



PUTTING PENSION COST IN CONTEXT: KENTUCKY

This brief on Kentucky is part of a series of state reports that compare pension obligation to subsidy spending for FY 2018.

The measure chosen for pension obligation is the employer normal cost, which is the portion of the total normal cost (i.e. present value of future benefits allocated to a particular fiscal year) that is attributable to employers. The employer normal cost is obtained from annual financial statements and actuarial valuation reports – either extracted directly or calculated by: 1) multiplying covered payroll by the employer normal rate; or 2) subtracting the employee share from the total normal cost; or 3) subtracting legacy costs (i.e. annual payment needed to amortize the unfunded actuarial accrued liabilities) from actuarially determined employer contribution.

The cost of economic development incentive programs was obtained from annual reports from economic development agencies, state tax expenditure reports, and GASB Statement No. 77 Tax Abatement Disclosures in annual financial reports. We also consider corporate tax dodging via offshore tax havens as reported by U.S. PIRG in 2016 (latest available data and likely a good approximation for 2018 data).

2018 Kentucky Public Employee Pension Obligations	\$588,166,776
2018 Cost of Kentucky Subsidies and Corporate Tax Breaks	\$618,309,219

Kentucky administers public pensions through Kentucky Retirement Systems (KRS), Kentucky Teachers Retirement System (TRS, which includes university employees), and either a defined benefit or hybrid cash balance plan for judges and magistrates. In 2018, these pension obligations for the state totaled \$588.2 million. For many years, the state has underpaid into the system, resulting in enormous unfunded liabilities.

Kentucky's pensions are underfunded in no small part because the Bluegrass State has long been a big spender on economic development subsidies; indeed, it spends more than \$600 million per year on 28 incentive programs administered by a slew of different departments and agencies. The Kentucky Economic Development Finance Authority administers the Direct Loan Program and the Small Business Loan Program and three tax-based programs under the Kentucky Small Business Credit Initiative. Bluegrass State Skills Corporation administers two job training

programs which provide tax credits, loans, and reimbursements to employers. Business investment, industrial development, tax increment financing, film production, energy, high-tech, and so on – there is hardly any kind of corporate activity that the state has not subsidized.

According to the state’s 2018 Comprehensive Annual Financial Report, a number of tax abatement programs reduced Kentucky’s sales and use tax revenue by \$28 million, property tax by about \$1 million, and income tax by \$139 million. The three costliest programs disclosed elsewhere are the Kentucky Rural Economic Development Act, Kentucky Business Investment, and Tax Increment Financing – each costing over \$20 million. Currently, at least for the programs reported under GASB Statement No. 77 on tax abatement disclosures [2], there are no provisions for recapturing any of the abated taxes, which means that firms that fail to honor the agreements (to produce new jobs or make new investment, for example) do not have to pay back their awards. Corporate tax dodging via offshore tax havens costs Kentucky an additional \$284 million a year. As very few local governments complied with GASB Statement No. 77, it is unknown how local programs affect state revenues.

Subsidy Program Costs

Economic Development Subsidies and Corporate Tax Breaks	Subsidy Amount
Bluegrass State Skills Corporation Skills Training Investment Tax Credit [3]	\$2,500,000
Bluegrass State Skills Corporation Training Grant-in-Aid [3]	\$ 8,890,021
Kentucky Business Investment Program [2]	\$25,057,000
Kentucky Enterprise Initiative Act [4]	\$18,000,875
Kentucky Reinvestment Act [2]	\$5,953,000
Kentucky Small Business Credit Initiative [5]	\$14,050,354
Kentucky Rural Economic Development Act [2]	\$21,122,000
Kentucky Industrial Development Act [2]	\$10,113,000
Kentucky Industrial Revitalization Act [2]	\$5,359,000
Kentucky Jobs Development Act [2]	\$6,729,000
Kentucky Tourism Development Act [2]	\$6,042,000
Kentucky Angel Investment Tax Credit [6]	\$2,997,936
Incentives undisclosed due to confidentiality [2]	\$60,211,000
Incentives undisclosed due to reporting threshold* [2]	\$4,502,064
Tax Increment Financing [2]	\$28,067,000
Tax Exemption for Machinery for New and Expanded Industries [7]	\$74,000,000
Foreign Trade Zone [7]	\$29,000,000
Single Sales Factor Apportionment [8]	\$11,400,000
Corporate tax dodging via offshore havens [9]	\$284,314,969
TOTAL	\$618,309,219

* Because GASB 77 does not require reporting for programs under \$5 million, Kentucky CAFR reported these as an aggregate. However, the costs of some of the aggregated programs can be found in other documents. We have subtracted those values from the original aggregated sum reported under GASB Statement 77 and listed them separately in the table. The remaining programs within the aggregated total are: Kentucky Economic Opportunity Zone; Kentucky Historic Preservation; Incentives for Energy Independence Act; Local Issued Industrial Revenue Bonds; Kentucky Film Industry Tax Credit; and Kentucky Investment Fund Act.

Source Documents

(Accessed December 18, 2019)

- [1] State of Kentucky. 2016. "Teachers' Retirement System of the State of Kentucky Report of the Actuary on the Annual Valuation as of December 31, 2016." <https://trs.ky.gov/wp-content/uploads/2016/11/2016-TRS-Report-FINAL.pdf>
- [2] Commonwealth of Kentucky. 2018. "Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2018." <https://finance.ky.gov/Office%20of%20the%20Controller/ControllerDocuments/2018%20CAFR.pdf>
- [3] Think Kentucky Cabinet for Economic Development. 2018. "Bluegrass State Skills Corporation 2018 Annual Report." https://thinkkentucky.com/kyedc/pdfs/Annual_Reports/2018_BSSC_Annual_Report.pdf?85
- [4] Think Kentucky Cabinet for Economic Development. 2018. "Kentucky Enterprise Initiative Act 2018 Annual Report." https://thinkkentucky.com/kyedc/pdfs/Annual_Reports/2018_KEIA_Annual_Report.pdf?41
- [5] Think Kentucky Cabinet for Economic Development. 2018. "Kentucky Small Business Credit Initiative 2018 Annual Report." https://thinkkentucky.com/kyedc/pdfs/Annual_Reports/2018_KSBCI_Annual_Report.pdf?85
- [6] Think Kentucky Cabinet for Economic Development. 2018. "Kentucky Angel Investment Tax Credit 2018 Annual Report." https://thinkkentucky.com/kyedc/pdfs/Annual_Reports/2018_KY_Angel_Investment_Annual_Report.pdf?85
- [7] Kentucky Office of State Budget Director. 2018. "Commonwealth of Kentucky Tax Expenditure Analysis Fiscal Years 2018-2020." <https://osbd.ky.gov/Publications/Documents/Special%20Reports/Tax%20Expenditure%20Analysis%20Fiscal%20Years%202018-2020.pdf>
- [8] Kentucky Office of the State Budget Director. 2018. "CFG Interim Session: An Update on Tax Reform and FY18 Final Revenue." <https://apps.legislature.ky.gov/CommitteeDocuments/209/11443/Jul%2019%202018%20CFG%20OSBD%20PowerPoint.pdf>
- [9] U.S. PIRG Education Fund. 2016. "Picking up the Tab 2016: Small Businesses Bear the Burden for Offshore Tax Havens." <https://uspirg.org/sites/pirg/files/reports/USP%20PickTab%20Nov16%201.0.pdf>