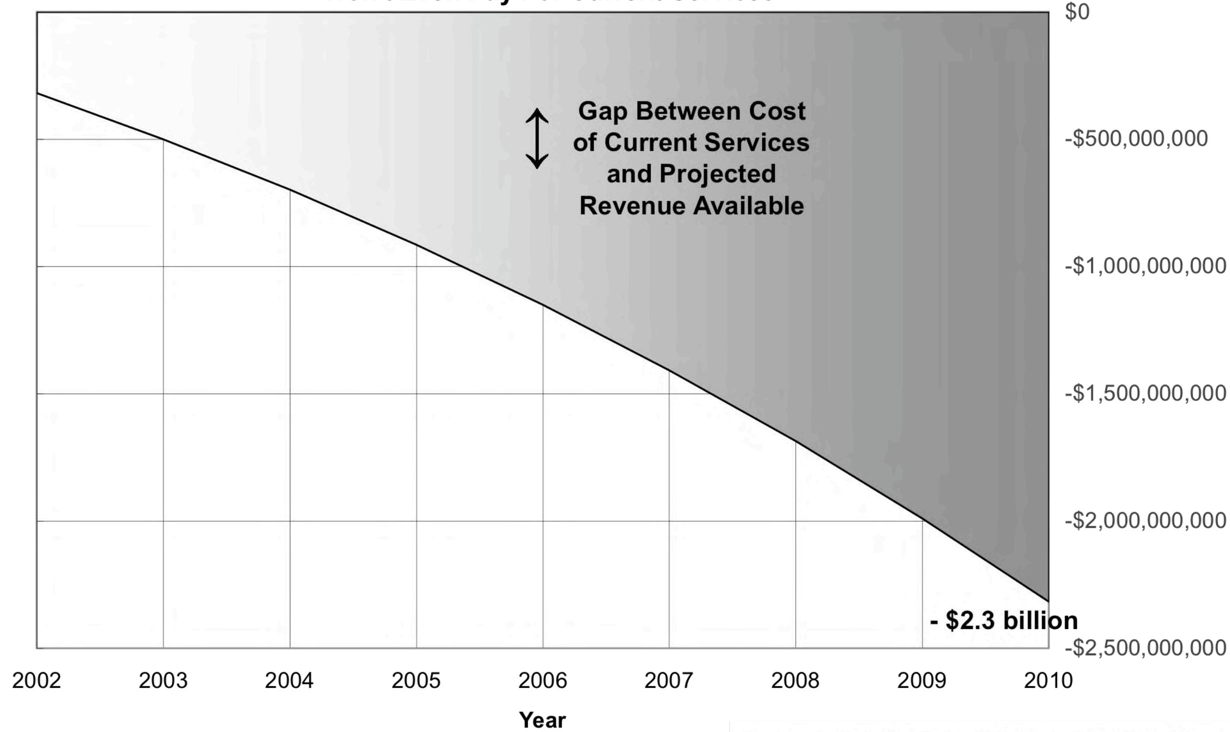
As bad as many of the indicators and statistics are, Kentuckians will likely face even greater hardship in the months and years ahead. The chronic under-funding of Kentucky's public schools, services and infrastructure is like a hurricane churning slowly offshore. When the budget storm makes landfall in Kentucky, the casualties and the costs will be severe. But so far, few Kentuckians—least of all those in elected office—are heeding the warning signs.

Consider the evidence: The Fox Report, a well-regarded study commissioned by the legislature in 2001, declared that Kentucky faces a growing gap between the money coming in from tax revenues and the money needed over the next decade to pay for existing services. The report predicted that by 2010 Kentucky would be $2.3 billion short of the money needed just to stand still. (Compare this shortfall to the size of our General Fund, which is about $8.3 billion in the current year.) The study blamed the gap on Kentucky's flawed and out-dated tax system, which is not designed to keep pace with the state's needs or economic growth. The tax plan that passed during the 2005 legislative session did little to address these flaws. (See Figure 1.)

While the worst of the budget storm has not yet hit, significant costs are being felt. Kentucky has endured six rounds of budget cuts in the last five years. We've cut $1.1 billion from state spending since 2001. Budget strains have caused good teachers to leave, class sizes to climb and program budgets to dwindle. As a result, Kentucky is now losing ground on progress made under the Kentucky Education Reform Act and higher education reform. A massive budget shortfall of $425 million in the Medicaid program threatens to diminish or end health coverage for hundreds of thousands of Kentuckians this year. Funding for our mental health system has slipped once again to near the bottom in state rankings. Between 1999 and 2004, state funding per pupil at the Kentucky Community and Technical College System (KCTCS) dropped by 30.6 percent. On the National Center for Public Policy and Higher Education's *Measuring Up 2004* report Kentucky's public colleges and universities earned a grade of D- in affordability, down from a C in 2002 and a B in 2000.

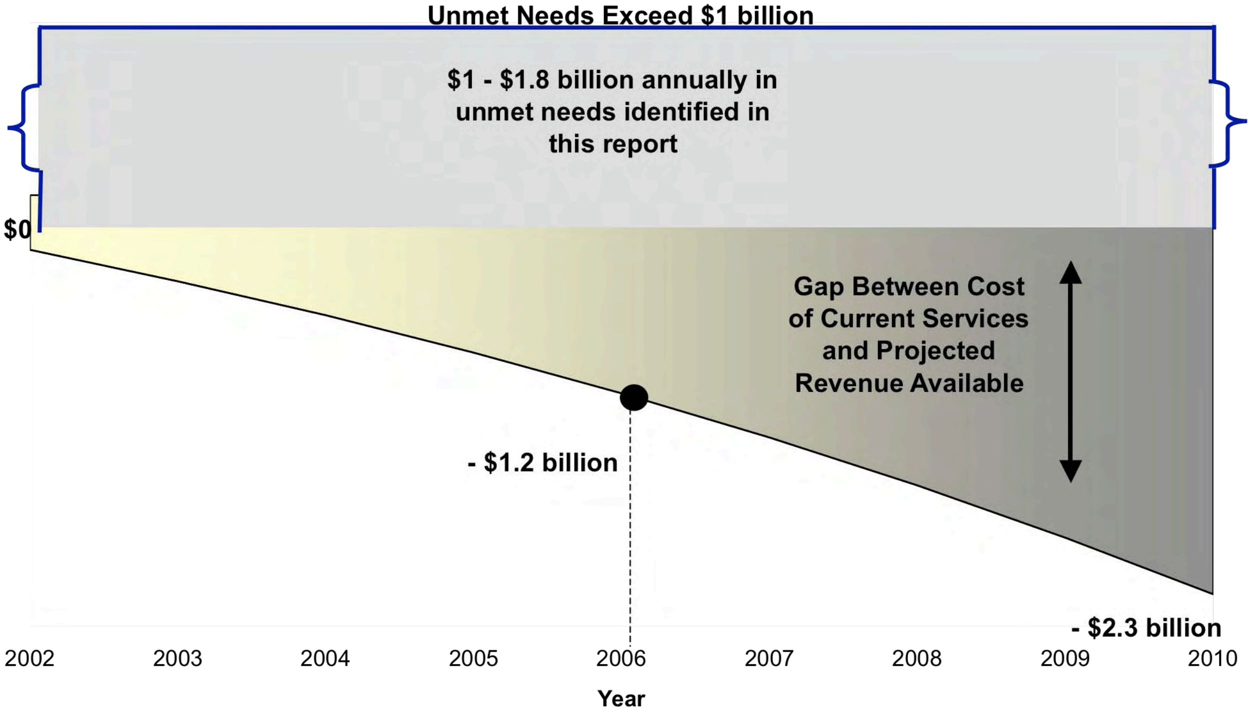
Many groups concerned with reversing those trends have made attempts to quantify

Figure 1: Kentucky's Flawed Tax System Won't Even Pay For Current Services



Source: Fox Report to the Kentucky General Assembly, 2001

Figure 2: Raising the Bar--Kentucky's Unmet Needs Exceed $1 billion



what it would take to adequately fund public services in Kentucky. Too often, however, those studies and recommendations exist in isolation from one another, discussed only in education circles, among mental health providers, or within the universe of low-income housing advocates. It is rare that Kentuckians have the opportunity to view the whole picture. This report brings together the accumulated evidence about the chronic under-investment across many of Kentucky's public services. The lesson to be drawn from this data isn't a specific number of dollars needed to move Kentucky forward. Rather, the information supports a broader conclusion that Kentucky must make large and sustained new investments in education, health and other services.

The deficits predicted by the Fox Report do not include the additional investments needed to lift Kentucky out of the nation's basement. When needed new investments are considered, a revision to the Fox chart indicates the scale of our budget storm—Kentucky has additional needs totaling $1 - $1.8 billion annually on top of the deficit documented by the Fox report. (See Figure 2.)

A Failure of Leadership

In response to repeated budget storm warnings, Kentucky's leaders have so far failed to take appropriate precautions. Rather, many have used their considerable political skills to hide the budget crisis from public view and postpone hard decisions. For example, consider the actions over the past five years by legislators and governors alike to obscure and delay the impact of Kentucky's budget storm. Among their strategies have been:

- **Raids of other funds:** In 2001, state revenues decreased in actual dollars for the first time in 50 years. In an effort to cover public services, the General Assembly dipped heavily into the state's rainy day fund and other so-called one-time pots of money. While the state's rainy day fund exists for this purpose, replenishing funds will be nearly impossible given the press of today's needs.

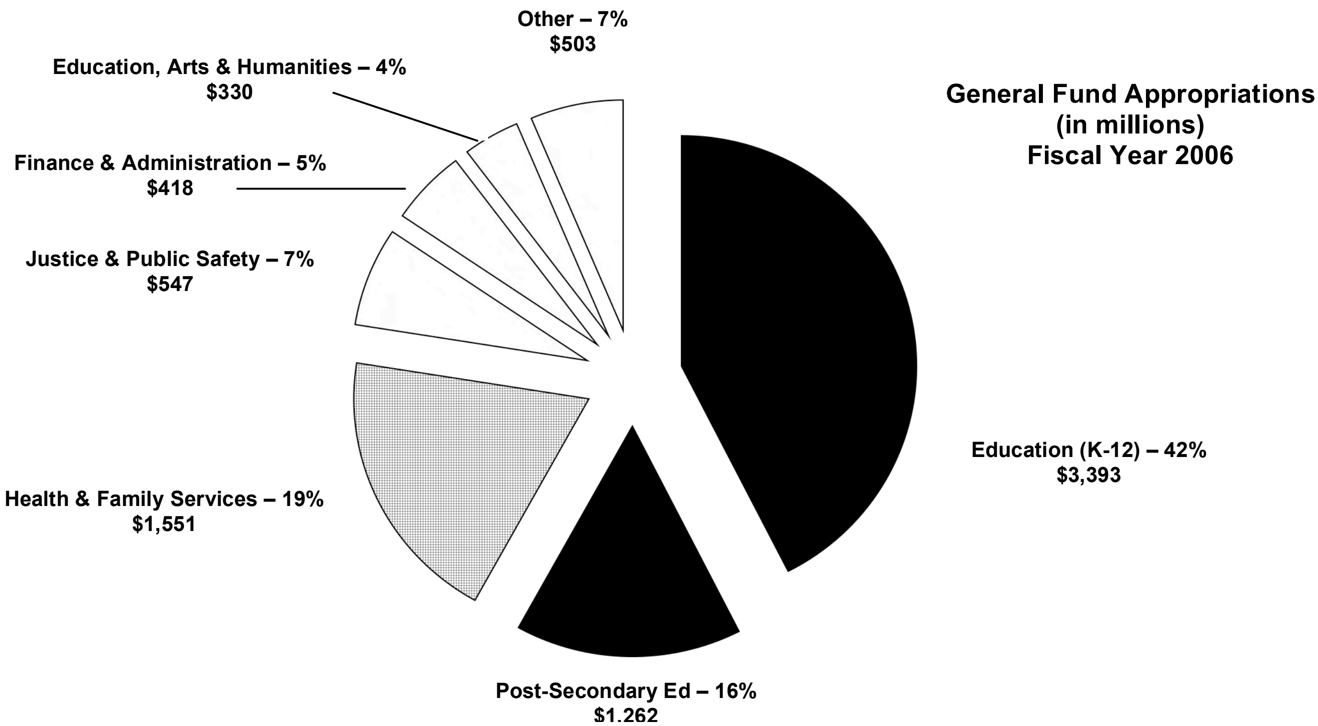
  Furthermore, raiding the one-time pots of money is simply a short-term solution. Since 2001, hundreds of millions of dollars have been taken from dedicated state accounts and used to cover costs in the state's General Fund. For example, the budget that passed in 2005 took $59 million from the assets of the Kentucky Higher Education Student Loan Corporation and $63 million from a fund dedicated to the cleanup of leaking underground petroleum storage tanks. The problem—in addition to the fact that these funds were set aside for other important purposes—is that the raided funds just paper over a budget hole that will reoccur in future years.

- **Higher debt:** According to *Governing Magazine*, Kentucky now carries the seventh highest per capita state and local debt in the nation. Our state and local debt is the second highest nationally relative to government revenues. Yet in 2005, the General Assembly adopted a budget containing the heaviest new debt burden ever, $2.2 billion. And, like a person buying furniture on credit with no money due until the next year, lawmakers pushed the real costs into future years by delaying the start date for some bond payments. The level of recent deficit spending is cause for alarm. If it leads investors to downgrade Kentucky's bond rating, interest rates available to Kentucky will rise and the higher costs of debt service will crowd out investments in other public services.

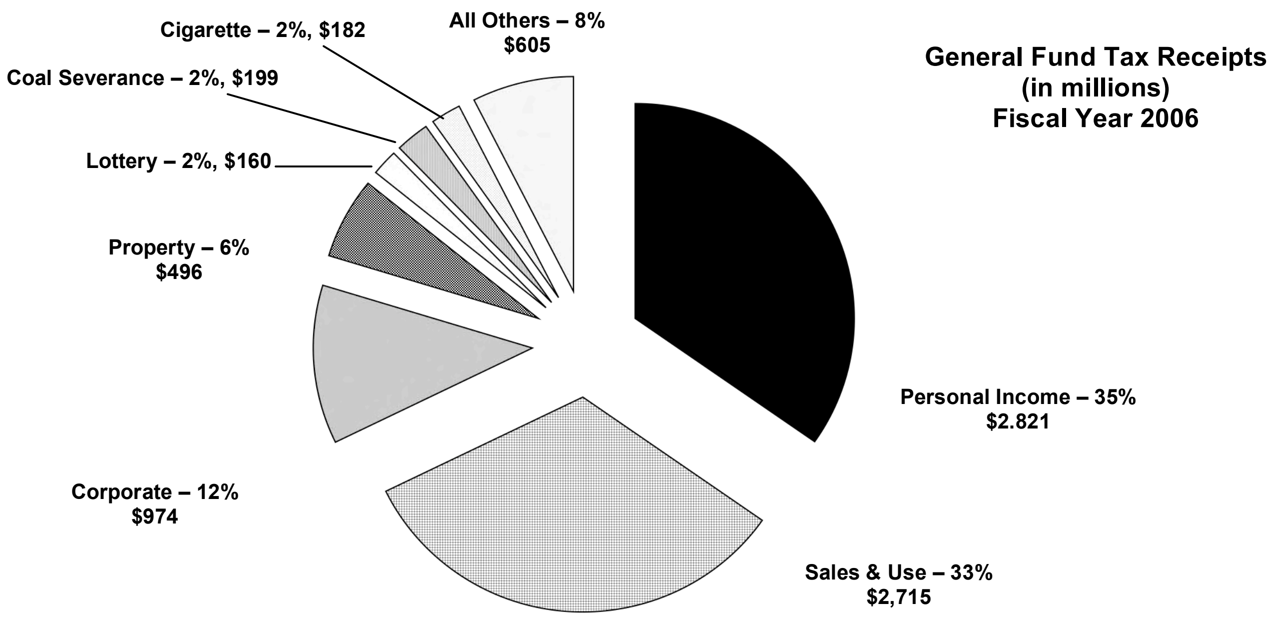
- **False promises:** When Governor Fletcher toured the state in 2004 to sell his tax plan, he claimed the changes were necessary for Kentucky to invest in education and move forward. But the tax plan did no such thing. Rather, it was designed (and certified by a DC based anti-government group) to be "revenue neutral." In fact, the Governor's original proposal included some fine print designed to actually shrink the growth of state revenues over time.

Understanding the State Budget

The General Fund is the primary source of funding for state government programs and services. In 2006, the General Fund is just over $8 billion.



The General Fund comes from a variety of taxes paid to the state of Kentucky.



The General Assembly soon made its own claims to do the impossible, passing tax and budget bills which promise new money for education but no new money from taxes. How did they do it? By phasing in tax changes slowly, lawmakers produced a one-time revenue bubble of $110 million in 2006 (when they are up for re-election) followed by several years of revenue losses due to tax cuts that start in 2007. As a result, the group of economists called the Consensus Forecasting Group has projected that Kentucky's revenues will grow by a blistering 7.1 percent in 2006, then fall to just 0.9 percent growth in 2007.

- **Failure to enact fair, adequate tax reforms:** For more than a decade, legislators and governors have recognized the need to reform Kentucky's tax system. Tax commissions, studies and even the courts have helped to pinpoint the many flaws. Yet—with a few notable exceptions—the 2005 tax overhaul fell far short of the changes Kentucky needed. For example, it did not expand the sales tax to additional services, the fastest growing sector of our economy. It did not establish a progressive income tax that would raise money by increasing the rate paid by Kentucky's wealthiest citizens while lowering or maintaining the taxes paid by a majority of Kentuckians. Legislators did raise the cigarette tax, but only enough to make Kentucky's tax the 45th lowest in the nation. And, while the 2005 tax bill closed some corporate loopholes, it slashed the top rate on corporate net profits from 8.25 percent to 6 percent. Taken as a whole, the tax reform failed to support the investments in education, health care, and infrastructure Kentucky needs to thrive.

- **Failure to re-evaluate tax breaks in light of budget needs:** Every two years, the state of Kentucky produces a *Tax Expenditure Analysis* that documents the impact of all the tax breaks awarded by the legislature. In 2004, there were about $6.5 billion in expenditures, while direct spending by the state that year totaled about $7.4 billion from the General Fund.

  As the introduction to the most recent *Tax Expenditure Analysis* explains, "Unlike direct appropriations, which must be continuously reviewed and approved by the General Assembly to remain in effect, tax expenditures are usually not included in this review process. As a result, programs funded through tax expenditures receive priority funding over all other programs. In all probability, many 'tax expenditure' programs would not receive the same priority if they had to compete with 'direct funding' programs."

- **Under-investment in Kentucky's essential services:** In the fall of 2004, Governor Fletcher stood before a large graph showing about $1 billion in budget cuts endured by state programs since 2001. Some of those cuts have been well publicized, including $63 million taken from higher education and a 2.5 percent across the board reduction in all levels of state government in 2004. Yet some of the pain is less visible. In many areas of government, including community mental health centers, public defenders offices, and community colleges and technical schools, programs must serve increasing numbers of Kentuckians with shrinking resources.

Kentucky Can Do Better

While the challenges we face are multiple and grave, a better future is possible. Of all our deficits, Kentucky suffers most from a lack of political will and leadership to make the necessary investments. There are no shortcuts to better health, rising incomes, and higher educational achievement, but many pieces of the long-term solution are known and within reach. Kentucky can do better.

The conclusion of this report lays out a number of policy recommendations that legislators should consider for moving Kentucky forward. At the top of the list is a set of fair, progressive tax reforms to support greater investments in public services. These recommendations call into question the notion that expanded gambling is the sole path to more revenue. The bottom line is this: whether or not expanded gambling passes, real tax reform is needed to fix the flaws in our system and raise much needed revenue.

A second set of policy recommendations aims at improving the quality of information available to lawmakers and the public about state tax and budget issues. Key reforms in this list include re-authorizing tax expenditures over a period of time so that these "off-budget" expenditures may be considered in light of other spending priorities. Also, we propose several tools the legislature could employ to better evaluate the impact of tax and budget decisions on low-income Kentuckians and the quality of public services.

The Kentucky Economic Justice Alliance believes in a positive vision for Kentucky's future. Our state's tax and budget policies can contribute to a better quality of life across the commonwealth. To move in that direction, more Kentuckians need to understand and support greater public investments in our schools, health care, and other essential services. We offer this report to inform the public debate about Kentucky's looming budget storm. Together we can create the conditions for the moral and courageous political leadership Kentuckians deserve.

Sources: US Census Bureau; *Governing* magazine's *State and Local Source Book 2005*; Anne E. Casey Foundation's annual *Kids Count* report; National Center for Public Policy and Higher Education's *Measuring Up* reports; *Cincinnati Enquirer*; Kaiser Family Foundation's State Health Facts website (www.statehealthfacts.org); *Lexington Herald-Leader*; *The Courier-Journal*; Office of State Budget Director; Kentucky's Tax Expenditure Analysis Fiscal Years 2004-2006; United Health Foundation, America's Health: State Health Rankings—2004; National Center for Higher Education Management Systems; William Fox's February 2002 "Report to the Sub-Committee on Tax Policy Issues"

PUBLIC EDUCATION

Parent Teacher Organizations commonly work bingo halls to raise funds for band uniforms or football camp. But early in 2005, members of the George Rogers Clark High School PTO in Clark County took to the bingo hall to raise money for textbooks. Too few textbooks is just one problem this district has faced as a result of having to cut its budget for each of the past three years in amounts ranging from $600,000 to $1 million.

The problems facing George Rogers Clark are not unique. The Fayette County school district has cut its budget for three straight years, including a $1.6 million cut in 2005. In 2003, the Webster County school district had to go to a four-day school week because of its budget strain. And in 2004, after running on a promise of balancing the budget by cutting only "waste, fraud, and abuse" and insisting on "revenue neutral" tax reform, Governor Fletcher ordered a 2.5 percent budget cut for all state cabinets. This meant cuts throughout education—early childhood development, technical and career education, family resource centers as well as core programs in public schools.

According to *Governing* magazine, Kentucky ranks 50th among states in per capita spending on education.

These circumstances suggest that Kentucky is not living up to the promise of "enough money to get the job done right" made at the April 11, 1990 signing of the historic Kentucky Education Reform Act (KERA).

KERA came about in response to a 1989 Kentucky Supreme Court ruling that declared the state's public school system unconstitutional. The court wrote that "the system of common schools must be adequately funded to achieve its goals…Each child, every child, in this Commonwealth must be provided with an equal opportunity to have an adequate education."

The passage of KERA signaled Kentuckians recognized education as the cornerstone of our state's vitality. "A high quality of life and economic success for all Kentuckians depends overwhelmingly on the quality of education they receive" notes the Partners for Kentucky's Future, a coalition of education organizations and business interests working to sustain our state's promise to adequately fund education at all levels.

Indeed, since the passage of KERA, Kentucky has made sure and steady progress in providing quality education:

- In 1991, the rate at which Kentuckians were getting a high school diploma or equivalent was 74.8 percent. By 2001, that rate had risen to 83.8 percent.
- College going rates have risen to the national average. In 1994, the state ranked 43rd in the percent of high school graduates enrolling directly in college. By 2000, Kentucky had risen to 26th.
- On the 2005 National Assessment of Education Progress's (NAEP) 4th and 8th grade reading tests, Kentucky students surpassed the national average.
- According to Education Week's annual *Quality Counts* report, Kentucky ranks among the top five states in efforts to improve teacher quality.

Kentucky's Progress is at Risk

Kentucky's investment in education is still showing dividends, but these gains are being threatened by Kentucky's recent inability to adequately fund public schools. According to *Quality Counts*, all surrounding states except

All surrounding states except Tennessee spend more per pupil than Kentucky. Kentucky spends $1,000 less per pupil than Indiana and $1,460 less than West Virginia.

Tennessee spend more per pupil than Kentucky. The Commonwealth spends $1,000 less than Indiana and $1,460 less than West Virginia.

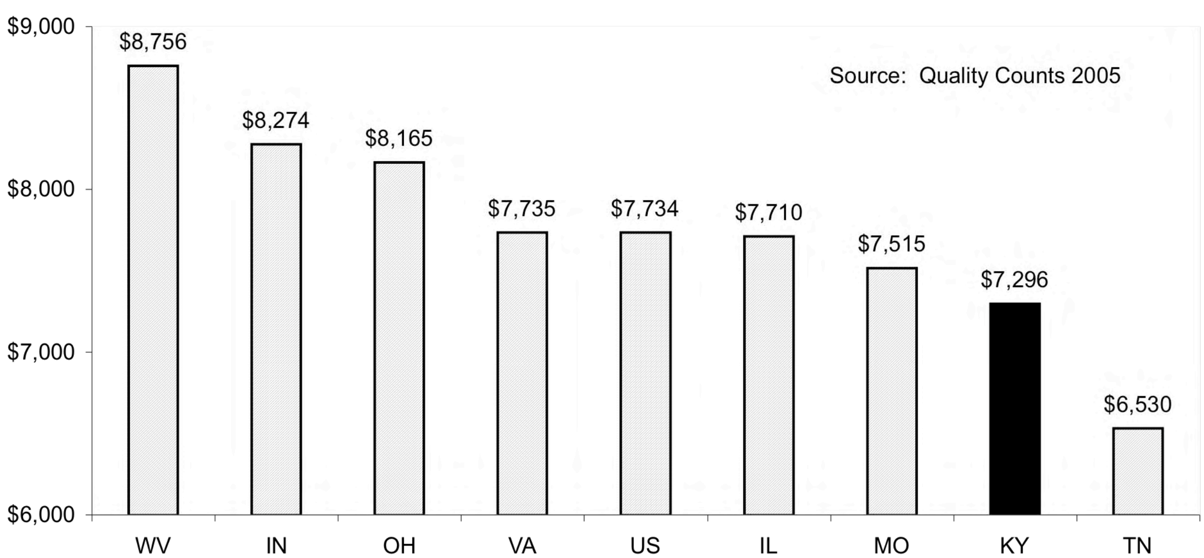
This has not always been the case. According to Education Week's annual *Quality Counts* report, in 1997, Kentucky ranked second in per pupil spending (adjusted for regional cost differences) compared to the surrounding states and also surpassed the national average. In 2002, however, we began to lose significant ground. By 2005, according to *Governing* magazine's *State and Local Source Book*, Kentucky has fallen to dead last among all states in two key categories indicative of effort—the amount spent on elementary and secondary education per capita and as a share of personal income in the state.

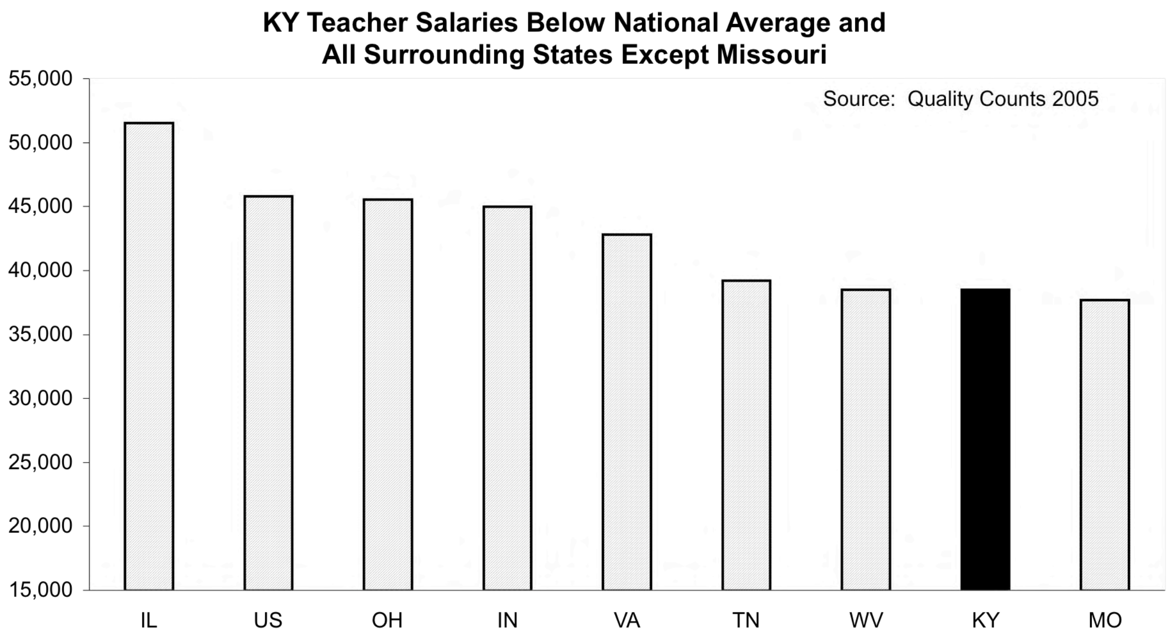
Without adequate funding, all the progress Kentucky has made in the area of education is at stake, and, in fact, the state is beginning to lose ground in several key areas. Scores on the NAEP 4th and 8th grade math tests trail the national average and most surrounding states. The percentage of middle and high school classes in core academic areas taught by teachers without a major or minor in the field is well behind the national average (32 percent in 1999-2000 compared to the 24 percent national average).

Inadequate funding has also damaged the state's ability to keep teacher salaries on par with the rest of the nation. In 1997, Kentucky surpassed the national average and ranked fourth among surrounding states in teacher salaries. By 2005, of the surrounding states, only Missouri had a lower average teacher salary and Kentucky had dropped well below the national average. In 2005, Kentucky's average teacher salary was $7,285 less than the national average and $4,382 less than the average of surrounding states.

Kentuckians recognize that the progress we've made in the area of education is in danger. According to a 2004 survey by the Kentucky Long-Term Policy Research Center, 58 percent of Kentuckians think the state is "standing still" or "losing ground" on the goal of having "an education system of lifelong learning that exemplifies excellence."

Kentucky's Per Pupil Spending Is Less than National Average and All Surrounding States Except Tennessee





What It Would Take

Kentucky has made significant gains in education since 1990 and, in fact, has become recognized nationally as a leader in education reform. If we wish to maintain our progress, Kentucky must adequately fund education.

A significant increase in funding is needed to bring Kentucky's per pupil spending to parity with two key benchmarks: the average of surrounding states and what it would take to rank among the top ten states nationally in per pupil spending. Kentucky needs $337 million to bring our per pupil spending up to the average of surrounding states. To rank among the top ten states in per pupil spending, Kentucky needs an investment of $982 million.

There is no doubt that Kentucky has made great strides in improving public education since 1990. We should be proud of these gains and build upon them. But, we cannot continue to move forward if funding for education continues to slip behind what other states are spending and behind what education experts deem necessary to continue our progress.

As Kentucky historian Thomas Clark once noted, "We must now decide: are we going to live up to the tenets of the Kentucky reform acts or are we once again going to allow the public school system to be shattered and injured?" Given that Kentucky ranks dead last among all states in education spending as a portion of personal income, there can be no doubt that substantially increased funding is possible. Kentucky can do better!

Sources: *Lexington Herald-Leader*; KY Department of Education; *Governing* magazine's *State and Local Source Book 2005*; KY Long-Term Policy Research Center's *Purpose, Publications, and Products 2005*; National Center for Education Statistics website; KY Long-Term Policy Research Center's *Visioning Kentucky's Future: Measures and Milestones 2004*; Education Week's *Quality Counts* reports, 1997-2005; Standard & Poor's School Evaluation Services' *Statewide Education Insights: Kentucky*, 2005

HIGHER EDUCATION

Investment in higher education is increasingly critical to the economic health of Kentucky. According to an analysis by the Kentucky Long-Term Policy Research Center, if by 2020 Kentucky climbed to the national average in the share of working-age adults with a bachelor's degree, it would mean an additional $120 billion cumulatively to the state's economy. The Council on Postsecondary Education says to meet that goal the state needs to double the number of bachelor's degree holders from 400,000 in 2000 to nearly 800,000. But that won't be easy. While Kentucky has made progress in recent years, the quality and accessibility of its higher education institutions are being threatened by inadequate state funding.

In 1997 Kentucky made a critical step toward increasing the accountability and performance of its system of higher education with the passage of the Postsecondary Education Improvement Act. The National Center for Higher Education Management Systems said the act is "widely recognized as one of the most far-reaching, significant state-level higher education reforms of the past quarter century in the United States." That reform has shown important results:

- Since 1998, total higher education enrollment in Kentucky has increased 25 percent.
- The percent of GED completers enrolling in college within 2 years increased from 12 percent in 1998 to 20 percent in 2001.
- At public universities, the six-year graduation rate rose from 36.7 percent in 1998 to 45.3 percent in 2003.
- Degrees and certificates awarded have increased 48 percent since 1997.

In 2003, the average full-time year round worker in the US with a 4-year degree earned 62 percent more than the worker with only a high school diploma.

Because Kentucky started so far behind, serious challenges remain despite these gains. For every 100 9th graders in Kentucky, only 15 go on to complete a higher education degree. The state's graduation rate of 45.3 percent for first-time, full-time college students in public universities is well below the national average of 54 percent. In 2000, Kentucky ranked 49th among states in the percentage of adults with a bachelor's degree.

About 1 in 20 Kentuckians is enrolled in our state's public colleges and universities.

Shifting the Cost of Higher Education

The state's progress in higher education has been undermined in recent years by a lack of state funding. In effect, Kentucky policy makers have been shifting the cost of maintaining a quality higher education system to Kentucky college students and their families.

Over time, state funding has shrunk as a share of higher education's revenue stream. In 1991-1992, state funding represented 42 percent of total funding for Kentucky's public colleges and universities. By 2000-2001, the state provided only 33 percent. That decline reflects a lessening commitment to helping Kentuckians attain the skills and expertise to achieve success.

In 2005, under pressure from the anti-government extremist Grover Norquist and his supporters, Governor Fletcher signed into law a tax plan that raises no additional revenue for public investment in higher education. Within a month, tuition at Eastern Kentucky University

From 1999 to 2004, tuition per student in Kentucky increased 33.3 percent while state higher education funding per student dropped 8.3 percent.

increased 23 percent. Tuition rose 12.5 percent at the University of Kentucky; 9.8 percent at the University of Louisville; and 6.5 percent at Kentucky's community and technical colleges. These spikes came on top of several years of double-digit tuition increases at Kentucky's colleges and universities.

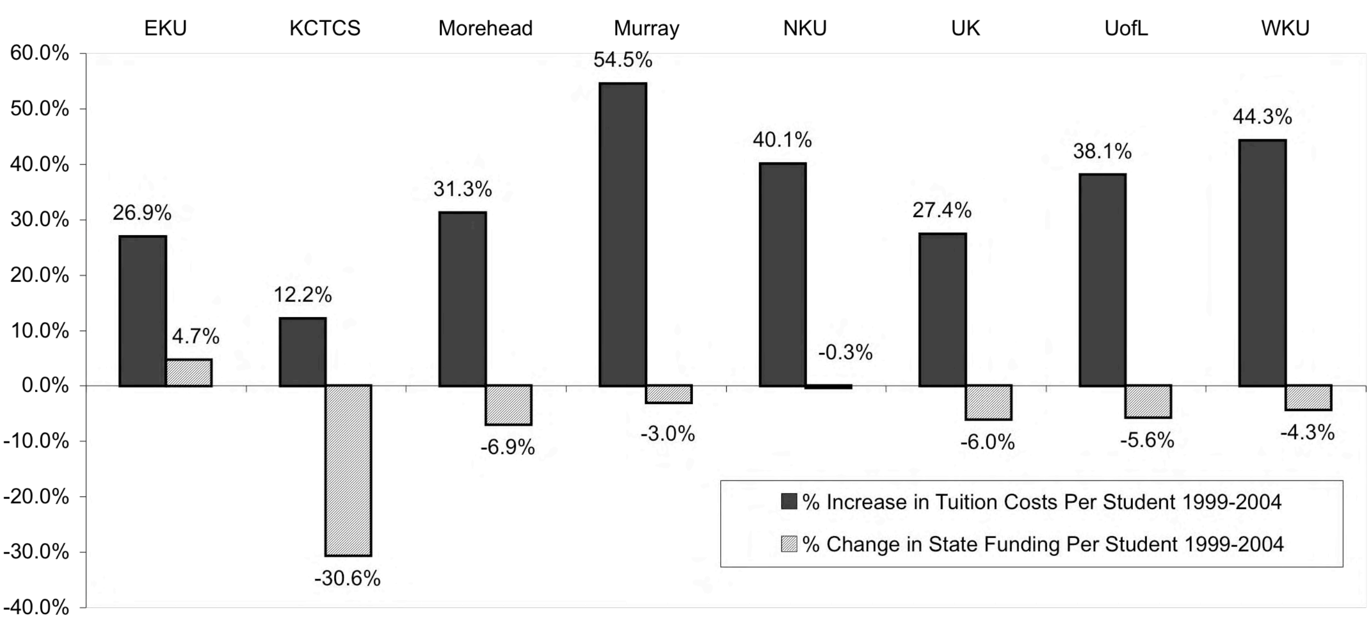
These tuition hikes are the result of inadequate state funding for higher education. In 2004 alone, $65 million was cut from higher education's budget while statewide enrollment increased by more than 2,000 students. As a result, the Commonwealth's public colleges and universities are being forced to do more with less, and Kentucky's college students and their families are left to make up the difference.

Between 1999 and 2004, state funding per pupil at the Kentucky Community and Technical College System (KCTCS) dropped 30.6 percent. At the same time, KCTCS tuition costs per student increased more than 12 percent. At the state's four-year universities, tuition costs rose by amounts ranging from 26.9 percent to 54.5 percent over that same five year period while state funding per student dropped as much as 6.9 percent. In fact, statewide, tuition and fees grew from 31 percent of higher education's budget in 1999 to 44 percent during 2004-2005.

These tuition increases are making college less accessible to many Kentuckians. The National Center for Public Policy and Higher Education's *Measuring Up* report notes that net college costs for low- and middle-income students at public colleges in Kentucky represent about a third of their annual income. This deteriorating pattern of state funding for higher education earned Kentucky a grade of D- in affordability in the 2004 *Measuring Up* report, down from a C in 2002 and a B in 2000.

Weakened need-based financial aid has worsened the situation for low- and middle-income students wishing to pursue higher education in Kentucky. The purchasing power of the federal Pell grant has declined considerably. In the mid-1970s, a Pell grant was equal to 84 percent the cost of attending a public four-year school. By 2003-2004, it covered only 23 percent.

Student Tuition Costs are Up
While State Funding Per Student Has Declined



Annual tuition increases can really pinch pockets over the course of a college career. University of Kentucky students graduating in 2005 paid 42 percent more in tuition and fees during their senior year of college than their freshman year.

At the state level, Kentucky's need-based financial aid program is capped in both the number and size of awards given. Unlike Kentucky's merit-based scholarships which are guaranteed to all who qualify (given they attend an eligible state school and use their award within a specified time period), a limited number of need based awards are given on a first–come, first-serve basis. The size of each award is capped at $850 per semester. This doesn't come close to covering the $1,470 in tuition paid by a student taking 15 hours of courses at KCTCS or the $2,900 in tuition costs paid by University of Kentucky freshmen.

As a result of the escalating tuition and weakened financial aid, more Kentucky students are relying on loans to fill the gap. According to *Measuring Up*, the average loan amount that Kentucky undergraduates borrow each year is $3,018. *The Courier-Journal* reports Kentucky college students "borrowed 130 percent more during the past five years, as their debt load ballooned from $174 million to $411 million…" Graduating with significant debt will impact the ability of these students to fuel economic spending and growth in future years.

What It Would Take

The National Center for Higher Education Management Systems has called the gains Kentucky has made in higher education since 1997 "nothing short of remarkable." To maintain this progress, Kentucky must recommit itself and provide the funding needed to propel higher education, and our entire state, forward.

According to the *Lexington Herald-Leader*, Kentucky's Council on Postsecondary Education reports that the state's higher education system needs $250 million to catch up with comparable schools in other states. However, according to the State Higher Education Finance report for fiscal year 2004, to rank among the top ten states in funds available for higher education per pupil, without raising tuition, Kentucky must increase higher education funding by over $438 million.

Excellence in higher education won't come cheap, but Kentucky's future depends on this investment. Higher education is the foundation of a thriving economy. It has been linked to better public health and increased civic participation. It is key to improving the quality of life for all Kentuckians.

Reminding Kentuckians of the benefits of investing in higher education, University of Kentucky President Lee Todd noted recently "average household incomes are higher in states with Top 20 universities. Unemployment rates are lower and fewer public dollars are spent on health care. These states also have healthier children and fewer people living in poverty."

As the National Center for Higher Education Management Systems notes, "There are virtually no other reforms that will have as profound an impact on lives in Kentucky as [higher education] reform. It affects every dimension of the state's quality of life and economy—early childhood education, K-12 education, health, civic participation, and the state's competitiveness in the New Economy. It is too important to future generations to abandon…"

Sources: National Center for Higher Education Management Systems; Council on Postsecondary Education; Kentucky Long-Term Policy Research Center; Bureau of Labor Statistics; *Lexington Herald-Leader*; The National Center for Public Policy and Higher Education's *Measuring Up 2004*; Institutional Research offices at Kentucky's universities; Kentucky Higher Education Assistance Authority; State Higher Education Executive Officers' *State Higher Education Finance Fiscal Year 2004*; *The Courier-Journal*

HEALTH CARE

In the US and Kentucky, health care costs are growing at rates that far outstrip both wage and revenue growth. National polls consistently find that two-thirds of Americans view the US health system as having "major problems or being in crisis." Since nearly half of the nation's health care expenses are paid with tax dollars, governments at all levels are now facing enormous budget strains.

In Kentucky our health care crisis can be described as severe and worsening, a perfect storm confronting policy makers, businesses, public institutions and citizens alike. Health problems facing Kentucky include an aging population, shrinking base of private employers who provide health benefits, rising premiums and out-of-pocket expenses that put private insurance out of reach for many, rising health costs that squeeze the budgets of businesses, non-profits and governments of all sizes, erosion of federal funding for health care programs, and a general population that is in poor health relative to the rest of the nation.

Some highlights from Kentucky's health statistics suggest the seriousness of our condition.

- Nearly one out of three Kentuckians (29.9 percent) under the age of 65 went without health insurance for all or part of the 2-year period from 2002-2003. Of the uninsured, 74 percent were members of a working family.
- Kentucky has the highest rate of lung cancer deaths in the nation and the second highest death rate from all cancers.
- Kentuckians experience more days of poor mental health per month than residents of any other state.
- In Kentucky, 47 percent of youth and 30 percent of adults smoke, the highest rates in the nation.
- In the 2000 census, 20 percent of Kentuckians aged 5 and older reported living with a disability.
- Kentuckians die at a rate that is 18 percent above the national average.

Race matters, especially when it comes to health. In Kentucky:

- **The death rate among blacks exceeds the rate for whites by 38.3 percent.**
- **The death rate for blacks diagnosed with cancer is 36 percent greater than for whites.**
- **The rate of infant mortality among blacks exceeds the rate among whites by 68 percent.**
- **Among black mothers, 25 percent do not receive first trimester pre-natal care, compared with 15 percent of all mothers.**

Health Care & the State Budget

Kentucky's public investment in health care is substantial. About 15 percent of the state's General Fund and 23 percent of the entire state budget is spent on health care. In fiscal year 2001, we ranked 22nd in overall state spending on health care programs. In 2004 we were 26th in the nation in per capita spending on public health, 21st in total spending on K-CHIP (a health care program for the children in working poor families) and 22nd in total spending on Medicaid (a health program for low-income and disabled people).

These investments have supported some improvements in the health of the population, especially in the area of maternal and child health. The number of teen births dropped by 14 percent in the 1990's and more expectant mothers are receiving critical prenatal care than ever. Kentucky's infant mortality rate in 1997 (7.2 deaths per 1,000 live births) was the lowest recorded in the state and matched the national average. Additionally, state investments in public health have helped cut the rate of infectious diseases (including HIV/AIDS, tuberculosis and hepatitis) in half since 1990.

In other areas, Kentucky's failure to invest is resulting in worsening the health conditions of our citizens. Four decades ago, Kentucky became a national leader by establishing one of the first statewide networks of regional mental health/mental retardation centers. However these centers, which served about 165,000 Kentuckians last year, are chronically under-funded. The legislature has provided just two cost of living increases since 1990. As a result, by 2001 Kentucky had fallen to 44th in state funding of mental health and substance abuse services and 49th in funding services for individuals with mental retardation and developmental disabilities. Kentucky spent just $49 per person on mental health, compared with a national mean of $72 in 2001.

Kentucky spends 23 percent of our entire state budget on health care programs, including support for:

- Local health departments that serve 750,000 individuals
- Rape crisis centers
- HIV/AIDS services
- Investigation and prevention of communicable diseases
- Immunizations (904,000 per year)
- Nutrition programs
- Drug treatment and substance abuse & prevention
- Maternal health
- Licensing and regulation of nursing homes, child care centers, assisted living facilities and emergency medical services
- Food inspection
- Programs for adults and children with developmental disabilities and special needs
- Alzheimer's and aging services programs
- Breast cancer education
- Mental health and mental retardation system
- Kentucky Children's Health Insurance Program
- Medicaid, which serves about 700,000 low-income and disabled Kentuckians

Current Budget & Policy Issues

In 1994 the Kentucky General Assembly passed legislation aimed at expanding access to affordable private health insurance. Provisions included the creation of a statewide purchasing alliance to negotiate lower-cost coverage and new regulations on insurers designed to control costs and protect consumers. In response to powerful opposition from insurance and health care providers, the legislature soon backpedaled. By 1998 the state had repealed most of the reforms. The lesson, according to many observers, is the extreme difficulty of making sweeping health insurance reforms at the state level. A 1999 report by the Kentucky Long Term Policy Research Center concludes, "…the current state of the health insurance market in Kentucky suggests that the best legislative action in this area is no action."

Efforts to expand access to private health insurance have fizzled, but policy makers are now facing another side of Kentucky's health care crisis: namely how to pay for the rising costs of publicly funded health care. This problem came to a head last year when the Governor attempted to shave $170 million from the health insurance program that covers 240,000 teachers, state employees and dependents. Having promised not to raise taxes under any circumstances, the administration proposed to trim costs through a mixture of benefit reductions and increases in premium costs and out-of-pocket expenses. Under the threat of a teachers' strike, lawmakers extended the current health care plan for another year, giving all sides a chance to create a new state-run insurance plan for public employees. While hopes are high that this will result in cost savings, it is projected to cost an additional $132 million next year.

Even more daunting, the Fletcher administration now says that "everything is on the table" as the state searches for a way to close a $425 million Medicaid shortfall for 2006. (Projections for the size of this deficit have fluctuated. This figure is based on reports released by the state in October 2005.) Medicaid is a $4.7 billion health program that serves nearly 700,000 low-income or disabled Kentuckians. Kentucky shares the costs of Medicaid with the federal government, based on a roughly two to one matching formula. Thus the state needs to come up with $132 million in additional funds this year in order to receive federal matching funds for the remainder of the projected deficit. The Fletcher administration has recently imposed new fees, including higher co-pays for prescription drugs. State officials are also seeking a waiver from many federal requirements to allow other cost cutting measures, including reducing or eliminating some Medicaid benefits or eligibility. Medicaid patients and advocates caution that people with multiple or chronic health conditions may have difficulty affording the care they need as program costs shift to individuals.

In 2006, Kentucky's Medicaid program faces a $425 million shortfall.

While Kentucky struggles to pay for the current level of health care services, it is important not to lose sight of the need to dramatically improve the health and health care of Kentucky residents. Thirteen percent of Kentuckians now lack any form of health insurance, including 9.5 percent of children. Many more are seriously under-insured. Lack of insurance is responsible for preventable death, suffering and financial ruin among the uninsured and for higher costs of premiums paid by employers, taxpayers and covered individuals. In addition to expanding insurance coverage, greater investments in public health are needed to reduce Kentucky's most common and costly risk factors, including smoking, obesity and occupational fatalities. And, the state's mental health and substance abuse system, which ranks near the basement in per capita spending, warrants substantial new investment. Kentucky is one of a few states that do not authorize Medicaid payments for substance abuse treatment for adults (except in the case of pregnant women). Studies show that providing this benefit would have cost the state just $3.3 million more in 2002 while benefiting many individuals, families and communities.

What It Would Take

Kentucky found out in the 1990's just how hard it is for a state to solve complex health care problems on its own. Kentucky's health care crisis is America's health care crisis. As a state we will continue to wrestle with many of these agonizing conditions and challenges until the political will develops to address the problems at a national level.

There are, however, important courses of action facing Kentucky lawmakers and citizens. Some of the questions we need to answer as a state and society include: What health outcomes do we want to achieve in Kentucky? What is the required level of investment to achieve those goals? Can we reduce (or slow) health care costs in ways that benefit Kentuckians, rather than cut services? What additional investments in public health, disease prevention and disease management could yield the strongest economic and health benefits? Finally, how will Kentucky raise the necessary funds to cover the uninsured, support prevention programs, and improve the health of our citizens?

There is no low-cost solution to Kentucky's health care woes. To prevent further decline in health services, Kentucky's legislature must find at least $132 million more to cover this year's Medicaid gap, plus another $3 million to cover substance abuse treatment. The new self-insurance plan for teachers and state employees requires an additional $132 million next year. A state commission determined in 2001 that Kentucky must invest an additional $25 million for the next ten years to move Kentucky from 44th to 25th in state mental health funding. Beyond those important measures, Kentuckians must to come together to identify the areas of greatest need and opportunity for improving health and health care and reducing costs.

Baretta Casey, a Hazard physician, may have stated it best in *The Courier-Journal*'s recent report on Kentucky's health care crisis. As she rightly noted, "We don't have to have the worst health in the nation."

Sources: Kaiser Family Foundation's State Health Facts website (www.statehealthfacts.org), Kentucky Long-Term Policy Research Center; *Lexington Herald-Leader*; *The Courier-Journal*, Kentucky Cabinet for Health Services: *Health Status of Kentuckians 1999*; Families USA: *The Uninsured: a Closer Look;* United Health Foundation: America's Health: State Health Rankings – 2004; Kentucky Commission on Services and Supports for Individuals with Mental Illness, Alcohol and Other Drug Abuse Disorders, and Dual Diagnoses, *Template for Change Report*, 2001

JUSTICE

Public Defenders

Kentucky's Department of Public Advocacy (formerly known as the Office of Public Defender) was created in 1972 to ensure that Kentucky's poorest citizens have access to a fair and reliable criminal justice system. Public defenders provide legal assistance to over 130,000 Kentuckians a year involved in criminal cases. Our public defense system helps ensure that justice is not reserved for only those who can afford to pay for an attorney.

Despite their best efforts, the quality of justice provided by Kentucky's public defenders has been compromised in recent years. The system has been caught in the cross hairs of an increasing caseload and reduced state funding. In fiscal year 2004, the average public defender in Kentucky opened 489 new cases. Despite hiring 16 new lawyers, that caseload was only reduced to 485 in fiscal year 2005 because of increasing demand. The Department of Public Advocacy's caseload for fiscal year 2005 is up 2.9 percent from 2004. That follows a 12 percent increase over 2003.

At 485 cases per attorney, Kentucky's public defender caseload is nearly double the recommended maximum caseload.

At 485 cases per attorney, Kentucky's caseload is nearly double the national standards. The recommended maximum caseload is no more than 150 felony cases, 200 juvenile cases, or 400 misdemeanor cases. Even if all 485 cases handled by the average public defender were misdemeanors, which they are not, Kentucky's caseload would far exceed what is deemed reasonable.

Handling the increased caseload would not be as problematic if the Department of Public Advocacy received adequate funding to meet these growing needs. However, in the last five years, the Department has faced two years of budget cuts and three years with only modest increases in funding—not nearly enough to cover the caseload growth of more than 37,000 in the same time period.

In fiscal year 2004, Kentucky spent just $228 per case handled by public defenders. That's far less than what other states were spending two years earlier. In 2002, Virginia spent $250/case; Missouri spent $384/case; West Virginia spent $513/case; and Ohio spent $719/case.

Kentucky Public Advocate Ernie Lewis recently commented, "Is the quality of justice compromised when public defenders in Kentucky are being called upon to represent Kentucky accused citizens at 185 percent of nationally recognized standards? We are approaching that point when our public defenders are simply unable to perform their essential task of defending the accused due to these crushing caseloads. The people of the Commonwealth want to believe that the quality of justice provided an accused does not depend upon the money available to pay a lawyer. These caseloads threaten that fundamental belief."

Legal Aid

Like public defenders, Kentucky's 70 legal aid attorneys represent our state's poorest citizens. However, whereas public defenders represent people in criminal cases—in which there is a constitutional guarantee of representation—legal aid represents low-income people in civil cases where there is no such guarantee. Unfortunately, this means that when the budget is tight, legal aid offices, unlike public defenders, are able to—and must—turn people away.

More than 600,000 Kentuckians are

eligible for legal aid. These are people who are dealing with domestic violence, eviction, predatory lending, job discrimination, and issues related to health care and disability benefits.

In 2004, Governor Fletcher cut legal aid's budget by 27 percent. One expert estimates that Kentucky's legal aid offices are currently turning away about 50 percent of the people who need their help.

Although legal aid handles about 20,000 cases a year, Jamie Hamon—executive director of the Access to Justice Foundation, a state support office for Kentucky's four legal aid offices—points to recent legal aid statistics that show they are turning away approximately 50 percent of people who seek out their services. The statistics represent people who are financially eligible and who actually find a way to overcome barriers like not having a telephone or working multiple jobs to seek out help, but are ultimately turned away because the legal aid offices lack sufficient resources to help.

Because of budget constraints, legal aid can take on only the most pressing cases. For instance, they take divorce cases only if domestic violence is involved.

"If their case is not an emergency, unfortunately, we aren't going to be able to help them even if they really need our help," says Hamon. "We can only do triage."

In 2002, Kentucky's legal aid program lost significant federal funding. To plug the hole left by the federal cuts, the state legislature did not increase the General Fund allocation to legal aid—which had been diminishing or stagnant since 2001—but instead increased a court filing fee that helps fund the program.

Then, in 2004, Governor Fletcher cut the program's budget by 27 percent. As a result, legal aid enacted a hiring freeze and reduced their caseload. That year, they closed only 18,700 cases compared to 20,000 cases closed normally. The Access to Justice Foundation had to develop a shut down plan.

By 2005, legal aid funding returned to $1.5 million, but will remain stagnant in 2006. However, this is the same level of funding they had in 1998—despite increasing demands for their services.

This stagnant funding will put legal aid in a pinch in the coming years, says Hamon. Drastic changes in federal programs such as the new bankruptcy law and Kentucky's Medicaid waiver will mean increased need for their services. "These changes impact a vulnerable population that we in legal aid must be able to respond to," notes Hamon.

Kentucky's Growing Drug Problem

Kentucky's growing drug problem reaches every corner of our state. From prescription drug abuse in eastern Kentucky to meth labs in western Kentucky, some would say the problem has become an epidemic.

A comprehensive approach to solving Kentucky's drug problem would go far beyond traditional drug prevention, treatment, and enforcement. A holistic approach would mean fully funding mental health programs since so many who turn to drugs suffer from mental health issues. Such an approach would also involve increasing access to education and re-tooling Kentucky's economy so that all Kentuckians have access to good paying jobs with health benefits—factors that can help one steer clear of the drug industry.

Such a comprehensive approach is hardly a viable option in Kentucky today. Simply put, our state cannot adequately address this public health crisis. We aren't able to fully fund basic prevention and treatment much less a larger, broader solution. In fact, in August 2004, Lt. Governor Pence's office released the Statewide Drug Control Assessment Summit 2004—Final Report. This report noted that insufficient funding was a problem in prevention, treatment, and enforcement areas. Yet when Governor Fletcher announced the drug plan resulting from the Summit, he noted that "all this will be done with the use of existing funds."

It is estimated that 266,000 Kentuckians abuse drugs, alcohol, or prescription drugs. However, the state's publicly funded regional treatment centers were able to serve only about 10 percent of that number in 2004. At that time, the centers had received no new state funding for 10 years.

According to the Drug Summit Report, the total residential clinical substance abuse treatment capacity in Kentucky amounts to only 1 bed per 152 people in need. Waiting lists at such facilities are so long it often means waiting two to three months for treatment.

Like these public treatment centers, Kentucky's prisons are also unequipped to handle the needs. About 60 percent of state prisoners are chemically dependent, but the Department of Corrections can only provide treatment for about 19 percent of those preparing to leave the system and only 7 percent of those who are being monitored in the community.

Kentucky underfunds these treatment needs despite the fact that they pay off in the long run. According to the Drug Summit Report, for every $1 spend on substance abuse treatment in Kentucky, $4.16 in crime costs are avoided. A study by the University of Kentucky's Center on Drug and Alcohol Research notes that it costs $3,358 to arrest someone on drug trafficking and possession charges, but only $2,395 per client to treat someone for substance abuse.

Kentucky's Drug Court program is also underfunded. This is a model program that uses a team approach of treatment, supervision, and case management as an alternative to incarceration of non-violent drug offenders. Drug Court graduates receive significantly fewer felony and misdemeanor charges and convictions and are less likely to be re-incarcerated or placed on parole or probation.

Drug Courts save the state money. The cost of imprisonment for a non-violent drug offender averages $17,000 while the cost of graduating someone from Drug Court is just $3,000. Since 1996, Drug Courts have saved the state $14.5 million in jail/prison costs. But, there are only 51 drug courts in Kentucky. According to the Drug Court Program, the goal is to have one in every county. That's impossible without additional revenue to cover the expansion costs.

County Jails

Kentucky's growing drug problem has led to a significant increase in the state's prison population. The prison population doubled in the 1980s and nearly did so again in the 1990s. By 2003, more than 17,000 Kentuckians were incarcerated. In 2005, the prison population was projected to peak at 17,424 but instead ballooned to more than 19,000. By 2006, it will likely exceed 20,000.

To deal with the growing prison population, the state contracts with county jails to house inmates. On any given day, county jails hold approximately 6,000 state inmates. But doing so is taking a toll on county budgets.

A study by the Kentucky County Judge/Executive Association notes that in fiscal year 2005, jails cost the counties approximately $200 million. Of this, over $100 million comes out of the counties' general funds.

"That is money that would otherwise be spent to enhance the quality of life of county residents on things that residents have the right to expect and demand from their county governments, such as roads, bridges, parks, water lines, sewers, emergency medical services, and senior centers," noted Bob Arnold, executive director of the Kentucky Association

About 22 percent of all Kentucky inmates serving time for a felony are in for drug-related crimes. In the last decade, the number of inmates entering the system on drug charges increased nearly 300 percent.

of Counties, in an op-ed earlier this year. "In short, with some counties spending more than 50 percent of their total general fund budget on their jails, skyrocketing jail expenses are lowering the quality of life for county residents."

One reason jails are becoming such a strain on county budgets is because state funding for county jail operations has decreased during the last 20 years. Whereas the state pays private prisons as much as about $44 per day to house each inmate, it pays county jails only $30.51 per day. To make matters worse, medical costs must come out of the $30.51 paid to counties and there is no guarantee of an annual increase in the per diem. That is not the case with private prisons which are guaranteed a three percent annual increase and aren't expected to pay medical costs out of their per diem.

Additionally, Vince Lang, Executive Director of the Kentucky County Judge/Executive Association notes that many counties have not gotten an increase in their county jail bed allotment since 1982. Counties are left to fill the budget gap and, because of that, "there's a lot of things that don't get done in the county," notes Lang.

What It Would Take

The Department of Public Advocacy estimates that it will take $10 million to fully fund an adequate public defender system. This level of funding would reduce caseload to no more than 400 cases per lawyer and would allow for a sufficient level of support staff, investigators, and social workers at each of the thirty DPA offices around the state.

For legal aid, Hamon notes that an increase in state funding would allow them to adequately respond to the legal service needs of poor Kentuckians who come to legal aid for help, but are turned away for lack of resources. This means increasing legal aid funding from $1.5 million to $3 million.

"It doesn't seem like a lot of money," says Hamon. "But it would really make a difference and help close the justice gap for low-income Kentuckians."

The Statewide Drug Control Assessment Summit 2004—Final Report noted that funding for treatment alone should be increased at least $15-$20 million. However, in 2001, a state commission found that it would take an additional $25 million for the next ten years to move Kentucky from 44th to 25th in the nation in state mental health and substance abuse funding.

According to Vince Lang of the Kentucky County Judge/Executive Association, county jails are running deficits of around $100 million. That's what the state would have to come up with in order for counties to avoid drawing down their general funds to cover the budget gap in their jails. Some advocates propose moving the county jails into the state justice system, which could cost significantly more.

As a state, we must ensure access to public defenders and legal aid services so that the most vulnerable among us are not denied justice simply because they cannot afford an attorney. We must develop an effective, long-term, and holistic approach to dealing with the drug crisis, and we must address the causes of and the problems associated with an exploding prison population. These are the primary components of a fair, equitable, and effective justice system and should be a priority for our state.

Sources: Department of Public Advocacy; Access to Justice Foundation; *The Courier-Journal*; Kentucky's Office of Drug Control Policy; *Lexington Herald-Leader*; Statewide Drug Control Assessment Summit 2004-Final Report; Kentucky Association of Counties; Kentucky County Judge/Executive Association; Kentucky Commission on Services and Supports for Individuals with Mental Illness, Alcohol and Other Drug Abuse Disorders, and Dual Diagnoses, *Template for Change* report, 2001

HOUSING

"Freedom from want" was one of the four basic freedoms that Franklin Roosevelt framed as our obligation and our civic duty. Yet for many working poor and elderly Kentuckians, safe and affordable housing is increasingly out of reach, leaving many "in want" of this basic human right.

Today in Kentucky, one in four households live in substandard housing, overcrowded conditions, or pay more than 30 percent of their household income for housing. In a year's time, nearly 44,000 Kentuckians experience homelessness. This includes 14,600 children.

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Some 130,000 low-income renters in Kentucky faced excessive housing cost burdens in 2000. In fact, a minimum wage earner must work 79 hours a week to afford the fair market rent of a modest two-bedroom apartment. Otherwise, one must earn $10.23 an hour (or more than $11 an hour in urban areas) to afford the fair market rent. In 2004, a disabled individual receiving SSI benefits ($564 monthly) could afford no more than $169 a month for rent; however, the fair market price on a one-bedroom unit is $438.

Housing assistance exists to help folks bridge the gap between their earnings and what is needed to pay for safe, affordable housing. However, the needs in Kentucky are so large that housing assistance programs have been stretched to the breaking point.

In Louisville alone, approximately 16,000 families are waiting for housing assistance while foreclosures there have increased nearly 400 percent since 1996. Waiting lists for Section 8 housing assistance vouchers in rural Kentucky are so overwhelmed that they are closed to new applicants. One study estimated it would take nearly $84 million to develop affordable housing for all those in need in Perry County alone.

The Kentucky Housing Corporation, which traditionally promotes homeownership and housing, recently went beyond this role to provide $10 million in housing vouchers for individuals and families who are homeless because of domestic violence or mental illness. The Housing Corporation stepped in to provide the vouchers because of the long waiting lists for Section 8 vouchers and because Kentucky's domestic violence shelters are full.

Much of the funding for affordable housing in Kentucky comes from the federal government. Since the 1970s, however, the federal housing budget has shrunk by 48 percent. This has squeezed already-tight state budgets to make up the difference.

The Kentucky Affordable Housing Trust Fund (AHTF) was created to address the unmet housing needs of Kentucky's lowest income families. Created in 1993, it is administered by the Kentucky Housing Corporation and is used to create new affordable housing and rehabilitate existing structures so that other financial assistance is unneeded. It is a long-term approach to Kentucky's increasing shortage of affordable housing and is a wise investment of resources.

Originally, the Affordable Housing Trust Fund was financed with the proceeds from the Kentucky Derby breakfast ($200,000 annually) that were matched by the Kentucky Housing Corporation. In 1998, legislation was passed that gave the Trust Fund any unclaimed lottery prizes in excess of $6 million. This generated about $4 million to $6 million annually, but the legislation was repealed in 2003.

Since 2003, the AHTF has been included in Kentucky's General Fund. Low-income housing advocates must now convince the legislators to include revenue for the Trust Fund each time the state budget is authorized. Current funding is $2.5 million from the state General Fund and $500,000 from the Kentucky Housing Corporation, an effective decrease of 30 percent since 2003.

A minimum wage earner must work 79 hours a week to afford the fair market rent of a modest two-bedroom apartment.

What It Would Take

The Kentucky Affordable Housing Trust Fund has never been adequately funded. Housing groups estimate that AHTF needs at least $10 million to $15 million per year to address the needs for safe and affordable housing throughout the state. Given the other important needs of the state and the "no new tax" climate that permeates the legislature, housing groups in Kentucky are gravely concerned about funding for programs that support that most vulnerable in the state.

Decent housing and strong communities are cornerstones for quality of life and economic well-being. Kentucky must find the resources to guarantee all citizens the right to quality, affordable housing.

Sources: Homeless and Housing Coalition of Kentucky; Urban Studies Institute at the University of Louisville: *Kentucky Housing Needs Assessment: Phase II*; Hazard-Perry County Housing Development Alliance, Inc.; *The Courier-Journal*

TAX EXPENDITURES & ECONOMIC DEVELOPMENT

Tax expenditures are changes to the normal tax structure designed to favor a particular industry, activity, or group of people. They are a change in the tax code that essentially says that a certain group is exempt from a specific tax. As such, tax expenditures result in a loss of revenue that the state would otherwise have to spend on schools, health care, and other programs. There are currently over 200 tax expenditures on the books, and 44 new ones have been enacted since 1988.

In 2004, tax expenditures totaled $6.5 billion compared to a General Fund of just $7.4 billion.

Although some tax expenditures are progressive and should remain intact—such as the exemption of food from the sales tax—as a whole they represent a huge loss of revenue for the state. In 2004, tax expenditures added up to $6.5 billion. That's $6.5 billion that would have otherwise been available for investment in schools, health care, and other important public services. In comparison, the total General Fund in 2004 was just $7.4 billion.

A major flaw in Kentucky's tax expenditures is that they are permanent, on the books indefinitely with mostly no evaluation. Whereas programs funded through the state budget, such as education and health care, are evaluated every budget cycle to determine funding levels, tax expenditures, once enacted, are rarely revisited and repealed. If a particular industry receives a tax break, they continue to get it every year no matter how strapped Kentucky's public schools or other services are for additional funding.

Kentucky's own *Tax Expenditure Analysis Fiscal Year 2004-2006* notes the unfair advantage that tax expenditures have over on-budget programs: "Unlike direct appropriations, which must be continuously reviewed and approved by the General Assembly to remain in effect, tax expenditures are usually not included in this review process. As a result, programs funded through tax expenditures receive priority funding over all other programs. In all probability, many 'tax expenditure' programs would not receive the same priority if they had to compete with 'direct funding' programs."

In the area of economic development in 2004, Kentucky spent approximately $808 million. About 71 percent of this spending—$571 million—was through tax expenditures and subsidies that are not subject to regular scrutiny by the legislature or the public. These breaks remain on the books indefinitely and most are never evaluated for effectiveness.

Rather than invest in small businesses, education, transportation, technology or infrastructure—proven strategies for real economic growth—Kentucky continues to pursue the short-sighted approach of industrial recruitment as its primary economic development strategy. About 80 percent of the $808 million spent on economic development is used on financial subsidies to attract businesses to Kentucky. This approach to job creation has been discredited by major national studies, yet, because there are very few mechanisms in place for evaluating off-budget expenditures like industrial recruitment activities, it remains Kentucky's main method for growing the economy.

The results speak for themselves. Industrial parks sit empty across the Commonwealth. The state continues to lose manufacturing jobs. For 34 years, Kentucky has remained 42nd among states in per capita personal income. The Corporation for Enterprise Development (CFED) gave Kentucky a grade of D in "economic performance," a C in "business vitality," and a D in "development capacity" in its 2004 edition of the *Development Report Card of the States*.

For 34 years, Kentucky has remained 42nd among states in per capita personal income.

The time has come for our decision-makers to lay aside the economic development strategies that have failed us and invest in strategies and public services that nurture Kentucky's business climate. In *Rethinking Growth: How State and Local Taxes and Services Affect Economic Development*, economist Robert Lynch analyzed hundreds of studies that have evaluated the impact of tax cuts and incentives on economic growth. Lynch notes that there is evidence that "increases in taxes, when used to expand the quantity and quality of public services, can promote economic development and employment growth."

Lynch found that investment in infrastructure such as roads can reduce costs for businesses and that investment in public schools and health services can increase worker productivity. He also found that increased investment in public services can increase the rate of small business creation and private employment. Lynch concludes, "Tax increases used to enhance public services can be the best way to spur the economy" and "is one of the most effective strategies to advance the quality of life of citizens."

What It Would Take

An analysis of tax expenditures and economic development spending is included in this report not because they require additional investment, but because they require substantial scrutiny since they, in fact, reduce the resources available for other investments.

Kentuckians and our policy makers must weigh the cost of maintaining the current level of tax expenditures while schools and other public services are squeezed by inadequate revenue. Can the state afford to allow tax expenditures to remain on the books permanently—without evaluation—while on-budget programs must make the case every budget cycle for limited funding?

As a state, we must also evaluate our priorities when it comes to economic development. Are we making good assumptions about what it will take to grow Kentucky's economy? Are we investing in education and infrastructure that can lead to prosperity? Are we finding ways to support home-grown businesses?

"Tax increases used to enhance public services can be the best way to spur the economy" and "is one of the most effective strategies to advance the quality of life of citizens."

--Robert Lynch

These are important questions that the public and Kentucky's decision makers must answer in evaluating the expense—in both real dollars and lost opportunities—of our current tax expenditures and economic development spending.

Sources: Mountain Association for Community Economic Development's *Accounting for Impact: Economic Development Spending in Kentucky*; *Tax Expenditure Analysis Fiscal Year 2004-2006*; Robert Lynch's *Rethinking Growth: How State and Local Taxes and Services Affect Economic Development*

Conclusion: Policy Recommendations

Kentucky must invest more than money to create better health, rising incomes, improved educational achievement, and a better quality of life in Kentucky. Real progress will require visionary leadership and redesign of public programs and policies; stronger commitments on the part of businesses and the private sector; and an active and informed civic culture. None of these factors, however, can be successful without substantial, sustained new investments of public resources. In fact, all totaled, the needs identified in this report amount to $1 - $1.8 billion annually.

Where should new revenue come from? Even after the passage of many changes in 2005, Kentucky lacks the fair and adequate tax system needed to move our state forward. Yet the Governor and nearly 50 lawmakers have signed a pact never to raise taxes, no matter how great the needs are or how big the flaws within the current tax system. Thus some legislators and special interest groups are now eyeing expanded gambling. Kentuckians will need to weigh the social costs of increased gambling—including higher rates of addiction, financial ruin, and crime—against the projected revenue that may be provided by expanded gambling. Either way, Kentucky's tax system will still need fixed and additional revenue will be needed to address Kentucky's needs.

The Kentucky Economic Justice Alliance believes Kentucky can do better. Meaningful tax reform can raise adequate funds to meet the current needs and support long-term investments in Kentucky's future. Kentuckians deserve fair tax reforms that close loopholes, improve health, ask more of those who can most afford to pay, help working poor families, and include the growing sectors of our economy. Below is a set of responsible reforms that should be carefully considered:

- raise the cigarette tax to the national average
- preserve KY's estate tax – which affects only the wealthiest 1 percent
- restore the top corporate tax rate to its 2004 level
- prevent further erosion or rollback of Kentucky's corporate taxes
- establish a state earned income tax credit to assist working poor families
- create progressive income tax brackets that asks more from those most able to pay
- expand the sales tax to include more services—the fastest growing sector of our economy
- increase the coal severance tax, one of the lowest among coal producing states
- gradually restore property tax rates which have fallen from 31.5 to just 13 cents since 1979
- establish a low-income property tax exemption

In addition, KEJA supports several good government initiatives designed to give lawmakers and the public better information and improve decision-making about the state budget and tax system. These reforms include:

- Require re-authorization of tax expenditures over a scheduled period of time. This would enable legislators to consider "off-budget" tax breaks at the same time that difficult choices are being made about Kentucky's direct spending priorities. Such a change would not require repeal of any tax breaks, but it would create an opportunity for appropriate review.

- Develop the capability of and require the Legislative Research Commission to do an analysis of the impact of any proposed tax change on Kentuckians in different income groups. In recent years, this type of analysis has been occasionally done by outside groups, including the Kentucky Economic Justice Alliance. Making it a function of the non-partisan Legislative Research Commission would better insulate the analysis politically and ensure that issues of fairness are always considered in tax decisions.

- Produce a "current services projection" each year a budget is passed. This analysis projects what it would cost to pay for the same level of services in each of the next five years. The forecast would provide legislators with an objective estimate of the state's budget needs in future years and create a benchmark against which Kentuckians could measure how well we are actually funding important programs and services.

Finally, the Kentucky Economic Justice Alliance calls on state policy-makers to make additional investments in critical areas of state government, including Medicaid and the Affordable Housing Trust Fund in 2006. These are among the essential public services that make Kentucky a good place to live, work and do business.

These policy recommendations are a starting point for moving toward the vision that we all share for a better future for our state. Kentuckians deserve great schools, quality healthcare, good jobs, and strong support systems. These are not just pipedreams. Our vision can become reality if we make public investment a priority. Starting today, Kentucky can and must do better.

KEJA seeks progressive tax reform that

- **Is fair.**
- **Raises adequate revenue to invest in Kentucky's future.**
- **Promotes the health and well-being of Kentuckians.**