



PUTTING STATE PENSION COSTS IN CONTEXT: KENTUCKY

2015 Normal Cost of Kentucky Public Employee Pensions:	\$400,000,000
2015 Cost of Kentucky Subsidies and Corporate Tax Breaks:	\$580,337,986
Percentage of Pension Costs to Subsidy Costs:	68.9%

With the most poorly funded state pension in the nation, Kentucky’s pension finance continues to be a hot topic for state legislators.¹ The state has diverted funding that actuaries have said was necessary to provide for future pension commitments to tax cuts and other uses.

While many pension numbers are circulated in public discussion, the central issue is how much of an obligation is being taken on each year to provide benefits for current government employees such as teachers and first responders. The best way to measure this is to use an amount known as employer normal cost. Such costs can be found in the annual financial reports that each public pension plan has to produce. In the case of Kentucky the main plans administered by the state are the Kentucky Retirement Systems (KRS) and the Kentucky Teachers Retirement System (TRS). KRS covers both state and local government employees. The most recent financial reports indicate annual employer normal costs for state employees of \$198.7 million for KRS² and \$201.3 million for TRS³. The total is \$400 million.

How should this amount be viewed? One approach is to compare it to the financial costs incurred by the state in supporting business through economic development subsidies and other special tax provisions. While not providing an assessment of the effectiveness of any particular subsidy or provision, this approach does provide an important perspective on public sector pensions.

While Kentuckians face dramatic shortfalls in funding of state pensions, the state also gives hundreds of millions of dollars a year in subsidies and tax breaks to corporations.

The state’s biggest subsidy is a \$67.7 million sales tax exemption for Machinery for New and Expanded Industry and Certain Industrial Machinery and for Coal Used in the Manufacture of Electricity. The latter cost the state \$55 million in 2015. The Film Industry Tax Credit cost \$1.4 million in 2015.

Kentucky’s Job Development Credits cost the state \$51.8 million in 2015.⁴ The Blue Grass State Skills Corporation Grant-in-Aid Program cost \$4.7 million. Four legacy economic development programs that are winding down (Kentucky Rural Economic Development Act, Kentucky Industrial Development Act, Kentucky Jobs Development Act and the Kentucky Industrial Revitalization Act) cost the state a total of \$20.8 million in 2015.

Through its Foreign Trade Zone program, Kentucky subsidized foreign manufacturers with \$21.2 million in property tax abatements last year.

Kentucky is one of the states that allow corporations to apportion their taxable income by methods other than the traditional three-factor (payroll, property and sales) weighting. Its corporate tax system allows multi-state businesses to double-weight sales. The Kentucky tax expenditure report does not contain an estimate of the revenue impact of double sales factor apportionment.

An archaic tax rule that allows retailers to keep a portion of the sales tax revenues they collect from customers (the “vendor discount”) cost about \$31.4 million in 2015.

Another major form of corporate tax avoidance that eats into state revenues is the use of offshore tax havens. In November 2016, the U.S. PIRG Education Fund published a report in which it calculated the impact on this practice on each state. For Kentucky, the estimated cost is \$284.3 million.⁵

The total of these corporate subsidies, official tax breaks and unofficial tax dodging amounts to about \$580 million per year, as summarized in the following table.

Sales Tax Exemption for Machinery for New and Expanded Industry	\$67,700,000
Sales Tax Exemption for Coal Used to Produce Electricity	\$55,000,000
Job Development Credits	\$51,800,000
Kentucky Enterprise Initiative Act	\$22,300,000
Foreign Trade Zone (property tax reduction)	\$21,200,000
4 Legacy programs absorbed by Kentucky Business Incentive Program	\$20,800,000
Double-Weighted sales factor	unknown
Bluegrass State Skills Corporation Grant-in-Aid Program	\$4,723,016
Film Industry Tax Credit	\$1,400,000
Tax Increment Financing	\$19,700,000
Vendor Discounts	\$31,400,000
Revenue loss from corporate use of offshore tax havens	\$284,314,970
TOTAL	\$580,337,986

The annual taxpayer cost of funding the retirement benefits of current Kentucky public employees belonging to the Kentucky Retirement Systems equals 69 percent of the cost to the state of economic development subsidies and corporate tax breaks and loopholes.

NOTES

¹ "U.S. State Pensions: Weak Market Returns will Contribute to Rise in Expense," S&P Global Market Intelligence, Global Credit Portal, September 12, 2016

https://www.globalcreditportal.com/ratingsdirect/renderArticle.do?articleId=1708443&SctArtId=400468&from=CM&nsI_code=LIME&sourceObjectId=9778524&sourceRevId=1&fee_ind=N&exp_date=20260912-20%3A30%3A04

² Derived by multiplying the employer normal cost rate for the five sub-portfolios within the pension plan found on page 154-155 of the 2016 Kentucky Retirement System CAFR

[https://kyret.ky.gov/Publications/Books/2016%20CAFR%20\(Comprehensive%20Annual%20Financial%20Report\).pdf](https://kyret.ky.gov/Publications/Books/2016%20CAFR%20(Comprehensive%20Annual%20Financial%20Report).pdf) by the covered payroll for each of the five sub-portfolios found on page 62.

³ Using the employer normal cost rate (pp 96-97) of the 2016 Kentucky Teacher Retirement System FY 2016 CAFR

<https://trs.ky.gov/wp-content/uploads/2016/12/2016.CAFR-FINAL.pdf>

⁴ Subsidy figures throughout this report come from the Commonwealth of Kentucky's Tax Expenditure Analysis FY2014-16. Report cites figures for 2015.

<http://osbd.ky.gov/Publications/Documents/Special%20Reports/Tax%20Expenditure%20Analysis%20Fiscal%20Years%202014-2016.pdf>

⁵ U.S. PIRG Education Fund, *Picking Up the Tab: Small Businesses Bear the Burden for Offshore Tax Havens*: (November 2016); <http://www.uspirg.org/sites/pirg/files/reports/USP%20PickTab%20Nov16%201.0.pdf>

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