

HORIZON

trends and issues to watch, ideas and innovations to use

Faltering economy hits state budgets

Budget shortfalls for half of the nation's state governments are expected this year, the highest number since 2002, *The New York Times* reports.¹ The 2001 recession forced 37 states to cut spending. Now many states face weakening tax revenues due to a troubled housing market and a looming national recession. California, Arizona, and Florida, for example, have seen stark declines in tax revenues after housing market crashes. With no income tax, Florida relies heavily on revenue from its sales tax, which has declined for two straight fiscal years. As for next fiscal year, a report from the National Conference of State Legislators finds that legislative fiscal directors from three-fourths of the states are either "concerned" or "pessimistic" about the FY 2009 general fund revenue outlook. The budget outlook for the other 13 states is either "optimistic" or "stable." Kentucky falls in the "concerned" category.²

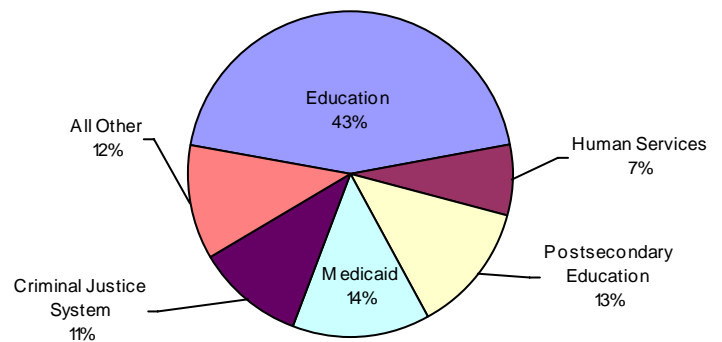
When fiscal pressures mount, states have typically cut spending rather than raise new revenue. Education, often the largest item in a state's budget, is a frequent target. Eight states have cut higher education budgets and nine are cutting primary and secondary education. Dwindling revenue and rising costs have led nine states to trim their Medicaid programs.

Potential Implications for Kentucky: With state agencies preparing for another round of budget reductions before the next fiscal year, the revenue outlook remains bleak for the short- to mid-term, while the long-term outlook appears uncertain at best. Now policymakers must anticipate the consequences of sustained cuts in state services, particularly health care and education, which exert broad influence on the state's economy. Collectively, these program areas account for about 70 percent of Kentucky's general fund appropriations.

Coal demand, cost spikes

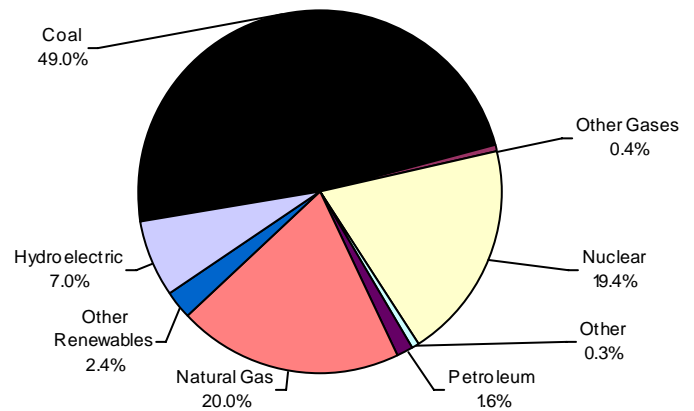
Once relatively inexpensive and plentiful, coal fuels half the nation's electricity.³ Around 90 percent of U.S. coal production is used to generate electrical power, a number that has been steadily increasing since the late 1940s.⁴ However, environmental concerns over greenhouse gas emissions and the subsequent loss of federal financing have forced some American utilities to abandon plans for coal-burning power plants.⁵ The Agriculture Department's Rural Utilities Service has suspended a low-interest lending program for rural electric cooperatives seeking to build such plants, according to *The Washington Post*.⁶ Meanwhile, *The New York Times* reports that we have become a major exporter of coal to countries like Germany and Japan.⁷ Consequently, domestic buyers now must compete with foreign buyers, causing prices to rise. Prices for two American grades of coal rose by 93 percent and

Distribution of Kentucky's General Fund Appropriations, 2008-2010 Biennium



Source: 2008-2010 Executive Branch Budget, Office of State Budget Director

U.S. Electric Power Industry Net Generation by Fuel Source, 2006



Source: Energy Information Administration, *Electric Power Annual 2006*, Table ES1

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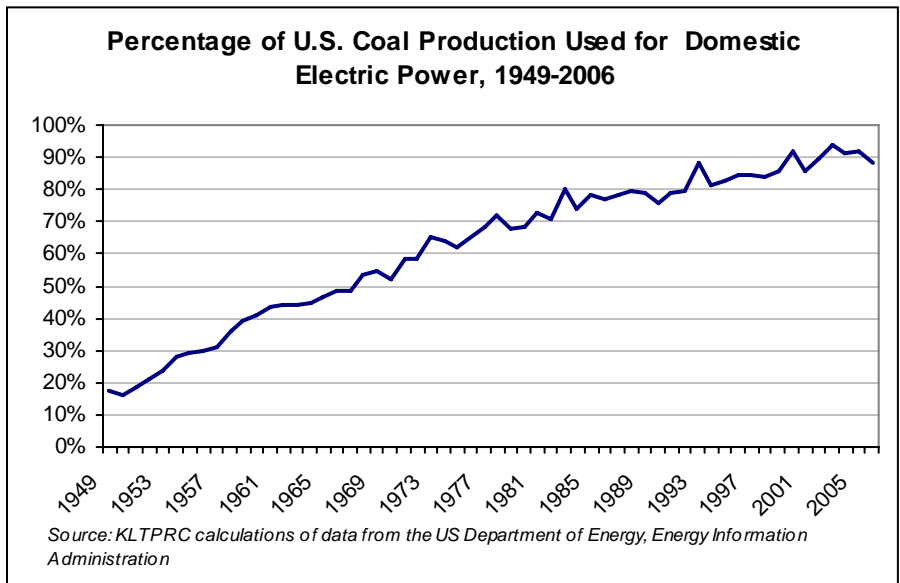
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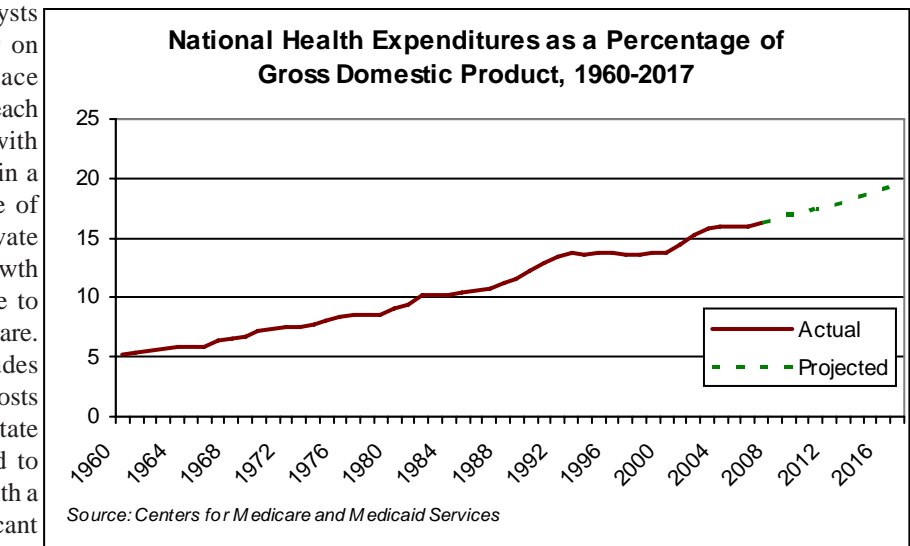
64 percent in the last year alone. Because American utility companies buy almost all their coal on long-term contracts, locking in prices for several years, most consumers have yet to feel the impact of rising coal costs. But when those contracts come up for renewal, they will likely incorporate price increases, and consumers can expect higher utility bills.

Potential Implications for Kentucky: As the demand for and cost of coal rises, utility prices may adversely affect business and industry profits and household budgets. Rising demand for coal may also create more coalfield jobs, giving rural economies a much-needed boost. This short-term boon, however, comes with long-term consequences, from local concerns about mine safety and mountaintop removal to the global threat of a warming planet.



Health care spending predicted to reach \$4.3 trillion by 2017

Over the next decade, U.S. health care spending is expected to reach \$4.3 trillion, double the \$2.1 trillion record of 2006, according to *Health Affairs*.⁸ Federal analysts project that health spending could consume as much as 19.5 percent of the nation's gross domestic product (GDP). Analysts anticipate that health care spending will grow on average 6.7 percent through 2017 and outpace economic growth by about 1.9 percentage points each year. Steady health spending growth, coupled with lower economic growth, is estimated to result in a gradual increase in health spending as a share of GDP. A probable slowdown in growth in private spending will likely be offset by accelerating growth in public-sector spending, partially attributable to the anticipated baby-boomer enrollment in Medicare.



A *Kaiser Daily Health Policy Report* concludes that fiscal pressures from increasing health care costs could contribute to severe budget shortfalls for state governments.⁹ Medicaid spending is estimated to increase by 7.3 percent in FY 2007, compared with a growth rate of 1.7 percent in FY 2006. A significant contributing factor for the increase stems from the

provision of prescription drug benefits to those whose low incomes make them dually eligible for Medicare and Medicaid. Under the federal Medicare prescription drug benefit, dual-eligibles now receive their drug benefits through Medicare. However, states finance these benefits through payments to the federal Medicare Trust Fund, which are projected to rise to about 5 percent of state Medicaid expenditures.

Potential Implications for Kentucky: Kentucky, like many other states, faces the likely potential of sharp health care spending hikes, stemming from retiree benefits to expanded Medicaid populations. The costs threaten to crowd out other vital priorities such as education. Kentucky's disproportionately poor elder population relies heavily on Medicaid; 24 percent of the state's 2003 Medicare enrollees were eligible for Medicaid based on their incomes. Prescription drug spending here exceeded the national average, 19 percent compared with 14 percent, respectively.¹⁰ As these costs exert growing pressure on state budgets, the call for solutions that move beyond shifting them to already strapped state budgets will likely mount.

Sources

¹ Jennifer Steinhauer, "As the Economy Falters, So Do State Budgets," *The New York Times* 17 March 2008; ² National Conference of State Legislatures, *State Budget Update*, <http://www.ncsl.org/programs/press/2008/pr042508StateBudgetReport.htm>; ³ U.S. Department of Energy (DOE), Energy Information Administration, *Electric Power Annual 2006*, Nov. 2007; ⁴ DOE; ⁵ Associated Press, "'Clean coal' plant loses funding," *Los Angeles Times*, 29 January 2008; ⁶ Steven Mufson, "Government Suspends Lending for Coal Plants," *washingtonpost.com*, 13 March 2008; ⁷ Clifford Krauss, "An Export in Solid Supply," *The New York Times* 19 March 2008; ⁸ Press Release, "Health Care Spending Expected to Double By 2018, Reaching \$4.3 Trillion And Consuming Nearly One-Fifth Of The Economy, Federal Report Says," *Health Affairs*, 26 February 2008; ⁹ Kaiser Family Foundation, "Rising Health Care Costs Threaten States' Economic Outlook, Report Says," *Kaiser Daily Health Policy Report*, December 6, 2007; ¹⁰ Kaiser Family Foundation, "Kentucky: Medicare" *statehealthfacts.org* 20 May 2008.