

FISCAL POLICY

The fiscal policy committee supports state income and expenditure practices that promote long-term economic growth in Kentucky. Tax policy, the state budget and government efficiency are among the focuses of the committee.



COMMITTEE CHAIR

Dan Bork, Vice President – Tax, Lexmark International, Lexington

Maximize competitive potential in the global marketplace

The Kentucky Chamber of Commerce believes that promoting long-term economic development and job growth should be a top consideration when state revenue policies are adopted. Tax policies must be guided by a well-researched, balanced approach that provides for necessary public investments and expenditures while avoiding policies that could serve as disincentives to private-sector employment and investment.

In short, Kentucky should seek to maximize its competitive potential in the global marketplace. Taxes levied on the business community should, at a minimum, incorporate the principles of fairness, competitiveness and simplicity and avoid double taxation or pyramiding.

Taxpayers deserve a culture of accountability within state government to ensure the expenditure of public funds is administered as efficiently and effectively as possible. The Kentucky Chamber believes effective, efficient operation of state government is necessary to maintain an attractive business climate. Sound fiscal management, including measurable performance standards, fiscally responsible personnel policies and a streamlined, responsive structure must be components of efficient public operations.

Prioritize Government Spending

In the past 20 years, Kentucky's General Fund appropriations have increased almost three-fold—from \$6.5 billion in FY 1986-88 to \$18.5 billion in FY 2008-10.

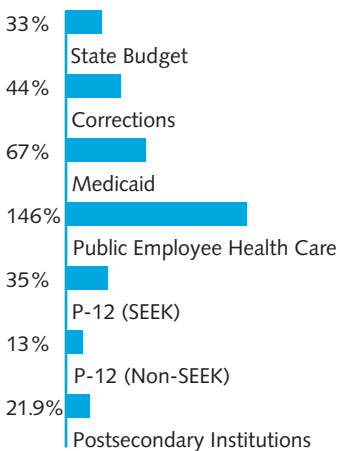
Despite the fact that tax revenue is growing with our economy, our state's spending priorities are shifting. Over the past 20 years, the share of the General Fund dedicated to K-12 and postsecondary education has been declining while significant spending growth has occurred in Medicaid, corrections and public employee benefit costs. Medicaid's share of the General Fund has doubled in the past 20 years, from 6.5% in FY 1986-88 to over 13% in the current fiscal year. Corrections spending has skyrocketed; in FY 1987-88, the total Corrections budget was \$115.7 million. By



Kentucky's business climate ranks 20th best when compared to other states; however, Kentucky's corporate tax ranking is 42nd and the unemployment insurance ranking is 36th according to the Tax Foundation.



CHANGING PRIORITIES



2000-2010 Spending Growth

Medicaid's share of the General Fund has doubled in the past 20 years, from 6.5% in FY 1986-88 to over 13% in the current fiscal year.

FY 2010, it had almost quadrupled to \$464.8 million. Public employee benefit costs are up 146% over the last decade.

Consideration of new or increased taxes or fees should occur only after exhausting all reasonable opportunities to reduce spending and increase efficiency. Streamlining services, consolidating departments, eliminating ineffective programs, initiating responsible personnel compensation and benefit policies and other efforts to maximize the performance of public funds are examples of such fiscally responsible public operations.

The Kentucky Chamber believes achieving a fiscally responsible state budget that promotes economic development will require a significant review of current spending trends and a shift in funding to our priorities of education and economic development. If not, we will continue to bear the high costs through unsustainable increases to treat poverty, crime and poor health. Programs that contribute to unsustainable growth in General Fund obligations should not be permitted to unduly consume tax dollars that could otherwise be invested in basic public priorities such as education and economic development.

Sustainable Public Employee Benefits

As public retirement and health care costs escalate, they are draining money away from such vital programs as education, and their continued increases put essential services at risk at both the state and local levels. State

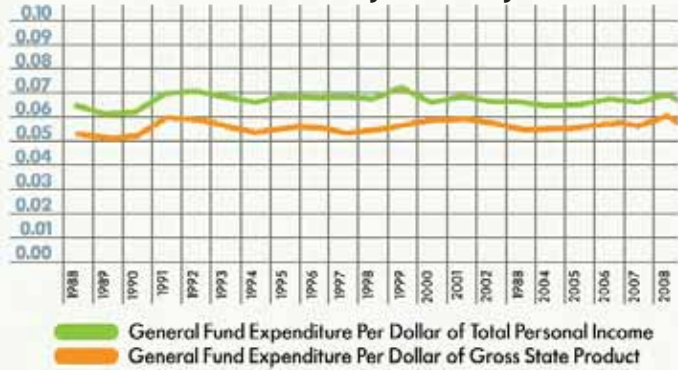
government now pays more than \$1.2 billion a year for health insurance for public employees, and these costs have been growing at a higher rate than inflation. K-12 funding, especially any new money, is being consumed by the cost of teacher salaries, health insurance and retirement costs.

As the General Assembly works to meet its obligations to public employees, it will become clear that additional changes to health and retirement benefits will be needed. Additional meaningful reform must take into consideration issues that private employers have addressed, including changes to eligibility requirements, pension benefits and health care benefits.

Eliminate the Inventory Tax

Personal property taxes on small business inventory are a disincentive to business growth because they tax the investment itself rather than the outcome or profit from that investment. Additionally, some types of inventory are exempt by law or enjoy exemption because of location, while other similar business inventory does not receive the same treatment. While taxing products as they are sold is a widely accepted form of state revenue generation, taxing products in inventory because they have yet to be sold is simply counterproductive, especially when unequal tax treatment exists. To bring Kentucky into alignment with most other states, the Kentucky Chamber supports repealing or phasing out the remaining property tax on business inventory.

State Government Budget as a Share of the Kentucky Economy



Competitive Business Taxes

The Kentucky General Assembly has made great strides in the last few years to improve the overall tax code in the Commonwealth, particularly making business taxes more competitive.

small business

The Chamber supports continued efforts to closely monitor the impact of Kentucky's tax code on business and industry and to take action when necessary to ensure Kentucky remains competitive with our surrounding states. Specifically, the Chamber is concerned about the effects of the Limited Liability Entity Tax (LLET) and the lack of ability to offset pass-through credits against taxes on income from other businesses and other years. The Chamber is also concerned about the impact on economic development due to the trend in other states to move to a single sales factor apportionment formula – 10 states have adopted this in the past five years. The Chamber supports additional efforts to adjust our tax code to encourage economic development and entrepreneurial investment in Kentucky.

Sustainable Debt Levels

The future of Kentucky's finances depends in large measure on its ability to manage debt in a way that is disciplined and effective. Borrowing for long-term capital projects of broadly recognized economic and social value is an appropriate use of public debt. However, debt must be limited to a level that is sustainable and does not adversely impact the overall credit rating of the Commonwealth.

In recent years, Kentucky has turned increasingly to issuing bonds to sustain the growth in government spending. Total state and local debt in Kentucky measures more than \$7,770 for each of the state's 4.2 million people. This is more than \$400 above the national average and places Kentucky 14th in government debt per capita. The Chamber believes the level of state debt should be closely monitored. Projects that have a related revenue stream or can create budgetary savings should receive priority consideration, and every project considered for financing should have a defined, supportable plan for repaying the debt service.

Education's share of General Fund appropriations has been declining over the last 20 years, from a high of 48.2% in FY 1986-88 to 43.8% in the current fiscal year.