ISSUES CONFRONTING THE 1990 GENERAL ASSEMBLY

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Informational Bulletin No. 166

LEGISLATIVE RESEARCH COMMISSION

Frankfort, Kentucky

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* * * * *

The Kentucky Legislative Research Commission is a sixteen member committee, comprised of the majority and minority leadership of the Kentucky Senate and House of Representatives. Under Chapter 7 of the Kentucky Revised Statutes, the Commission constitutes the administrative office for the Kentucky General Assembly. Its director serves as chief administrative officer of the Legislature when it is not in session.

The Commission and its staff, by law and by practice, perform numerous fact-finding and service functions for members of the General Assembly. The Commission provides professional, clerical and other employees required by legislators when the General Assembly is in session and during the interim period between sessions. These employees, in turn, assist committees and individual members in preparing legislation. Other services include conducting studies and investigations, organizing and staffing committee meetings and public hearings, maintaining official legislative records and other reference materials, furnishing information about the Legislature to the public, compiling and publishing administrative regulations, administering a legislative intern program, conducting a pre-session orientation conference for legislators, and publishing a daily index of legislative activity during sessions of the General Assembly.

The Commission is also responsible for statute revision, publication and distribution of the *Acts* and *Journals* following sessions of the General Assembly and for maintaining furnishings, equipment and supplies for the Legislature.

The Commission functions as Kentucky's Commission on Interstate Cooperation in carrying out the program of the Council of State Governments as it relates to Kentucky.

ISSUES CONFRONTING THE 1990 GENERAL ASSEMBLY

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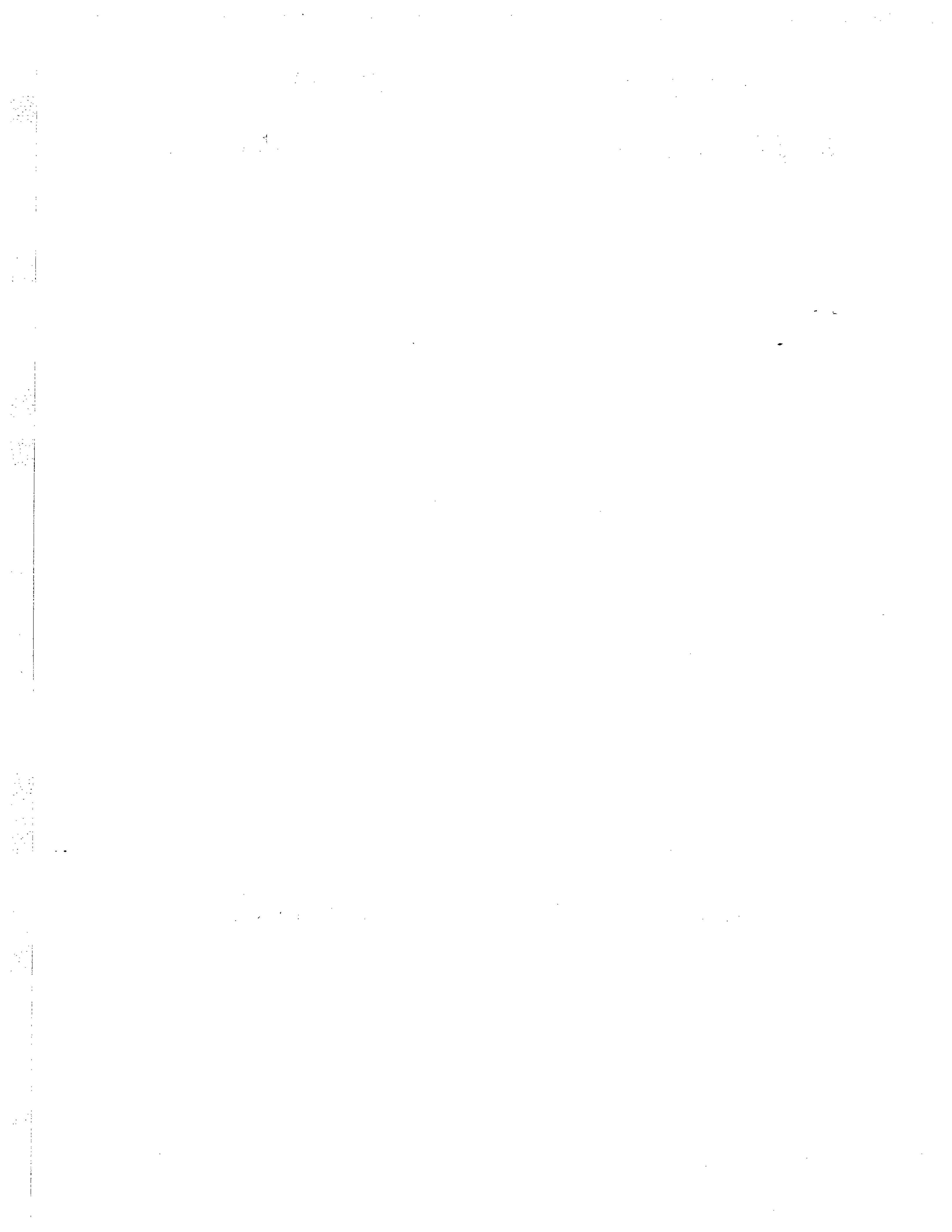


FOREWORD

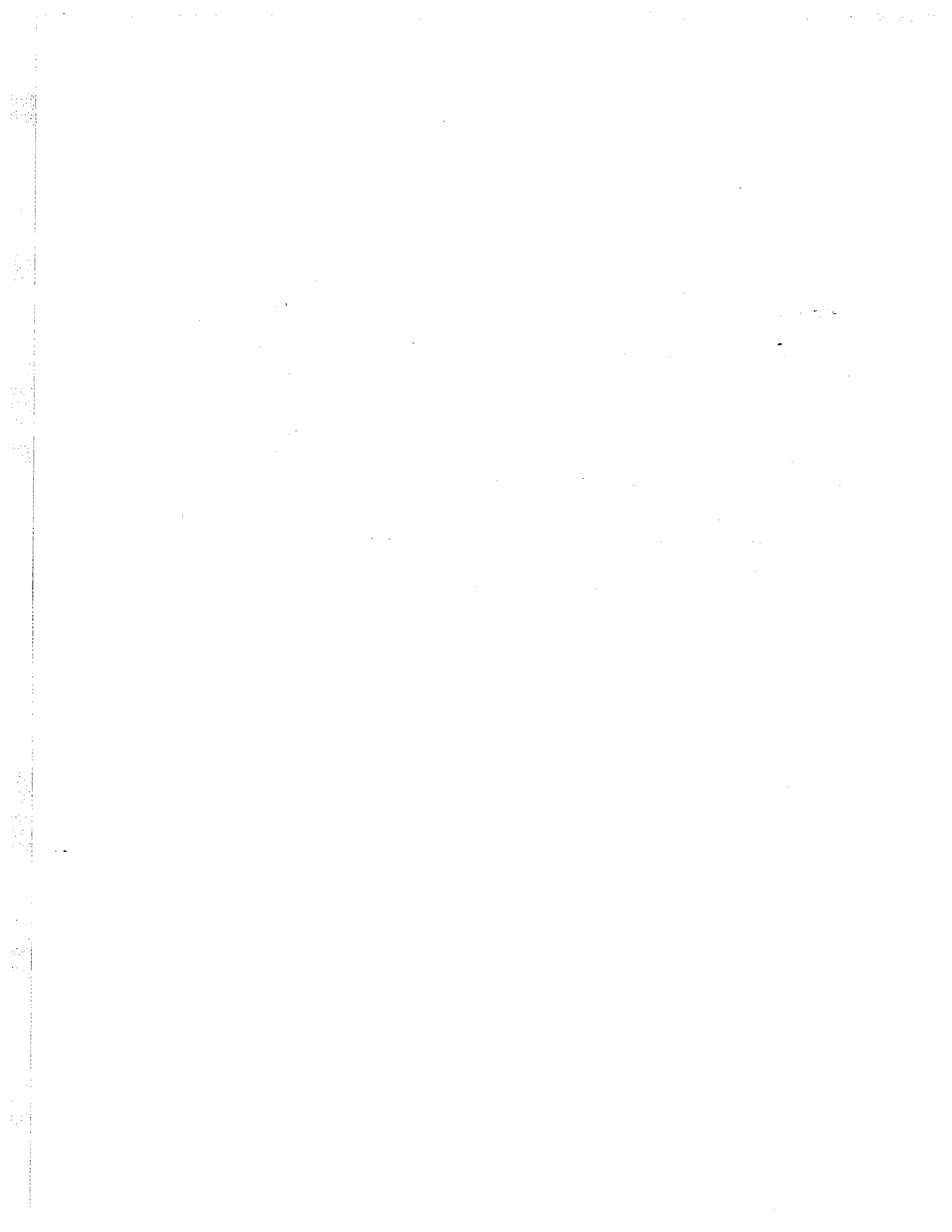
This collection of briefs, prepared by members of the Legislative Research Commission staff, attempts to bring into sharper focus some of the major issues which have received considerable legislative attention during the interim. The reports by no means exhaust the list of important issues facing the 1990 Legislature. At the same time the alterntives and comments suggested are neither exclusive nor exhaustive.

Effort has been made to present these issues objectively, unemotionally, and in as concise a form as the complexity of the subject matter allows. They are grouped for the convenience of the reader into the various committee jurisdictions and no particular meaning is placed upon the order in which they are presented.

Staff members who prepared the reports were selected on the basis of their knowledge of the subject matter and their work with the issues during the 1988-89 interim. Most of the staff has worked closely with the interim legislative committees which studied the issues and helped draft some of the proposed legislation.

Vic Hellard Jr.
Director

Frankfort, Kentucky
October, 1989



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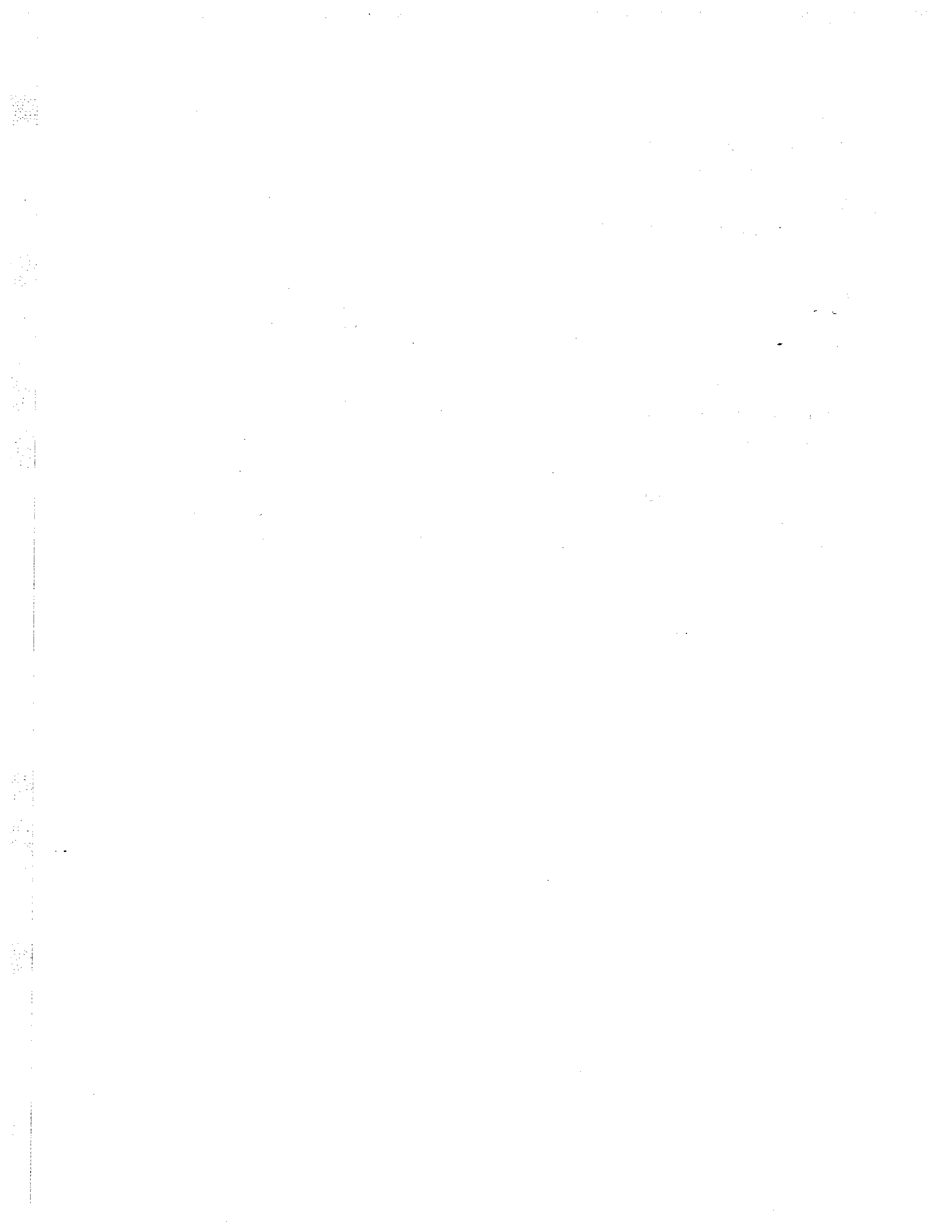

ADMINISTRATIVE REGULATIONS REVIEW SUBCOMMITTEE

ADMINISTRATIVE REGULATIONS

Prepared by Gregory Karambellas and Joseph Hood

Issue

Should KRS Chapter 13A, governing the review of administrative regulations by legislative committees, be amended?

Background

At its 1988 Regular Session, the General Assembly amended KRS Chapter 13A to provide for review of administrative regulations by interim joint committees after initial review by the Administrative Regulation Review Subcommittee.

The 1988 amendments to KRS Chapter 13A provide that an administrative regulation to which an objection has been made by a legislative committee shall expire unless it is enacted into statute at the Regular Session following such objection.

The 1988 amendments also establish detailed drafting and filing rules.

Discussion

Questions have been raised over the interpretation of the two-committee review procedure, the sunsetting of administrative regulations, and the detailed drafting and format requirements of KRS Chapter 13A.

The current version of KRS Chapter 13A is the result of separate enactments during the 1988 Regular Session. Because of the different terms employed in the separate enactments, it is unclear whether certain requirements apply only to the review conducted by the Administrative Regulation Review Subcommittee, or also include the second review conducted by other legislative committees.

KRS Chapter 13A may need to be amended to clarify terminology.

The extent of the authority granted legislative committees is unclear. During the Interim, the Administrative Regulation Review Subcommittee and the Legislative Research Commission have interpreted KRS Chapter 13A to require the:

(1) Approval of a legislative committee for the amendment of an administrative regulation at the committee meeting during which the regulation is reviewed;

(2) Exemption from the sunset requirements of KRS Chapter 13A if an administrative regulation, to which the Administrative Regulation Review Subcommittee has objected, is amended at the second hearing conducted by a legislative committee to remove the language that caused the objection;

(3) Exemption from the sunset requirements of KRS Chapter 13A if an administrative regulation, to which the Administrative Regulation Review Subcommittee has objected, is

(a) refiled with LRC with an amendment removing the language that caused the objection; and,

(b) if no other objection is raised at either the Subcommittee or Interim Joint Committee meeting considering the refiled regulation;

(4) Exemption from the sunset requirements of KRS Chapter 13A if an administrative regulation, to which an Interim Joint Committee has objected, is

(a) refiled with LRC with an amendment removing the language that caused the objection; and,

(b) if no other objection is raised at either the Subcommittee or Interim Joint Committee meeting considering the refiled regulation; and,

(5) Rejection of an amendment offered by an agency at the hearing conducted by an interim joint committee, if the subject matter of the proposed amendment was not part of an amendment or objection made at the Subcommittee meeting at which the regulation was considered.

While these interpretations will become part of administrative regulations promulgated by LRC, KRS Chapter 13A may need to be amended to incorporate these items to comply with the intent of KRS Chapter 13A to reduce the number of regulations.

In addition, administrative bodies have objected to certain drafting requirements, such as the requirement that definitions of terms appear in each administrative regulation in which they are employed. The Subcommittee has agreed with this objection.

KRS Chapter 13A may need to be amended to permit definitions to appear only in the first regulation of a chapter of the Kentucky Administrative Regulations.

AGRICULTURE AND NATURAL RESOURCES

DEPARTMENT FOR ENVIRONMENTAL PROTECTION PERMIT FEES

Prepared by Daniel J. Risch

Issue

Should the permit fees charged by the divisions of the Department for Environmental Protection be increased?

Background

The Department for Environmental Protection within the Natural Resources and Environmental Protection Cabinet administers programs related to the air, water and management of waste. The programs are run by the Divisions of Air Quality, Water and Waste Management. The heart of each program is a permitting system. The Cabinet has been authorized in KRS 224.033 (20) to establish by regulation fees for the cost of processing applications for permits and the cost of processing applications for exemptions. In addition, KRS 224.871 requires the Cabinet to charge fees by regulation in connection with the application, review, and issuance of hazardous waste generator registration certificates and hazardous waste permits.

Discussion

Administrative regulations which are to be promulgated or amended are subject to review by legislative committees. The Interim Joint Committee on Agriculture and Natural Resources reviewed seventeen regulations of the Divisions of Air Quality, Water and Waste Management which increased permit fees. The regulations had previously been objected to by the Administrative Regulation Review Subcommittee, thus requiring that they be considered by the 1990 General Assembly or they will automatically sunset in July of 1990.

The primary objections are: (1) The increase in fees will generate more money than is necessary to run the programs; and (2) Fees are being assessed for non-permit-related activities.

The Cabinet states that the increased fees are directly related to program costs and are not excessive, and that their statutory authority is sufficiently broad to authorize the collection of fees for activities not directly related to issuing a permit.

AMENDMENTS TO WASTE MANAGEMENT PROGRAMS

Prepared by Daniel J. Risch

Issue

Should the waste management programs for the Commonwealth be amended?

Background

Like stars in portentous alignment, external events, federal Resource Conservation and Recovery Act (RCRA) Subtitle D requirements, economics, increased knowledge, and the Superfund Amendments and Reauthorization Act of 1986 (SARA), are exerting a steady pull upon state policy makers and administrators to recast the waste management programs of Kentucky. Each alone would significantly impact aspects of the waste disposal mechanisms used by Kentuckians. Conjoined, they have caused questions to be asked about the very fact that wastes are generated and must be disposed of.

The federal Resource Conservation and Recovery Act (RCRA) drives state programs for solid and hazardous waste management. First enacted in 1976, the law has been amended often, perhaps most notably in 1986 with the Hazardous and Solid Waste Amendments (HSWA). Also, significantly, the regulations implementing the law have had several rewrites. Subtitle D within RCRA establishes the framework for managing solid waste and is a clear example of the dynamic quality of the law and how it attempts to track developments in the solid waste management industry.

After conducting studies required by HSWA and analyzing the characteristics of solid waste, waste disposal practices and the effect of disposal techniques on the environment and public health, the U.S. Environmental Protection Agency (EPA) concluded that the requirements of Subtitle D must be updated.

The EPA is steadily working toward finalizing the proposed changes by the end of 1989. Affected are the minimum national criteria for the location, design, operation, clean-up, and closure of new and existing solid waste landfills.

For example, the operator of a landfill would be required to implement a program to detect and prevent attempts to dispose of regulated quantities of hazardous waste. Also, disposal of liquids would be prohibited, with some limited exceptions. Upon closing a landfill, new requirements would necessitate action to minimize the formation and release of leachate (contaminating liquids) and explosive gases to the air, groundwater, or surface water. A final example is a proposal that landfills be designed with liners, leachate collection systems, and final cover systems sufficient to meet a risk-based goal.

When these changes are implemented EPA will have, in effect, raised the level

of safeguards perceived to be necessary to minimally protect the environment from the negative aspects of landfilling solid wastes. Kentucky can not ignore these regulatory changes nor fail to adapt the state's management program to this trend.

The first obvious reason lies in the growing knowledge that burying solid waste has profound impacts on soil and water resources and ultimately human health.

Illustrating this point is the fact that 158 solid waste landfills, built and operated before any controls were required, are on or proposed for a list for clean-up under the federal Comprehensive Environmental Response Compensation and Liability Act. (CERCLA, or Superfund, helps to pay for the clean-up of waste sites presenting the most immediate threat to human health and the environment.)

What then is the problem? Burial of solid waste as a management technique has been hit with a double whammy. First, solid waste is a regulatory creation, just as is hazardous waste. Yet, to call the material a solid waste does not change its physical composition. The solid waste legally placed in landfills contains hazardous components. Second, over time the early landfills have become field laboratories in which the interplay of landfill design and content has yielded new knowledge. A paramount conclusion drawn from this knowledge is that a 12-inch clay liner at the bottom of a landfill fails to stop the leaching of accumulated organic contaminants.

Thus, simple prudence dictates that Kentucky review its own solid waste management standards in view of the federal Subtitle D proposals. Combined with some simple economics, a complex mix of circumstances has been created demanding that the state act to upgrade solid waste regulations.

Four to 20 dollars will buy a cubic yard of landfill space in Kentucky. This basic economic fact has spurred a mini-industry in the Commonwealth: disposal of other states' garbage.

At the present time approximately 3.15 million pounds of non-Kentucky trash is buried each day at one Kentucky landfill. The cost of landfilling that waste in the state of origin is between 100 dollars and 120 dollars per cubic yard. No wonder entrepreneurs seek disposal sites in the Commonwealth.

Ironically, the one significant reason for disposal costs being so high in New Jersey and other northeastern states, such as New York and parts of Pennsylvania, is that the policy makers in the northeastern states have responded to citizens concerned about inadequate environmental safeguards. State-of-the-art design standards and operational requirements must now be met, forcing upward the cost of disposal. Therefore, as those states act to protect their environments, an economic atmosphere is produced that, in essence, encourages commerce in potential environmental degradation.

The final external force reshaping the state's waste management policies is the Superfund Amendments and Reauthorization Act of 1986, commonly referred to as SARA. SARA was written with a legislative eye on economics of a different sort.

Hazardous waste management techniques are costly. Even with approximately 751 generators producing an average of 5,649,000 tons of hazardous waste in Kentucky each year, the state cannot support all methods of hazardous waste management. Congress, in enacting SARA, recognized that few states could support all waste management methods in a free market system. At the same time, the SARA sponsors noted with a sharp eye that some states which had capacity in certain disposal categories, such as landfilling, might try to hoard that capacity for their own citizens. Conversely, other states were taking steps which might prevent hazardous waste management capacity from growing. To stop the conflicts between states and head off the potential for orphaned hazardous waste ending up in ditches and streams, Congress enacted SARA, the goal of which is summarized by the following statement taken from the EPA Draft State Capacity Assurance Guidance:

> Superfund money should not be spent in states that are taking insufficient steps to avoid the creation of future Superfund sites. The Congress recognized that a safe and rational hazardous waste management program for the nation depended in part on the creation of new facilities employing the most advanced technologies. While many states enacted or planned to enact siting legislation, Congress concluded that few, if any, were developing policies and siting programs that would assure continued facility capacity in the long term.

To reach this goal, Section 104(c)(9) of CERCLA, as amended by SARA, requires each state to assure EPA that adequate capacity will exist to manage the hazardous waste created in the state over the next 20 years. Failure to submit the capacity assurance plan (CAP) by the October 1989 deadline will expose the state to loss of federal money to help in the clean-up of abandoned waste sites.

Kentucky's significant financial stake in Superfund warrants careful attention to meeting the SARA requirements. There are 17 waste sites in the state which are on, or proposed for inclusion on, the National Priority List. (Listing on the NPL qualifies a waste site for federal money under Superfund.) For just one site the state expenditure for clean-up was $1,114,000.

Discussion

The 1988 General Assembly passed House Joint Resolution 60 in light of these increasing pressures on both the solid and hazardous waste management programs in Kentucky. This resolution created the Waste Management Task Force, which is composed of representatives of state government, industry, environmentalists, and state legislators.

The task force was divided into two subcommittees, one to study solid waste and one to study hazardous waste.

The solid waste subcommittee studied the following: universal collection, recycling and source reduction; role of government, i.e., planning/permitting, regionalization, county solid waste management boards; funding for the Natural Resources and Environmental Protection Cabinet; out-of-state solid waste; resource recovery/waste-to-energy; public education; insuring that the permit program continues during any transition; and content/composition of solid waste, i.e., radiological, infectious, and hazardous.

The hazardous waste subcommittee studied the following: funding for EPA-required programs, such as the hazardous waste program under the Resource Conservation and Recovery Act (RCRA), the state responsibility to match Superfund money used to clean up Kentucky abandoned waste sites on the National Priority List, and the leaking underground storage tank program; public education of hazardous waste management; emergency response planning for the transportation of hazardous waste and the siting of hazardous waste facilities; the state capacity assurances mandated by the Superfund Amendment and Reauthorization Act of 1986; hazardous waste minimization; and abandoned hazardous waste sites not on the National Priority List.

From the testimony and discussions within the subcommittees to this date, some points of agreement have been closed on, but, given the complexity of the subject and the diversity of those interested in the outcome, no majority positions have yet emerged.

The direction of policy change in the state's management of solid waste conceivably can shift radically. One need not look just to the northeastern states for clues, because Illinois, Ohio, West Virginia and Virginia have also rewritten their solid waste laws to adapt to the changes within the solid waste disposal universe.

Changes are evolving, albeit in an atmosphere of contradictions: (1) Landfills cause environmental degradation. (Perhaps a matter of degree, but the public perception that this statement is always true renders it true for purposes of defining public policy.) (2) Landfills are essential. (There are alternatives but no immediate and realistic replacement management methods.) Kentucky creates approximately 14,100 tons of garbage each day and each year an amount approaching 5,150,000 tons. The nation generates 160,000,000 to 250,000,000 tons each year, depending on who does the estimating.)

The task force, as a microcosm of the larger solid waste industry, has labored under the tensions resulting from these contradictory premises.

The shift of policy direction in the management of hazardous waste will not be radical but will subtly alter attitudes about hazardous waste generation for the years to come.

There are two key components of the capacity assurance plan required by SARA. Kentucky has a capacity shortfall in 11 of the 15 SARA management codes. These are

categories of hazardous waste management techniques. Consequently, Kentucky must document the type and quantity of capacity needed and the procedures that would result in the development of additional capacity, including participation in interstate or regional planning efforts. Additionally, the CAP must show that state and local laws, regulations, practices, and policies will not hinder development of additional capacity.

The task force will need to consider whether 1988 legislation which expanded the role of local government review of hazardous waste facility permits hinders development of additional capacity in the state.

The second aspect of the CAP in which the task force may play a prominent role is deciding to what extent hazardous waste minimization will be stressed in complying with the SARA requirements.

Discussion of encouraging an industrial attitude to reduce the formation of hazardous waste has led to a legislative proposal to require environmental audits. Also, the task force has considered expanding the Center for Hazardous Waste Reduction which was created by the 1988 General Assembly.

APPROPRIATIONS AND REVENUE

CONSTITUTIONAL RESTRICTIONS ON GENERAL OBLIGATION DEBT

Prepared by Virginia Wilson

Issue

Should the Constitution of Kentucky be amended to reduce or eliminate restrictions on the issuance of general obligation debt by state and/or local governments?

Background

General obligation (GO) bonds pledge the full faith and credit of the issuing government to the timely repayment of principle and interest. Sections 49 and 50 of the Kentucky Constitution state that the Commonwealth may not incur total general obligation debt in excess of $500,000 unless the act authorizing the particular debt issue has been approved by the majority of those voting on the act in a general election. Similarly, Sections 157 and 158 limit the ability of local governments to issue general obligation debt. Local governments may not incur general debt in excess of current year revenues unless such issuance has been approved by two-thirds of those voting on the issue in a general election. Even with voter approval, local governments may not incur total general obligation debt in excess of a specified percentage of the total assessed value of property within their jurisdiction.

The apparent intent of these sections in the Constitution was to limit the ability of a current legislative body to obligate the spending decisions of future legislative bodies. In a technical, legal sense the sections may have been successful in fulfilling their intent. However, it is clear that in the practical political and financial sense, they have not been effective. The practical effect of the Constitutional limitations has been that the use of revenue bonds has almost totally replaced the use of general obligation bonds for virtually all long-term investments by both sate and local governments. According to the 1988 *Local Debt Report,* general obligation debt accounts for less than one percent of total local debt outstanding . The most recent local government GO bond issue was in 1980. At the state level, general obligation debt accounts for approximately eight percent of total appropriation-supported debt outstanding. The last state GO bond was issued in 1966.

Revenue bonds are legally structured so that only the revenue stream of the project being funded by bond proceeds is pledged to debt service. For example, if the state issues a revenue bond to fund a public parking facility, the only legal claim the bond holder has is against the revenues which are generated by those who pay to park in the facility. If these revenues are not sufficient to meet debt service payments, the state is under no legal obligation to use its general revenue raising power to make the payments. The buyer of a revenue bond has less legal certainty that debt service payments will be made than

does the buyer of a general obligation bond. Therefore, the interest costs associated with revenue bonds are normally higher than the interest costs associated with GO bonds.

What has happened over the years in Kentucky is that, as demand for capital services (such as water and sewers, highways, public buildings, etc.) has grown, the difficulty of issuing GO bonds has caused state and local governments to shift to the use of revenue type bonds to fund these public use projects. However, strong political and financial pressures make it highly unlikely that the General Assembly would choose not to appropriate revenues to service debt incurred for a public use project. Such an action would almost certainly result in a significant increase in interest costs for any future state project funded with bond sales. The net effect of these pressures is that the Commonwealth pays the bond holder an interest premium for the lack of legal protection while, in actual practice the bond holder bears little increased risk. The size of this interest premium represents the cost to units of government from having to use revenue bonds for public use projects rather than GO bonds. While the size of this interest premium is currently unknown and probably varies over time and among units of government, it is clear that even small differences can yield large effects.

Discussion

There are several policy options relating to this overall question. Both state and local governments are subject to numerical limits and approval requirements for the issuance of GO debt. Although the results of the restrictions have been similar, their structure and, therefore, associated policy options are somewhat different.

For units of local government, every issuance of GO debt must be approved by voter referendum. The specified percentage of total assessed value acts as an absolute cap on GO debt. This percentage cannot be exceeded even with voter approval. Data indicates that it is the requirement of voter approval (along with relatively easy issuance of revenue type debt) rather than the numerical limit which acts as the constraint on local government use of GO bonds. Few, if any, units of local government carry GO debt close to their numerical limit.

Some of the policy options regarding local government GO debt issuance are as follows. The first option is to make no change, leaving the current restrictions in place. A second option is to remove all restrictions. A third option is to leave the absolute numerical limit intact but remove the requirement for voter approval. A final option is to allow the issuance of GO debt *up to* the numerical limit without voter approval but require voter approval for GO debt issuance which raises outstanding GO debt above the limit.

At the state level, any GO debt issued above the numerical limit of $500,000 must be approved by ballot. Major policy options at the state level are as follows. The first option is to make no changes in the current constitutional provisions. A second option is to raise the numerical amount below which voter approval of bond issuance is not required. Instead of the flat $500,000 numerical limit, an index number which reflects changes

in the state economy, particularly from inflation, could be used. For example, one commonly used index number is total debt outstanding as a percent of state total personal income. As another option, the $500,000 limit could be left intact (or an index number could be substituted) but the approval mechanism could be changed. Instead of the requirement of voter approval, debt issuance above the limit could be subject to the approval of a super-majority of each chamber of the General Assembly.

At both the state and local levels, if restrictions on the issuance of GO debt are reduced, consideration may be given to instituting some additional restrictions on the use of revenue type debt for public use projects. Otherwise, governments may still find it easier to use the more expensive form of borrowing.

Opponents of a constitutional amendment reducing the restrictions on GO debt issuance would tend to focus on two points. First, that it may be difficult to change the public perception that removing GO debt restrictions will increase government borrowing. This would tend to reduce the likelihood that voters would approve the amendment. Second, some individuals believe that the bond market accurately assesses the true financial risks associated with public use revenue bonds, so that the difference between the interest costs of such a bond and a GO bond may be minimal.

Proponents see the proposal as a cost-free way for state and local governments to save a great deal of money without reducing infrastructure development. This is thought to be particularly true for local governments. Also, the removal of GO debt restrictions could actually improve the oversight of public use debt, since quasi-public authorities would not have to be used to issue debt for public use projects. Finally, it is believed that voter approval of the amendment is feasible, if the public can be shown that the current restrictions have no practical effect on debt levels and that removal of the restrictions could save considerable state and local tax dollars.

ESTABLISHMENT OF A CAPITAL PLANNING AUTHORITY

Prepared by Virginia Wilson

Issue

Should the General Assembly enact legislation to establish an independent Capital Planning Advisory Commission and authorize it to recommend an annually updated six-year capital plan for the Commonwealth?

Background

As of June 30, 1988 the Commonwealth had approximately $3.7 billion appropriation-supported debt service remaining from FY 1991 till the maturity of all bonds. Nearly $800 million additional capital project appropriations were made in the FY 1989-1990 Capital Construction Budget. Although the Commonwealth is obviously making major fiscal commitments to long-term capital investments, there currently exists no explicitly documented process to prioritize investment goals, assess investment needs and evaluate the future consequences of current investment decisions.

One example of the effect of not having a capital plan was shown in the report titled *Space Needs of State Government in Franklin County*, which was issued by the Capital Projects and Bond Oversight Committee in October, 1987. The conclusion in this report was that the state is probably paying significantly more in the long run by leasing state office space rather than paying for the construction of state-owned facilities. The report recommends the development of a six-year capital improvements plan for state office needs.

Discussion

The Debt Capacity Task Force concluded that decisions about the amount of debt the Commonwealth should have were somewhat meaningless without information about what the most pressing capital needs are now and what they are likely to be in the future. Therefore, the Task Force voted to recommend that the General Assembly enact legislation to establish an independent advisory commission on capital planning and budgeting. It is recommended that such a commission be composed of 12 (or 16) members with 3 (or 4) members being appointed from each of the executive, legislative and judicial branches of state government and 3 (or 4) members being appointed from the public at large. This commission would be charged with responsibility for developing a six-year capital plan for the Commonwealth. Based on that plan, the Commission would make recommendations to the Governor and Legislature concerning biennial capital budgeting decisions.

The commission would be required to issue an annual report which would include the following sections.

1. Capital Inventory: A section which details the location, condition, use and capacity of existing capital investments. Specific information would be contained concerning maintenance cycles and leasing of capital facilities.

2. Statement of Goals: An explicit statement of the Commonwealth's long term priorities for capital investment.

3. Needs Assessment: A section which details what new capital projects would be needed to meet the stated goals. Specifically included would be available information about demographic, economic and other trends that could significantly affect future capital needs.

4. Long-Term Capital Plan: This section would lay out the Commission's recommendation concerning the long-term strategy that should be used to meet the above needs, given existing capital resources, projected revenue levels and expected demands for non-capital services. Proposed capital projects would be ranked across all departments.

5. Recommended Capital Budget: In this section the Commission would make recommendations concerning the implementation of the first two-year period of the six-year plan. Thus, budget recommendations would be tied directly to the long range plan. Included in this section would be the recommended funding sources for each project and an assessment of the effect of the funding proposals on the Commonwealth's overall debt burden.

6. Status Report on Implementation: This section would provide summary information on the progress of previously approved projects. It would also provide a report of maintenance requirements to preserve existing capital resources.

The Task Force recommends that all areas of capital investment be incorporated into the long-term plan, including higher education and roads. It is believed that the development of a set of documents containing centralized information relating to capital investments will improve the ability of decision makers to evaluate the economic, fiscal and political tradeoffs inherent in making major long-term capital decisions.

INDICATORS OF DEBT BURDEN AND THE SETTING OF TARGET DEBT LEVELS

Prepared by Virginia Wilson

Issue

Should the General Assembly define appropriate indicators of debt burden and require the Executive Branch to submit an annual report detailing the Commonwealth's status with regard to each indicator?

Should the General Assembly set target debt levels based on one or more of the indicators of debt burden?

Background

Citing the fact that Kentucky is ranked 10th from the highest state in net tax-supported debt per capita and 7th in net tax-supported debt as a percent of personal income, the 1988 General Assembly created the Debt Capacity Task Force and charged it with responsibility for defining appropriate indicators of debt burden for the Commonwealth. The Task Force was also instructed to recommend target levels of debt using one or more of the indicators.

Discussion

The Task Force had to make several sets of decisions in order to complete its charge. The first set of decisions concerned the scope of the analysis. The Task Force came to the conclusion that an analysis of the level of state debt is somewhat meaningless without some consideration of the scope of long-term investment needs. Therefore, the Task Force recommended the creation of an independent capital planning advisory commission to develop an annual 6-year capital plan for the Commonwealth.

The second set of decisions centered on the definition of whose debt would be included in the analysis. Some legislators have expressed concern about the total government debt burden borne by the average Kentucky citizen, including both state and local debt. It has also been argued that, since ratings agencies consider the total debt already supported by the economy of an area in rating any new bond issue, it is pertinent to include the debt of local governments in debt indicators.

Another argument has been made that the non-appropriation supported debt issued by independent authorities is a "moral obligation" of the state and should, therefore, be included in the analysis. The Task Force decided to request information about appropriation and non-appropriation supported debt at both the state and local levels.

A third set of decisions concerned the appropriate criteria for evaluating debt levels. These decisions incorporated assessments about the following four separate but interrelated areas.

1. Identification of relevant characteristics of debt: Total debt outstanding, annual debt service, borrowing costs, etc.

2. Identification of relevant current characteristics of the state: Personal income, population, revenues, assessed value of property, rank compared to other states, etc.

3. Identification of relevant future characteristics of the state: Anticipated growth or decline of the general economy, anticipated revenues, future demand for capital and non-capital government services, etc.

4. Type of model: Rule of thumb, historical trend, statistical, policy decision, etc.

Criteria for evaluating debt levels is being developed by identifying important relationships among these four areas. Although this work is in progress, the Task Force is considering recommending the development of two types of indicators. First are the "economic" indicators. These indicators provide information about total outstanding debt levels of state and local government in reference to general economic conditions in the state. An example of an economic indicator would be total debt outstanding as a percent of state personal income. Other economic indicators under consideration include total debt outstanding as a percent of full assessed value of property, and total debt outstanding per capita.

A second type of indicator being developed is called a "fiscal" indicator. These indicators are more directly tied to budgetary conditions. The definition of these indicators will be limited to include only appropriation-supported debt. The most important indicator in this category is annual debt service as a percent of non-dedicated revenues, although other indicators are also being considered.

The final set of decisions before the Task Force is to recommend whether target levels of any or all of the debt indicators should be used to limit any or all of the considered forms of debt. If a decision is made to recommend debt targets, a decision must also be made as to whether limits should be advisory only or incorporated into the statues.

Proponents of setting advisory or statutory debt targets argue that such action will ensure that the economy of the state will not become overburdened with government debt (excluding federal debt, of course). They also note that keeping debt levels in check will help maintain the state's current credit rating. They believe that limits will reduce the danger that fixed debt service will "crowd out" more discretionary, but no less important, current services at some point in the future. Finally, proponents hope that limiting the amount of debt which can be issued will cause decision makers to allocate the allowable debt in a more responsible manner.

Opponents of debt targets argue that there is no one number, or set of numbers, which can identify the "right" amount of debt the state should carry in all situations. They believe that debt indicators represent important information which should be considered, but that the "right" amount of debt is a function of priorities among proposed long-term investments and current service needs. They also note that limits which seem reasonable for the conditions existing at the time they are set may not be reasonable for future conditions. Finally, they note that statutory debt limits are not viewed with great favor by representatives of rating agencies, because they reduce the flexibility of governments in responding to changing circumstances, including the possible emergence of major investment opportunities with large positive benefits.

GENERAL FUND REVENUE ALTERNATIVES

Prepared by Terry Jones

Issue

Alternatives for raising new revenue.

Background

The ability of the existing General Fund tax structure to adequately provide for the needs of the citizens is increasingly being constrained. In addition, potential new needs for General Fund revenues in the areas of education, prisons and health and human services, along with possible reductions of General Fund revenues by court-ordered refunds of insurance premiums and individual income taxes, make General Fund revenue alternatives an issue for the 1990 Session of the General Assembly.

Discussion

The analysis of General Fund revenue alternatives will be divided into four categories: new taxes, tax conformity, rate changes to existing taxes and tax expenditures (credits, deductions and exemptions). The analysis will be limited to those alternatives which have a significant fiscal impact.

New Taxes

A tax on soft drinks, not currently imposed by Kentucky, would produce approximately $100 million annually. This estimate is based on a tax rate of five cents for each twelve ounces of soft drink, proportionately applied for containers larger than twelve ounces, $5.00 per gallon of soft drink syrup, proportionately applied for fractions of a gallon, and five cents per ounce or fraction thereof of dry soft drink powders.

Tax Conformity

Updating our income tax law to the current Internal Revenue Code would produce approximately $100 million per year. Currently our income tax law is tied to the Internal Revenue Code in effect as of December 31, 1985. The major tax conformity provisions affecting individual income taxes and their fiscal impact are as follows:

Provisions	$ Million
Repeal dividend income exclusion	$ 1.2
Tax all unemployment compensation	5.0
Alter employee business expense and miscellaneous deductions	15.0
Limit non-business interest deduction	18.6
Raise AGI floor on medical deductions	6.0
Repeal sales tax deduction	13.5
Eliminate capital gains exclusion	39.2
Total	$98.5

Rate Changes to Existing Taxes

The following is a list of selected taxes and an estimate of the fiscal impact of certain rate changes. Also included in this category is a section of "special rates" for ad valorem taxes on certain classes of property.

Tax	Rate	$ Million
Sales and Use	1 increase	$215
Individual Income	10% surcharge	106
Corporate Income	10% surcharge	30
Coal Severance	1/2% increase	21
Cigarette	1 increase	5

Ad Valorem Taxes

Class of Property	Rate	$ Million
Domestic bank deposits	25 vs .1 per $100	$43.0
Business inventories	45 vs .1 per $100	19.0
Accounts, notes, mortgages performed out of state intercompany accounts, & affiliated company stock	45 vs 1.5 per $100	16.5
Manufacturing machinery	45 vs 1.5 per $100	15.0
Farm machinery	45 vs .1 per $100	10.0
Retirement Plans	45 vs .1 per $100	10.0
Banks for cooperatives, production credit associations & domestic savings & loan associations	25 vs 10 per $100	7.9
Livestock & poultry	45 vs .1 per $100	6.5

Tax Expenditures

Tax expenditures are the largest category of revenue alternatives. Tax expenditures are those exemptions, deductions and credits that are currently in the tax laws. The following is a listing by type of tax of those tax expenditures which have a significant fiscal impact.

Sales and Use Tax

Tax Expenditures	$ Million
Services	$190.6
Food	150.0
Motor vehicles	149.0
Gasoline and special fuel	122.0
Residential utilities	65.0
Coal used to manufacture electricity	47.0
Livestock, poultry, feed, seeds, etc.	46.0
Machinery for new & expanded industry	30.0
Energy & energy-producing, fuels	26.0
Out of state retailers mail order sales	17.1
Prescription medicine	14.0
Horses purchased for breeding	12.0
Horses less than 2 years of age	12.0
Sales to nonprofit educational, charitable and religious institutions	12.0
Sales to the state, cities and counties	12.0
Farm machinery	10.0
Retailers compensation for collecting & remitting the tax	10.0
Interstate telephone communication charges	8.5
Semi-trailers and trailers	8.5
Pollution control facilities	7.0

The exemption of food, utilities and prescription medicine is commonly thought of as tax relief for low-income households. However, the tax loss of these three exemptions attributable to the low-income households (those households with $10,000 or less income) is approximately $43 million, while the total tax loss is approximately $249 million. An alternative to a total exemption would be a refundable, low-income credit that targets low-income households as the recipient of tax relief for food, utilities and prescription medicine.

Individual Income Tax

Tax Expenditures	$ Million
Federal income tax deduction	$167.7
Net exclusion of pension contributions & earnings: employer plans	111.7
Personal dependent tax credit	65.0
Deductibility of mortgage interest on owner-occupied homes	50.7
Deductibility of non-business state & local taxes other than owner-occupied homes	44.8
Exclusion of employer contribution for medical insurance premiums	40.9
Exclusion of social security benefits	30.4
Deductibility of property taxes on owner-occupied homes	17.6
Deductibility of charitable contributions	15.8
Exclusion of interest on life insurance savings	9.8
Deferral of capital gains from principal residence sales	9.5
Deductibility of IRA contributions	6.6
Exclusion of capital gains at death	6.2

Corporate Income Tax

Tax Expenditure	$ Million
Net operating loss deduction	$ 16.0
Subchapter S election	9.0

Coal Severance & Processing Tax

Tax Expenditure	$ Million
Deduction for transportation expense	$ 15.0

Inheritance & Estate Tax

Tax Expenditure	$ Million
Total exemption for surviving spouse	$ 18.0
Exemption of life insurance proceeds payable to designated beneficiaries	15.0
Exemption of transfers to educational, religious, charitable or certain governmental organizations	6.0

INSURANCE PREMIUM TAX REFORM

Prepared by Dee Baugh

Issue

Should Kentucky equalize its insurance premium tax rates?

Background

In the early part of this century, Kentucky began taxing out-of-state insurers doing business in Kentucky. The rates, which with some exceptions remain the same as when initially levied, are either $2 per $100 of premiums received by the insurance company or 2% of receipts. While these premium taxes are paid by the insurers, they are assumed to be passed on to the policyholders.

Insurance premium taxes flow into the General Fund. In recent years this source has made a greater contribution to the Fund, reflecting the dramatic increase in insurance premium costs. The state will collect more than $62 million in fiscal year 1988-89 and expects revenues to increase as premium growth continues. The revenues, however, appear to be in jeopardy.

Kentucky's insurance premium taxes, which are levied only against out-of-state companies, are threatened by a 1985 U.S. Supreme Court decision (*Metropolitan Life Insurance Co., et al v. Ward, et al.*) which struck down a similar taxing mechanism in Alabama. That ruling held the Alabama tax to be unconstitutional in imposing "discriminatory taxes on non-resident corporations solely because they are non-residents." The Supreme Court's decision in the Alabama case could also extend to a virtually parallel situation in Kentucky. Kentucky, like Alabama, justifies its levy of an insurance premiums tax as a means of equalizing the total tax burden between in and out-of-state insurers, given the fact that foreign insurance companies do not pay tangible or intangible property taxes to Kentucky.

At least fourteen out-of-state insurers are currently seeking refunds from the Kentucky Board of Tax Appeals, arguing that Kentucky's law is unconstitutional. The Alabama case has spurred several states with similar laws to equalize their rates. Some states have also paid substantial refunds to out-of-state insurers. However, the Alabama case is not definitive. The U.S. Supreme Court has returned the case to a lower court in Alabama to allow the state another opportunity to justify the disparity.

Discussion

The litigation involving Kentucky's insurance premium taxes is being held in abeyance by the Board, pending further action on the Alabama case. A final court decision

on these cases is unlikely before the 1990 Session. With the Alabama case still in legal limbo, Kentucky's cases could go to the Supreme Court for resolution. To resolve objections to the premium taxes, the tax burden would need to be equalized either by repealing the taxes now applied only to out-of-state insurers, or by imposing those same rates on the approximately eighteen domestic insurers. In the former case, the state would lose $60 million plus, per year; in the latter case it would gain an estimated additional $21 million per year.

INDIVIDUAL INCOME TAX POLICY AND RETIREMENT ANNUITIES

Prepared by C. Gilmore Dutton

Issue

What are the options available to the Kentucky General Assembly in complying with the federal court mandate to provide equal treatment of federal and state and local retirement annuities for individual income tax purposes?

Background

On March 28, 1989 the U. S. Supreme Court, in *Davis v. Michigan Department of Treasury*, ruled that income tax exemptions offered to retired state and local employees are unconstitutionally discriminatory if similar exemptions are not offered to federal employees. The Court arrived at its decision by interpreting the Public Salary Act of 1939, the pertinent section of which states that the United States consents to state taxation of a federal employee's "pay or compensation" so long as the taxation "does not discriminate against the officers or employees because of the source of the pay or compensation."

The Court dismissed Michigan's argument that the law applied only to current employees and not to retirees, by concluding that retirement benefits were "compensation" under the statute. The Court said that Congress would not have intended to permit discrimination against retirees, while forbidding discrimination against current employees.

Michigan had also argued that there was a rational distinction between federal and state employees, and that the exemption was a reasonable inducement for hiring and retaining employees. In response the Court said "[t]he state's interest in adopting a discriminatory tax, no matter how substantial, is simply irrelevant to an inquiry into the nature of the two classes receiving inconsistent retirement." The Court also rejected the argument that the burden of any discrimination was offset by the more substantial federal retirement benefits, by suggesting that a non-discriminatory adjustment would be made through a tax based upon the amount of a benefit received.

The Court refused to resolve whether equal treatment should be achieved by extending the exemption to federal employees or eliminating it for state and local employees, and remanded the case to the state court to determine the proper way to comply with the equal treatment mandate. The Court's approach provides the opportunity for resolution by the Michigan legislature, and avoids the appearance of taxation by judicial fiat.

Kentucky's law presently provides for a partial exemption of federal retirement pay and a total exemption of all state government retirement pay and nearly all local government retirement pay.[1] The exemption for federal retirement benefits, which covers

both federal civil service and military retirees 50 years of age or older, is set at a maximum of $4,000, and phases out in graduated steps as the taxpayer's earned income approaches $6,000. The exemption for state and local government retirees has no limitations, and covers members of the Kentucky Employees, Teachers', Legislative, Judicial, State Police and County Employees Retirement Systems and university sponsored retirement systems.

While Kentucky's tax provisions affecting federal retirement pay are codified in Kentucky's income tax chapter, Chapter 141, and its tax provisions affecting state and local retirement pay are found in the chapters in which the respective retirement systems are established, the combined provisions produce a result identical to that found in Michigan law. Thus, a result similar to that in the Michigan case can be expected from litigation of the question in Kentucky, prompting, thus, preemptive action on the part of the 1990 Session of the Kentucky General Assembly.

Discussion

To comply with the U. S. Supreme Court mandate to provide equal treatment of federal and state and local government retirement pay under the state's tax laws, it would appear that Kentucky has three general options

a. Total exemption of federal retirement pay;

b. Total taxation of all government retirement pay; or

c. Partial exemption/taxation of all government retirement benefits.

Total Exemption

There are presently 37,386 federal civil service and military retirees residing in Kentucky (see Table 1, columns 3 and 5), who receive approximately $520 million in annual retirement benefits. Fifty-eight percent of the civil service and 30% of the military retirees are age 65 or over; 32% of the civil service and 50% of the military retirees are between the ages of 49 and 65.

The current exemption provided to federal retirees is estimated to cost $5.6 million, based upon the assumptions of average effective exemptions of $2,000 for persons 50, but less than 65 years of age, and $4,000 for retirees 65 years of age or older, and an average effective tax rate of 5.8%.[2] A total exemption of federal retirement benefits, without limitation as to earned income or age of recipient, is estimated to cost an *additional* $19.0 million, based upon the assumption of an average effective tax rate of 4.5%.

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1 The only exceptions are benefits received from municipal police and fire retirement systems.

2 Kentucky's tax rate is graduated from 2% to 6%, with the maximum rate applicable to taxable income of $8,000 or more.

Total Taxation

Total taxation of all government retirement pay would mean the loss of the partial exemption for federal retirees and loss of the full exemption for state and local retirees. In the case of the former federal employees, more than 32,000 individuals would be potentially affected; in the case of retired state and local government employees, more than 43,000 individuals (see Table 1, columns 7, 9 and 11) would lose their exemption. Approximately $282.0 million in annual retirement benefits is sheltered under state and local retiree exemption provisions.

The loss of revenue currently resulting from the exemption for state and local government retirees is estimated to be in excess of $8.8 million,[3] based upon the assumptions of an effective tax rate of 3.0% and 90% residency of retirees in Kentucky. Conversely, the gain to the state resulting from taxation of currently exempt state and local retirement benefits would exceed $8.8 million, and, when coupled with the gain from full taxation of federal retirement pay, would result in a total gain in excess of $14.4 million.

The loss of after-tax income resulting from the taxation of state and local government retirement benefits could be offset by an annual adjustment in retirement benefits. The adjustment could be expressed in an absolute dollar amount or a percentage of benefits, based, in either case, upon actual income tax collection experience. Such an adjustment, however, would not be an efficient method of compensating state and local government retirees for dollars lost through taxation, would only accidentally result in an exact substitution for lost monies and could be subject to question as to its constitutionality.

Partial Exemption/Taxation

The taxation or exemption of government retirement pay could take the form of a partial exemption. The exemption could be expressed as a flat amount of retirement income, as a percentage of retirement pay or an amount falling below a statutory gross income threshold.

As an example of a flat dollar exemption, assume an exemption of retirement income less than $7,200 per taxpayer. Under a first $7,200 of retirement pay exemption, the following numbers and percentages of retirees would be totally exempt:

Federal Civil Service	2,147	10.1%
Federal Military	2,468	15.3
Teachers	5,582	30.4
Non-teachers (state)	12,085	77.4
County	8,039	89.4

3 This amount includes the loss from members of the Teachers', Kentucky Employees and County Employees Retirement Systems only; losses resulting from members of other exempt retirement systems would total less than $1.0 million.

The cost of a $7,200 exemption for all retirees would amount to approximately $21.3 million. Since the state is losing approximately $14.4 million under existing exemption provisions, the net revenue loss would amount to $6.9 million. The impact upon the various retiree groups, expressed as a reduction (-) or increase (+) in tax burden over existing tax provisions, would be as follows:

Federal Civil Service	- $4.8 million
Federal Military	- 4.4
Teachers	+ 1.6
Non-teachers (state)	+ .6
County	+ .1
Total	- $6.9 million

Exemption of 50% of all government retirement benefits would result in a gross loss to the state of $16.7 million, or a net loss of $2.3 million. The impact upon the various retiree groups, expressed as a reduction (-) or increase (+) in tax burden over existing tax provisions, would be as follows:

Federal Civil Service	- $4.5 million
Federal Military	- 2.2
Teachers	+ 2.6
Non-teachers (state)	+ 1.2
County	+ .6
Total	- $2.3 million

Exemption of government retirement benefits could be based upon a gross income test, with only that amount of retirement income in excess of a statutory gross income threshold being subject to taxation. As an example, assume a gross income threshold of $12,000 and a gross income of $14,000, of which $6,000 is government retirement income. Since the gross income is only $2,000 above the predetermined (statutory) threshold, only $2,000 of the government retirement pay is taxable.

At present, no information is available as to the cost of a gross income test scheme. In order to measure the impact of various thresholds, information about the non-retirement income of government retirees must be obtained from federal and state tax returns. Such information is being developed, however, and will be made available to the appropriate interim committees of the Kentucky General Assembly prior to the 1990 Session.

KENTUCKY'S INDIVIDUAL INCOME TAX POLICY

Prepared by C. Gilmore Dutton

Issue

Simplicity, reform or revenue? What will be the Kentucky General Assembly's objective when it addresses the state's individual income tax law to consider changes suggested by the Federal Tax Reform Act of 1986?

Background

The Federal Tax Reform Act of 1986 has been labeled the most significant amendment to the nation's Internal Revenue Code since its last major revision in 1954. Kentucky's individual income tax, beginning with its adoption in 1936, has been "coupled" with the Internal Revenue Code to the extent that federal definitions of income and deductions have been adopted for state tax purposes.

There are two major reasons for conforming to the federal tax code: ease of administration and ease of taxpayer compliance. By adopting federal definitions, Kentucky can rely upon case law generated in federal courts, thus saving the state government and its taxpayers the time and expense of litigating issues not explicitly dealt with in the statutes. The taxpayers' reporting burden is also eased by the ability to enter on their state income tax return many of the same figures used in completing their federal income tax return.

The Kentucky General Assembly maintains conformity with federal tax law by periodically "adopting" the current version of the Internal Revenue Code. Failure to enact "code update" legislation can result in significant disparities between figures used for filing federal and Kentucky income tax returns.

Discussion

Because the Tax Reform Act of 1986 dramatically broadens the federal individual income tax base by adding taxable items of income and reducing deductions, as well as increasing standard deductions and personal exemptions, the Kentucky General Assembly must deal with a subset of conformity issues unprecedented in recent history.

Simplicity. More than three dozen differences between Kentucky and federal individual income tax law will exist when the General Assembly convenes in 1990. For the average taxpayer, simplicity in filing a state tax return means similarity with the federal tax return. To maximize ease of filing, blanket adoption of all of the changes to the federal tax law would be in order.

But many of the amendments made by Congress are controversial, and not happily embraced by all of the taxpaying public. The repeal of the $100 per taxpayer dividend exclusion, the severe limitation on the deductibility of contributions to individual retirement plans and the repeal of the capital gain exclusion are only a few of the items which may result in a tax increase for a significant number of taxpayers, and which the General Assembly may wish to reject, but reject only at the risk of adding to the real, or at least perceived, complexity of filing the state tax return.

Reform. Kentucky grants each of its individual income taxpayers a $20 personal credit and a $650 standard deduction. The combined effect of the credit and deduction is to "shelter" $1,650 of income for each single taxpayer, and $3,300 of income for two married taxpayers, both of whom have taxable income. For tax year 1989, federal personal exemptions will be $2,000 per taxpayer or dependent, and the federal standard deduction will be $3,100 for single filers and $5,200 for married couples filing jointly. A single taxpayer filing a federal tax return will enjoy $5,100 of tax-free income, and a married couple filing jointly will not have to pay federal income taxes until their income exceeds $9,200.

According to Kentucky Revenue Cabinet estimates, approximately 60,000 Kentuckians will be removed from the federal income tax rolls who, absent any changes to state tax law, will continue to pay state income taxes. This revelation, coupled with the fact that federal poverty guidelines — $5,000 plus income levels — far exceed the amount of state tax-free income, argues for an increase in the state's personal exemption or standard deduction, or both.

But an increase in personal exemptions or standard deductions will cost money. For example, a $10 per taxpayer increase in the personal credit would result in a revenue loss in excess of $15 million, and if dependents, who, like taxpayers, are currently granted a $20 personal credit, were awarded the same increase, the revenue loss would double.

Money considerations aside, some state policy makers argue that Kentucky's low personal exemption and standard deduction, which result in taxation of income at relatively low levels, is sound public policy. Their contention is based on the premise that all citizens of the state should pay some taxes, and, given the exemptions from sales tax for the basic commodities of food, medicine and residential utilities, many low-income citizens would not otherwise make a contribution toward payment for services rendered by the state.

Revenue. Kentucky allows a deduction of federal taxes paid for individual income tax purposes. The deduction is "automatic"; that is, the deduction may be taken whether or not the taxpayer itemizes other deductible expenses. When federal taxes are increased, Kentucky taxpayers' deductions are likewise increased, and the state loses revenue. Conversely, when federal taxes are lowered, Kentucky taxpayers' deductions are likewise decreased, and the state gains revenue.

Because of this phenomenon, and because the Federal Tax Reform Act of 1986 has resulted in a reduction in Kentuckians' federal tax liability in excess of $365 million

per year, the Kentucky Revenue Cabinet estimates that the state is annually receiving approximately $25 million in additional revenue. This revenue is being realized without any action having been taken by the Kentucky General Assembly.

If the General Assembly acts to adopt the changes made in the Federal Tax Reform Act of 1986, the state will gain substantial additional revenue. According to Kentucky Revenue Cabinet estimates, the state would generate approximately $100 million annually from adoption of the new amendments to the Internal Revenue Code.

PROPERTY TAX REVENUES

Prepared by C. Gilmore Dutton

Issue

Should House Bill 44 be repealed or amended to allow local governments more flexibility in raising property tax revenues?

Background

When the Kentucky General Assembly met in Special Session on August 23, 1965, it was in reaction to a June 8, 1965, Kentucky Court of Appeals decision ordering the Department of Revenue (now the Revenue Cabinet) to assess all property at its fair cash value. The court's landmark decision, *Russman v. Luckett*, gave Jefferson County parents the relief they had sought by reaffirming that Section 172 of Kentucky's Constitution did, in fact, require the assessment of property at its fair cash value.

At the time of the court's decision, property tax values averaged, state-wide, 30% of fair market value. Many school systems were levying the maximum statutory tax rate (and many local governments were at their constitutional rate limits), and because the majority of local property valuation administrators were not reassessing the property in their jurisdictions, little additional money was being made available for the operations of local schools (or cities or counties). This problem led to the legal challenge to the prevailing system of property assessment.

The result of the General Assembly's action in that First Extraordinary Session of 1965 was House Bill 1. That act, which became popularly known as the "roll-back law," directed each taxing district to roll-back its tax rate for tax year 1966 to the point where the same amount of revenue would be produced under a 100% of value assessment system as was produced the year before under a partial value assessment system. House Bill 1 also gave each local taxing district the option of raising its rate by 10% in 1966 and the following year, but from that point on, House Bill 1 froze, on the upside, local property tax rates. In other words, the rate levied by school districts and other local taxing districts in 1967 was the maximum tax rate that could be levied from that point on.

During the ten-year period between 1965 and 1975, Kentucky's property tax system lived a rather quiet life. Property tax revenues increased annually at an average rate of about 5%, property tax assessments increased annually at a rate of about 5%, and property tax revenues to the local taxing districts increased annually at about 5%. While schools and local governments were not getting rich, they were, at least keeping pace with inflation, which was running at an annual rate of about 5%.

But in 1975, property values began to escalate at a very rapid rate. By 1978, property values were increasing at an annual rate of 10 to 12%. When local assessors increased their assessments by that same amount, the tax bills also went up by that amount, because the policy makers of the local taxing districts continued to levy the same tax rate, thus taking full advantage of the increase in assessments.

Taxpayers who had remained quiet with 5% increases in their tax bills now became irate at 10% increases. The legislative bodies of the local taxing districts countered by saying, "We didn't raise taxes, we just levied the same rate as we levied last year," and pointed their finger at the local assessor.

Consequently, property tax assessments began to fall behind, and by 1978 they had reached a level of 65% of fair market value, the lowest since 1966. The Department of Revenue took notice and ordered a number of county assessors to make substantial increases in their assessments for 1978. As a result of the department's action, the total, state-wide assessed value of property jumped by 11.4% in 1978. In some counties, 1978 assessments increased as much as 40 and 50%, a number increased by 20 to 30%, and still others by 10 to 20%.

By the fall of 1978, the taxpayers in a number of Kentucky counties were up in arms. In the face of substantial increases in the assessed value of property, the legislative bodies of the local taxing districts had levied the same rates that they had generally levied since 1977, often without a public explanation of their need for the additional funds. The public saw the major tax increases as unnecessary windfalls.

When the Kentucky General Assembly met in special session on the 8th of January in 1979, the property tax pot was approaching the boiling point. About one-half of Kentucky's 120 counties had received substantial increases in assessments in 1978; the other one-half were scheduled for substantial increases in 1979. As an example, the Department of Revenue had ordered for 1979 a 50% increase in farm land assessments and a 9% increase in residential property assessments for Jefferson County, a 19% increase in residential property assessments in Fayette County, a 14% increase in residential property assessments in Boyd County, a 22% increase in residential property assessments in Harlan County, and a 13% increase in residential property assessments in Madison County. With cries of anguish still ringing in their ears from the taxpayers whose 1978 assessments had jumped so dramatically, the General Assembly was looking at a long list of increases for 1979. The product of that special session, House Bill 44, combined full disclosure and public participation provisions with tax revenue benchmarks, to produce an effective mechanism for local property tax restraint.

To meet the requirements of House Bill 44, local taxing districts (counties, cities, school districts and special taxing districts) must annually perform several functions. The first of these is the computation of a "compensating tax rate." The compensating rate, zero growth rate, or fully rolled-back rate, as it is variously known, is the rate which,

when applied to the current year's value of "old year" real property, will produce just the same amount of revenue as was produced from the same property the year before.

Next, if the local taxing district proposes to levy a rate which will exceed the compensating tax rate, i.e., a rate which will produce more revenue from the real property which was on the tax roll last year than was produced from that property last year, it must advertise and hold a public hearing on the proposed rate. The advertisement must include specified data about the amount of additional revenue the district would earn, in addition to time and place information about the hearing.

Finally, if the local taxing district levies a rate which produces more than a 4% growth in revenue from old-year real property, it must again communicate with the local taxpayers through an advertisement, notifying them of its action and advising them of their rights under the law. Those rights involve the filing of a petition which places the question of the tax rate on the ballot at the general election held in November of each year. If the rate is approved by the voters, it stands as levied; if it is defeated, it is automatically rolled-back to an amount which will produce just a 4% increase in revenue from old-year real property.

(The magic of the 4% level, set into law by the 1979 Special Session, was that a 4% growth in revenue from old-year real property, plus a 3% growth in revenue from new real property and a 7% net growth in revenue from old and new personal property [the state-side averages in each of the three years prior to 1979], would give each taxing district an approximate annual 7% increase in revenues. Immediately prior to the General Assembly coming into special session in 1979, then President Carter had asked all elements of business, both private and governmental, to hold wages and prices at or below 7%. Thus, the 7% increase for local governments complied with the President's request.)

Looming over the 4% benchmark tax rate, however, is the ultimate local property tax restraint, the maximum tax rate provision of 1965 House Bill 1. Retained in 1979 House Bill 44, this provision has had an even greater impact when coupled with the constraints added by House Bill 44.

While House Bill 1 established the tax rate levied in 1977 by schools and other local taxing districts as the maximum tax rate that could be levied in the future, when added to the provisions of House Bill 44, that feature took on a new dimension. If a local taxing district chose to roll-back its property tax rate to stay within the House Bill 44 4% revenue increase benchmark, that rate then became the new maximum tax rate that could be levied by that taxing district in future years. And, while that same process was true under House Bill 1, House Bill 1 lacked the impetus to roll-back rates that was present in House Bill 44.

That House Bill 44 has effectively restrained local tax rates cannot be denied by even the most casual observer of Kentucky's local taxing process. In the initial years subsequent to the enactment of House Bill 44, the impact of that act was dramatic. The

vast majority of schools and local taxing districts chose to levy rates that produced revenues within the 4% benchmark, and a number even adopted the compensating rate as their tax levy, thus experiencing no revenue growth. During this same period, unfortunately, the cost-of-living grew to double-digits, reaching 11.5% in 1979 and 13.8% in 1980, and while most local governments were able to realize a full 7% annual increase in revenue, the disparity between income and expense was disastrous for schools and local governments.

In recent years, the pendulum has swung to the opposite side. Inflation has been held in check at levels of 3 and 4%, but a new problem has arisen.

With a low rate of inflation, the increases in property values have also been extremely modest, frequently trailing the cost-of-living index. In fact, during 1986 and 1987, property values experienced little or no increases. As a result, schools and local governments, trapped by the maximum tax rate provision of House Bill 44, were unable to generate new revenues in any appreciable amount.

Given a situation where local taxing districts are unable to increase tax rates, and where property values are stagnant, no new revenues are forthcoming. And while annual cost-of-living increases are modest, the cumulative effect of no new revenues and annual 3% to 4% rates of inflation is taking its toll.

The impediment of HB 44 to the raising of new revenues recently received judicial notice. Ruling in *The Council for Better Education, et al. vs. Wallace Wilkinson, Governor, et al.*, Judge Ray Corns, Franklin Circuit Court, Division I, had this to say:

> This Court does not hold that House Bill 1 (H.B. 1) of the 1965 Extraordinary Session of the General Assembly or House Bill 44 (H.B. 44) of the 1979 Extraordinary Session of the General Assembly are *per se* unconstitutional. They are, however, when considered as part of the overall system of school finance, a contributing factor to an unconstitutional result. In fact, by this legislation, the General Assembly has set a maximum permissible *ad valorem* tax rate for each of the one hundred seventy-seven (177) school districts which flies in the face of all logic, tax equity considerations, and revenue raising potential.

Discussion

There are several options available to persons interested in allowing local governments more flexibility in raising property tax revenues. Since the immediate problem is the result of the maximum tax rate provision, it is only logical that any alternative include repeal of this provision.

One option would be to simply repeal the maximum tax rate provision, while maintaining the 4% benchmark, full disclosure and public participation provisions of House Bill 44. Another alternative would be to repeal the maximum tax rate provision and the

4% benchmark, substitute a floating benchmark pegged to an increase to the Consumer Price Index (CPI), a fraction of the CPI, or an economic index designed specifically for this purpose. A third alternative would include repeal of the maximum tax rate provision and removal of the 4% benchmark and the petition and referendum provisions, while retaining the public notice and public hearing provisions. The proponents of this position argue that it gives local officials full flexibility to increase revenues, but also allows the taxpayers to make an informed decision at the ballot box at the next local officials' election. The fear of reprisal on election day would, presumably, keep tax rates within reasonable bounds.

A fourth alternative would involve the removal of the 4% benchmark and maximum tax rate provisions, thus allowing local officials to set whatever tax rate they choose, but giving the local taxpayers the right to petition for a referendum on <u>any</u> tax rate levied above the compensating tax rate. Under this proposal, of course, the public notice and hearing provisions of House Bill 44 would be retained.

The proponents of this last option claim that in the long run it would allow schools and local governments to realize more revenue than under any of the other alternatives. Removal of the 4% benchmark, which is seen as a psychological barrier, would make taxpayers more responsive to arguments by local officials for increased revenues. Local officials, knowing that taxpayers could voice their displeasure by voting down the rate rather than the officials, would be more likely to seek revenue increases. An increase in the percentage of signatures of qualified voters necessary for a valid petition could be a partial trade-off for giving the public the opportunity to challenge any tax rate.

DISTRIBUTION AND BUDGETING OF LOTTERY PROCEEDS

Prepared by Dee Baugh

Issue

How should Kentucky's lottery proceeds be budgeted and allocated?

Background

In 1988, following approval by the voters of a Constitutional amendment allowing creation of a state lottery, Governor Wallace Wilkinson called a Special Session of the legislature to establish the framework for the lottery. In the call for that Session and his subsequent proposed legislation, the Governor sought to allocate the net proceeds of the lottery among a one-time bonus for Vietnam-era veterans, early childhood programs and programs for the elderly. The legislature, however, declined to follow those suggestions, with the exception of the bonus, which will be distributed from accumulated net proceeds in 1990. Net proceeds not required to meet needs of the bonus will be held for appropriation by the 1990 General Assembly. The legislature will also decide in 1990 on the questions of distribution of future net proceeds and on the method of budgeting those proceeds.

Discussion

The question of earmarking net lottery proceeds is one with strong advocates on both sides. Of those states with lotteries at the end of 1988, ten allocate net proceeds to their General Funds. Of the remaining states, nine earmark net proceeds for education purposes, three earmark for economic development purposes, two return net proceeds to local governments, one allocates net proceeds to capital construction and one uses net proceeds exclusively for programs for the elderly. Several states are bound to the earmarking through Constitutional or statutory provisions. Other states utilize a hybrid approach by earmarking the net proceeds of specific games.

Maryland, for example, while channelling net proceeds into its General Fund, has also instituted two instant games, proceeds from which benefit construction of a stadium. New York, while required by law to use lottery proceeds for education, has made two exceptions: one to meet a budget shortfall in fiscal year 1976-77, and a second to create an Olympic Lottery, with proceeds from that game supporting the Winter Olympics.

Earmarking can be done by formula, such as the method used in Arizona, where the first $23 million is allocated to local transportation, the next $7.65 million goes to county governments and the remainder is deposited to the credit of the General Fund. Colorado also uses a formula method and earmarks approximately 30% of its net proceeds, with 40% of that amount allocated to a conservation trust fund, 10% to parks and 50% to capital construction.

Advocates of the earmarking approach cite a high degree of citizen satisfaction and approval when certain projects or purposes are identified with the lottery. Colorado can point to a new 500-bed prison, a new marina in a major city or acquisition and development of a 1,500-acre state park. Michigan equates the $800 million in revenue earmarked for education in the past two years as a "state tax savings of about $250 per household." Earmarking proponents claim that these types of examples motivate higher participation in the lottery.

It would be difficult, however, to sustain that reasoning in all cases; e.g., when ticket sales soared recently in Pennsylvania, it's doubtful that the earmarking for the state's elderly was an overriding factor. Advocates of allocating net proceeds to the General Fund cite greater flexibility in meeting the state's shifting budgetary needs. They also point to the unpredictability of revenues as support for budgeting and appropriating those funds in the context of total state revenue, not as a single funding source for important programs.

Tied to the question of earmarking is the method of budgeting the net proceeds. The choices are either to budget the funds based on estimates (just as other revenue sources are treated) or to appropriate the funds from actual proceeds. Most states use the estimating approach; six states appropriate from actual proceeds. Virginia is following what might be called the more conservative approach, with the legislature appropriating the funds after they accumulate, while making estimates on anticipated revenue as a guideline in preparing its budget.

In the case of estimating lottery revenues (particularly critical when earmarking is used), the method of arriving at an estimate varies widely. For example, in Missouri the Lottery Commission in the Department of Revenue makes an estimate, but the Governor and the legislature also make estimates. The legislature appropriates lottery proceeds using a range for anticipated revenue, but has often faced shortfalls using that approach. In New Hampshire, net profits are transferred annually to the state department of education, which distributes the funds. In budgeting for the funds, estimates are used, but with General Fund dollars available as a backup for any shortfall. Oregon also budgets based on estimates, but includes in its appropriation bills provisions for shortfall and surplus circumstances. In Pennsylvania, if lottery proceeds fail to meet statutory funding requirements for its senior citizen programs, the legislature is required to appropriate General Fund dollars to meet those needs.

The question of a budgeting method naturally becomes more critical when net proceeds are used to supplant, not supplement, other funding sources and when earmarking ties the funds to vital budget areas, such as education. The overall fiscal health of the state and level of competition for state revenues also affects the choice of budgeting, with appropriation to more critical needs favoring the actual proceeds budgeting method. States which either do not earmark or earmark in less vital areas can more easily afford to utilize the estimating method. The issues of earmarking and budgeting should be considered concurrently.

BANKING AND INSURANCE

BRANCH BANKING

Prepared by Jim Baker

Issue

Should banks be allowed to establish branch banking offices outside the geographic boundaries currently permitted by law?

Background

A Kentucky bank is are currently permitted to establish branch banking offices within the same city in which its principal office or an existing branch office is located. Banks are restricted from establishing branch banking offices in areas where there is a principal office of another existing bank. Banks may not branch in another county. This is known as the home office protection rule. Expansion which is otherwise prohibited by home office protection can only be accomplished by acquisition or chartering a new bank. Bank holding companies which have acquired banks in good markets paid a premium for the franchise. Independent banks desire to protect their market from outside competition. These groups would probably oppose changes in the branching laws. Other banks regard home office protection as an unrealistic barrier to common business practices, particularly in integrated metropolitan areas where geographic boundaries are considered an artificial means to restrict competition and progress. It will be extremely difficult to achieve a consensus within the banking industry to modify the branching laws in any respect.

Discussion

There are several possible alternatives which could be considered to expand banking markets through branch office establishments. The first alternative would permit an applicant bank to establish a branch in the city where another bank has its principal office if that other bank operates a branch in the home office city of the applicant bank. The second alternative would permit county-wide branching at any location. The third alternative would permit branching in contiguous counties.

REVOLVING CREDIT

Prepared by Jim Baker

Issue

Should the revolving credit mortgage statutes be amended to conform with current lending practices?

Background

Revolving credit mortgage practices now in use are based in part upon industry standards developed to take advantage of federal tax code changes on the deductibility of interest payments. Kentucky law is silent on the structuring of many credit transactions. The banking industry supports a proposal to statutorily define the terms and conditions of revolving credit secured by mortgages.

Discussion

All parties appear to aggree that statutory guidelines relating to revolving credit for Kentucky financial institutions and consumers would be preferable to business practices now in use. Statutory guidelines would provide uniformity in the commercial marketplace and provide direction for the courts in resolving legal disputes. The other alternative is for financial institutions to continue current lending practices without statutory guidance.

MULTIBANK HOLDING COMPANIES

Prepared by Jim Baker

Issue

Should the bank holding company law be amended to (1) increase the 15% deposit cap; (2) permit consolidation of operations; (3) permit the conversion of banks to branches; and (4) allow bank holding companies to acquire savings and loan associations?

Background

(1) When the multibank holding company legislation was enacted in 1984, bank holding companies were limited to 3 bank acquisitions per year through July 15, 1989, in addition to a 15% deposit cap based upon the total deposits in all banks in the state, regardless of the number of banks acquired. The bank acquisition limit is removed in 1989. The deposit cap remains in effect. In 1988 it appeared that the two largest bank holding companies in Kentucky would need relief from the deposit cap to make other acquisitions. An attempt to increase the deposit cap to 20% in an omnibus banking bill was not enacted during the 1988 General Assembly. However, bank deposits increased by 9.8% in 1988 to $28,937,000,000. The deposit cap for calendar year 1989 is $4,341,000,000. National City Corporation, Cleveland, Ohio/First Kentucky National Corporation, Louisville, Kentucky, with 6 acquisitions, controls $3,676,883,000 in deposits, and PNC Financial Corporation, Pittsburgh, Pennsylvania/Citizens Fidelity Corporation, Louisville, Kentucky, with 9 acquisitions, controls $3,666,095,000 in deposits. The third largest bank holding company, Liberty National Corporation, Louisville, Kentucky, has made 7 acquisitions and controls $2,237,030,000 in deposits.

(2) Another unsuccessful legislative effort during the 1988 General Assembly was a proposal to permit bank holding companies to consolidate operations. This would permit the centralization of selected administrative, management or operational activities common to all affiliated banks in a holding company organization with one specific bank. These activities could include the trust department, investments, loan collections and record maintenance. From an economic perspective, consolidation is promoted as a means to control expenses within a banking group and provide better services to customers.

(3) A third carry-over from the 1988 General Assembly is a proposal to permit a bank holding company to convert acquired banks to branch offices. Branching by acquisition, the technical definition for this process, is a more comprehensive organizational restructuring than consolidation of operations. Each converted banking office would be designated as a branch of the lead bank. The most significant change would be in the management structure of the banks. Operational executive officers would be accountable

to one super board of directors, which would be responsible for the entire banking organization. Banks would also lose their community identity.

(4) With the financial crisis confronting the savings and loan industry on a national basis, the Federal Reserve Board has permitted bank holding companies to acquire problem savings and loan associations on a limited basis. Congress is also considering a bail out program for the insolvent Federal Home Loan Bank Board deposit insurance fund. A merger with the Federal Deposit Insurance Corporation deposit fund is one option under consideration. Permitting financially sound and well-managed bank holding companies to acquire savings and loan associations is an emerging trend to strengthen public confidence and regulatory oversite of the savings and loan industry.

Discussion

(1) With an increase in statewide bank deposits during 1988, the 15% deposit cap is not as critical an issue as it was when several bank holding companies were approaching the deposit limit. Continued growth in 1989 will also improve the situation. An alternative to increasing the deposit cap would be to include deposits in savings and loan associations and credit unions in the deposit base used to calculate acquisition limits. Several states use this method.

(2) If the consolidation of operations proposal is considered impractical as a banking industry change, one specific area should be addressed from a legislative policy perspective. That area is the consolidation of trust operations. There is a legitimate difference of opinion regarding whether a bank may delegate its fiduciary duties to an affiliate bank under current banking law.

(3) Branching by acquisition is a broad corporate restructuring plan which encompasses the limited consolidation of operations proposal. Enactment of this alternative would accomplish both objectives.

(4) Acquisitions of savings and loan associations by bank holding companies is a national trend which will eventually involve Kentucky. The most likely means of this occurring will be legislation at the federal level, unless the states enact specific legislative programs based upon political considerations in those states. A delay in enacting legislation may place Kentucky's financial services industry at a competitive disadvantage if other states are permitted to develop regional markets before Kentucky becomes an active participant.

BANKS AND THE MARKETING OF INSURANCE

Prepared by Jim Baker

Issue:

Should banks be allowed to engage in the direct marketing of any type of insurance product?

Background

Under Kentucky law banking organizations are restricted in the marketing of insurance products to credit life, health and mortgage-related insurance. The direct marketing of other lines of insurance is prohibited. Banking organizations believe they can offer all lines of insurance at competitive premiums. Insurance groups will oppose the proposal. On an industry-wide basis, there are insurance companies or their affiliates which own banks and offer these services.

Discussion

In actual practice, many banks in Kentucky now have business relationships with insurance agencies through common ownership of bank and insurance stock by officers and directors. This proposal would permit banks to improve their earning potential by acquiring or chartering an insurance agency. Proponents contend that consumers would benefit from reduced costs, wider range of choices, and improved services. Opponents argue that banks will gain the potential to coerce bank customers to buy insurance from them, banks will face increased risks if allowed to underwrite insurance, and the possibility of economic power being concentrated among a few, large financial institutions will increase.

RATE REGULATION BY THE COMMISSIONER OF INSURANCE

Prepared by Bill VanArsdall

Issue

Should the state be given more authority to regulate insurance rates?

Background

Rising insurance rates have affected almost everyone in Kentucky. Individuals, businesses and governments find themselves devoting a larger portion of their earnings than ever before to insurance on vehicles, buildings, liability, health and accidents. Increased attention to insurance costs has led legislators and others to question whether Kentucky is adequately regulating the premiums that insurance companies charge.

Various lines of insurance are regulated in different ways under Kentucky law:

Subtitle 13 — Subtitle 13 of the insurance code governs the rates of property and casualty insurance involving personal, family and household risks (automobile, homeowners', etc.). It also covers commercial risks designated by the Commissioner of Insurance; lines presently designated include workers' compensation, professional liability and farmowners' insurance.

Until 1982, rates in these categories required the approval of the Commissioner of Insurance (or of the Kentucky Insurance Regulatory Board, which existed for two years). In 1982, the system was changed so that many of these rates no longer required prior approval before going into effect. If a competitive market is determined by the commissioner to exist for a particular type of insurance, an insurance company needs only to file the rates with the commissioner within fifteen days after their first use. If a market is designated noncompetitive, rates must be submitted at least thirty days before the proposed effective date and the commissioner has the power to disapprove them.

In 1988, the General Assembly added a "flex rating" requirement whereby insurers proposing to adopt a twenty-five percent increase or decrease in their rates must receive prior approval from the commissioner.

Health Insurance — Group health insurance rates receive little regulation under Kentucky law.

Individual health insurance rates may be disapproved by the commissioner if benefits are "unreasonable in relation to the premiums charged" (KRS 304.14-130). Reasonableness is currently defined in a regulation (806 KAR 17:070) in terms of the "loss ratio," the proportion of premiums paid out in claims.

Health maintenance organizations are forbidden by regulation from setting rates that are unfairly discriminatory or that will result in unjustified accumulations of reserves.

Life Insurance — Rates are set by the insurers, usually according to national standards.

Credit Life and Health Insurance — KRS 304.19-080 establishes maximum rates.

Discussion

During 1988, three bills were introduced to reinstitute a Kentucky Insurance Regulatory Board which would have the power to review and disapprove all rates under Subtitle 13. These bills would have required insurance companies to justify their rate filings. Distinctions between competitive and noncompetitive markets would have been abolished, and the current "file and use" mechanism would have been repealed.

In the health insurance field, a recent rate increase has caused the courts to consider the insurance commissioner's power to review rates. In May of 1988 Blue Cross & Blue Shield of Kentucky announced a rate increase on its individual health insurance policies. Premiums rose an average of thirty-eight percent, and some elderly policyholders were faced with increases of eighty percent.

The insurance commissioner disapproved the rate increase after a hearing officer determined that it would be "devastating to older policyholders." Blue Cross appealed that decision to court, challenging the commissioner's power to reject the new rates. Franklin Circuit Court heard the case and reversed the commissioner's decision. Judge Graham wrote that the commissioner's arguments were "compelling and disturbing" but that the legislature had not granted the commissioner sufficient power to deny the rate increase. The statutes demand that individual health insurance premiums must not be "unreasonable in relation to the premium charged," and the regulation states the sole standard of reasonableness in terms of the company's loss ratio. Since Blue Cross could demonstrate that it met the fifty-five percent loss ratio requirement in the regulation, Judge Graham wrote, he had no choice but to approve the increase. The judge also rejected the commissioner's argument that the company had not submitted enough information to prove the new rates were reasonable.

The Department of Insurance appealed the case directly to the Kentucky Supreme Court, bypassing the Court of Appeals. On June 22, 1989, the Supreme Court heard arguments from several parties. The Attorney General, arguing against the rate increase, stated that there is nothing in the current law demanding such a narrow interpretation of the term "unreasonable." The Department of Insurance has the power, he said, to consider the full impact of proposed rate changes on the consumer and on the company. In its argument, the department claimed it possesses the power to disapprove rates under KRS 304.12-130, which allows the commissioner to prevent business practices that are "unfair, deceptive or not in the public interest."

STATE HEALTH INSURANCE CONTRACT

Prepared by Bill VanArsdall

Issue

Should benefits offered under the state health insurance contract be improved?

Background

Since 1948, people who work for the state of Kentucky have been allowed to participate in group health insurance. At first, employees were responsible for the entire premium, but since 1972 the state has paid all or part of the cost of the program. In 1975, school board employees were included in the state group, and other workers and retirees have been added since then. The state plan now insures Kentucky employees, school board employees, retirees under the age of sixty-five and local health department employees.

In 1988, the General Assembly allowed the state to operate its own health insurance program rather than to hire an outside company. After bids were solicited from insurance companies throughout the nation, self-insurance appeared to be the only option for the 1988-1990 contract. The Department of Personnel reports that forty of the largest insurance companies in the country were asked to submit bids and only three responded. None would agree to the terms of the proposal. After declaring an emergency and further negotiating with insurers, the state declared that it would self-insure. The Department of Personnel now manages the state employee benefit fund, with a third-party administrator, the ICH Corporation, to administer the claims.

Persons covered by the plan have several options. They may choose one of the two benefit levels offered under the self-insurance program (Kentucky Kare and Kentucky Kare Select) or they may choose from a variety of health maintenance organizations (HMOs) and preferred provider organizations (PPOs). Between November, 1988, and October, 1989, there were seven HMOs and one PPO available to at least some of the employees covered by the plan. In all cases, the state pays the same amount per employee ($89.07 per month for 1988-89 and $102.96 per month for 1989-90). If the plan chosen by an employee charges more than this amount, the employee makes up the difference.

Kentucky Kare charges employees nothing for single coverage and $124.70 per month for family coverage. Under Kentucky Kare Select, which offers higher benefits, single coverage costs $9.00 per month and family coverage costs $143.60 per month. HMOs and PPOs charge various amounts for single and family coverage.

Discussion

When the 1988-90 levels of coverage were announced, a wave of protest swept across the state. State employees held rallies, wrote their legislators, and visited Frankfort. Teachers in some counties took days off from work. At least two groups of employees filed suit against the state.

At the heart of the protest were two complaints: (1) benefits have been significantly reduced under the self-insurance program, even though employees are in most cases required to pay more money; and (2) in many counties, employees have no option other than the self-insurance program. HMO and PPO coverage is available in less than half of Kentucky's counties, mainly in an area some employees call "the golden triangle" — the bluegrass and northern Kentucky. Teachers and state workers who live in eastern and western Kentucky often have no option other than Kentucky Kare and Kentucky Kare Select.

Employees who choose or are forced to take coverage under Kentucky Kare or Kentucky Kare Select face higher premiums, higher deductibles, higher copayments and higher maximum expenses than they faced in the past. Under the previous two-year contract, deductibles were no higher than $200 for a family; now they are $400 per family under Kentucky Kare Select and $800 under Kentucky Kare. The copayment ratio was 90/10 (the state paid 90%, the employee paid 10%); now the ratio is 80/20. The maximum out-of-pocket expense for a family was $1,000 a year; now it is as high as $3,500 a year.

Some employees and teachers claimed they could not afford such reductions in coverage. Some families dropped their insurance in favor of the cheaper individual coverage. Teachers complained that their morale was undermined by cuts in insurance when they already faced low pay and cutbacks in other areas. Many said that they actually faced a net reduction in pay because the lower insurance benefits more than offset their two-percent pay increase.

The Subcommittee on Insurance of the Interim Joint Committee on Banking and Insurance held a series of hearings around the state in response to these complaints. Large crowds turned out for the meetings, which were held in Hazard, Ashland, Kentucky Dam Village, Bowling Green and Owensboro. Commissioner Thomas Greenwell of the Department of Personnel accompanied the subcommittee to these hearings, explaining the new coverage in detail and responding to questions. After the hearings, the subcommittee submitted a report and a set of recommendations to the Banking and Insurance Committee, which approved them and sent them to the Governor. Several members of the committee met with the Governor to discuss the report.

The principal topics at the hearings were the reduction in coverage and the unavailability of an HMO option in many areas of the state. Participants also wanted to know about the agreements that had been signed with a number of hospitals. Participating hospitals were agreeing to waive deductibles and to improve the copayment ratio to 85/

15, but most of the participating hospitals were located in central Kentucky. Many people who testified saw this as another example of discrimination against persons living outside the "golden triangle." At the hearings and on several later occasions, Commissioner Greenwell assured his questioners that the Department of Personnel was aggressively seeking participation by hospitals in all areas of the state.

Another question that arose repeatedly at the hearings concerned the mail-order prescription program. Under Kentucky Kare and Kentucky Kare Select, maintenance medication (any prescription over thirty days, not to exceed a ninety-day supply) was to be available only through the mail. This requirement, intended as a cost-saving measure, was widely criticized at the hearings for being impractical, inconvenient and inconsistent with good service. Pharmacists spoke at all the hearings, complaining that out-of-state suppliers could not provide prompt or personal care, and that Kentucky pharmacists should be allowed to participate in the state plan because they contribute a great deal to the state by paying taxes, employing Kentuckians and participating in state programs. As a result of the discussion at the hearings and elsewhere, the implementation of the mail-order prescription program was delayed. The issue was later discussed in several interim legislative committees. On August 17, 1989, the Finance and Administration Cabinet canceled its request for proposals, abandoning the mail-order prescription program for the time being.

Since the hearings, two other problems have arisen relating to coverage under Kentucky Kare and Kentucky Kare Select. One concerns the gap in coverage for pre-existing conditions when teachers retire on disability. Teachers leaving active employment are covered under a separate plan operated by the Teachers' Retirement Board. Until very recently, a teacher leaving active employment because of disability received only $1000 of coverage for pre-existing conditions during the first year of retirement. Disabled teachers with serious medical conditions could easily be faced with $50,000 or $100,000 of medical bills during the first year of retirement, even though their insurance coverage was very limited. Members of the Banking and Insurance Committee agreed that this was unfair, and the committee prefiled a bill (90 RS BR 239) giving disabled teachers the right to continue their coverage under the Kentucky Kare and Kentucky Kare Select plans until any limitations on pre-existing conditions in their retirement coverage have expired.

If enacted, this bill would take effect in 1990. To cover the gap until that time, the Teachers' Retirement Board announced in June of 1989 that it was expanding its coverage from $1000 to $100,000 for pre-existing conditions during the first year of disability retirement. This temporary change in policy will apply to the period beginning on November 1, 1988, and ending on October 31, 1990.

The other problem that arose after the hearings were concluded concerned coverage of injuries received in the course of outside employment. An employee of the Hardin County Board of Education was told that his claim would be denied under the state plan because the injury occurred while he was operating machinery on a farm. This denial was the

result of a strict interpretation of language that had applied to the state plan for years. The booklet accompanying Kentucky Kare coverage contains the following language under the heading "Exclusions": "Services or supplies for any condition, disease, ailment or accidental injury arising out of and in the course of employment." Under earlier state insurance plans, identical language had been interpreted to mean that only injuries covered by workers' compensation would be excluded. The new interpretation broadened the exclusion to include all injuries received on outside jobs.

The Department of Personnel subsequently reversed its interpretation and agreed to cover the Hardin County employee and all others whose work-related injuries are not covered by workers' compensation. Commissioner Greenwell assured two committees of the legislature that "we have no intention of not continuing to cover these claims as has been done in the past." The bill prefiled by the Interim Joint Committee on Banking and Insurance, 90 RS BR 239, included a section requiring the state to adhere to this interpretation. The bill allows the state plan to exclude coverage of conditions arising out of employment "only if such services and supplies are covered by workers' compensation under KRS Chapter 342."

For more information, see "Health Care for Employees and Retirees" in the State Government section of this publication.

INSURANCE SYSTEM REFORM: CALIFORNIA'S PROPOSITION 103

Prepared by Greg Freedman

Issue

Should the 1990 General Assembly continue the overhaul of the insurance system in Kentucky it started at the 1988 Session by enacting provisions of California's Proposition 103?

Background

Proposition 103, which was approved by California voters on November 8, 1988, requires rates to be rolled back for property and casualty insurance from 10 to 20 percent below July 1, 1988 levels. Although the rollback was the most highly publicized change in the insurance reform initiative, other provisions will have a more significant effect over the years on California's insurance rates. These provisions will surface in the form of bills in many state legislatures, as they already have in two neighboring states, Indiana and Ohio.

Discussion

Time will tell whether Proposition 103 will provide effective insurance reform for consumers or will further complicate the relationship between insurers and insureds. The rate rollback is a backlash by the public to years of seemingly unchecked rate increases in excess of the rate of inflation. The other provisions signify the public's concern that the insurance industry be more competitive and the consumer be afforded more consideration both by the industry and the insurance commissioner. These reforms may amount to little more than ill-advised regulatory restraints approved out of frustration, but the fact that the initiative was approved indicates insureds in California will no longer tolerate rising insurance premiums without clear and convincing proof that an increase is warranted.

The Kentucky General Assembly acted in 1988 to alleviate the insurance availability and affordability issue with enactment of House Bills 551 and 552. It will take time to judge the effectiveness of those initial efforts to overhaul the tort and insurance systems in Kentucky. In the meantime, as insureds continue to grapple with rising insurance costs, the reforms in Proposition 103 will spread across the country and be introduced in state legislatures in an attempt to halt the persistent increase in insurance premiums. Six of those reforms are described below.

1. Insurers in California will now be prohibited from cancelling or failing to renew automobile insurance policies except for non-payment, fraud or material

mispresentation, or a substantial increase in the risk being insured. In Kentucky, an insurer may cancel an auto insurance policy for only two reasons, but it may refuse to renew for any reason except the age of the insured. Kentucky simply requires that the insurer notify the insured of the reason for nonrenewal.

2. Banks will be allowed to act as insurance agents or brokers in California. It is contended that banks may save consumers money since they already have in place a branch network. Such a proposal would invoke strong opposition by the insurance industry in Kentucky. A survey conducted for the Kentucky Bankers Association, however, found that most Kentuckians would consider buying homeowner's, auto and life insurance from a bank if it were available.

3. California has repealed laws which prevent agents and brokers from rebating commissions. This could make agents more competitive by returning part of their commissions to insurance buyers. In Kentucky, KRS 304.9-421 prohibits agents from sharing their commissions with anyone other than a licensed agent, broker, consultant, solicitor or adjuster.

4. California will now require automobile insurance rates to be based on the insured's driving record, number of years of driving experience, and other factors adopted by the insurance commissioner. Previous attempts by Kentucky legislators to base rates on driving records have failed, but this may be the time for change. According to the National Insurance Consumer Organization, auto insurance premiums increased 9 percent in 1987 when inflation was 4 percent, 13 percent in 1986 when inflation was 1 percent, and 11 percent in 1985 when inflation was 4 percent.

5. California will elect the insurance commissioner beginning in 1990. In Kentucky, the commissioner is appointed by the Governor. There is a growing feeling that insurance commissioners are pro-industry and when their terms are up they are employed too frequently by insurers. An elected commissioner would have to face the consumers on election day. According to a study by the National Association of Professional Insurance Agents and the Consumer Insurance Interest Group, out of 3,044 requests for rate increases nationwide in 1986, state insurance departments held hearings on only 44. Of the other 4,310 rate filings that did not require state approval but were eligible for public hearings, all were passed without hearings. The study also found that in most states "regulators lack the personnel and tools to properly fulfill their missions of providing adequate consumer protection and monitoring insurers for solvency."

6. California will now subject insurers to liability under the state's anti-trust law. It is expected that this change will end the industry practice of exchanging actuarial and other data. Critics contend this practice has resulted in price-fixing. Insurers claim the practice has been useful in producing fair and economically efficient rates.

ELECTRONIC FUNDS TRANSFER

Prepared by Greg Freedman

Issue

Should the General Assembly enact legislation to regulate the electronic transfer of funds?

Background

Electronic funds transfer (EFT), or electronic banking, is the checkless, or nearly paperless, movement of money. Point-of-sale terminals, an alternative to the traditional check processing system, is an EFT system that transfers funds from a consumer's bank account to the merchant's account. EFT systems such as Fedwire and Bankwire allow financial institutions to communicate among themselves.

The most familiar EFT system is automated teller machines (ATMs). In 1968, The First National Bank of Atlanta installed the first ATM in the nation at Valdosta, Georgia. An ATM dispenses cash, transfers funds between accounts, accepts deposits, answers balance inquiries, and may make payments to third parties. Banks promoted ATMs as a no-charge convenience which were cheaper to operate and more efficient than human teller services. Today, however, more and more banks are imposing charges for withdrawals at ATMs, usually 25 or 50 cents per withdrawal. A few banks charge to make balance inquiries at ATMs. Some banks charge a one-time, annual or monthly fee for an ATM card.

Kentucky statutes regulating financial institutions do not address EFT. An administrative regulation that has been in effect since November 12, 1975, 808 KAR 1:060, provides a procedure and set of criteria for the establishment of "remote service units." It is questionable whether this regulation was promulgated with statutory authority and it is the subject of litigation in *Bank of Crittenden v. Department of Financial Institutions*. The case has been submitted to Franklin Circuit Court.

The regulation permits a remote service unit to be used for the withdrawal of funds, instructing the financial institution to receive funds, and transferring funds for the customer's benefit. The Department of Financial Institutions must approve the establishment, use or sharing of a remote service unit before the actual use of the unit and after the financial institution submits certain information. Section 11 of the regulation provides that a financial institution may only operate or use a remote service unit that is located in the county in which the institution's principal office is located. There is an exception that permits an institution to share in the use of an out-of-county unit, but only if the unit is programmed so that the only type of transaction available to the out-of-county user is the dispensing of funds. The regulation does not provide for ATM minimum

standards to protect customers from assaults. It is estimated that 1,600 persons in this country are attacked each year at ATMs.

Discussion

There is no statute that either clearly defines EFT and provides for its regulation or authorizes the commissioner of the Department of Financial Institutions to promulgate regulations. Because of the broad implications of EFT on the banking system, the legislature may want to exercise its legislative authority by enacting legislation that designates permissible EFT systems and the types of transactions that each system may perform. Section 11 of the regulation points out the need for a statute that specifies the types of transactions that are permissible. That section provides that a bank or savings and loan may share in the use of a remote service unit located in another county, but only if the "only type of transaction available to an out-of-county user is the dispensing of funds." Despite the clear language of Section 11, EFT networks in Kentucky are not merely dispensing funds to out-of-county users, but are also handling transfers and account inquiries for them. This indicates that the regulation is not only outdated and inadequate, but also treated with indifference.

The operation of EFT networks across county lines in Kentucky has raised the issue of whether ATMs are branch banks. KRS 287.180 restricts the establishment of a branch to the county of the bank's principal office. EFT networks enable a customer of a bank in Paducah to withdraw funds from his or her account at an ATM in Louisville. If ATMs are deemed to be branches, the EFT networks operating in Kentucky are violating the statutory prohibition on cross-county branching. The General Assembly has not addressed the issue. In 1975, the Commissioner of the Department of Financial Institutions addressed the issue by proclaiming in Section 13 of 808 KAR 1:060 that a remote service unit is not a branch. What is and is not a branch bank is unclear, since Kentucky's statutes do not provide a clear definition. Under the McFadden Act a branch is a place "at which deposits are received, or checks paid, or money lent." In 1974 the Comptroller of the Currency issued a ruling that ATMs are not branches. The ruling was overturned in *Independent Bankers Association of America v. Smith*, 534 F.2d 921 (D.C. Cir. 1976). The federal court held that ATMs are branches under the McFadden Act. The Comptroller then adopted regulations stating that an ATM that is not owned or rented by a national bank is not a branch. This was challenged and upheld in *Independent Bankers Association of New York State v. Maine Midland Bank*, 757 F.2d 453 (2d Cir. 1985). It seems that an ATM not owned or rented by a bank is not subject to a state's branching laws, whereas an ATM owned or rented by a bank is subject to the branching restrictions of a state.

Although it is not certain whether an ATM is a branch in Kentucky (notwithstanding Section 13 of 808 KAR 1:060), it is certain that any EFT legislation must take into consideration the state's branching restriction. If legislation is enacted by the General Assembly prohibiting cross-county use of ATMs, whether owned by the financial institution or not, state-chartered banks would be at a disadvantage to the extent that national banks participate in a system of ATMs not owned or rented by banks. It is argued that prohibiting

EFT networks will hurt small banks, which can use the network to compete more effectively with large banks. Small banks could also be harmed if ATMs are treated as branches, because federal savings and loan associations and credit unions are not subject to state branching restrictions. There seems to be little, if any, objection to allowing EFT networks to use ATMs to dispense funds, transfer funds from one account to another, and to respond to inquiries of customers. These are the functions currently being performed by ATMs for out-of-county users in EFT networks in Kentucky. The objections are to the acceptance of deposits at ATMs. The acceptance of out-of-county deposits by ATMs in an EFT network can be construed to be cross-county branching.

Any regulation of EFT should take into consideration the protection of bank customers. It is estimated that 1,600 people are attacked annually at ATMs. Settlements have been won by victims of ATM-related robberies. Many times the assaults occur after the customer has left the bank's property and may never be reported to the bank. A bank's liability might be reduced and customers protected if there were minimum standards for ATM location and lighting, brochures with warnings distributed to customers, surveillance equipment installed at ATMs, and secret emergency numbers at ATMs to alert police. An alderman in Chicago recently proposed that ATMs be closed between midnight and 6:00 a.m., that an annual city license be obtained, and that safety inspections be conducted by police.

The issue of electronic funds transfer will again confront the General Assembly when it convenes for the 1990 Session. The 1988 Kentucky General Assembly did not approve a major banking bill, HB 652, which contained two sections on EFT. The legislation defined "electronic funds transfer" and other terms. It permitted a bank to use or share an electronic terminal or cash dispensing machine located in Kentucky outside of the area within which a bank can establish a branch. It did not allow for the acceptance of deposits at ATMs. Inadequate regulations and uncertain statutory authority produce diverse interpretations by financial institutions and litigation. Legislation which provides for the development of EFT systems within a framework of rules which are fair to all banks, provide for changes in the technology associated with electronic banking, and allow for the growth of electronic banking services to meet the demands of bank customers could remove the uncertainty in this area. A bill has been pre-filed by a legislator to regulate EFT, and the Department of Financial Institutions is currently developing its own legislation on EFT.

BUSINESS ORGANIZATIONS AND PROFESSIONS

INTERTRACK WAGERING

Prepared by Michael Greer

Issue

Should Kentucky's intertrack wagering law be adjusted to provide for more equitable application and division of revenues?

Background

Since New York state implemented this country's first off-track betting (OTB) system in 1971, most racing states have looked at various forms of off-track betting as ways to expand markets and increase revenues to the racing industry. In December, 1973, the Kentucky Legislative Research Commission completed a study of off-track betting. The study concluded that OTB would have public support and would provide net economic benefits to both the state and the racing industry. Despite these findings, the study Advisory Committee voted to not recommend off-track betting legislation. This position reflected a concern in the racing industry over the negative impact of OTB on live racing.

Over the ensuing years, the postion of the racing industry has gradually changed. The OTB experience of other states has done much to calm industry fears and bring about the change. Another very prominent factor has been the passage of the Kentucky Lottery, which was seen by the racing industry as serious competition for the wagering dollar. The industry quickly realized that additional revenues were needed to offset anticipated losses to the lottery.

The 1988 Kentucky General Assembly enacted HB 956, authorizing intertrack wagering in Kentucky. The legislation was drafted with considerable input from the racing industry and passed with industry support. Very simply described, intertrack wagering permits Kentucky tracks that are not racing to simulcast and conduct wagering on live racing at other Kentucky tracks. This system allows expansion of wagering markets through increased use of existing facilities. It also continues to limit wagering to track premises, which has led many to contend that intertrack wagering is not really off-track betting.

Intertrack wagering was initiated in September, 1988, when Turfway Park in Northern Kentucky simulcast its fall meet to Ellis Park in Henderson. During the first year of operation, all thoroughbred tracks participated in intertrack wagering and Bluegrass Downs, a quarter horse track in Paducah, also participated. The only harness track to participate was Louisville Downs, which as an experiment simulcast Turfway's winter meet along with its own live racing.

Over the first year of operation, Kentucky tracks did experience a reduction in on-track attendance and handle. ITW may account for part of this, but some of the decline may also be attributed to the Kentucky Lottery, which started in April, 1989. The additional revenues produced by ITW appeared in many cases to offset the losses. From September, 1988, through June, 1989, $102.2 million was wagered through intertrack wagering. For the period, the state realized an additional $4 million in pari-mutuel tax revenues.

Discussion

Overall, intertrack wagering may be termed a success, but a qualified success. Its impact on the racing industry has been uneven and not all segments of the industry have benefited. The thoroughbred industry has been the big winner, due to the popularity of thoroughbred racing. The harness industry, according to press reports quoting industry representatives, has been hurt. Because of this, provisions of the intertrack wagering law relating to simulcasting rights and the division of revenues may be reconsidered by the 1990 General Assembly.

One issue that may arise concerns simulcasting rights in counties containing more than one track. In counties with more than one track and a population over 150,000, intertrack wagering may not be conducted by a track when live racing is being conducted at the other track. At other times, a track has simulcast rights for racing of its own breed, and the other track may not simulcast that breed unless agreed to in writing by the track of breed.

In Jefferson County, Churchill Downs has simulcast rights for thoroughbred racing but declined to participate this past year as a receiving track. Churchill Downs agreed to let Louisville Downs simulcast Turfway Park's winter meet in exchange for fifty percent of the revenues. Considerably more money was wagered on the simulcast thoroughbred racing than on the live harness racing, causing the harness handle to drop dramatically. This had a particularly negative impact on the purse program at Louisville Downs.

In counties containing more than one track with a population under 150,000, simulcasting policy is different. Tracks may simulcast their own breed when live racing is being conducted at the other track. This provision prompted court challenge by Riverside Downs, a small quarter horse track in Henderson. Their suit contended that the provision was special legislation and therefore unconstitutional, since it applied only to Henderson County. They claimed that thoroughbred simulcasting at Ellis Park would be damaging to live racing at Riverside. In a decision rendered in the spring of 1989, the Franklin Circuit Court upheld the statute.

The pari-mutuel tax on intertrack wageirng may also be an issue in 1990. The current rate is 5% and after the respective breed development fund deductions are applied, the state receives a net of 4.25%. A new tax rate is scheduled to go into effect July 1, 1990. The new rate will be 3% and the development fund deductions will increase to 2%, leaving a net tax of 1%. This could mean a loss of $3 million or more in state tax revenues.

Another issue may be the percentage of the commission that is allocated to intertrack expenses. By law, 12% of the net take-out goes for expenses, to be split evenly by the host and receiving track. This split appears to be more advantageous to the host track, especially when there are multiple receiving tracks.

Another issue may be the expansion of intertrack wagering beyond the existing tracks. Under current law, any person with an association license may conduct intertrack wagering. A provision of law permits a license to be issued for limited steeplechase racing. According to news reports, a Nashville interest is attempting to get a license to conduct a steeplechase event in Simpson County, near the Tennessee border. There is the possibility also that the licensee may build an intertrack facility at this location to take advantage of the large Nashville market. Some legislators feel this effort would be damaging to existing tracks and is not consistent with the intent of the intertrack wagering legislation. A bill has been prefiled to require tracks to race a minimum of thirty (30) days per year to qualify for intertrack wagering.

LITTER CONTROL

Prepared by Michael Meeks

Issue

Should the state of Kentucky take further steps to control litter?

Background

Kentucky law prohibits the dumping, dropping, placing or throwing of litter on public highways or into public or private waters. It is the duty of the Kentucky state police, county sheriffs, police officers, city police officers, water patrol officers, fish and wildlife conservation officers, and all other law enforcement officers and peace officers to enforce the criminal littering laws of Kentucky. Although numerous law enforcement agencies are authorized to enforce the criminal littering laws, the environment reflects an ever increasing litter problem. One of the more effective methods of litter control in recent years is recycling.

Discussion

The Subcommittee on Business Regulation of the Interim Joint Committee on Business Organizations and Professions has addressed the problem of enforcement of the criminal littering laws. The Kentucky State Police, Fish and Wildlife Resources, Department for Natural Resources, and Parks Department have testified as to the number of citations issued by each agency for criminal littering within the past three years. Each agency testified that increases in the number of citations are desirable, but cite the problem of proof in obtaining a conviction on the charge. It is necessary that an enforcement officer personally see the act of littering in order to obtain a conviction. The subcommittee will be hearing from the District Judges' Association on the special problems which judges encounter in considering cases involving criminal littering.

Litter on highways and waterways comes in many forms, including plastic items, newspapers, cans and bottles. The subcommittee has received testimony from recyclers of glass and aluminum and will hear testimony from recyclers of plastics and paper. Glass and aluminum recyclers maintain that their industry is helping to solve the litter problem by offering money for the return of the glass and aluminum products. At present, aluminum has a 54% recycling rate and offers payments averaging approximately $.36 per pound. Glass has a 15% recycling rate and offers payments averaging approximately $.01 per container. It should be noted however that the recycling market is extremely sensitive to the law of supply and demand.

In addition to the recycling of glass, aluminum, paper, and eventually certain plastic products, other possible methods of combatting the litter problem include:

a. distribution of self-addressed cards to the public to report cases of littering to a central agency;

b. increasing fines for criminal littering;

c. distribution of litter bags to the public;

d. distribution of literature on the problems and effects of litter; and

e. increasing the number of law enforcement officers on the road and waterways.

SMALL WINERIES

Prepared by Mike Greer

Issue

Should the 1990 General Assembly enact legislation to further encourage grape cultivation and wine production?

Background

The 1970's saw a marked increase in the popularity of wine in the United States. A number of states, including Kentucky, viewed this trend as an opportunity for a new or expanded industry and adopted legislation to encourage wine production. Most states recognize that competition with large wine-producing states like California was not realistic. They chose instead to fill a market niche by encouraging "boutique" wineries, which would produce a quality local product and at the same time serve as tourist attractions.

The Kentucky Small Wineries Act was enacted in 1976. This legislation creates a special license for a "small winery", defined as a winery producing less than 50,000 gallons of wine per year. Small wineries are exempted from certain provisions of Kentucky's three-tiered marketing structure, an exemption intended as an incentive for the development of small wineries. Specifically, small wineries may offer samples for tasting and sell directly to consumers on the premises.

Soon after the enabling legislation was enacted, a small winery license was issued to the Colcord Winery in Paris, Kentucky. It was anticipated that other small wineries would follow, but to the disappointment of many, the Paris winery remains the only one in the state. In contrast, small wineries have flourished in other states. Michigan, for example, now boasts fifteen small wineries.

Discussion

Why has the small winery industry flourished in other states and not in Kentucky? According to the Kentucky Vineyard Society, one important reason is the lack of grapes in Kentucky for wine production. Other states produce the grapes used in wine production while in Kentucky only a few acres of grapes are under cultivation.

There is considerable potential for grapes as an alternative crop for Kentucky farmers. The soil and climate in Kentucky are conducive to grape growing. In fact, a thirty mile strip adjacent to the Ohio River has been compared to Germany's Rhine Valley. In addition, Kentucky is in an advantageous market location for both wine and table grapes.

A major problem appears to be a lack of information available to farmers on grape growing. Other states promote grape production by funding viticulture research and by providing sources of low-cost capital.

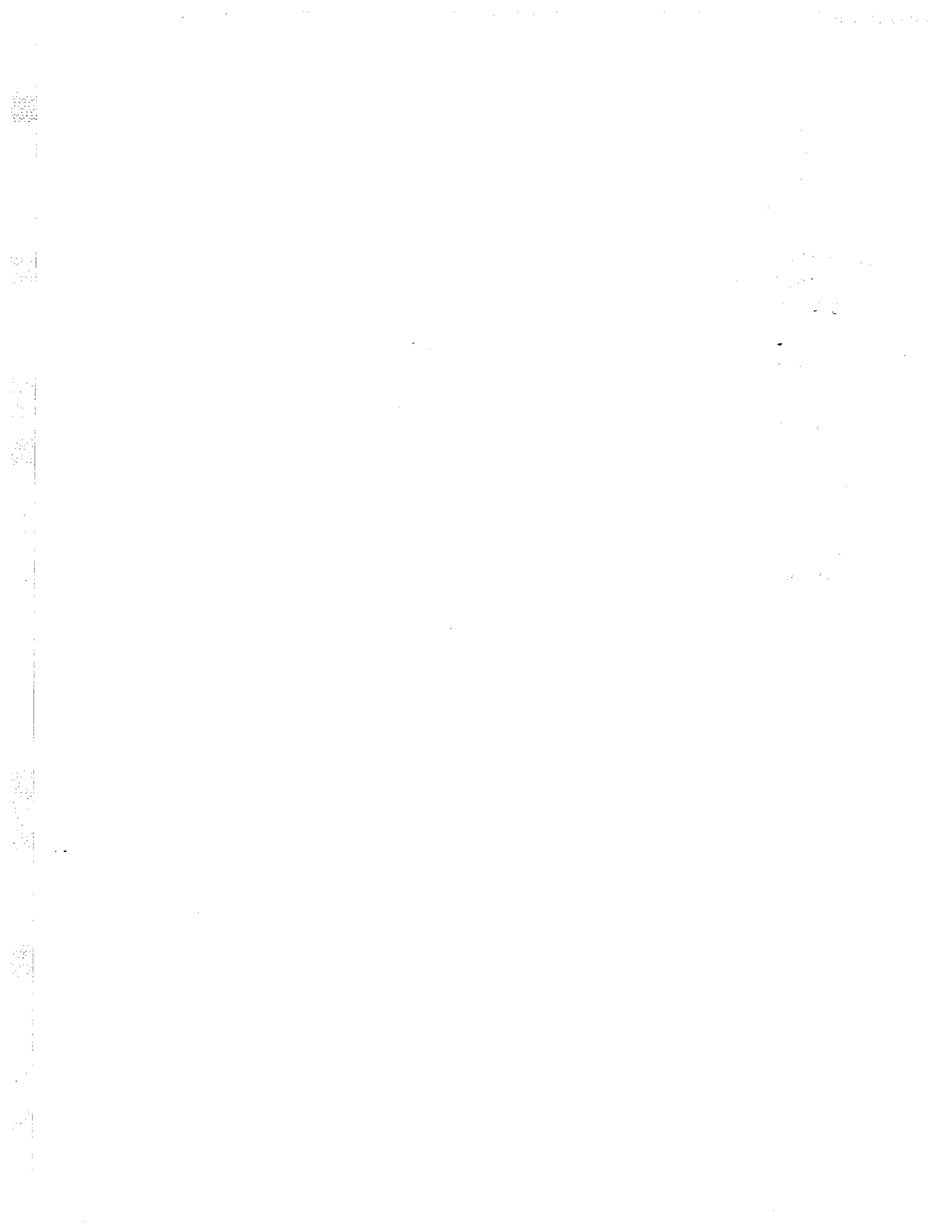
The Kentucky Vineyard Society appeared before the Interim Joint Committee on Business Organizations and Professions in February, 1989, to give an overview of grape growing and wine production in Kentucky and the problems being encountered. In May, representatives appeared again with a list of specific recommendations to address the problems. They recommended:

1. The creation of a Grape Industry Advisory Committee to promote and facilitate the development of a grape industry in Kentucky.

2. The creation of a special "farm winery" license to encourage wine production in conjunction with a producing vineyard.

3. Amendment of the Small Winery Act to permit a greater latitude in the marketing of wines produced by small wineries.

A bill containing these recommendations, BR 283, has been prefiled for the 1990 session and reviewed by the Interim Joint Committee on Business Organizations and Professions.



CITIES

ABSOLUTE MAXIMUM TAX RATES

Prepared by Jamie Jo Franklin

Issue

Should the General Assembly amend KRS 68.245(1), 132.023(1)(b) and 132.027(1)(b) to remove the absolute maximum tax rate for local governments?

Background

The ability of Kentucky local governments to set rates and levy taxes on property has always been controlled by state government. For the last 34 years limitations on this authority have come primarily from two major pieces of legislation, 1965 HB 1 and 1979 HB 44.

The Kentucky Court of Appeals on June 8, 1965 issued its judgment in the case of *Russman vs. Luckett*. The court determined that the constitutional and statutory provisions requiring the assessment of property at its full, fair cash value had been rendered obsolete by custom. The court said that despite this customary procedure of underassessing property, the provision for assessment at "fair cash value" was still the "law of the land." The court then directed that effective January 1, 1966, all property was to be assessed at its fair cash value.

The General Assembly, reacting to this decision, enacted House Bill 1, commonly known as the "Roll Back" Law, during the First Extraordinary Session of 1965. Because tax rates were based on property assessments which averaged about 30% of the fair cash value, the legislature was also seeking to calm the state-wide fear that property taxes might triple overnight.

HB 1 reduced state property tax rates to 30% of the old rates. But for local property tax rates, a limit was placed on the total 1966 revenues which could be collected by all local jurisdictions. Tax revenues for 1966 for local taxing districts were prohibited from exceeding the 1965 revenues, except for "new property." Thus rates would have to be "rolled back" to the point where they would not produce more revenue at the "full value" assessment than had been produced in 1965 for the same property. To many this has become known as the "absolute maximum tax rate" (AMTR). At the time, the General Assembly did realize a certain fiscal crisis might occur as a result of its actions. So it did permit local taxing districts to increase their revenues up to 10% in FY 66-67 and FY 67-68, to allow them to bring their tax rates up to an acceptable level. Except for these two years, the AMTR and "roll back" provisions of HB 1 have remained applicable.

Since 1965, only three changes have been made to the basic local tax rate limitation provisions of HB 1. The first two were of only minor consequence. One, enacted in 1972, permits local governments to increase tax rates to make up for property exemptions granted under the Homestead Act. The second, enacted in 1976, more or less eliminated school districts from the AMTR issue. The third, enacted in 1979, was of major consequence in further limiting local tax units from increasing property tax rates.

In 1979, faced with soaring property values brought on by double-digit inflation rates, the General Assembly met in extraordinary session to address this issue. The result was HB 44.

HB 44 contained four primary provisions relating to the setting of local government property tax rates:

(1) The "absolute maximum tax rate" (AMTR) that may be levied is the rate levied the preceding year, adjusted for any loss of taxable assessed value resulting from the homestead exemption;

(2) A "compensating tax rate" (CTR) is to be calculated which will produce the same amount of revenue produced the preceding year by the same property. This contains the "roll back" provisions of 1965 HB 1;

(3) Under prescribed conditions, 4% additional revenue may be generated over that produced by the same property in the preceding year. However, the tax rate must be less than the AMTR. In other words, there must be a difference between the CTR and the AMTR before any additional revenue can be generated. And the only way such a difference may occur is by an increase in the assessed value of the property on the tax rolls from the preceding year; and

(4) After complying with prescribed public notice requirements and a possible public referendum, a tax rate which would produce more than 4% additional revenue could be levied. However, such rates must still be within the limits of the AMTR.

Therefore, regardless of a community's wishes, expressed by referendum, or their compensating tax rate, no tax rate may be set which will exceed the absolute maximum tax rate.

Discussion

When 1965 HB 1 and 1979 HB 44 were enacted, both solved very serious issues which were before the General Assembly. HB 44 worked especially well to check tax rates on skyrocketing property values which were brought on by the double digit inflation factors of the 1970's.

But double digit inflation is no longer with us. And state control of local property valuation assessments keeps property valuations close to their "fair cost values".

It is being argued by many local government officials that current statutes, specifically those imposing an absolute maximum tax rate, are seriously hampering local governments' ability to provide vital, basic services to their residents. These officials point out that most taxing units are experiencing very little increase from year to year in the assessed value of their "old property." As a result, the gap between their AMTR and their CTR is so small that very few are able to get any of the "additional 4% revenue" offered by HB 44. They point out that if only the absolute maximum tax rate provisions were removed, citizens would still be protected by the "compensating tax rate", public notice and recall provisions of HB 44.

Legislation attempting to remove the absolute maximum tax rate provisions has been introduced in every session of the General Assembly since 1982. The misconception that such action would repeal HB 44 has brought a swift death to each of these proposals.

During the last five months, the Interim Joint Committee on Cities has discussed this issue with local officials at four public hearings throughout the state. Public and private comments from representatives of the Kentucky Department of Local Government, Kentucky Association of Counties, Kentucky League of Cities, the Kentucky Governmental Finance Officers Association and various elected local officials, seem to place this issue in the forefront of local government issues for the 1990 General Assembly.

To date, no legislation has been pre-filed on this subject.

UNIFORM FINANCIAL INFORMATION REPORT

Prepared by Kathy A. Campbell

Issue

Should the General Assembly require Kentucky cities to submit an annual uniform financial information report?

Background

Prior to 1980, there were no uniform financial reporting requirements for cities. The 1980 General Assembly created KRS Chapter 91A which provided various financial mandates for cities of all classes. For the first time, all Kentucky cities were required to have annual budgets and audits (KRS 91A.030-91A.041). Cities were also required to forward copies of their audits to Frankfort for the use of the Department of Local Government and the Legislative Research Commission. The audits were to be used for informational purposes only, to supply data for the development of a comprehensive, statewide data base on cities.

In 1982 the General Assembly enacted legislation that prohibited any bill or resolution relating to "any aspect of local government or any service provided thereby" from being voted upon until a fiscal note has been prepared. Codified as KRS 6.950 to 6.975, fiscal notes are designed to inform legislators of the estimated effect of proposed legislation on local government revenues and expenditures. Executive agencies promulgating administrative regulations relating to local governments are also required to prepare fiscal notes which estimate the financial effect of the proposed regulation on local government expenditures from local revenues.

Since 1982, the Legislative Research Commission has been attempting to develop a financial data base on city governments. All too often, fiscal notes state that the impact is "indeterminable" due to the lack of financial information on cities. Detailed financial information is needed not only for the preparation of fiscal notes, but is required by bond markets to verify the solvency of a city and its debt capacity. Other financial institutions also require information for many other reasons in today's complex and limited lending arena.

Currently, the main source of financial data available for city governments is the annual audit report. KRS 91A.040 establishes guidelines governing city audits and financial publication requirements. While audit information is better than no information, its use poses several problems that need to be addressed. First, city audits are difficult to analyze and compare purposes because they are not prepared in a uniform manner. With over 400 Kentucky cities and no two audits alike, this obstacle alone is almost insurmountable.

Secondly, even though KRS 91A.040 requires cities to submit their audit reports to the Department of Local Government, this statute does not contain any serious or deterring penalties for noncompliance. Traditionally, many cities simply ignored the statutory requirements, not seeing a need to submit reports to Frankfort in a timely manner.

Discussion

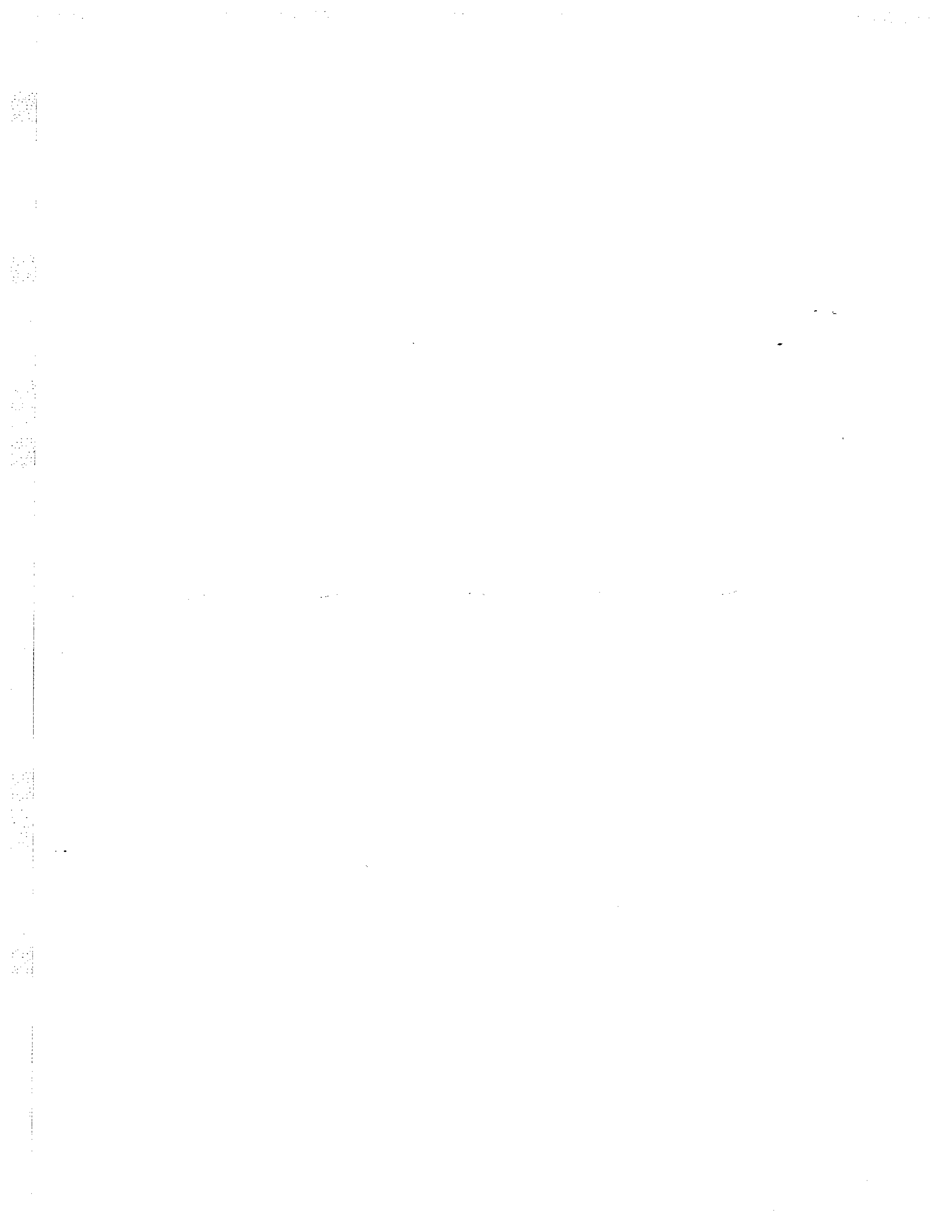
The trend of noncompliance may be changing due, to aggressive efforts on the part of the staff of the Department of Local Government. At the time of this writing, the Department had received audits for FY 1988 for 303 of the 433 cities required to submit audit reports, approximately 90 more than were submitted for FY 1987.

Problems still exist, however, with trying to develop a comprehensive financial data base using only audit information. For example, audit reports do not include data on city property tax rates, assessed property values, lease purchase agreements, or long-term indebtedness of a city — either general obligation or revenue bonds.

The Subcommittee on Municipal Finance of the Cities Committee has been working with the Department of Local Government, the Kentucky League of Cities, the Governmental Finance Officers Association, and other interested persons to develop a single, uniform financial report for cities. Such a report would greatly assist the legislature in developing a comprehensive financial data base on city governments. Ideally, it would also replace several other financial reports cities are required to submit to both state and federal government, and could be completed by the Certified Public Accountant during the preparation of the annual city audit.

The Debt Capacity Task Force, created by the 1988 General Assembly, has been following the work of this Subcommittee relating to a uniform financial report and supports its efforts in this area. In fact, the Task Force would like to see a uniform report mandated for counties and special districts.

The Subcommittee on Municipal Finance is currently drafting legislation mandating a uniform financial information report for cities and will present it to the Interim Joint Committee on Cities for its consideration by the close of the 1988-89 interim.



COUNTIES AND SPECIAL DISTRICTS

COUNTY INSURANCE PREMIUM TAXES

Prepared by William Wiley

Issue

Should counties be permitted to levy insurance premium taxes?

Background

Counties are limited to two forms of taxation for revenue purposes. These are the property tax and the occupational license tax. Property tax increases are limited by statute, and the occupational license tax based on incomes is not efficient in counties where a high percentage of the work force commutes out of the county for employment. The insurance premium tax, which is a license tax on insurance companies based upon the amount of premiums written, is an attractive alternative revenue source. It applies to all citizens with insurance policies who reside within the taxing jurisdiction.

Cities may levy the tax and have the insurance companies act as the collection agent. Counties of 30,000 to 300,000 in population are prohibited from levying the tax. Counties below 30,000 and above 300,000 in population may levy the tax, but there is no provision for the insurance companies to collect it. In the 1988 session a bill was introduced to permit all counties to levy and collect the insurance premium tax in the same way as the cities. Any city insurance premium tax would be credited against the county tax. The bill passed the Senate and was defeated on the floor of the House.

Discussion

Many counties, especially those low in population and rural in nature, have financial problems which have been exacerbated by the termination of federal general revenue sharing and the reduction in the availability of other federal grants. The insurance premium tax is seen as an attractive revenue alternative because nearly everyone will pay, and the burden will not fall on property owners. Closer analysis of the incidence of the tax, however, indicates that in some cases it is quite similar to the property tax. The tax as levied by cities is currently applied to fire and allied perils, casualty liability, vehicles, inland marine, health, life and all other risks. Three of these categories, fire and allied perils, vehicle, and inland marine, would require coverage in direct proportion to the amount of property to be protected. Therefore, the premium tax on these categories of insurance would in effect be just like a property tax. Coverage under two of the categories, casualty liability and life, would tend to be related to income, so that the insurance premium tax on these types of policies would be more like a tax on income. Finally, the health insurance premium tax must be considered carefully, because health insurance premiums rise with the age of the insured. The tax as applied to health insurance premiums might unduly burden elderly citizens with fixed incomes. Cities currently can vary the tax on different lines of insurance to avoid harmful tax consequences. The General Assembly could also restrict the tax by statute for the same purposes.

CONSOLIDATION OF COUNTIES

Prepared by John M. Spangler

Issue

Should the number of counties in the Commonwealth of Kentucky be reduced through consolidation?

Background

With 120 counties, Kentucky has the third greatest number of counties of any state in the nation. Only Texas, with 254 counties, and Georgia, with 159, have a larger number of counties. On a per capita basis, Kentucky ranks first in the number of counties.

In 1792, when Kentucky was granted statehood, the Commonwealth consisted of only nine counties: Jefferson, Fayette, Lincoln, Nelson, Bourbon, Mercer, Madison, Mason, and Woodford. By 1800, this number had increased to 43, and in 1850 there were 100 counties. When the current Constitution was adopted in 1891, Kentucky had 119 counties; the last county to be formed was McCreary County, created in 1912.

Over the past hundred years there have been numerous calls for a reduction of the number of counties in Kentucky. At the 1890 constitutional convention, the chairman of the Committee on Municipalities noted that "[t]he trend of public opinion in Kentucky is towards a reduction of this number, if it were possible." Substantial public discussion of the topic occurred during the 1930's, and the State Planning Board and the Legislative Council jointly issued a lengthy report on county consolidation. In 1952, a specific plan was introduced in the Kentucky Senate to reduce the number of counties to 47, and two years later, a resolution was offered in the House of Representatives to direct a study on the desirability of reducing the number of counties to sixty or less; neither piece of legislation returned from committee. More recently, both the 1987 Shakertown Roundtable and the Kentucky Chamber of Commerce's Project 21 have called for a reduction of the number of Kentucky's counties.

The 1988 regular session of the Kentucky General Assembly enacted Senate Concurrent Resolution 53 (1988 Ky. Acts ch. 216), which created a Special Commission for the Study of the Consolidation of Counties. This commission is comprised of twenty-three members, including members of the General Assembly; elected county officials from small counties; representatives from the academic community, the League of Women Voters, the Kentucky Association of Counties, and the Department of Local Government; and citizens from each of the Commonwealth's seven congressional districts.

Discussion

Senate Concurrent Resolution 53 mandates the Special Commission for the Study of the Consolidation of Counties "to carry out a study on the desirability, feasibility, and methodology for consolidation of counties within the Commonwealth." Beginning with its first meeting in August 1988, the Special Commission has conducted a series of meetings at Frankfort to gather information relative to its responsibilities. Two public hearings at Gilbertsville and Maysville were conducted in the spring of 1989 to obtain comment and input from interested citizens in areas with several small counties.

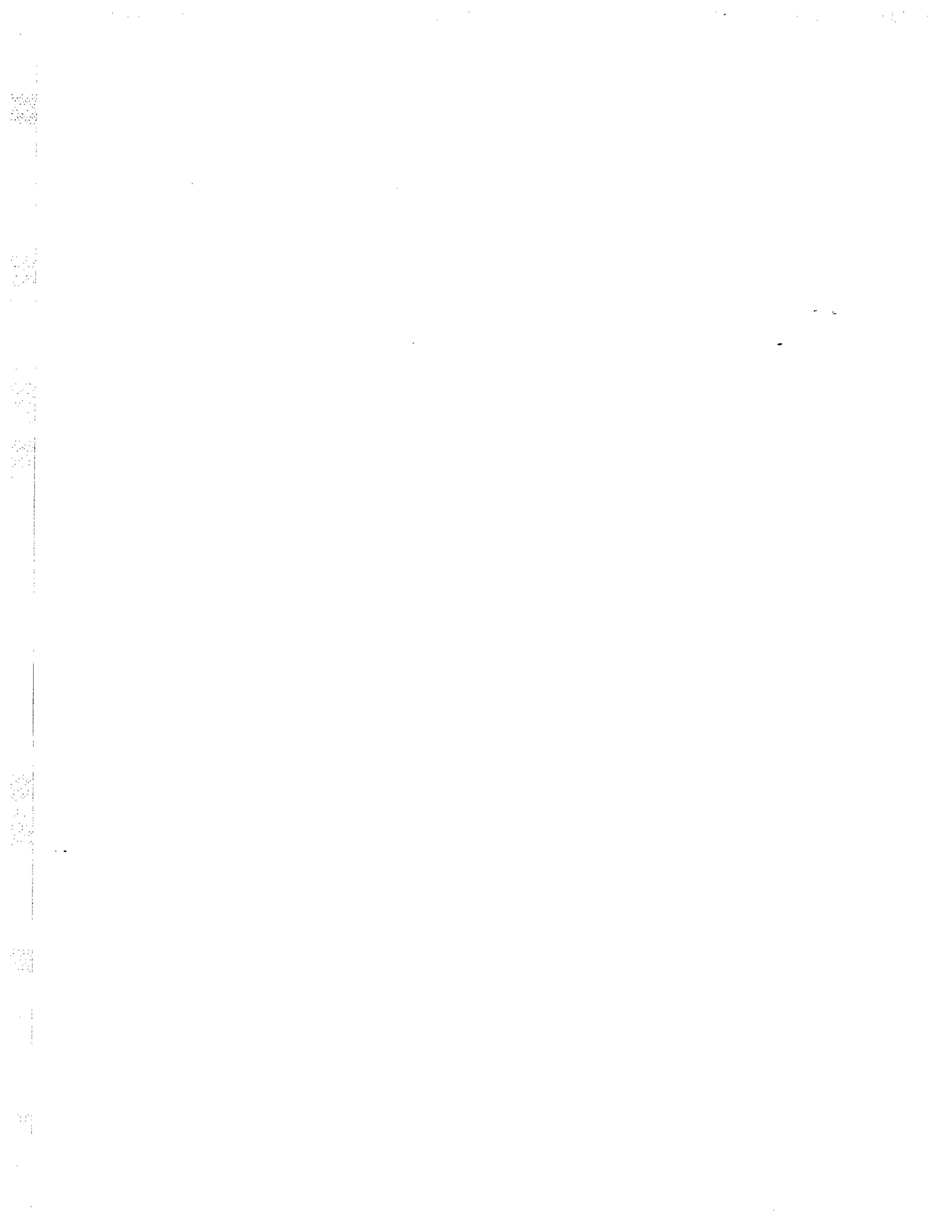
At the request of the Special Commission, questions on county consolidation were included in the spring 1989 poll conducted by the University of Kentucky's Survey Research Center. When asked whether they would favor or oppose the idea that smaller counties in Kentucky should be combined into larger units, 47.8 percent of those surveyed favored the idea and 43.0 percent opposed it, with the remainder undecided or not responding. The poll's margin of error was plus-or-minus four percent.

In addition to evidence and testimony on the physical consolidation of counties, the Special Commission has also examined joint or shared services between counties. The existing system of area development districts is an example of what can be accomplished through multi-county cooperative efforts. In such areas as sanitary landfills, public health care, and waste management, joint county action is already apparent.

The Special Commission has heard a wide divergence of views on the subject of its study. Some believe that reduction of the number of counties can result in substantial savings in resources and improvement in the quality of county government services. Many small counties are experiencing fiscal difficulties in providing even minimal services for their residents; it has been suggested that combining them into larger county units would mean that these services could be provided in a more cost efficient manner and that additional services might be made available. With improvements in the Commonwealth's system of roads and advancements in the means of transportation, travel within Kentucky has greatly changed over the past two hundred years; reasonable accessibility to the county courthouse no longer requires the existence of so many small counties.

Others maintain that the people are better served by smaller units of government closer to them. Kentuckians elect more officials in county government than most other states. County politics is an important element in Kentucky life. Strong feelings of identification and local pride have developed for Kentucky's county government units. Some feel that a small size for counties is a major factor in maintaining a particular way and quality of life.

Recommendations for any constitutional amendment proposals or statutory changes will be included in the Special Commission's final report, which will be issued prior to the beginning of the 1990 regular session of the General Assembly.



ECONOMIC DEVELOPMENT AND TOURISM

TOURISM ADVERTISING

Prepared by Don Stosberg

Issue

Should Kentucky's tourism advertising program be expanded?

Background

In 1988 the Kentucky tourism industry contributed 117,000 jobs and $4.2 billion to Kentucky's economy. It is an important part of that economy. According to the Kentucky Department of Travel Development, a hundred new tourists per day per year to a Kentucky community can mean over a million dollars in new sales, 39 new travel industry jobs, and $78,000 in new state and local taxes.

In calendar year 1988, the Department of Travel Development received more than 84,200 telephone calls, 84,000 coupon responses from newspapers and magazines, and 36,300 letters. These inquiries, principally in response to the previous year's advertising campaign, resulted in more than 162,000 tourism information packages being mailed out in 1988.

In the 1988 session, the General Assembly appropriated approximately $2 million per year for comprehensive tourism advertising. This was approximately double the amount previously appropriated for advertising. As a result of that budget, a $1.5 million contract has been awarded to Doe-Anderson Advertising Agency in Louisville and a plan for placement of ads has been prepared.

Included in the plan are incentives for encouraging local and regional advertising for tourism which is coordinated with the overall state theme. Included in the 1989-90 budget is $630,000 allotted for distribution through the regional committees of the nine tourism regions. $35,000 is allotted to each region for media advertising and other promotions and, in addition, money is allotted based on population for local projects approved by the regional committee. The money for local projects can be pooled for regional projects if the committee approves.

Discussion

The expanded campaign has meant some experimentation in the types of advertising and in testing of new media markets. Some tourism groups will no doubt criticize some of the advertising decisions made. Discussion will probably focus on how to learn from this year's campaign. Some judgments about maintaining the present level or seeking futher increases will have to be made. These judgments will have to be made without complete assessment data, because the research will not be complete by the 1990 session.

As the Task Force on Economic Development and Tourism traveled to Paducah, Somerset, and other areas of the state, it heard many complaints that there were too few signs directing travelers to major attractions. One suggestion for communicating with travelers was short range radio messages.

PARKS DEVELOPMENT

Prepared by Don Stosberg

Issue

Should money appropriated for Kentucky state parks be used to upgrade existing parks or to build new ones?

Background

Kentucky's fifteen resort parks and twenty state recreation parks and shrines, with a total annual budget of about $51 million, have provided an important foundation for Kentucky's tourism industry in the last twenty years. The system has commonly been referred to as "the nation's finest".

Tight state budgets in the last eight to ten years have meant that available state funds have been dedicated to maintaining the existing facilities. Only two state parks have been built in the eighties (Taylorsville Lake and Paintsville Lake). Both were the result of Corps of Engineers projects which had been committed to many years previously. Resort park enhancements, such as meeting room additions and dining room improvements, and basic maintenance projects have been the type of projects approved in recent years.

Discussion

Two questions emerge as important in the discussion about maintaining the high quality of Kentucky's parks.

Is the state appropriating enough funds to keep the facilities from deteriorating? A 1986 study by the Division of Historic Properties strongly indicated that our historic shrines maintained by the parks department were seriously deteriorating and lacked the resources for properly exhibiting historic artifacts. Some legislators have also expressed concern about declining parks facilities.

Is it time to build some major new developments, as advocated by certain local groups? In January, 1989, the Urban Studies Center at the University of Louisville completed a feasibility study on converting Fort Boonesborough state park to a full state resort park. The center concluded that the conversion was not advisable because of problems with the site and because the projected market would not be generating sufficient operating revenue. However, the local proponents have questioned the analysis and conclusions in that study before the Capital Projects and Bond Oversight Committee.

Similarly, studies on the possibility of conversion to resort parks have also recently been completed on Kincaid Lake, Green River, and General Burnside Parks. Also, a market analysis on the expansion of the golf course at Lake Barkley has been completed. A

development plan for Columbus Belmont state park was completed in June, 1989. Recommendations from these studies vary, but the fact that studies have been completed indicate that there have been proposals and discussion that may result in further debate in 1990.

EDUCATION

KENTUCKY'S SYSTEM OF PUBLIC EDUCATION

Prepared by John M. Spangler

Issue

How will the General Assembly respond to the decision of the Supreme Court of Kentucky in *Rose v. Council for Better Education, Inc.*?

Background

On June 8, 1989, the Supreme Court of Kentucky issued its decision in the case of *Rose v. Council for Better Education, Inc.*, Ky., No. 88-SC-804-TG. This appeal arose from an action filed in Franklin Circuit Court in November, 1985, challenging the constitutionality of Kentucky's system of school finance. The plaintiffs were a non-profit corporation made of sixty-six local school boards; seven individual local school boards; and twenty-two public school students, suing through their parents. They sought a declaration of rights that the existing school funding system was unconstitutional and inadequate. The Franklin Circuit Court ruled in favor of the plaintiffs by a final judgment entered October 14, 1988.

The Supreme Court affirmed the judgment of the circuit court in part and reversed it in part. It based its decision solely on Section 183 of the Kentucky Constitution, which provides: "The General Assembly shall, by appropriate legislation, provide for an efficient system of common schools throughout the state." The Court found that "the present system of common schools in Kentucky is not an 'efficient' one . . . [and that] [t]he common school system in Kentucky is constitutionally deficient."

The Court discussed the scope of its decision in these words:

> Lest there be any doubt, the result of our decision is that Kentucky's entire system of common schools is unconstitutional. There is no allegation that only part of the common school system is invalid, and we find no such circumstance. This decision applies to the entire sweep of the system - all its parts and parcels. This decision applies to the statutes creating, implementing and financing the system and to all regulations, etc., pertaining thereto. This decision covers the creation of local school districts, school boards, and the Kentucky Department of Education to the Minimum Foundation Program and Power Equalization Program. It covers school construction and maintenance, teacher certification - the whole gamut of the common school system in Kentucky.

No specific statutes, however, were individually declared invalid, and the Court indicated that some statutes might be "reenacted as components of a constitutional system if they combine with other component statutes to form an efficient and thereby constitutional system." The Court discussed the characteristics of a constitutionally "efficient" system of public education.

Finality of the Court's decision was withheld "until the adjournment of the General Assembly, *sine die*, at its regular session in 1990." A petition for modification is pending, seeking to clarify, among other things, whether the Court intended the effective date of its opinion to be the adjournment date of the 1990 regular session or the normal effective date for legislation enacted during that session.

Discussion

In response to the Court's decision, the leadership of the General Assembly and the Governor have created a twenty-one member panel called the Task Force on Education Reform. The task force is composed of eight members of the Senate, eight members of the House of Representative, and five members from the Executive Department. It is chaired jointly by the President Pro Tem of the Senate, Senator John A. "Eck" Rose, and the Speaker of the House, Representative Donald J. Blandford. The panel will develop a response to the Supreme Court's decision.

At its first meeting, on July 12, 1989, the Task Force agreed to divide itself into three committees, on finance, governance, and curriculum, to deal with specific areas of the Commonwealth's public school system. Members of the Interim Joint Committee on Education not already serving on the Task Force have been assigned as *ex officio*, nonvoting members of the three committees.

The General Assembly will be faced with enacting legislation to remedy the constitutional deficiency in Kentucky's existing school system.

ELECTIONS AND CONSTITUTIONAL AMENDMENTS

PRESIDENTIAL PREFERENCE PRIMARY

Prepared by Rob Williams

Issue

Should Kentucky continue to participate in the "Super Tuesday" presidential preference primary?

Background

The concept of a presidential preference primary is not a new one in Kentucky. The 1972 General Assembly first established such a primary to be held concurrently with the regular primary in May, and this selection process was used in the 1976 and 1980 presidential elections. However, because general opinion was that the state had little impact upon presidential nominations, which were all but decided by the time Kentucky held its primary in May, the General Assembly repealed the presidential preference primary provisions and returned to the party caucus system. The caucus system, used in the 1984 presidential nomination process, received extremely low participation and was criticized as being ineffective because many voters did not understand the process and many who did understand the procedure viewed it as a return to the days when nominees were chosen by a select few behind closed doors. In 1985, political leaders, many representing the Southern Legislative Conference, began advocating a regional primary to be held on the second Tuesday in March. This primary became known as "Super Tuesday," because nearly one-third of the delegates necessary to win either party's presidential nomination would be selected from the participating states. Proponents of this primary argued that by joining forces, Kentucky and the 15 other Southern or border states who chose to participate would receive more national media attention, benefit from campaign expenditures by the presidential candidates and insure that candidates address issues of particular concern to their region.

In 1986, the General Assembly responded by reestablishing the presidential preference primary, to be held on "Super Tuesday" separate from the May primary. In addition, the law provides that the entire cost of this additional primary is to be paid by the state. During the 1988 Regular Session, three bills were introduced which would have ended Kentucky's participation in the "Super Tuesday" primary and would have returned to the May primary date for voting for candidates for each party's presidential nomination, but those bills were not enacted. The Interim Joint Committee on Elections and Constitutional Amendments has since received testimony regarding the retention or repeal of the "Super Tuesday" statutes.

Since the first "Super Tuesday" primary was conducted, one state, Arkansas, has chosen not to participate again. Two other states, Virginia and Missouri, enacted sunset

provisions in their "Super Tuesday" statutes, to provide that they would participate in the 1988 primary only, unless their statutes were subsequently amended to allow further participation.

Discussion

The effects of Kentucky's "Super Tuesday" primary were perhaps less than completely satisfying for its proponents. Voter turnout was very light, the lowest of all participating states, as only 23% of the state's 1,910,907 registered voters actually went to the polls. That 23% included 24.6% of registered Democrats and 22% of registered Republicans. These figures compare with a 27% turnout for the 1976 primary, a 20% turnout for the 1980 primary, the last primary at which presidential candidates were voted upon in May, and 39% turnout for the 1987 primary, at which nominees for the states' constitutional officers were chosen.

While the Republican winner of the "Super Tuesday" primary was the eventual party nominee, the Democratic winner was not, and the winner of the Kentucky Democratic primary did not garner sufficient support elsewhere and withdrew from the race soon after "Super Tuesday."

Under the new law, the state must pay all costs associated with the "Super Tuesday" primary rather than share election costs with the counties, as is the case in other state primaries and elections. Those costs totalled almost $1.4 million in reimbursement to the counties for conducting the election. The state also paid an estimated $1.5 million to provide four hours of voting leave for 34,500 state employees. Therefore, the state spent approximately $2.9 million to participate in the "Super Tuesday" primary. Comparatively, the total state share of election costs (excluding voting leave costs) for the 1987 primary was $265,760 and the 1988 state primary cost the state $214,710 in reimbursement to the counties. In the 1984 primary, the last year for which unreimbursed county election cost figures are available individually, the counties spent a total of $1,201,745. The state cost of the 1988 general election, the first at which counties were reimbursed $255 for each precinct, as opposed to $85, was $836,510.

According to the Federal Election Commission, nine of the 12 presidential candidates entered in the "Super Tuesday" primary in Kentucky spent a total of $496,732 in the state in campaign expenses. However, the total spent in Kentucky may have been higher, because certain travel costs, salaries and other expenses are exempt from the reporting requirements if a candidate spends less than four consecutive days in a state. An undetermined amount was also spent in Kentucky by the media covering the candidates as they campaigned here.

Proponents of repealing the "Super Tuesday" primary provisions contend that the high costs of conducting the additional election is a political luxury which the state cannot afford during tight economic times, especially if voters do not go to the polls in greater numbers. They point out that conducting the additional primary cost the state

six times what it received in campaign expenditures by the candidates. They also contend that a regional consensus regarding candidate selection is not the inevitable result, as favorite son candidacies fared better than those with more national appeal.

Those urging continuation of the "Super Tuesday" primary concede that it is expensive but argue that having the earlier separate primary permits the people a greater opportunity to vote for a full slate of candidates before the eventual nominees are already decided or before momentum has swung greatly toward one candidate before the regular May primary date.

The options available to the General Assembly to address this issue would include: continuing to participate in the "Super Tuesday" primary; reverting to a presidential preference primary held concurrently with the regular May primary; conducting the regular state primary concurrently with the "Super Tuesday" primary in March of presidential election years; conducting a presidential preference primary at an earlier or later date than either the "Super Tuesday" date or the regular May primary date; or returning to the party caucus nomination process.

The U. S. Congress is currently considering mandating a series of regional presidential preference primaries that would include every state and U. S. territory, to be held on one of eight days (every other Tuesday beginning with the second Tuesday in March) during March, April, May and June of presidential election years. The order of the primaries would be determined by lot. A "presidential primary" would include a primary, first tier caucus, convention or other means of expressing a preference for presidential candidate nominations or for the election of delegates to a national party convention. Adoption of federal legislation on this issue would require conforming state legislation.

ABSENCE OF THE GOVERNOR FROM THE STATE

Prepared by Anita Esham-Taylor

Issue

Should the General Assembly propose to amend the Kentucky Constitution to allow the Governor to retain power when he or she is temporarily absent from the state?

Background

Section 84 of the Kentucky Constitution requires that the duties of the office of Governor be automatically transferred to the Lieutenant Governor when the Governor is absent from the state. The necessity of this provision has long been questioned, in light of technological advancements in the area of telecommunications since 1891. Also, those who favor removing this clause point out the potential for political confrontation when the Governor and Lieutenant Governor are from opposing political camps and the Governor is reluctant to leave the government in the hands of the Lieutenant Governor.

Discussion

The 1950 Constitution Review Commission, the 1966 Constitution Revision Assembly, and the 1987 Special Commission on Constitutional Review recommended that this provision be removed, so that the Governor would retain authority even when absent from the state.

During the past interim, the Interim Joint Committee on Elections and Constitutional Amendments studied this issue, and heard testimony from two former governors, who urged that Section 84 be amended to allow the governor to retain authority when absent from the state, so long as the Governor feels it will be possible to stay in close communication with Frankfort.

PUBLIC FINANCING OF ELECTIONS

Prepared by Rob Williams

Issue

Should a voluntary system of partial public financing of campaigns for governor and lieutenant governor with appropriate expenditure limits be enacted?

Background

The costs of campaigns for governor and lieutenant governor in Kentucky have risen at a dramatic rate over the last several elections. For example, the total spent by all candidates for governor in 1975 was $2.2 million; in 1979 and 1983, $9.3 million was spent in each year; in 1987, $18.2 million was spent, including $9.9 million by the eventual winner. The total spent by all candidates for lieutenant governor in 1979 and 1983 was $1.6 million and $1.3 million, respectively, compared to $6.0 million spent in 1987, including $3.0 million by the eventual winner. At least part of the increased expenditures can be attributed to the greater use of media advertising and the candidates' use of personal wealth to finance their campaigns.

Compared to the 36 states that conducted gubernatorial elections in 1986, the 1987 Kentucky gubernatorial candidates spent more in their campaigns than other candidates in all but the three largest states in the Union, California, New York and Texas, where approximately $22.5 million was spent in each state. None of the 33 other 1986 gubernatorial election states reported total campaign expenditures in excess of $10 million.

On the premise of "leveling the playing field" for all candidates and reducing the influence brought by large contributions by special interest groups, tax-assisted funding for candidates for various elective offices and for political parties originated at the state level in 1973, gained momentum in the aftermath of Watergate and generally has held its ground during the 1980's.

The 1976 General Assembly enacted statutes permitting Kentucky taxpayers to "check-off" $1.00 (now $2.00) of their individual income tax liability for use by the designated major political party for support of the party's candidates in a general election and for the administrative costs of maintaining a political party headquarters. Total General Fund revenues paid to the two major parties over the last ten years total $1,948,639, but it should be noted that check-off participation levels have steadily decreased over that same period. In 1979, check-off funds for the Democratic Party totaled $180,127 but netted only $92,424 in 1988. Check-offs for the Republican Party totaled $64,644 in 1979 and had dropped to $47,789 in 1988.

In 1973, Congress created a system of financing presidential campaigns with revenue from federal income tax check-offs, but did not extend its coverage to Congressional campaigns.

In 1976, the United States Supreme Court ruled in *Buckley v. Valeo*, 424 U. S. 1, that simply setting a limit on total campaign expenditures violated the First Amendment guarantee of freedom of expression, but that a limit on total campaign expenditures could be established as part of a voluntary public financing scheme.

During the 1980 and 1988 Regular Sessions, the General Assembly considered proposals to repeal the check-off funds for the political parties and instead to provide increased check-off amounts for direct matching fund grants to candidates for governor or governor and lieutenant governor who agreed to abide by set campaign expenditure limits, but both bills died in Senate committee. 1988 SB 356 set a spending limit of $1,425,000 in the primary and $950,000 in the general election for participating gubernatorial candidates and $850,000 in the primary and $570,000 in the general election for candidates for lieutenant governor. After a candidate raised a threshold amount of 10% of the spending limit, contributions of $250 or less would be matched dollar-for-dollar until the combined grants and contributions equaled the set expenditure limit. If a non-participating candidate exceeded the spending limit, the participating candidates would receive matching grants of $2 for each dollar raised, up to the spending limit. Participating candidates would also each receive a minimum of four hours of Kentucky Educational Television programming time for presenting their platforms.

In its final report, issued in December, 1988, the LRC Special Commission on Election Reform endorsed a public financing proposal based on 1988 SB 356, with spending limits of approximately $1.5 million per election for candidates for governor and an $850,000 limit per election for candidates for lieutenant governor. The Interim Joint Committee on Elections and Constitutional Amendments received testimony regarding the Special Commission's proposal, information on other states' activity on public financing issues and input from the state political parties.

Discussion

At present, 23 states have some system of public financing of campaigns for major elective offices, though in three states the system is not currently operational. Eight states provide matching funds directly to eligible candidates who agree to abide by spending limits, while 11 others provide assistance to the political parties. One state, Oklahoma, equally divides its assistance between the candidates and political parties. The states use a variety of methods for generating the funds granted to candidates or parties: nine use the tax check-off method, four use a tax add-on or surcharge method, two allow taxpayers to deduct certain amounts of political contributions, two provide direct General Fund appropriations, one uses revenue from the sale of personalized motor vehicle license plates and five use a combination of these methods.

Proponents of public financing with voluntary adherence to expenditure limits contend that limitation of expenditures opens the political arena to non-wealthy candidates, diminishes reliance on wealthy contributors and encourages "grass roots" campaign organization, as opposed to dependence on the expensive media blitz. Lessening of the media blitz might help eliminate voter apathy engendered by the barrage of advertisements. In addition, they assert that dependence on public monies would lessen the need for PAC monies and that limiting total expenditures reduces the need for PAC contributions. They note that the number of PAC's has mushroomed nationally from 722 in 1975 to more than 4,000 today, with the majority representing business or professional interests. In addition, they argue that public financing systems permit candidates to spend time addressing the issues with the voters which would otherwise be spent soliciting campaign contributions.

Opponents of public financing assert that imposing expenditure limitations results in a reduction of expression of ideas, because candidates will no longer be able to afford expensive media campaigns to present their ideas. They also contend that the matching fund concept requires candidates to spend too much time seeking more small contributions which would qualify for matching funds. In addition, they argue that public financing systems with expenditure limits make it difficult for a previously unknown candidate to get the name recognition necessary for election. They assert that special interest group participation should not be foreclosed, because they educate candidates on a variety of complex issues. Finally, opponents claim that a public funding plan might require a state General Fund appropriation in a time of tight budgets, because the revenue from an income tax check-off could be insufficient to fully fund the program.

LEGISLATIVE CALL OF EXTRAORDINARY SESSIONS

Prepared by Anita Esham-Taylor

Issue

Should the General Assembly propose to amend the Kentucky Constitution to allow the General Assembly to call itself into extraordinary session, or to add matters to a call issued by the Governor?

Background

Section 80 of the Kentucky Constitution gives the Governor the authority to call the General Assembly into special session, and restricts the subject matters to be taken up by the Legislature to those enumerated in the proclamation. Some feel that this provision, coupled with the biennial session schedule, prevents the General Assembly from responding in a timely and effective manner to problems occurring during the interim. Unless the Governor calls a special session, the Legislature can take no action until the next regular session, while the interests of the public could be better served if action could be taken earlier.

Discussion

Currently, the legislatures in thirty states are empowered to call themselves into extraordinary session. In thirty-seven states, the legislature may determine the subject matter to be considered during special session, whether the governor issues the call or the legislature calls itself into session. It is generally felt that the ability of the legislature to either determine the entire agenda for a special session or to at least have the authority to consider questions in addition to those enumerated by the governor allows the legislature to act in response to needs of the public, rather than react to the issues deemed important in the eyes of the governor.

Legislation was introduced during the 1986 session of the General Assembly which would have allowed the legislature to call itself into extraordinary session. A bill has been prefiled for the 1990 session which would propose to amend the Kentucky Constitution to permit the President Pro Tempore of the Senate and the Speaker of the House to jointly convene the General Assembly in extraordinary session, upon petition by two-thirds of the members of the General Assembly. The subject matter to be considered would be limited to those issues contained in the proclamation.

REELECTION OF STATEWIDE ELECTED OFFICIALS

Prepared by Anita Esham-Taylor

Issue

Should the General Assembly propose to amend the Kentucky Constitution to allow statewide elected officials to succeed themselves?

Background

When the delegates to the 1890-91 constitutional convention met in Frankfort to adopt a new constitution, there was a strong feeling of mistrust toward public officials, and that attitude is reflected throughout the document eventually adopted by the delegates. As a result, the governor, lieutenant governor, and all other statewide elected officials are specifically prohibited from immediately succeeding themselves in office.

Currently, Kentucky is one of only four states which prohibit the governor from succeeding himself or herself, the other states being Mississippi, New Mexico, and Virginia. It should be noted, however, that beginning in 1991, New Mexico will limit the governor to two consecutive terms.

Kentucky's voters have been reluctant to allow elected officials to succeed themselves, as the following chart indicates:

Year Submitted to Popular Vote	Section(s) Affected	Purpose of Amendment	Outcome
1959	99	Permit sheriffs to succeed themselves in office.	Rejected. For: 232,136 Against: 239,144
1973	91, 93, 95, 99, 183, 209	Require appointment of the Supt. of Public Instruction, abolish the Railroad Commission, permit sheriffs to succeed themselves.	Rejected. For: 159,005 Against: 186,157
1981	71, 82, 93, 99	Permit statewide constitutional officers to serve two successive terms and permit sheriffs to succeed themselves.	Rejected. For: 213,988 Against: 381,362
1984	99	Permit sheriffs to be reelected or act as deputies for succeeding terms.	Adopted. For: 512,741 Against: 303,987
1986	160	Permit mayors of cities of the first and second classes to serve two successive terms beyond their original terms.	Adopted. For: 297,883 Against: 219,201

During the 1988 session of the General Assembly, several bills were introduced relative to succession, and one of those, HB 630, passed the House but died in the Senate.

Discussion

The succession issue has been the subject of debate for many years and the arguments for and against are well known. Proponents of succession argue that a four-year term is simply not enough time for a governor to implement and refine programs, and that allowing for two consecutive terms would provide the opportunity for a governor to make decisions with fewer political pressures. As an alternative to succession, some have argued that the governor and other statewide elected officers should serve a single six-year term, which would offer some of the same benefits as two four-year terms.

Opponents of succession maintain that succession would concentrate too much power in an officeholder, especially in the governor's office, which has traditionally been the locus of tremendous power. Also, there has clearly been increased opposition to succession proposals which would apply to incumbents rather than future governors.

Succession for other statewide elected officials creates the same basic questions on both sides, but an additional argument for allowing those officers to serve two consecutive terms is that it could discourage the "musical chairs" scenario in which several executive branch officials have traditionally moved from one office to another.

ENERGY

ENERGY ASSISTANCE FUND ALLOCATIONS

Prepared by Linda Kubala

Issue

Should the state reallocate the funds available for low-income energy assistance and conservation?

Background

The debate over how to allocate limited funds among various energy programs is not new. However, two studies directed by the 1988 General Assembly, and responses to their findings, again have raised basic issues about the relative effectiveness of weatherization or conservation programs versus direct energy assistance payments to low-income households, and about the priority to be given different types of persons or situations within these programs. Where these issues concern allocations of funds between programs, or weights given to program components, they may become issues for the 1990 General Assembly.

The 1988 General Assembly passed SCR 1, directing a study of the state's energy conservation and weatherization programs, and SCR 82, a study of LIHEAP, Kentucky's Low-Income Home Energy Assistance Program. Both studies were completed by the Program Review and Investigations Committee. Each was a comprehensive program review, and made recommendations about many aspects of the programs in addition to funding. Each study recommended expanded funding, either directly or by recommending enhanced services or services to a larger client group. However, both low-income weatherization assistance and direct energy assistance payments are funded in large part from the same sources: the federal Low Income Home Energy Assistance (LIHEAP) block grant, and the Energy Assistance Trust Fund. The latter is a state fund consisting of refunds paid by various oil companies for overcharging customers under pricing regulation in the 1970's. Each of these funds in turn also supports other related programs. The LIHEAP block grant also is used to fund in-home health services (10% of the block grant amount is transferred for this purpose). At least $500,000 of the Energy Assistance Trust Fund is used annually to fund conservation measures in public schools and hospitals (the Institutional Conservation Program, administered through the Department of Natural Resources). Unless additional funds are appropriated to these programs by the General Assembly, or the Energy Assistance Trust Fund is spent faster than planned, an expansion in any one must come at the expense of the others.

A central recommendation of the weatherization study(SCR 1) is that the legislature reconsider the current statutory allocations of oil overcharge funds, to give more of the money to weatherization programs and less to energy assistance,with the justification that weatherization provides low-income beneficiaries with permanent relief from high heating

bills, instead of a one-time check. It also provides jobs, stimulating the economy. The LIHEAP study recommended that more funds be used for low-income families who are not yet facing a home-heating crisis, by expanding the subsidy component of the program. Sixty-eight percent of funds last year went to the crisis component. The Cabinet for Human Resources, which administers both programs, points out that subsidy payments have had to be severely curtailed over the years to stretch the limited funds. Advocates also argue that even though weatherization may offer longer-term savings, the immediate need for assistance is so great that there is no surplus to transfer from direct assistance to weatherization.

Money for energy assistance from the annual LIHEAP block grant never has been sufficient to serve all who apply for help. Furthermore, LIHEAP funds decreased from a high of 29.1 million in 1985 to 20.9 million in 1988; an additional 10% cut is expected this year. These reductions have led some groups to recommend using all of the LIHEAP block grant for assistance payments. Twenty-five percent of these funds currently go to fund the state Weatherization Assistance Program and in-home health care services.

Within the Weatherization Assistance Program, the SCR 1 study recommends lessoning the strong preference now given to elderly or disabled individuals. The SCR 82 study of LIHEAP recommends that energy subsidy payments not be limited to the elderly and disabled, as they currently are. If followed, these recommendations could shift benefits within both programs more to younger families with children. These decisions do not require General Assembly action.

Discussion

Federal funds underwrite most of Kentucky's low-income energy assistance and weatherization efforts, as well as the energy conservation programs now administered through the Department for Natural Resources. The General Assembly could, within the limits of the federal guidelines, direct allocations of available LIHEAP block grant funds between programs or program components. The state could allocate less, but not more, of the funds to weatherization, or to in-home health services. The present transfer of 25% of LIHEAP funds to these other programs is the maximum transfer allowed under federal guidelines.

The General Assembly also has considerable flexibility in directing the use of Kentucky's Energy Assistance Trust Fund, which currently totals about $43 million. The fund was established as a perpetual trust fund in 1986, when Kentucky's oil overcharge funds equaled about $27 million. Originally, proceeds from the fund were to be used exclusively for weatherization or conservation programs which would result in long-term energy savings for low-income households (KRS 42.570). In response to objections by the U.S. Department of Energy to the perpetual nature of the fund, the General Assembly amended it in 1988 so that both principal and interest will be disbursed over ten years. It redirected the payments at the same time, providing a minimum of $500,000 per year to the Institutional Conservation Program, which funds conservation measures in public

schools and hospitals, and allocating 60% of the remainder to the LIHEAP program, and 40% to the state Weatherization Assistance Program.

The use of oil overcharge funds is constrained by the terms of settlements in the individual cases; some of the money must be allocated to one or more of five federal programs, while other funds can be used more flexibly, as long as they tend to return money to the people who were charged too much for gasoline and other petroleum products in the past. General Assembly action would be required to change the present fund allocations. Oil overcharge funds have been used for a wide variety of programs in other states, in addition to energy assistance, from funding mass transit and water system leak detection programs, to demonstrations of alternate energy sources such as wood industry waste. There are many potential contenders for these funds in Kentucky, in addition to the three programs presently funded. A reassessment of the fund in 1990 probably would involve a broad reconsideration of funding priorities, including new uses, which could reduce funding for the current beneficiary programs.

JUNK FAX

Prepared by Linda Kubala

Issue

Should the General Assembly regulate unsolicited advertising via facsimile machines?

Background

Facsimile units (fax machines), which allow documents to be sent and received by telephone, now are widely used. Advertisers have discovered that this is a lucrative advertising medium; as long as the fax machine is attached and turned on, it will receive any document sent to it. Response rates to fax ads are higher than to other media, so its use has multiplied. To recipients, however, this material, tagged "junk fax," can be an expensive nuisance. Each incoming page ties up the machine for about one minute. While the sender pays for the telephone call, the receiver has to pay for the special paper on which the incoming document is printed, putting receivers in the position of paying for information they do not want.

Discussion

Legislation to prohibit the use of facsimile machines for unsolicited advertising has been introduced in at least nine states this year, and enacted in at least two (Maryland and California). Congress also has noted the problem. The House Telecommunications and Finance Subcommittee has held hearings and is considering legislation on this subject. Users and manufacturers are looking at technical solutions to junk fax, like machines which accept documents only from approved telephone numbers, or require a user code. In time, these technical innovations may make legislation obsolete.

UTILIZATION OF WOOD WASTE

Prepared by Mary Lynn Collins

Issue

Should the state help the forest products industry dispose of its waste products?

Background

The state's forest products industry is facing a serious wood waste disposal problem which could hamper further expansion of the industry. Byproducts of wood processing, particularly sawdust, have limited markets in many areas of the state. Environmental regulations prohibit open burning of wood waste and restrict the burial of wood waste to permitted landfills. Unable to find sufficient markets for its waste and unable to dispose of the waste in an economical manner, many in the forest products industry have allowed their wood waste to pile up to critical levels. Some sawmill owners, enjoying increased demand for their lumber products, are nonetheless delaying expansion because expansion will increase disposal problems. The 1988 House of Representatives recognized the seriousness of the wood waste problem by passing House Resolution 163, directing the Interim Joint Committee on Energy, now the Task Force on Energy, to study the issue.

Wood waste includes bark, slabs, edgings, chips, shavings, and sawdust. The largest user of wood waste in Kentucky is the paper industry, with two paper mills located on the Ohio River in Western Kentucky. A third paper mill which utilizes Kentucky wood waste is located in Chillicothe, Ohio. The paper mills use wood chips in the pulping process and sawdust to fuel the boilers for steam production. Additional amounts of wood waste are utilized in the agricultural and horticultural industries and for charcoal manufacturing.

According to a survey conducted by the State Division of Forestry, 722,404 tons of mill residue, approximately one-third of all residues produced by the primary wood industry, went unused in 1988. Sawdust, with the fewest market outlets, accounted for 50% of the unused mill residues. The area of the state where the waste disposal problem appears most acute is Eastern Kentucky.

Discussion

Concern for wood waste disposal comes at a time when the forest products industry is being targeted for greater development. Each year as much as 75% of Kentucky's lumber is shipped out of state with no further processing. The state's economy, particularly its rural economy, would be greatly enhanced if more processing of this natural resource was done within the state's borders. If the state is to successfully expand its wood-using industries, the state may well have to step in and help solve a major problem of the existing industry, that of waste disposal.

The degree to which wood waste disposal is a problem in other states varies, depending on the size and type of wood-using industries present. States which have been successful in fully utilizing their wood waste generally have two things in common: (1) a number of large wood waste users, such as paper mills and particleboard manufacturers, and (2) a thriving wood energy industry.

While industrial use of wood energy in this state, for the most part, is limited to the forest products industry itself, interest is growing in tapping the energy potential of wood waste. Sawdust, for example, is now supplying all heating needs for a public school in Rowan County. Morehead State University included a project to retrofit a coal-fired boiler to burn sawdust alone or in combination with coal in its 1990-92 capital construction request. Private investors are considering the building of a 36-megawatt wood waste-to-energy power plant in Burkesville, Kentucky.

One energy application for wood waste which could potentially aid the coal industry as well as the forest products industry is the co-firing of wood and coal. Sulfur emissions are reduced by burning the blend, since wood contains little sulfur. Evidence from various studies conducted suggests that burning coal and wood together in the same combustion chamber results in an even greater sulfur emission reduction than a simple dilution effect would account for. One explanation for this is that the wood flame, which burns higher than the coal flame, causes the sulfur in the coal to more thoroughly combust.

Possible actions the state could take to alleviate the wood waste disposal problem and which the Task Force on Energy may recommend to the 1990 General Assembly include:

(1) Developing an incentive package to attract pulp mills and other large users of wood waste to areas where excess wood waste is being produced;

(2) Funding a match marketing database to link producers and users of wood waste;

(3) Using state economic development funds to build an industrial park with the capacity to supply the energy needs of the occupants with wood waste;

(4) Creating a loan and grants program or a tax credit for industries installing or modifying their energy systems to burn either wood waste or a blend of coal and wood waste; and

(5) Funding the Morehead State University boiler retrofit project to demonstrate the benefits of co-firing wood and coal.

ENERGY PERFORMANCE CONTRACTING

Prepared by Mary Lynn Collins

Issue

Should the state encourage energy performance contracting for energy saving investments in public buildings?

Background

Energy performance contracting is a relatively new mechanism that states and the federal government are increasingly using to make comprehensive energy conservation improvements in public facilities. Energy performance contracting is an arrangement in which a building owner contracts with a private firm for conservation services that typically include engineering design, equipment procurement, installation, financing, and maintenance. In most cases energy savings are guaranteed. Payment for the service is by installment and is structured so that the payments are less than the savings achieved. The key advantages to the financing arrangement are that there are no up-front costs to the user and risk is, because of the guaranteed savings, minimal. For government entities the concept provides an opportunity to finance energy saving improvements in public facilities which would probably not be attempted under traditional financing terms.

The federal government became involved in energy performance contracting in 1986, when Congress passed legislation authorizing the Pentagon and other federal departments to solicit energy saving performance bids. In addition, the U.S. Department of Energy provides a clearinghouse for information on innovative public sector energy financing. At least fourteen states are either actively participating in energy performance contracting of state-owned facilities or are providing technical assistance to local governments, nonprofits, and school districts interested in the financing concept.

Since the cost of energy is one of the largest components of a building's operating expense, energy performance contracting offers to the public sector significant opportunities for savings. There is a great deal of interest now in Kentucky in energy conservation projects in public buildings. Services provided under the state Institutional Conservation Program, which provides grant monies to public schools and hospitals for implementation of energy conservation measures, are in great demand. Average annual energy savings to those institutions participating in the program are estimated to be 24%. Unfortunately, the program does not have sufficient funds to provide assistance to many of the institutions which annually apply for assistance.

Few public sector energy conservation projects have been completed in the state using performance-based financing. In addition to institutional barriers present in any new program, such as a lack of knowledge and a perception of risk, there are state

constitutional provisions limiting the power of both state and local governments to contract debt which have discouraged energy performance contracting. These contractual agreements often involve payments beyond one budget cycle and even though the payments may be technically paid from savings — from money previously allocated to paying energy bills, the contractual agreements could be interpreted to be forms of indebtedness. Other states with similar prohibitions on indebtedness have overcome such barriers in different ways. Some states have worked out lease-purchase agreements with energy performance contractors which are subject to renegotiation annually, so that they cannot be considered long-term debt obligations. Oregon and Washington passed constitutional amendments to exempt energy projects from debt limitations set out in their state constitutions. Iowa established a nonprofit corporation with bonding authority to negotiate energy performance contracts with private energy firms on behalf of state agencies and school districts. The agencies receiving the energy improvements sign a lease-purchase agreement with the corporation. The improvements are then the property of the corporation until all lease-purchase payments are made. Bond programs recently developed by the Kentucky League of Cities and the Kentucky Association of Counties could be used as vehicles for city and county governments to implement energy performance contracting in a manner similar to Iowa's.

Discussion

As the 1990 General Assembly begins to wrestle with the state's many pressing budgetary issues, they may well consider how energy performance contracting could be implemented in state facilities, in order to divert future state dollars from energy payments to essential state services. Consideration may also be given as to how schools could implement energy cost-saving measures now through performance-based financing instead of remaining on the waiting list for funding through the Institutional Conservation Program.

If the General Assembly should decide to encourage energy performance contracting for energy saving investments in public buildings, the first step might be a thorough study of the concept, including identification of any statutory or constitutional barriers. Other actions which could be considered include a demonstration project in a state facility or the establishment of a bonding authority similar to the one in Iowa.

HEALTH AND WELFARE

PURCHASE OF CHILD DAY CARE FOR LOW-INCOME WORKING FAMILIES

Prepared by Jennifer Dickman

Issue

Should the General Assembly make a specific appropriation to serve low-income working families in the Title XX Purchase of Child Day Care Program?

Background

Over the past decade, dramatic changes in the economic and social structure of society have forced many women into the labor force. With the significant increase in the number of mothers entering the workforce out of economic necessity and the increase in single-parent families and female-headed households, more than half of all mothers with children under age six are now in the labor force. In Kentucky, the labor force participation rates for women have gone from 17.6% in 1940 to 51% in 1987. Women with children under six have become the fastest growing segment of the workforce. The University of Kentucky Center for Business and Economic Research reported that business has come to depend on the increase in the number of women in the workforce and that labor economists predict a skilled labor force shortage in the 1990s, with the rate of growth in the labor market expected to be cut in half between now and the year 2000. As a result, child care has emerged as a growing and urgent issue for working parents and policy makers in both the public and private sector.

In the Omnibus Budget Reconciliation Act of 1981, Congress amended Title XX of the Social Security Act to create a Block Grant for Social Services. The purpose of the Act was to consolidate federal assistance for social services into a single grant in order to increase state flexibility in using social service funds. This Act gave the states the responsibility for determining what services will be provided, who will be served, and who will administer the funds provided by the federal government.

In 1981, the Governor designated the Cabinet for Human Resources as the agency to administer the Title XX Block Grant for Social Services. Kentucky statutes mandate the Cabinet to administer certain programs. However, General Fund dollars are not available to meet the total cost of these mandated programs. Therefore, the first priorities for use of Title XX funds must be to carry out the state's mandates. These were developed from recommendations of the 1985 Governor's Protective Service Advisory Committee. The Committee concluded that Kentucky needed to develop an entirely new prevention system which addressed neglect and abuse before it occurs and provide intensive services after abuse occurs. Thus, child protection became one of the priorities mandated by the state. To assure compliance with this mandate, several services must be provided, including child day care.

The Title XX Purchase of Day Care Program expends funds on the basis of prioritized target groups of clients. The first funding priority is to serve children who are abused/neglected or are from multi-problem families with a valid need for day care. Priority I children are not placed on a waiting list. Children of low-income working families are the second priority of the program. Families are eligible if their income is below 60% of the state's median income and program funding is available. If program funding is unavailable, these families are placed on a waiting list.

The Cabinet purchases care for these children by contracting with private child care providers. These providers are reimbursed $8.00 per day or up to $9.00 per day for protective service children. Child care facilities receiving payment from the Title XX Program must be licensed. Reimbursement is by direct payment following the month of the service.

The Title XX Purchase of Day Care Program has received an increase in state funds over the past five years. The total state allocation for the Purchase of Day Care Program is $7.62 million in FY 89 and in FY 90. The additional funds appropriated will allow 300-400 more children to receive day care assistance.

Discussion

Currently, the Title XX Purchase of Day Care is the only state program directly serving low-income working families. According to the Cabinet for Human Resources, the program generally serves an equal proportion of protection children (Priority I) and low-income working families (Priority II). However, while there is no waiting list for Priority I children, there is a substantial waiting list of low-income working families needing child care assistance. Also, the Cabinet reported to the Budget Review Subcommittee on Human Resources that Priority II families receiving assistance are re-evaluated every six months and if the budget is overspent, there is every likelihood the family will be discontinued, even though they are still eligible. However, the Cabinet has placed an intake restriction on new approvals for Priority II rather than discontinue those working families already receiving assistance.

In fiscal year 1988, the Cabinet was able to serve 1,199 new cases of low income working families (1,880 children). Yet in March 1989, there were 1,549 families (with 2,485 children) waiting to receive child care assistance so that the parents would be able to work. The current waiting list represents more than a one-year waiting period before assistance will be available. Also, the list alone does not accurately reflect the need low-income working families have for child care assistance. Once the waiting list contains the number of families that could possibly be served in one year, the list is closed. In March 1989, the Cabinet documented an additional 294 requests for services for 456 children of low-income working families.

The study on "Women in Poverty in Kentucky" conducted by the University of Kentucky Center for Business and Economic Research reported that state funding to assist

low-income working families with child care was critically lacking. The average cost of child care is $35 to $65 per week per child. A parent with two children must earn at least $7.00 an hour with a minimum take home pay of $905 a month to be able to afford child day care without a state subsidy.

The Cabinet for Human Resources recommended to the Interim Joint Committee on Health and Welfare that the state increase the appropriation to the Title XX Purchase of Day Care Program. The Cabinet suggested that 5,600 children be phased into the program over the next biennium. This proposal would cost $4 million in General Funds in the first year and $12 million in the second year. The Cabinet also recommended that additional funds be appropriated to serve 2,800 children in before and after school child care. This proposal, while phasing children in, would cost $2.6 million in the first year and $7 million in the second year.

Allocating funds specifically to serve more low-income working families in the Title XX Purchase of Day Care Program would enable families to achieve and maintain self sufficiency. Such action would further the objectives of the welfare reform legislation passed by the 1988 General Assembly (88 HB 381) and the federal Family Support Act.

Furthermore, without the provision of adequate and affordable child day care, these families are likely to stay out of the workforce, increasing dependence on welfare and other subsidies. National studies indicate that poor day care arrangements lower job productivity, raise turnover rates, and increase absenteeism of both working parents.

However, a specific allocation to serve low-income working families could also generate problems. For instance, the first priority, as mandated by law, is to provide day care assistance to protective service children. If a specific appropriation generated more child day care slots for low-income working families, Priority I could be in jeopardy. Priority I cases vary from month to month; therefore, it is difficult to budget. Adequate funding would have to be ensured for Priority I, if providing a specific allocation in the Title XX Purchase of Day Care Program for low-income working families is to be successful.

MEDICAID REIMBURSEMENT FOR LONG-TERM CARE

Prepared by Bob Gray

Issue

Should Kentucky increase Medicaid reimbursement for long-term care facilities and continue the moratorium on the construction of new long-term care beds?

Background

Long-term care has been a long standing issue of interest in the Kentucky General Assembly. Considerable legislative attention has been given in past sessions to the licensing and regulation of long-term care facilities, Medicaid reimbursement for long-term care, and the development of in-home services. Medicaid is the largest payor of long-term care in Kentucky, paying for approximately 50% of all skilled nursing beds and 78% of all intermediate care beds. In fiscal year 1988, Medicaid spent $37.9 million for skilled nursing care, $141.1 million in intermediate care, $46.1 million for intermediate care for the mentally retarded, and $25.5 million for home health care. This represents over $250.6 million per year in Medicaid expenditures, over 35% of total Medicaid expenditures of $706.7 million for FY 1989. It should be noted that these expenditures go to approximately 14,000 Medicaid recipients in long-term care facilities. This represents about 4% of the total 340,000 Medicaid recipients now receiving services in Kentucky. According to a 1988 study published by the Intergovernmental Health Policy Project, Kentucky ranks 21st nationally in total long-term care per capita expenditures.

Discussion

There are several factors to be considered when reviewing long-term care expenditures. First, despite the large total amount spent, long-term care facilities have maintained that individual reimbursement levels are inadequate to allow them to offer quality care at profitable levels. The Kentucky Association of Health Care Facilities has testified before the Budget Review Subcommittee on Human Resources that long-term care facilities lose an average of $6.34 per day, or $2,314 a year, in caring for each Medicaid patient. The Association has subsequently petitioned the Secretary for Human Resources for a Medicaid reimbursement increase.

Second, a provision of the federal Omnibus Budget Reconciliation Act of 1987 eliminates the skilled nursing and intermediate levels of care in the Medicaid program. Effective October 1, 1990, these levels of care will be combined into a new category called "nursing facilities." Since the distinction between skilled nursing and intermediate care will be removed, states will have to devise a method of paying for residents with differing health conditions within the "nursing facility" category. Such methods usually involve a

case mix or patient-based reimbursement system in which payment is based on the individual health care needs of the resident rather than one payment rate for all residents in a particular level of care. Under such a system, patients with heavier care needs would receive a higher level of reimbursement than patients with lesser care needs within the same level of care. The Cabinet for Human Resources estimates the cost of such a system at $4.6 million per year in state General Fund dollars.

A third consideration is that the federal Omnibus Reconciliation Act of 1987 also requires all nurse aides employed by long-term care facilities participating in the Medicaid or Medicare programs to have 80 hours of training by October of 1990. The Act requires state Medicaid programs to cover the cost of such training at an estimated cost in Kentucky of $3.5 million per year.

And finally, government has become the number one payor of long-term care through the Medicaid program. There is a growing line of thought that other financing options for long-term care should be developed instead of expecting government to bear the bulk of the financial burden. Many middle class elderly persons enter a nursing home and exhaust their financial resources within a short time and become eligible for Medicaid. Legislation passed by the 1986 General Assembly requires all health insurers in Kentucky to offer coverage for long-term care in addition to basic health care coverage. The decision to purchase the long-term care benefit is left up to the consumer. The theory behind this legislation is to encourage more private payment of long-term care by making private sources of payment more readily available. The Department of Insurance has reported that policies have annual premiums ranging from $600 to $2500 depending on the level of coverage. The 1986 legislation did not set minimum requirements for all long-term care policies; therefore, there may be an effort to set such standards during the 1990 Session in an attempt to promote uniformity among policies, so as to reduce confusion on behalf of consumers.

In response to these factors, the Cabinet for Human Resources has raised rates for skilled nursing facilities from $56.07/day to $62.32/day and rates for intermediate care facilities from $38.61/day to $43.78/day, effective July 1, 1989. This increase will cost an additional $15 million a year in state General Funds. Since this increase comes so close to the 1990 Regular Session, it seems unlikely that the Cabinet will allocate funds for an additional increase, given the other budget demands within Human Resources.

Another related issue is the need for long-term care beds. There are now 31,025 licensed long-term care beds in Kentucky, including 5,322 Skilled Nursing Facility (SNF) beds, 16,417 Intermediate Care Facility (ICF) beds, 7,860 personal care beds and 1426 family care beds. The projections of the future need for long-term care beds is contained in the Kentucky State Health Plan. The State Health Plan is a document prepared by the Cabinet for Human Resources health planning staff and approved by the Statewide Health Coordinating Council, which inventories health services in Kentucky, and the need for new health services, and serves as a guide for achieving acceptable health care goals. The State Health Plan is used by the Commission for Health Economics Control in Kentucky

(formerly the Certificate of Need and Licensure Board) in determining whether to allow new health care facilities and services to be built or established in Kentucky. For the long-term care facilities, the projections are based on the current number of beds, the ratio of the number of beds per 1000/population of age 75 and over, and the desire to provide more care to persons at home rather than in a nursing home. Based on these projections, the 1988-1990 State Health Plan shows a statewide need for 283 skilled nursing beds, 59 personal care beds and 234 family care beds, and a surplus of 87 intermediate care beds.

In an attempt to reduce the amount the state pays for long-term care, a moratorium prohibiting the construction of new long-term care beds has been in place since 1980, and was recently extended until June 30, 1990. The moratorium appears to be at odds with the fact that long-term care facilities have high occupancy rates (91.2% for SNF and 97% for ICF) and many have admission waiting lists. There are also reports of Medicaid patients having to go out of their home county to find an available nursing home bed. However, a Cabinet for Human Resources study (*Long-Term Care in Kentucky*, October, 1986) points out that there is a difference between the demand for a service and the need for the service. The report argues that as many as 20% of the residents of nursing homes could be cared for at home with in-home services.

Critics have also maintained that if persons who could be cared for at home were moved out of facilities and appropriate in-home services were available, the demand for nursing home beds would decrease. Apparently, either in-home services are not being taken full advantage of, or the actual need for long-term care beds is greater than that projected by state health planners. Whatever the case, the Cabinet has estimated that adding an additional 1,000 long-term care beds to the Medicaid program would cost $3.3 million in state General Funds in FY 1990.

INSURANCE: MENTAL HEALTH AND SUBSTANCE ABUSE COVERAGE

Prepared by Bob Gray and Karen Main

Issue

Should the state require insuring entities offering for sale mental health and substance abuse coverage to inform consumers of the scope and duration of such coverage?

Background

Recent years have witnessed tremendous growth in expenditures for alcoholism, drug abuse and mental illness, as well as lessening of the stigma associated with them and an increase in the availability of services, primarily inpatient facilities. The increased recognition of the problems and efforts to treat them are primarily due to heightened awareness of the economic burden of these disorders (estimated at $249.2 billion nationally by the Research Triangle Institute in 1983), as well as the cost in human suffering.

Many states have responded by requiring that insurers make coverage available for treatment of substance abuse and mental illness. In 1978, Kentucky passed legislation requiring health insurers to include coverage for alcoholism treatment in all health insurance policies. In 1986, the General Assembly of Kentucky passed House Bill 585, which requires all insurance companies and Health Maintenance Organizations (HMOs) to offer mental health coverage "to the same degree that coverage is provided for physical illness".

During the same period of time, the availability of services was expanding rapidly, both nationally and in Kentucky, especially for the treatment of substance abuse. In 1983, there were 1,237 private psychiatric beds in Kentucky and 153 beds for substance abuse treatment. As of May 31, 1989, there were 1,699 private psychiatric beds and 623 substance abuse beds. The psychiatric beds are in addition to the 1,159 available in state facilities. Statewide, the total beds for psychiatric care exceed the need as determined in the State Health Plan by 316 and there is a statewide excess of 185 substance abuse beds, although there is still a need in some planning districts.

Nationally, states which have repealed their Certificate of Need programs have reported the greatest amount of development in the areas of psychiatric and substance abuse services.

Utilization has increased accordingly. For instance, although there are no Kentucky-specific data, nationally, discharges from acute care hospitals for drug dependence increased from 3.1 per 10,000 population in 1979 to 6.0 per 10,000 in 1985. Likewise, discharges for drug abuse increased from 3.8 per 10,000 in 1979 to 7.7 per

10,000 in 1985. In 1988, Blue Cross/Blue Shield of Kentucky paid for 5,996 psychiatric and substance abuse admissions, which totaled 77,620 days. The hospital cost for these was $23,287,546 and the physician cost was $2,963,883. These figures do not fully illustrate increases in expenditures because they also reflect the cost containment strategies quickly implemented by almost all payers as soon as the costs began dramatic escalation.

The most common cost containment measures are the following limitations: co-payments on both inpatient and outpatient services (the co-payment for visits is usually 50% versus 20% for other services), limitations on the number of days in and admissions to a treatment facility, limitations on the number of outpatient visits (usually 20), life-time maximums on the amount of service covered (often $25,000), preadmission review and length of stay review by the payer's review organization of choice, and certification of the need for any service by the payer's designee. All of the insurance options available to state employees and teachers include some or all of these cost containment features.

Discussion

Because of the proliferation of services, cost containment measures and the vague nature of both psychiatric and substance abuse disorders, there is no assurance that clients are receiving either necessary services or the most appropriate services.

In the first place, criteria for diagnosis are not clear-cut and frequently rely heavily on self-reporting. Since denial is often a symptom of these disorders, it is likely many persons who need treatment are not receiving it. Secondly, criteria for the most appropriate services are even less well defined. Providers and patients often complain that the decision as to whether an individual should receive inpatient or outpatient services is more a function of payer economics than it is of patient need. Third, whatever criteria are used by payers or their designees, they are usually not made available in written form to providers or patients. As a result, patients are sometimes provided services which they later learn their insurer will not reimburse. Also, there would appear to be a conflict of interest when the agency responsible for determining what, if any, treatment is appropriate can refer potential clients to itself. Finally, there is no regulation or statute which determines the qualifications of the reviewing agencies.

On the other hand, payers complain that providers do not individualize treatment and that the "success" rate is very low. Regardless of the patient need, 21, 28 or 30 days seems to be a generally recognized length of stay for inpatient service. Whether this is based on the treatment regimen, the client's need, or the availability of coverage is unclear. Patient care is not very well individualized, especially in substance abuse, where all clients are provided the same treatment, with little or no individual counseling in many facilities. Outcomes are not encouraging. Some estimate as few as three of 100 substance abuse patients will successfully stop using drugs for as long as a year. Likewise, there are no clear indicators as to when a person may successfully stop a series of counseling sessions. Finally, the costs of inpatient treatment seem out of line to many observers, often over $500 a day for patients who are essentially ambulatory and in need of little medical treatment following detoxification.

The question is, then, what if any legislative action could be taken to assure the delivery of the most cost-effective treatment? Recognizing the difficulty of establishing criteria, nevertheless, the General Assembly could require that insurers make available to the public the criteria they do use to determine the type and length of treatment they approve. The State of Maryland has recently enacted legislation that requires such criteria to be made public, and establishes minimum standards for those agencies that review patients to determine the need for treatment. Similarly, providers could be mandated to make public their admission and discharge criteria. Such measures could help consumers of health insurance to understand the conditions under which their insurance will pay for substance abuse and mental health treatment.

FEDERAL FAMILY SUPPORT ACT OF 1988

Prepared by Bob Gray and Jennifer Dickman

Issue

What options does the state have in implementing the new Federal Family Support Act of 1988?

Background

In September of 1988, the United States Congress passed the Family Support Act of 1988 (Public Law 100-485). The Act requires states to establish a program of education, training and support services necessary to promote employment among adult AFDC recipients and encourage economic self-sufficiency. Entitled JOBS (Job Opportunity and Basic Skills), this program must be implemented by October 1, 1990. In implementing this program, states are required to provide child care and transportation services needed by AFDC recipients to participate. In addition, states are required to establish an AFDC-Unemployed Parent Program to allow two-parent families to receive AFDC when the principal wage earner is unemployed but has a recent work history. Stricter state enforcement of child support orders and establishment of paternity are also mandated.

Discussion

Kentucky has various options available in implementing the Family Support Act. First of all, the state has quite a bit of freedom in deciding what services to offer recipients under the JOBS programs. Mandatory services include:

- educational activities, including high school or GED, and remedial education for literacy and language proficiency;

- job skills training;

- job readiness activities;

- job development and placement; and

- support services (child care, transportation and work-related expenses).

States are at liberty to offer additional services, such as college or other postsecondary education, to the extent permitted by state resources.

In addition, states are required to offer *two* of the following activities:

- group and individual job search;

- on-the-job training;

- work supplementation programs, in which AFDC payments are diverted to subsidize salaries; and

- community work experience or similar work experience approved by the federal Department of Health and Human Services.

The Act requires that each participating AFDC recipient be assessed to determine the individual's needs, skills, circumstances, prior work experience, education, need for child care, and other supportive services. An "employability plan" is to be developed for each participant, stating the services to be provided by the state, the activities in which the participant will enroll and the employment goal. States have the option of formalizing the employability plan as a contract between the recipient and the welfare agency.

Another option afforded states is the ability to assign a case manager to each JOBS program participant to work with the client in obtaining necessary services and achieving that client's educational or employment goal. The case manager would act as an advocate for the client in the system, coordinate the provision of services, monitor the client's participation in the program, and provide followup or counseling when needed. Human Resources officials have stated that case management will initially be offered in 25 counties.

States also have considerable latitude in determining the affordability, availability and quality of the child care they are required to provide to JOBS program participants. How child care is provided is the first major option of the state. While the state has to guarantee child care entitlements, it has the option to provide the care directly, arrange the care through providers by use of purchase of service contracts, or vouchers, provide cash or vouchers to the caretaker relative in the family, reimburse the caretaker relative in the family or adopt other arrangements as the state deems appropriate. These options offer the state flexibility in paying for care, including up front payments to parents or providers rather than providing reimbursement later. The previous policy in the state has been to reimburse the AFDC recipient on a two-month delayed basis. This resulted in several problems for the recipient because of the lack of providers willing to accept delayed payments. The payment option chosen should respond to the needs of the recipient and focus on the purpose of the Act, the promotion of self-sufficiency for welfare recipients.

Another option is the rate at which care will be reimbursed. The state may claim federal matching funds for child day care provided up to the market rate under any child care delivery system it chooses. This provides the state the opportunity to improve the quality of child care to low-income families. A University of Kentucky study stated that the most important variable affecting the quality of care children receive is the family's income. Low-income working families with young children are unable to afford quality child care without financial assistance. Quality child care which provides a safe, clean

environment with a program developmentally appropriate for social, cognitive, emotional and physical growth is especially crucial to the development of a disadvantaged child.

Another opportunity for the state to assure quality child care is the mechanism created to meet the strict requirements contained in the legislation to protect the safety of children. The Act requires that the child care provided meet applicable standards of state and local law and that the entity providing such care allow parental access. The state must establish procedures to ensure that center-based child care will be subject to state and local requirements designed to ensure basic health and safety. The state could choose to require these providers to meet criteria which go beyond current licensing standards. Many other states have chosen to place such additional criteria on providers accepting children through the Title XX Social Services Block Grant Child Care Program. Further, the Department for Health and Human Services will award grants to the states to improve child care licensing and registration requirements.

The state also has the opportunity to enhance the resources and availability of child care. The Act requires that the child care activities be coordinated with existing early childhood education programs. The state has the option to meet this requirement by identifying resources and services and the lack thereof.

The final option in child care relates to assuring that the intent and goal of maintaining self-sufficiency is achieved. The Act requires the state to guarantee twelve months of transitional child care, to the extent that such care is determined to be necessary for an individual's employment, in any case where a family has ceased to receive AFDC as a result of employment. Eligible recipients will be entitled to reimbursement of such care under a sliding scale formula based on the family's ability to pay. While the Act requires the provision of transitional child care, the state has the option in formulating the policy to determine eligibility and notification procedures.

In addition to transitional child care, states must also offer transitional medical assistance for up to one year following the date the recipient becomes employed. States have the option of extending Medicaid benefits for this period or offering a comparable private health plan with premiums based on the recipient's income.

The total cost of implementing the Family Support Act in Kentucky has been estimated by the Cabinet for Human Resources at $75 million. Since the federal matching rate for AFDC and related services under the Act is 72% federal/28% state, the cost of implementation to the General Fund will be approximately $22 million. The issue before the 1990 Kentucky General Assembly will be which options to exercise in implementing the federal law.

HEALTH CARE FOR THE MEDICALLY UNINSURED

Prepared by Karen Main

Issue

How should the State address the problem of the medically uninsured?

Background

There are approximately 700,000 Kentuckians who do not have health insurance and who are ineligible for public programs. About half of these have annual incomes below the federal poverty level. Another half are in families where someone is employed full- or part-time, most frequently in small businesses which do not provide health insurance benefits. Additionally, there are persons who become medically indigent because their insurance benefits are exhausted or whose insurance does not cover necessary treatment. Many of this latter subgroup have extremely costly hospitalizations. In a 1987 study by the Kentucky Hospital Association it was shown that five percent of the medically indigent incurred costs exceeding $10,000 and that the financial resources consumed by this group were 35% of the hospital dollars spent for charity care.

The Kentucky Medical Assistance Program (KMAP) is the primary state program for providing health care for the poor. KMAP provides reimbursement for 32 health and medical services to persons who would be medically indigent without it. Around 340,000 people, approximately half of the population below the federal poverty guidelines, are eligible for Medicaid. Recipients include the categorically needy, who also receive cash assistance, and the medically needy, persons who have too much income to qualify for cash assistance. In either case, eligible people must meet both technical requirements (e.g., be aged, blind, disabled, or in a family receiving AFDC) and income requirements. Kentucky has among the lowest income standards in the country. To be considered medically needy, an individual must "spend down" enough on medical expenses or have very little income so that non-medical spendable income does not exceed $2,500 a year. For a family of two, the level is $3,000 and for additional family members, $50 a month per member. There are some exceptions, such as pregnant women and their children under age two, who may qualify for the program with incomes up to 125% of the poverty level. But generally people with incomes greater than 37% of poverty do not qualify for Medicaid.

With some exceptions, it is not possible to increase the income criteria for Medicaid without simultaneously raising the income eligibility level for AFDC. The program has not had sufficient funds to pay for this expansion in the past. However, even if the income eligibility level were raised to 100% of poverty, only 30,000 additional participants would be added to the program. Such a change would also mean that around 19,000 of these would become eligible for welfare. Expanding income eligibility to 100% of poverty would cost $83.2 million in state dollars. Of this, $76 million would be for AFDC benefits.

Presently there are insufficient and uncoordinated sources of funds to pay for health care for low-income and uninsured persons. Some services are provided voluntarily, such as those from doctors in the Kentucky Physicians Care Program. Others are underwritten by state and federal funds, as in the case of health department programs. Kentucky hospitals provide charity care (which amounted to $73 million in 1986). Hospitals have tried to compensate through higher charges to other payors. However, because of increasing cost containment activities on the part of major purchasers of health care, the profit margin previously available to hospitals to support charity care has been shrinking rapidly. This problem is acute in many small rural hospitals because of their large proportion of indigent patients. Some relief for adult hospital indigent care in Jefferson County has been found in a city-county-state contract with Humana, Inc.

Discussion

The General Assembly must consider two difficult problems: programmatic solutions which assure access to needed care for the indigent and identifying sources of revenue which are sufficient and do not place an unfair burden on any segment of the population. Among the strategies which are under consideration across the country are the following:

Maximizing the use of private and public insurance by means of mandating that employers provide health insurance; or as appears to be more feasible, encouraging employers to support the cost of health insurance for the uninsured working population. This is accomplished through such mechanisms as multiple employer trusts, so small employers can get large group rates; developing "limited" benefit packages at affordable prices for the uninsured employed; and assisting employers in starting employee insurance programs through time-limited tax credits, as in Oregon and Massachusetts. Tax credits are a reasonable means of forging a public/private partnership to serve a common good. However, in some instances, simply educating the employer about the fact that he can recover from 15% to 39% of the cost of employee health insurance through state and federal tax deductions may be sufficient incentive. In other cases, employers may be encouraged to purchase health insurance coverage for employees in lieu of a wage increase. If so, the employer could easily average a 50% to 60% recovery of his expenditure because of savings on Social Security taxes, unemployment insurance taxes and worker's compensation taxes. In this situation, the savings would be permanent, as opposed to a credit, which is usually temporary.

However, most employer groups object to mandated employee health insurance programs; they assert that the small firms don't offer health insurance because they can't afford to. In Kentucky, 67% of small employers offer their employees health insurance. Fifty-six percent pay the full cost of premiums. However, a study by the National Association of Self-Employed suggested that in companies with 10 or fewer full-time employees, health benefits could reduce their profits by as much as 30%. The average profit in these firms was $32,000. In some cases, profits constituted the salary of the small business owner. Another objection to mandated health insurance is that the burden would be borne unfairly

by employers who cannot self-insure. The self-insured employers (such as state government) are protected from required participation in state insurance benefit mandates by the federal Employment Retirement Income Security Act (ERISA). Approximately 20% of the companies in Kentucky are self-insured.

Some states have created special "risk pools" to provide health insurance to high-risk individuals, but this serves a very small proportion of the population. Other states are expanding Medicaid eligibility to 100% of poverty; implementing a state medical indigency program; and/or, implementing a catastrophic expense program, such as those which have been tried in four states for individuals with ruinous medical bills.

Providing direct financing to major providers through providing financing or subsidies to providers which serve a disproportionate share of the uninsured; and/or, funding providers for specific services such as neonatal care, or providing direct subsidies for consumers in a kind of state-only Medicaid program supported solely by state funds. This is generally the type of program supported by the Kentucky Health Care Access Foundation, a private corporation concerned with the problem of the uninsured. In its preliminary plan, the Foundation has identified the need for additional funding of several health services which focus on prevention and primary care. The number one priority of this group is reimbursement for comprehensive primary care for indigents provided by existing health services, including local health departments. The Foundation estimates its priorities would cost approximately $27.5 million a year in new funds, but that this would be an investment which would offset later, greater expenditures of $155.5 million resulting from inadequate or absent care.

Ensuring efficient use of existing funds by expanding primary care sources; encouraging participation in prepaid plans; and/or, selectively contracting with providers at a discounted rate.

Providing sufficient funds by authorizing a revenue decrease as a result of tax incentives to employers; conforming the state's tax code to the Federal Tax Code; increasing income, sales or special luxury taxes; and/or, special taxes, such as those on health insurance premiums, all health industry participants or health insurance providers.

Assuring fair sharing of financing and care burdens by developing indigent care financing pools; implementing care or share arrangements; restricting hospital patient transfers; and/or, legislating all-payer rate setting.

THE KENTUCKY MEDICAL ASSISTANCE PROGRAM

Prepared by Karen Main

Issue

How will Kentucky fund the maintenance of the Medicaid program and should the General Assembly invest additional funds to expand the Medicaid program?

Background

Medicaid is an assistance program for low-income people. Approximately 350,000 Kentuckians are enrolled. Through a federal-state partnership, money from federal and state taxes pays certain medical bills for people who are eligible for Medicaid. In Kentucky, the federal match for state funds is very advantageous - 72.94 federal dollars for 27.06 state dollars. Each state designs its own Medicaid program within federal guidelines. In Kentucky, the program is called the Kentucky Medical Assistance Program (KMAP). Medicaid is authorized by Title XIX, a 1965 amendment to the federal Social Security Act. The Kentucky Medical Assistance Program is administered by the Cabinet for Human Resources through the Department for Medicaid Services, in accordance with the Social Security Act. The Kentucky Medical Assistance Program makes payment for covered services only to health care providers who have entered into a participation agreement with the program. Not all service providers and facilities accept Medicaid. Unlike Medicare, the Medicaid Program does not reimburse the recipient for medical expenses incurred.

The following groups may qualify for Medicaid if they meet the income and resource limits:

- Persons aged 65 years or older
- Blind or disabled persons
- Members of families with dependent children
- Children in foster care homes
- Children under age 18
- Pregnant women
- Individuals under age 18 in psychiatric hospitals

Some of these persons are automatically eligible because they receive financial assistance from the Kentucky Cabinet for Human Resources Aid for Families with Dependent Children.

Also, aged, blind or disabled persons receiving Supplemental Security Income (SSI) benefits from the Social Security Administration are automatically eligible.

In addition, other pregnant women and children under age 1 with family income not in excess of 125% of the federal poverty level and pregnant women and children under age 2 with family income not in excess of 100 percent of the federal poverty level may be eligible for Medical Assistance. For these individuals, all resources are disregarded, except liquid assets.

Recently, the federal government has also required Medicaid to cover certain expenses, including Medicare premium payments, co-payments and deductibles for Qualified Medicare Beneficiaries. These are persons eligible for Medicaid with incomes under 90% of the federal poverty level ($449 individual and $602 for a couple per month).

In terms of assets and income, the following limitations apply. Limits for countable resources are $2,000 for one person, $4,000 for a couple, plus $50 for each additional person. Countable resources are adjusted each January 1 with an increase of $100 for the individual and $200 for a couple. A person can have these resources and still be eligible for Medicaid:

- A home, household equipment and personal effects.
- Burial reserve totaling up to $1,500 for one person.
- Equity in income-producing non-homestead property up to $6,000.
- One automobile used for employment or to obtain medical treatment, or if specially equipped for handicapped persons.
- Equity in other automobiles up to a total of $4,500.

Following is the income scale for basic maintenance needs*:

Family Size	Annual	Monthly
1	$2,600	$217
2	3,200	267
3	3,700	308
4	4,600	383
5	5,400	450
6	6,100	508
7	6,800	567

*Does not apply to SSI Clients

For each additional member, $720 annually or $60 monthly is added to the income

scale. If net income exceeds the limits on the above scale, a person may be eligible for Medicaid if the amount of medical bills is equal to or exceeds net income for a given period of time (on a quarterly basis).

The benefits which are provided to persons who qualify for Kentucky Medicaid are among the most extensive in the nation. The federal government mandates that KMAP provide reimbursement for the following services: inpatient hospital, physician, skilled nursing, outpatient hospital, home health, family planning, screening, laboratory, dental (for recipients under age 21), emergency and non-emergency transportation and vision and hearing care for those under age 21. In addition, KMAP covers the following optional services: intermediate nursing home care (the second most costly service after inpatient hospital care), intermediate care for the retarded, pharmacy, Medicare premiums, community mental health, mental hospitals, renal dialysis, primary care, podiatry, home- and community-based services for the mentally retarded and the elderly, ambulatory surgery, adult day care, nurse midwife, nurse anesthetist, hospice, preventive care, targeted case management, and KenPAC, a program which links recipients with primary care providers. In addition,qualified Medicare beneficiaries receive the following Medicare-mandated services: chiropractor, portable x-ray, physical therapist, occupational thereapist, and psychologist.

This array of services is very expensive. They are expected to cost $814.0 million by the end of fiscal year 1989, of which $221.9 million are General Funds. While these services are costly, we are probably purchasing about $1.2 billion in care for the $814 million in expenditures. This is the result of the huge discount that the Medicaid program receives when purchasing medical services. To continue this service package in 1990 will cost an additional $83.7 million ($22.7 million in state funds) and in 1991, $92.2 million ($24.9 million in state funds).

In addition to continuing current services, the federal government has imposed a number of new mandates on the program. These include the requirements in the Medicare Catastrophic Act of 1988 and the Omnibus Budget Reconciliation Act of 1987, regulatory mandates, provisions for children's orthodontic services, along with related administrative cost. The implementation of the Family Support Act of 1988 (Welfare Reform) will add an additional $13.8 million ($3.7 million in general funds) to the program cost for FY 1991. The total net federally-mandated costs in 1990 are projected to be $32.0 million ($8.4 million in state funds) and in 1991, $73.9 million ($19.7 million in state funds). This will result in an anticipated cost overrun of $55.4 million for FY 1990.

Discussion

Because of increases in the cost of health care and the new federal requirements, the Medicaid Program will soon cost more than a billion dollars a year. Even at the favorable federal match (which some predict will be going down from 72.94 to 70 or 69), the state portion of the budget is considerable. To maintain the current program and comply with federal requirements, the Medicaid budget in 1990 will be $922.0 million ($249.5 million

in state funds) and in 1991, $1.14 billion ($294.4 million in state funds). This represents an increase in state expenditures of $27.6 million in 1990 and $72.5 million in 1991 over the current state investment of $221.9 million. Obviously, finding the revenue to cover the costs of these minimum requirements will be a significant problem for the General Assembly.

However, because of the influx of federal funds to match the state's investment, many people argue that Medicaid ought to be expanded, not only to improve health care for the needy but because it would be an economical use of state dollars. A return of almost 300% on a state investment certainly merits consideration.

For example, it has been suggested that the low-income eligibility requirements (37% of poverty) be raised to 100% of the federal poverty guidelines. However, with some exceptions, it is not possible to increase the income criteria for Medicaid without simultaneously raising the income eligibility level for AFDC. The program has not had sufficient funds to pay for this expansion in the past. But even if the income eligibility level were raised to 100% of poverty, only 30,000 additional participants would be added to the program. Such a change would also mean that around 19,000 of these would become eligible for welfare. Expanding income eligibility to 100% of poverty would cost $83.2 million in state dollars. Of this, $76 million would be for AFDC benefits.

Another popular recommendation is that Kentucky take advantage of the federal option to expand income limits for pregnant women and children under age one from the current level of 125% of the federal poverty to 185% of poverty. It is projected this would result in 6,500 additional recipients the first year and 8,000 each year thereafter. It is expected this would cost $14.7 million ($4.0 million in state funds) annually.

It has also been suggested that Medicaid eligibility be extended to children under age 5 (from the current age 2) who are in families with incomes up to 100% of poverty. This would add 7,500 children to the program and would cost $6.9 million ($1.8 million in state funds) annually.

The Medicaid Program has also been under great pressure to increase reimbursement to providers who participate in the program. For example, the rates currently paid to dentists are based on a percentage of their 1978 charges. As a result of this low reimbursement, the number of dentists who participate in the program has dropped from over 1,200 to just over 800. These are only about one-third of the dentists licensed in Kentucky.

A similar situation exists with regard to most physicians. Physician hospital inpatient services are currently paid at about 35% of their 1980 charge level. Also, Kentucky hospital reimbursement is one of the most restrictive in the nation. Other service providers present equally convincing cases for increased reimbursement; however, simply to increase funds for physicians, dentists and hospitals would require $11.8 million in 1991.

The suggestions for additional KMAP investment discussed above are those which seem to be discussed most often. However, there are a number of other options relating to additional eligible populations and additional provider payments which would increase the scope and cost of KMAP.

The important questions facing the General Assembly with regard to Medicaid are (1) how to find the additional funds necessary to maintain the program in the next biennium; and (2) whether to invest additional state dollars in KMAP in order to attract more federal funds to the state.

CONTINUITY OF CARE FOR THE SEVERELY MENTALLY ILL

Prepared by Jennifer Dickman

Issue

Should the General Assembly enact legislation mandating state psychiatric hospitals and community mental health centers that follow specific discharge planning procedures for severely mentally ill patients?

Background

The National Mental Health Association estimated the incidence of mental illness in the U.S. to be 2.5% of the population and a 1980 report from the U.S. Department of Health and Human Services, which considers diagnosis, disability and duration, estimated that 3.14% of the population have various levels of mental illness. Applying these percentages to Kentucky's estimated population yields a range of 95,500 to 117,759 persons with various levels of mental illness. However, these persons do not necessarily all experience the most severe forms of mental illness, as the Cabinet for Human Resources found through a needs assessment, which estimates that 28,500 persons in Kentucky are severely mentally ill.

Severe mental illness, as defined in KRS 210.005, is an illness which has persisted for a continuous period of at least 2 years or has caused an individual to be hospitalized for mental illness more than once in the last two years. Additionally, persons with severe mental illness are significantly impaired in their ability to function socially, occupationally or both. While Kentucky statute actually uses the word "chronic", professionals have adopted the word "severe," which is consistent with national terminology.

In KRS 210.040, the Cabinet is mandated to administer and supervise programs for the care of persons with severe mental illness. The programs include assisting these persons in gaining access to essential mental health services, medical and rehabilitation services, employment, housing and other supportive services designed to enable such persons to function outside inpatient institutions to the maximum extent of their capabilities. To provide these services, the Cabinet operates three state psychiatric hospitals and contracts with the fourteen Community Mental Health Centers.

Treatment of the severely mentally ill has shifted from a restrictive institutionalized setting to the utilization of psychotrophic drugs in the least restrictive setting. This movement initially led to massive deinstitutionalization of patients in the state psychiatric hospitals and continues to reduce the length of hospital stay. The community mental health centers were established to provide community treatment facilities for individuals who had been released from state mental hospitals, as well as provide other community mental health services.

Discussion

While each state psychiatric hospital has different discharge policies, generally the procedure involves scheduling an appointment with the local community mental health center. The appointment serves as a linkage in treatment from the institutional setting to the community. The community mental health center determines what outpatient treatment the patient will need. The goal is to enable the patient to function outside of the institution. But many severely mentally ill persons may be unable to keep scheduled appointments for a variety of reasons. If the appointment is not kept, there is no uniform method for follow up by either the hospital or the center. It is almost impossible for a person with mental illness who has a low tolerance to stress and inadequate social and mental functions to locate the needed services. Without the appropriate follow-up and linkages to services, their condition is likely to deteriorate until they are hospitalized again.

Many have argued that the homeless are a glaring example of this problem. The Cabinet has estimated that 5% of the state's population with severe mental illness may be homeless. Using this figure it is estimated that there are approximately 1,400 homeless persons with severe mental illness. Advocates also identify the number of severely mentally ill individuals, mostly untreated, in county jails around the state as another indicator of breakdown in outpatient services and failure of aftercare.

Under the current statutes, only KRS 202A.181 provides a mechanism which addresses continuity of care for persons with severe mental illness when they are discharged from the hospital. This statute requires that to be released from a psychiatric hospital on a convalescent leave status, a patient must have a treatment plan developed jointly by the hospital and by a provider of outpatient care. The plan must provide follow-up for continual monitoring of that patient's condition by the provider. However, the provisions only relate to involuntarily committed patients, which is about half of all state psychiatric patients.

The nature of severe mental illness, which is characterized by periods of relative stability, interspersed with acute psychotic episodes, requires attention to the unique relationship between the individual and the provider system. In fact, the Cabinet states that the effects of the lack of continuity of care are especially detrimental to severely mentally ill as they move between the hospital and the community. This lack of continuity, while effecting the ability of the severely mentally ill to remain in the community, can also be expensive given the large number of readmissions to state hospitals.

The continued cycle of readmission to the state psychiatric hospitals can be reduced by developing successful linkages to the community mental support system. A Hospital/Community Task Force was formed in January 1988 to examine the interactions and relationships between the psychiatric hospitals and the community mental health centers as they affect the people who receive those services, and to develop options.

As one option, the Task Force recommends a Continuity of Care Protocol which

establishes a mission statement and operational principles and provides procedural guidelines for continuity of care. The protocol would establish regional Continuity of Care Advisory Councils to provide an ongoing dialogue regarding continuity issues and to provide a structure for periodic review and revision of related policies and procedures. Continuity of care procedures would be most effective if they establish that the severely mentally ill are the first priority for state psychiatric services, if they organize services for the convenience of the patient rather than for the provider, and if there is better monitoring of services, especially by outside agencies and consumer groups, to assure appropriate linkage.

Another option would be to increase the number of case managers. Under KRS 210.040 (7) (2), the Cabinet must assure the availability of a case manager for each person with severe mental illness. Case managers assist the client in gaining access to needed social, medical, vocational, residential and other services. The activities include assessment, planning, monitoring, helping clients meet basic human needs, onsite visitation, care coordination, client advocacy, tracking and follow-up. While case managers would serve to assure continuity of care for the severely mentally ill, adequate funding has not been available to provide enough case managers to serve each person. Currently, there are 71 case managers serving 2,861 of the estimated 28,500 severely mentally ill in the state.

To summarize, the General Assembly has several options with regard to this problem: (1) assume that the Continuity of Care Protocol developed by the Task Force will be implemented without additional legislative involvement; (2) incorporate the Protocol into statute; or (3) appropriate funds to provide additional case managers.

REGULATION OF BOARDING HOMES

Prepared by Steve McCollum

Issue

Should the General Assembly pass legislation to regulate boarding homes?

Background

Recent accounts of abuse to aged persons living in boarding houses have renewed the debate over whether boarding houses should be regulated. Among the concerns expressed is the health of the aged person in the boarding house. Some aged persons in these settings are in such ill health that they require trained medical attention either on a part-time or full-time basis.

A second concern is the safety of aged persons in boarding houses. If a fire occurs, is there a plan to get the boarders out? Are invalids on the second or third floors with no way to get out? What kind of environment are they living in? Is it sanitary?

A third concern is exploitation by caretakers of aged persons' resources. Kentucky currently has a law (KRS 209.990[2]) prohibiting exploitation by caretakers. Regulation of boarding houses would make it possible for the state to monitor the health, safety, and general welfare of aged persons in such settings.

Discussion

Three previous attempts at regulation have all failed. In 1982, the General Assembly considered HB 43, which mandated regulation of boarding homes. Such regulation included requiring boarding home operators to register annually with local or regional health departments for a fee of $25. An annual renewal fee of $25 was also required. The health departments would be responsible for inspections, to insure that the boarding homes had safe and sanitary conditions. If at any time a health department discovered that safe and sanitary conditions did not exist, the department could begin proceedings to close the house. As part of the proceedings, the operator of the boarding house had to be given adequate notice of the closing and an opportunity for a hearing. Hearing procedures were to be decided by regulations promulgated by the Cabinet for Human Resources.

On a quarterly basis, each health department would notify the cabinet and other local agencies having jurisdiction that newly registered boarding homes were in compliance with fire safety and building codes. HB 43 did not apply to boarding homes that housed college students or those operated or regulated by the federal government.

HB 98, introduced in 1984, sought to regulate boarding homes in much the same way. The only changes from the 1982 legislation were a change from a legislatively set

registration and renewal fee to one set by regulation, and that a permit to operate would be issued by county or district health departments instead of by a local or regional health department.

In 1986, HB 20 was introduced to regulate boarding homes. It was quite similar to the previous pieces of legislation. Notable differences included the initial sanitary and safety inspection. Prior legislation had just said that such inspections would be carried out by the health department issuing the permit to the operator. HB 20 required the inspection to be done by a health enviromentalist from the local or district health department.

Other changes were that permits for operation would expire on December 31; complaints received about the operation of a boarding home would be referred to the appropriate regulatory body, who would investigate and take corrective action, if necessary; and health departments would notify the cabinet and other local agencies on a monthly, instead of a quarterly, basis that newly registered boarding homes complied with fire safety and building codes.

These previous attempts all failed, primarily because of concerns over government encroachment into yet another area of landlord/tenant relations.

COURT-ORDERED JUDICIAL REVIEW OF LEAST RESTRICTIVE SETTINGS FOR MENTALLY RETARDED

Prepared by Steve McCollum

Issue

Should the 1990 General Assembly establish judicial review procedures for "least restrictive settings" for mentally retarded persons?

Background

Judicial review of "least restrictive settings" for mentally retarded people pertains to the right of mentally retarded adults to have their treatment questioned in court. It is a complicated issue that involves the legal concepts of due process and equal protection. In Kentucky, the issue of judicial review has surfaced because of the court case Doe v. Austin and the case of Teresa Ann Horton. On one side of the issue are advocates for the mentally retarded, who contend that mentally retarded adults have been denied their rights because they have been unfairly placed and kept in institutions, when in fact they could function quite well in a community or group home. On the other side are those who say that the third-party intrusion by the advocates violates the parent/child relationship and takes out of the hands of the parents a substantial say in the treatment of their mentally retarded offspring. Furthermore, the adult mentally retarded are not capable of making the decision themselves, so the parents and institutions should decide their treatment. Discussed below are the decisions of the courts in Doe v. Austin, the the 1986 General Assembly's response to the first decision handed down in district court, and the appeals court response to the General Assembly's action. The issue of judicial review is whether the General Assembly should mandate a formalized system that turns on equal protection and due process with regards to the treatment of mentally retarded persons and mentally ill persons.

In January 1986, the United States District Court for the Western District of Kentucky decided in Doe v. Austin that mentally retarded persons were not being given equal protection vis-a-vis mentally ill persons with regards to involuntary commitments. The court ruled that to deny mentally retarded persons due process in involuntary commitments while making due process a requirement in involuntary commitments of the mentally ill was a violation of equal protection mandated by KRS 202B.050. KRS 202B.050 guaranteed that all rights for the mentally ill enumerated in KRS Chapter 202A and Chapter 210 applied to the mentally retarded as well. KRS 202A. 051 lists the procedures to be used in involuntary commitments of mentally ill persons and in part states that no person may be committed for more than a 360-day period without a judicial hearing.

The 1986 General Assembly responded to the ruling by passing HB 477. A portion of the bill amended 202B.050 by adding a parenthetical section which excluded mentally

retarded persons from involuntary commitment procedures set forth in KRS 202A.026 and 202A.051. The effect of this amendment was to remove the right of mentally retarded adults to have an annual judicial hearing to decide whether they are in the least restrictive setting. HB 477 also amended 202B.040 to state that any mentally retarded person committed by parents or guardians should be considered a voluntary commitment. A third component of HB 477 set out an admission procedure for mentally retarded persons. Codified as 202B.045, the admission policy did not offer due process to mentally retarded persons nor did it allow for periodic judicial hearings.

Austin v. Doe was appealed to the United States Court of Appeals for the Sixth Circuit. In June of 1988, the Court ruled on *Doe v. Austin.* The court's findings were as follows:

(1) Commitment of mentally retarded adults by the Commonwealth upon application by a parent or guardian is to be considered involuntary.

(2) The current procedures for involuntary commitment do not insure due process because they fail to provide minimal safeguards, such as adequate notice and cross examination.

(3) Equal protection requires the Commonwealth to provide a judicial hearing to mentally retarded persons, either upon admission, or, if now committed, when they reach adulthood.

(4) (a) Due process requires that some periodic review take place during confinement, but it does not mean that due process requires periodic judicial reviews.

(b) But, as a requirement of equal protection, the state must make some type of periodic judicial review available to the mentally retarded. These procedures can differ for mentally retarded and mentally ill, as long as the process is a judicial hearing.

At present, the case is back in District Court with instructions from the Court of Appeals to develop a periodic judicial review procedure.

Discussion

Chapter 202B was held to be unconstitutional by the United States District Court for the Western District of Kentucky, because it violated the equal protection clause of the 14th Amendment to the United States Constitution. The clause requires "that all persons similarly situated be treated alike." The findings of the Court of Appeals discussed above affirmed the lower court's ruling in this respect.

According to KRS 202B.040(5) all commitment petitions initiated by a parent or guardian of a mentally retarded person are to be considered voluntary. Such a distinction, in the words of the Court of Appeals, is an "illusion". Thus this section, which was added in 1986 to make this distinction, is out of compliance with the court ruling.

Secondly, the procedures for admitting mentally retarded adults to institutions do not insure due process. KRS 202B.045, which controls admissions, does not provide for the necessities of due process. At the least, the admission procedures must provide notice to persons about pending commitments to an institution, and a method of assuring that the notice is given adequately in advance so that the person facing commitment has a chance to prepare. There has to be a procedure whereby the person may present witnesses or documentary evidence, and an opportunity to cross examine witnesses. Independent assistance must be allowed. Currently, Kentucky requires such independent assistance for the mentally ill. But, KRS 202B.050, as amended in 1986, denies this right to mentally retarded persons. Finally, though not ruled as necessarily denying due process, the presence of a parent or guardian on the interdisciplinary team was held to pose a serious threat to impartiality. The interdisciplinary team was established by HB 477 in 1986 (KRS 202B.010) to be responsible for the diagnosis, evaluation and individualized program planning and service implementation of a committed mentally retarded person.

"Equal protection" assumes that the state will regard mentally ill persons and mentally retarded persons in a like manner. Since mentally ill persons are given periodic judicial reviews as part of due process, the state should also make some type of periodic judicial review available to mentally retarded persons. KRS 202A.051 describes the procedures for involuntary commitment of mentally ill persons, but the language of KRS 202B.050, as amended in 1986, unconstitutionally denies this aspect of equal protection to mentally retarded persons. The options for the 1990 General Assembly are to either let the courts decide how a judicial review for a mentally retarded person is to be conducted or do so legislatively. If the General Assembly chooses to do so legislatively, the procedure does not have to be the same as that for mentally ill people.

EXTENDING HANDICAPPED DISCRIMINATION LAWS TO INCLUDE AIDS

Prepared by Steve McCollum

Issue

Should the 1990 General Assembly consider extending handicapped anti-discrimination laws to include AIDS victims?

Background

Twenty-eight states have extended handicapped anti-discrimination laws to cover person with AIDS. In doing so these states are following the precedent established by *Chalk v. U.S. District Court* for the Central District of California (Chalk v. U.S. District Court, 87-6418). The case extended the provisions of section 504 of the Federal Rehabilitation Act of 1973 to include persons who have AIDS. Section 504 prohibits discrimination against handicapped persons who are "otherwise qualified." But, the ruling applies only to the federal government or programs which receive funding from the federal government. The Rehabilitation Act was amended by the 100th Congress to define persons with a contagious disease or infection as handicapped, as long as the person does not "constitute a direct threat to health or safety" and is able "to perform the duties of the job." Congress also passed The Fair Housing Amendments Act of 1988, which for the first time extended nondiscrimination protection for people with disabilities to the private sector. Homeowners and landlords may no longer discriminate against people infected with HIV (Human Immunodeficiency Virus). Another act, The Americans With Disabilities Act, will be introduced in the 101st Congress to provide protection in private sector areas, including employment, accommodations, restaurants and stores.

The U.S. Supreme Court ruled in *School Board of Nassau County, Florida v. Arline* (U.S. Supreme Court 107 S. Ct. 1123 1987) that contagiousness is protected under section 504 if the person is otherwise qualified. The Court held that an employer cannot "seize upon the distinction between the effects of the disease on others and the effects of the disease on a patient and use the distinction to justify discrimination. These decisions do not address persons who are asymptomatic carriers of HIV, since they are not yet able to prove their disability. One can see then that the states have considerable legal ground left to cover both in extending coverage beyond the federal government and federally funded programs and to persons who are asymptomatic HIV carriers.

Discussion

Currently, 28 states have taken steps to provide anti-discrimination protection for AIDS victims. Twenty-one of these states have formally extended protection to include persons with AIDS, ARC (AIDS Related Complex), and HIV infection. Formal extension means that the states' civil rights commission, attorney general, courts or appropriate

agencies have issued written statements or rulings declaring current handicapped anti-discrimination statutes sufficient protection for persons with AIDS.

It is not certain whether these methods will work for Kentucky. Opinions of the attorney general are advisory only. Consequently, no one is compelled by law to follow the opinions. No court cases have yet been tried in Kentucky that would test the applicability of handicap laws. The general assembly will probably have a chance to act on this matter before such a case evolves. The status of regulations issued by the appropriate cabinets or the Kentucky Commission on Human Rights could be challenged, because they might exceed statutory authority.

Five states — Florida, Iowa, Missouri, Rhode Island, and Washington — have passed legislation that extended the handicap laws of their states to cover persons with AIDS. Florida, Iowa and Missouri include protection for HIV-infected persons. Florida's legislation is the most extensive. It prohibits discrimination against individuals with AIDS, ARC, or other manifestations of HIV infection. Individuals may not be required to test for hiring, promotion, or continued employment.

Currently, Kentucky has statutes protecting handicapped persons from discrimination in government employment (KRS 18A.140), housing (207.180), loans (207.190) and by labor organizations (207.180). KRS 207.170 prohibits employment discrimination against handicapped persons with respect to apprenticeship programs or training programs. KRS 207.150 prohibits an employer from refusing to hire a handicapped person unless the handicap restricts the person's ability to perform the work. Further, an employer cannot distinguish a handicapped person from the rest of the workforce in a way that would deprive that person of an employment opportunity unless a "bona-fide and necessary reason" for such treatment can be established.

However, KRS 207.140 allows an employer to refuse to hire a person with a communicable disease. This is a sticky point, given that according to 902 KAR 2:020 AIDS is indeed a communicable disease, if only by limited methods of transmission. Casual contact has not been established as a method of transmission, and in practically all workplace environments, most person-to-person contact is casual.

Those in favor of anti-discrimination legislation contend that it removes fear of reprisal. People who are at a higher risk of contracting AIDS, they say, are in groups that are traditionally discriminated against by society. They argue that the additional protection afforded by anti-discrimination legislation will encourage the at-risk population to seek testing and treatment, thus slowing or even halting the spread of AIDS. Also, many who are not in at-risk groups get AIDS. Such legislation would protect these sufferers as well.

Those opposed to anti-discrimination legislation believe that such legislation condones behavior that they find morally wrong. They argue that the most frequent victims of AIDS, homosexuals and IV drug abusers, should just stop their particular behavior.

The issue facing the 1990 General Assembly is whether it chooses to extend anti-discrimination protection to AIDS victims. If the General Assembly decides to do so, it can either amend current Kentucky handicap laws, adopt model legislation other states have enacted, or create its own legislation to deal with the problem.

A COMMUNITY-BASED SYSTEM OF CARE FOR EMOTIONALLY DISTURBED CHILDREN

Prepared by Dianna McClure and Jim Sharpe

Issue

Should the state enact statutory guidelines and provide increased funding to require a coordinated, community-based system of care for children with emotional problems?

Background

The last two decades have seen tremendous economic and social upheavals that have had a marked effect on the family. Economic factors have dictated that two parents work to maintain family income levels. As a result of high divorce rates and teenage pregnancies, single parent families have proliferated. Divorce, remarriage, and frequent moves into new communities have precipitated high degrees of family turmoil. Two-career households have yielded families that are either too busy with economic survival or too distracted by the demands of the workplace to invest as much energy as they once did into child care tasks. High rates of alcoholism and drug abuse have added chaos to the lives of many families, and are themselves a mark of the high levels of stress in modern family life.

Experts in the mental health field cite the problems outlined above as some of the reasons for the growing number of children who are unable to be maintained in their home. Although the numbers of children and adolescents in the general population have been declining throughout the 1980s, the number of children placed outside the home have steadily increased. Currently, the nation as a whole spends more than a billion dollars on these children (excluding funds spent on psychiatric hospitalization). The Center for the Study of Social Policy in Washington, D.C., projects that if the present trend continues, there will be over one million children in out-of-home placements by the year 2000. There is also a growing population of "runaways", children who leave home for a life in the streets. And in the last few years, the term "throwaway" has been used to describe the growing numbers of children abandoned by their families.

While changing social conditions have resulted in more children with greater needs for child welfare services, private and public agencies have not been able to rapidly and effectively adapt to the new demands placed upon them. Traditionally, these agencies have relied upon foster families as a mechanism for child care, but there has been an enormous increase in the numbers of children whose needs demand more expertise and resources than foster parents are able to provide. These children are described as "hard to place" by child welfare workers seeking shelter for them; as having "emotional problems" or

being "behaviorally disturbed" by mental health professionals; and as being "emotionally/ behaviorally handicapped" by professionals in the field of education. Professionals involved in the care of these children have come to define this population as "severely emotionally disturbed" (SED) and report that they are one of the most underserved and inappropriately served populations.

The capacity of SED children to live in a family environment is diminished. They may be angry and explosive or depressed and withdrawn, compromising their ability to build and maintain the quality relationships every child needs to grow and mature. Frequently, they are impulsive and their capacity to make appropriate decisions and control their behavior is reduced. Their emotional problems result in school and social difficulties. Without help, they fail repetitively in a variety of settings. In the absence of appropriate community-based services, often the alternative has been psychiatric hospitalization. Nationally, between 1980 and 1987, the rate of hospitalization of children between the ages of 10 and 19 increased 43%, while the population of that age group has decreased by 11%, according to the National Center for Health Statistics.

National estimates have placed the number of children who undergo some emotional disturbance at 11.8%. Estimates of the number of children whose disturbance is pervasive and can be categorized as severe is 5%. These figures have been accepted by the National Institute of Mental Health; several different studies have shown them to be reasonable, if not conservative. There is a population of approximately 1,022,225 persons under the age of 18 in Kentucky. Using the above figures, the number of children in need of some form of mental health intervention is 120,620. The number of children who qualify as SED is 51,000.

National child care experts agree that severely emotionally disturbed children and youth have multiple and changing needs. An SED child whose behavior is out of control may need help to avoid an out-of-home placement and at the same time require special services to remain in school. Successfully addressing these needs requires a coordinated network of organized services. While this network is often referred to as a "continuum" or "system" of care in the professional literature, these terms refer to the same desirable goal: a range of services or programs at varying levels of intensity with arrangements for service coordination among all the parts.

Children at Risk for Emotional Disturbance

Any child may develop emotional disturbance to such a degree as to qualify as severe. However, certain life experiences place the children exposed to them at high risk. These situations that place children at risk for emotional problems have been identified by studies both on the national level and by a 1986 Kentucky study of 1,082 SED children conducted by the Department for Mental Health and Mental Retardation.

The children most at risk are those who are victims of physical abuse, sexual

abuse or neglect, those who have foster or adoptive parents, those who have alcoholic/ drug dependent parents, those who become involved with the court, and those who live in poverty.

At first glance, it may seem unreasonable to suggest that there are 51,000 children with severe emotional problems in Kentucky. However, examination of a single at-risk category gives perspective to this estimate. In the last three years alone, 56,327 Kentucky children have been substantiated as victims of physical abuse, sexual abuse, or neglect.

Definition of the SED Child

There are several different definitions of Severely Emotionally Disturbed Children that have been assimilated by various organizations. The following is consistent with the National Institute of Mental Health, the federal Children and Adolescent Service System Program (CASSP), and the Education for Handicapped Children Act (P.L. 94-142). An SED child is one who meets the following criteria:

Age: Under age 18, or under 21 and receiving services prior to age 18 that must be continued for therapeutic benefit.

Functional Disability: Child presents substantial limitation in at least two of the following five areas:

(1) Self-Care, defined as the ability to provide, sustain and protect his/herself at a level appropriate to their age.

(2) Interpersonal Relationships, defined as the ability to build and maintain satisfactory relationships with peers and adults.

(3) Family Life, defined as the capacity to live in a family or family type of environment.

(4) Self-direction, defined as the child's ability to control his or her behavior and to make decisions in a manner appropriate to their age.

(5) Education, defined as the ability to learn social and intellectual skills from teachers in home and school educational settings.

Duration: Problems must persist for one year or be judged by a qualified mental health professional to be at high risk to continue for at least one year without professional intervention.

Multi-Service Needs: Child needs special services from two or more agencies or systems at the same time.

Discussion

Coordination, Accountability and Funding

Kentucky, like most states, faces a major problem in the lack of coordination within and among agencies that serve SED children. There is no formal body to coordinate services and policy among the Department for Social Services, the Department for Mental Health and Mental Retardation, the Department of Education, and the Juvenile Court. Often, coordination is a problem within agencies. "The Turning Point", a recent report of the DSS Children's Residential Advisory Committee, cited a lack of coordination between the Division of Family Services and the Division of Children's Residential Services as a major issue. At present, there are no clear-cut lines of responsibility for SED children and youth.

This leads to problems in accountability, both in terms of children and in terms of funds. Because SED children are more difficult to work with than other populations, agencies are reluctant to claim responsibility for meeting their needs. There is a tendency to suggest that difficulties in school are the school's problem, or that difficulties in the home environment are in the family service worker's domain. In reality, these problems involve the same child and addressing them as separate entities by professionals under separate lines of organization makes problem solving a difficult exercise.

With the current lack of coordination, it is impossible to accurately ascertain how many SED children are currently receiving services in Kentucky. In school year 1988-89, school districts had identified 2,155 children as emotionally or behaviorally disturbed. One thousand four hundred thirty-three children (1,433) were served by DSS treatment programs in 1988.

Less than 5,000 SED youth were served in 1985 by Community Mental Health Centers. An estimated 3,150 children were admitted to psychiatric hospitals in 1988. Many children are counted more than once in these figures; there is no mechanism for tracking these children across the various service systems.

In terms of funding, because there are so many different avenues for funds to flow through to this population, states do not realize how much money they are expending on SED children. With no single point of entry, there is no total funds figure available. Without knowledge of the total funds expended in Mental Health, Education, Social Services, and Juvenile Justice on services to SED children, legislators are unlikely to be aware of the costs expended on these children and give them the oversight they need to provide effective services.

The SED child is frequently involved with more than one service delivery system at the same time. The same child who, due to family problems, is placed in a foster home by DSS is also a problem in the community and school settings and may be involved with the school counselor, Community Mental Health Center, and Juvenile Court. Often

professionals work with a child in each of these settings without knowledge of each other's efforts. A change in one setting, for instance, removal of a child from a foster home, disrupts the work being done in other settings.

Two different solutions to the problem of coordination have been tried in other states. Some states have combined the majority of agencies providing services to children into one department. Proponents of this approach cite clear accountability for children, a single point of entry for accountability of funds, and central planning as positives. Opponents say that it will lead to agencies for each separate group in the population, that it makes handling federal grant monies more difficult.

The other approach is to coordinate services and funding through the creation of statewide, regional and local coordination councils. Usually charged with allocating funds to provide resources for children with multiple needs and policy development, these groups have allowed blended funding for individual children and coordination for the most serious cases. Those who favor this approach point to the blending of funds from two or more agencies for individual cases, individualized services, and increased accountability within local communities as positives. Those who oppose it suggest that it is another set of bureaucratic layers and adds more employees to provide the same services.

Psychiatric Hospitalization of Children

Fueled by a lack of alternative resources and a very liberal Medicaid policy, Kentucky has seen its own explosion of psychiatric beds for children in the last decade. In 1982, there were 74 psychiatric beds in hospital units specially designed to serve children and youth; today there are over 500. The costs to the Medicaid program have increased an average of 39% per year during this period, going from $2.8 million in 1981 to $24 million in SFY 1988. Payments in SFY 1989 seem to be consistent with this increase and will approach $36 million. In comparison, the entire budget for DSS Division of Residential Services is $31 million. The Cabinet for Human Resources has projected over $50 million in expenditures in this category in 1990. If the growth rate in Medicaid payments for the psychiatric hospitalization of children remains at 39% per year, SFY 1992 will see payments of over $97 million; by 1994, expenditures would be over $187 million.

Kentucky's Medicaid policy (907 KAR 1:004 & E) allows Medicaid eligibility to be based on the child's income alone if the child has been hospitalized in a psychiatric institution for 30 days or is one "whose physician has specified that it is anticipated he will remain in the facility for 30 or more days (regardless of whether the child actually does so)". If family income is disregarded, the number of children eligible for Medicaid payments for psychiatric hospitalization is near universal.

Nationwide, a survey of several states found that 40% of all psychiatric placements of children are inappropriate (Knitzer, 1982). A 1986 study conducted by the Department for Mental Health and Mental Retardation found that 39% of children in Kentucky's

psychiatric facilities on June 30, 1986, exhibited none of the six behaviors which are normally considered reasons for hospitalization. These studies, coupled with the increase in private beds and expenditures of public monies have made psychiatric hospitalization the most controversial issue surrounding children in Kentucky.

Those critical of the hospitalization policy point out that it is the most restrictive and costly form of treatment, consuming public resources that could be used to develop/ support more appropriate community services. Hospitalization labels the child admitted as "crazy", and teaches the child to function in an institution, making return to the community more problematic. They suggest there is the potential for inappropriate dependence on drugs to control child's behavior, and the previous hospitalization for mental illness greatly increases difficulties in acquiring private health/life insurance afterward. They cite the pressure to fill the increased number of beds, as evidenced by increased intensive marketing campaigns by private facilities, and point to profit motive as the driving force behind hospitalization. They point out that even for children who do need hospitalization, the lack of transitional services and care when they are returned to the community often results in the erosion of gains made while hospitalized.

Those defending hospitalization suggest the lack of other less restrictive community-based services as a reason for the increased rates. They say that Medicaid's Peer Review Process ensures that children are appropriately hospitalized, and that hospitals actually lose money on psychiatric beds for children.

According to the Department for Medicaid Services, the state's Peer Review Organization turned down two children for hospital services in SFY 1988. There is some concern that the PRO does not have the expertise to conduct a thorough utilization review of psychiatric services.

Other states faced with this problem have set up independent review boards and required that any children placed in psychiatric facilities and supported by state funds, must obtain prior approval. These "gatekeeping boards" have been effective at screening children for placement into appropriate facilities.

Another approach used by other states is to approve Medicaid payments to less restrictive residential settings. These settings provide psycho-social therapy without the expensive medical components of hospitals, reasoning that children who do not require medication do not require a hospital setting. Costs per day are about one-third of hospital costs.

One state, Vermont, has gained approval of a waiver plan to provide community-based services to SED children in their homes. The Oklahoma legislature has directed the executive branch to submit such a plan.

Education

Education is central to the life of any child, and educational services are crucial to SED children. The behavior of these children often requires special efforts to enable them to profit from an educational experience. Because of their behavior, they are often expelled from the school setting, an action that precipitates a family crisis and sometimes results in the removal of the child from the home. For this reason, educational services are central to any network of services to SED children.

The Federal Education for All Handicapped Children Act (P.L. 94-142) stipulates that schools are responsible for providing an education for all school age handicapped children, including those handicapped by emotional or behavioral disturbance (ED/BD). Services must be provided in the least restrictive environment.

The most conservative national estimate is that 2-5% of students are emotionally handicapped. Nationwide, states identify an average of .93% of their students as ED/BD, but Kentucky identifies only .3% of children in this category.

In an August 1986 report, a Kentucky State Board of Education Task Force estimated there were over 11,000 unidentified ED/BD students in Kentucky. In school year 1987-88, over half of Kentucky school districts identified no ED/BD children within their boundaries. Of the 2,733 students identified as ED/BD that year, 534 were placed in restrictive settings outside their districts for educational services, including 144 placed in psychiatric hospitals for this purpose.

Of the 272 emotionally disturbed teaching units in the state, 74% are in Jefferson, Fayette, or Kenton County. Only Fayette County identifies the national estimate of 2% of enrolled students as ED/BD.

1986 House Bill 241 provides for educational units for ED/BD students but has not received full funding. There is some speculation that Kentucky is at risk for a federal class action suit to provide more services to ED/BD children under P.L. 94-142.

Possible Actions by the 1990 General Assembly

(1) Coordination and Accountability for Children/Funds

(a) Combine various state agencies providing services for children into one organization. This would ensure accountability and responsibility, for children as well as funds provided by the General Assembly.

(b) Require representatives of agencies now providing children's services to form coordinating bodies at the state, regional and local levels. At the state level, representatives would coordinate programs/policies. At the regional/local levels individual cases would be considered as well. Currently, there is no formal body to coordinate efforts among

the Department for Social Services, the Department for Mental Health and Mental Retardation Services, the Department of Education, the Juvenile Court and other agencies.

(2) Psychiatric Hospitalization of Children

(a) Increase funding for community-based treatment programs to provide a less expensive alternative to hospitalization.

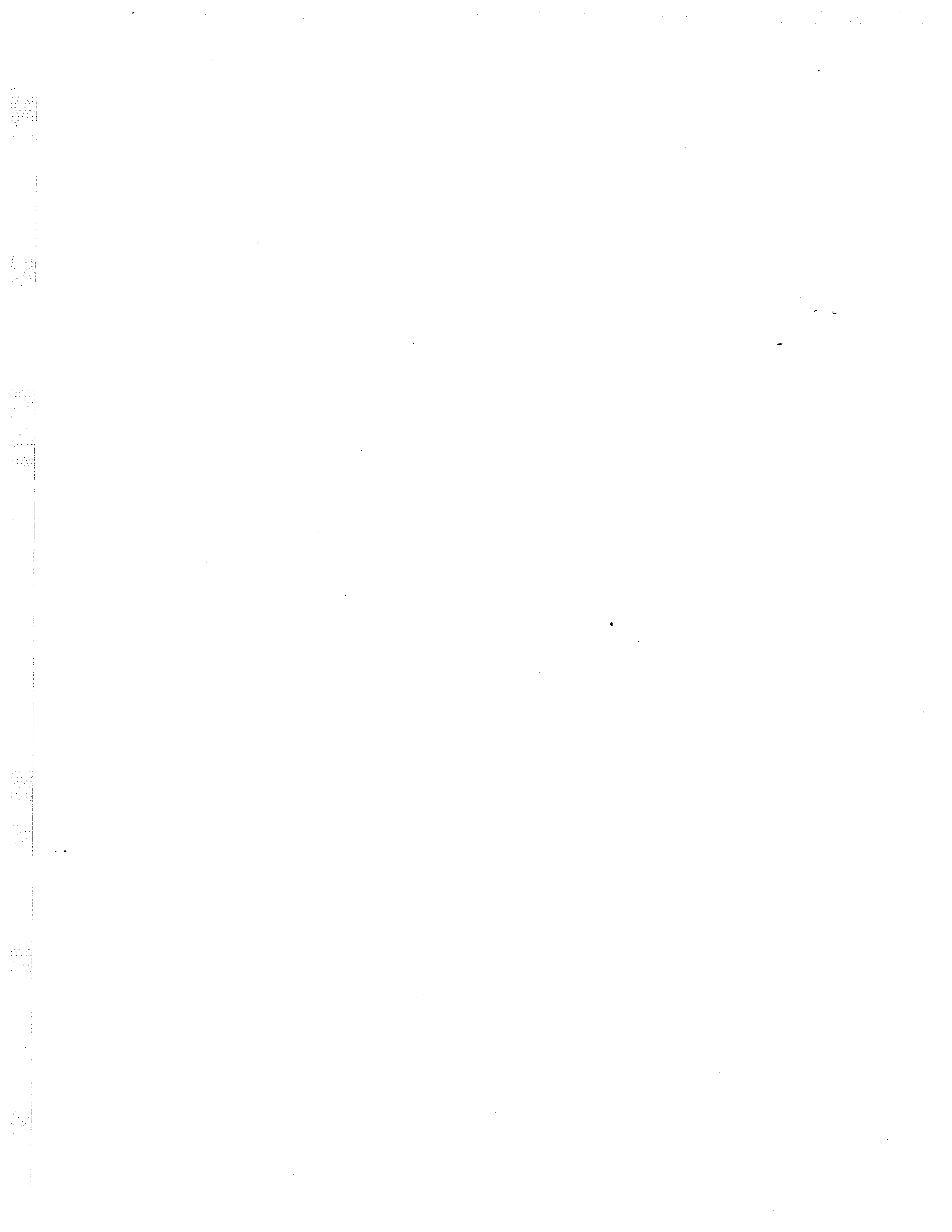
(b) Direct the Department for Medicaid Services to reimburse treatment in less restrictive settings.

(c) Require independent review boards of qualified mental health professionals to approve placement/treatment of children receiving state support in psychiatric facilities.

(d) Enact statutory guidelines for psychiatric facilities treating children/adolescents.

(3) Education

(a) Increase funding for the provisions of 1986 House Bill 241 for the education of exceptional children.



JUDICIARY

CONFINEMENT FOR JUVENILE OFFENDERS

Prepared by Norman Lawson

Issue

Should the Kentucky Unified Juvenile Code be amended to create more places of lawful confinement for juvenile offenders?

Background

When the juvenile code was enacted, very severe restrictions were placed on places of confinement for juvenile offenders. Specifically, the use of adult jails for the confinement of children was prohibited, as were facilities which were shared with an adult jail. This left extremely few facilities in the state to which juvenile offenders could be taken for incarceration. Many complaints were received from police and judges with regard to the situation.

Discussion

Juvenile advocates believe that jails are not the place for the incarceration of children and cite numerous problems ranging from assaults to suicides and long-term psychological problems for children incarcerated in jail. They also cite the fact that federal money for juvenile programs hinges on keeping children out of adult jails. They hope that more adequate juvenile facilities will be constructed. Police, judges, and other persons concerned about the juvenile justice system say that while they agree that jail is not an ideal place, juveniles can be placed in a separate section of the jail, separated by sight and sound from adults. They believe that certain juveniles require detention, either for their own safety or for that of the public, and that this need outweighs the potential harm. They also maintain that sight and sound separation, while not a cure-all, does reduce the chance of association with adult inmates.

DRUG LAW REVISIONS

Prepared by Norman Lawson

Issue

Should laws governing controlled substances be revised?

Background

Kentucky's controlled substances act was written in 1972, and although it has been amended numerous times, it has never been totally revised and updated.

Discussion

Proponents cite the fact that new drugs have been introduced and have not been added to schedules in the statute and that the present law is thus out of date. They also believe that penalty development has been sporadic. They want to completely update the law, make provision for adding new drugs, and revise the penalties.

Opponents feel that the law is working well as drafted and that the General Assembly has updated the law as necessary to take care of marijuana sales, look-alike drugs, drug paraphernalia and other matters of importance. They feel that the law as presently constituted can be updated through amendments, as in the past.

VIOLENT OFFENSE SENTENCES

Prepared by Norman Lawson

Issue

Should sentences for various types of crimes, such as violent offenses, be increased?

Background

During the 1986 session of the General Assembly, legislation was passed to increase the amount of time which violent offenders must serve before parole from 20% of total sentence to 30%, and increase from six to eight years the time which must be served on a life sentence.

Discussion

Proponents of the legislation wish to keep dangerous felons separated from society for as long as possible. The original proposals were for 50% on a term of years and 12 years on a life sentence. They also feel this would have a deterrent effect on serious assaultive crimes.

Opponents of the legislation cite prison overcrowding and feel that other felons must be let out early to accommodate the longer sentences for the violent offenders. They also feel that excessively long sentences do not aid rehabilitation but hamper it, thus compounding the crime problem.

DETERMINATE SENTENCING

Prepared by Norman Lawson

Issue

Should the General Assembly replace the present method of indeterminate sentencing with determinate sentencing, which would eliminate parole?

Background

The present method of sentencing felons in Kentucky utilizes a maximum sentence which is determined by a court or jury but which relies on a parole board to let various felons out of prison before their sentence has been fully served. Determinate sentencing would provide for a flat sentence which must be fully served, from which there is no parole. In modified form, as introduced in the 1970's, the provisions would have included "good time" provisions, which would have let prisoners out much earlier if they behaved well during incarceration. These proposals might also be accomplished by sentencing guidelines which would narrowly restrict sentences by judges and juries.

Discussion

Proponents of such legislation feel it would help eliminate sentencing disparity, since everyone committing the same crime would receive the same flat rate sentence, and they point out that the cost of the parole board and cost of supervising parolees would be eliminated.

Opponents suggest that lengthy flat rate sentences result in an increase in prison overcrowding, the lack of incentive to participate in educational and industrial programs (particularly if sentences are shortened) and the loss of discretion by judges and juries.

ASSET FORFEITURE LEGISLATION

Prepared by Norman Lawson

Issue

Should Kentucky expand its asset forfeiture legislation to new crimes and new types of assets.

Background

For a number of years Kentucky has had legislation which provides for the forfeiture of certain items, such as vehicles and equipment, used in the commission of crimes such as drug offenses. Now proposals have been made to expand the legislation to include all drug offenses and seizure of real estate and money under broader circumstances.

Discussion

Proponents of the legislation believe that enhancing forfeitures will take the profit out of such offenses and will permit moneys and property from such forfeitures to be used for law enforcement, corrections, substance abuse, and other programs. Proponents feel that asset forfeiture is a way to make criminals help finance the criminal justice system as well as "sending a message" to the criminal community that Kentucky is tough on crime.

Opponents of the legislation suggest that the penalties may be disproportionate to the offense. They claim that under the legislation, a vehicle, or even a home, could be seized simply for possession of a marijuana cigarette. They also fear that selective enforcement of the legislation may mean that it is misapplied. Opponents also fear that portions of the legislation, which permit seizure of funds prior to a trial, could lead to a situation where the defendant has no funds with which to employ an attorney, thus causing the state to have to defend the person through the public advocate.

PRISON OVERCROWDING

Prepared by Norman Lawson

Issue

Should statutes and penalties be revised so as to reduce prison overcrowding?

Background

Since the adoption of the penal code in 1976, the General Assembly has defined many new crimes, particularly in the sex offense and child abuse and pornography areas. It has also mandated that prison terms be the primary penalty for crimes committed with firearms, violent offenses, offenses against children, and crimes by career criminals. This legislation has contributed, according to corrections cabinet officials, to prison overcrowding.

Discussion

Proponents of a legislative approach to reducing prison overcrowding state that the use of prison as an option has been overutilized as a means of dealing with crime and that other options, such as intensive supervision probation, restitution, home incarceration have been under-utilized or ignored. Many of these persons favor increasing the felony theft limit, decreasing or eliminating the prison option for nonviolent offenses and similar measures to force reduction of the prison population.

Opponents of a legislative approach to prison overcrowding cite continuing increases in crime, particularly in repeat property crime and drug offenses which are nonviolent, as an indication that the persons who commit these crimes must be separated from society and that prison is the primary means of accomplishing this mission. These persons believe that probation and other remedies, particularly for repeat offenders who have committed property offenses, do not work and that they depreciate the seriousness of theft and burglary as crimes. Many of these persons feel that constructing new prisons is the best answer to the problem of prison overcrowding.

ARTICLE 2A OF THE UNIFORM COMMERCIAL CODE ("LEASES")

Prepared by Patricia Hopkins

Issue

Should the General Assembly enact the proposed Article 2A of the Uniform Commercial Code, pertaining to leases of goods?

Background

The Interim Joint Committee on Judiciary has received written request and heard public testimony in support of adoption of Article 2A of the Uniform Commercial Code by the General Assembly. This new Article, offered by the Commission on Uniform State Laws, pertains to the subject of leases of goods.

Discussion

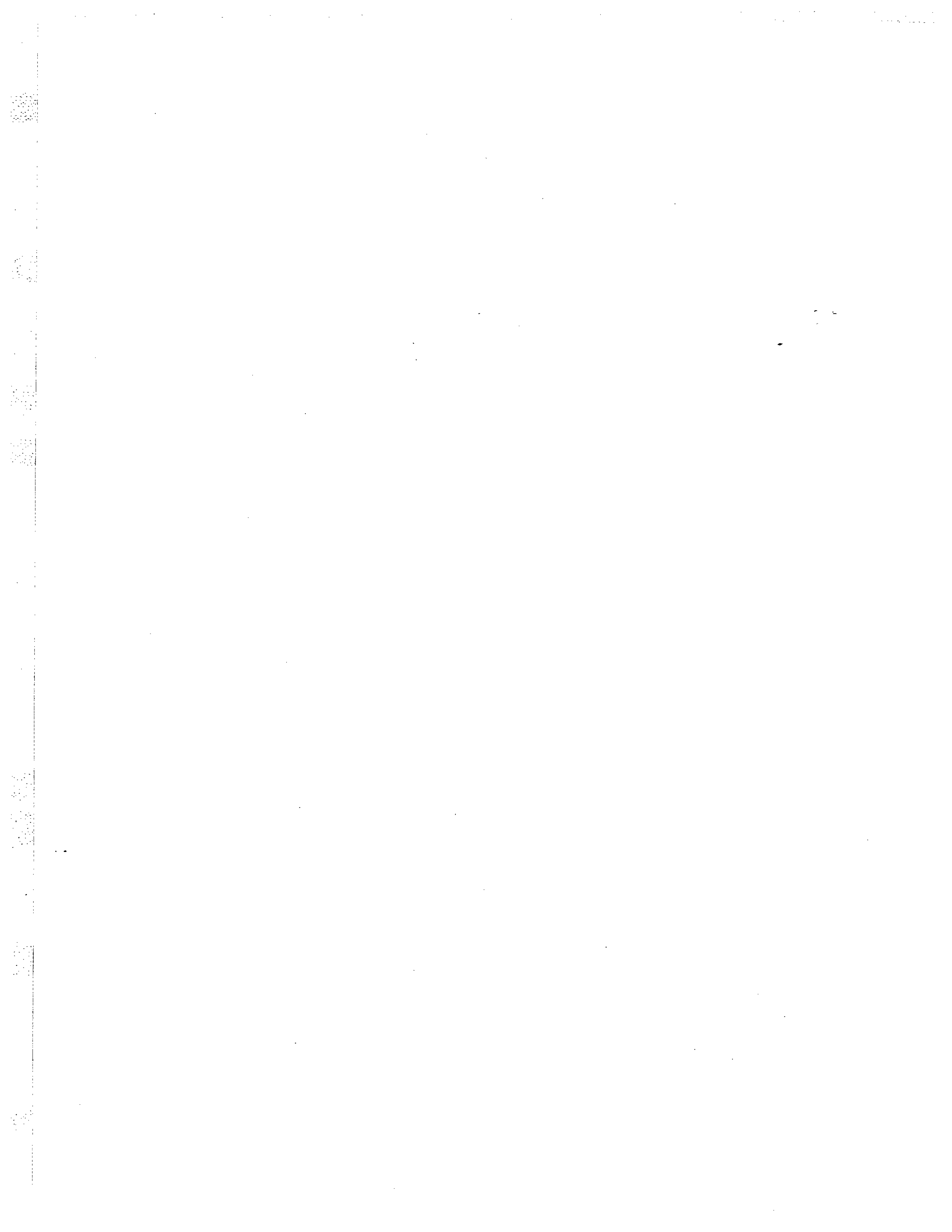
Article 2A codifies the law with respect to leases of goods. Such a codification may be desirable in order to resolve such questions as:

1. Is a transaction a lease or a security interest?

2. What warranties is a lessor deemed to have made to the lessee?

3. What remedies are available to the lessor upon the lessee's default?

A special study commission has been formed to give this matter further study. Nine persons, representing groups with interests in various aspects of the leasing business, were appointed to membership, and professors from each of the Kentucky law schools were asked to advise the membership. The commission had its mission expanded by the LRC to include the entire U.C.C., with priority to Article 2A. The commission expects to have a report and recommendations ready for the next General Assembly.



LABOR AND INDUSTRY

UNEMPLOYMENT INSURANCE

Prepared by Linda Bussell

Issue

Should the 1990 General Assembly amend the unemployment insurance law in Kentucky?

Background

The last omnibus revision to the unemployment insurance law in Kentucky was made in the 1982 General Assembly. The 1982 omnibus revision has been refined and supplemented by amendments in subsequent legislative sessions.

The overall effect of the legislative revisions made during 1982 and subsequently has been positive. This positive effect is demonstrated by the fact that for the past four years, employer contribution (tax) rates have decreased, while the maximum weekly benefit levels for unemployed workers has increased.

Discussion

The 1990 General Assembly is unlikely to disturb the balance and positive effect that exists between the unemployment insurance contribution (tax) schedule and the weekly benefit levels.

However, the General Assembly may choose to enact a few legislative proposals presented to the Interim Joint Committee for its consideration by the Cabinet for Human Resources. The legislative proposals would not affect employer contributions or employee benefit levels but, basically, would (1) conform the state unemployment insurance law to the Federal Unemployment Tax Act (FUTA) with regard to the eligibility of part-time employees of the General Assembly for unemployment insurance benefits; (2) strengthen certain record-keeping requirements relating to information concerning claimants; (3) clarify the situations in which wage reallocation will occur for the purpose of determining eligibility for benefits; and, (4) modify the benefit disqualification provisions relating to an employee's quitting one job to accept another.

Indeed, the Interim Joint Committee has endorsed the legislative proposals presented by the Cabinet for Human Resources and legislation containing these proposals will probably be pre-filed before November.

WORKERS' COMPENSATION

Prepared by Linda Bussell

Issue

Should the 1990 General Assembly amend the Kentucky workers' compensation law?

Background

In an Extraordinary Session of the General Assembly held in October 1987, the General Assembly enacted an omnibus revision of the workers' compensation law in Kentucky. The omnibus revision was contained in House Bill 1. The scope of the revision was very broad and included a complete restructuring of the benefit levels and eligibility criteria for black lung; a total revision of the administrative and adjudication procedures for the workers' compensation program and the processing of claims; an adoption of a medical fee schedule; and the promulgation of administrative regulations necessary to implement the rehabilitation provisions which have been in the law for several years.

Discussion

Almost two years have passed since House Bill 1 was enacted and all of its provisions have been implemented except for those relating to rehabilitation and the adoption of the medical fee schedule. These two remaining provisions should be in place and effective no later than mid-October of this year.

The consensus seems to be that the workers' compensation law is working reasonably well, given the broad scope of the 1987 revisions. This consensus is supported by the fact that no requests for additional major workers' compensation revisions have been presented to the Interim Joint Committee on Labor & Industry. However, there is one area in which legislative amendment is probably necessary. The 1990 General Assembly will probably statutorily increase the number of administrative law judges to allow and facilitate a more efficient and expeditious rendering of decisions on initial applications for workers' compensation benefits and other matters that come before the administrative law judges.

SMALL BUSINESS TASK FORCE

SKILLS DEVELOPMENT AND TRAINING PROGRAMS

Prepared by Randolph Bacon

Issue

Should state skills development and training programs, as economic development tools in the Commonwealth, be better coordinated in terms of planning, budgeting and implementation?

Background

In September 1988, the Secretary of the Economic Development Cabinet, Gene Royalty, asked the Small Business Task Force to consider the merits of 1988 Senate Bill 274, the job training certificate program, which passed the Senate but was not voted on by the House during the 1988 Session. The issue was referred to the task force's Subcommittee on Issue Development.

As a result of an examination of the job training certificate proposal, the Subcommittee decided to take a broad look at manpower training programs and their coordination in the Commonwealth. The subcommittee held hearings on this subject at its meeting in January, February, March, April, May and June, 1989.

Discussion

Testimony has been received from the following agencies: the Bluegrass State Skills Corporation, the State Board for Adult, Vocational Education and Vocational Rehabilitation; the Department for Employment Services; the Department for Social Insurance; and the University of Kentucky Community College System. Testimony revealed considerable cooperation and coordination of the programs administered by these agencies but an absence of a statewide manpower development training policy.

Historically, different structures, ranging from secondary and higher education institutions to human service and economic development agencies, have evolved to provide somewhat similar services. Consolidation of these services into some super agency would probably result in creating a new set of problems and would perhaps be counterproductive. However, current duplication of services and a failure to adequately focus limited state resources often result in inefficiencies which are not desirable anytime, but particularly during a period when the legislature and executive branches are seeking to get the most from available appropriations.

After further study the subcommittee will consider whether to make legislative recommendations to the Small Business Task Force regarding the need for better coordination of these programs in their phases of planning, budgeting and implementation.

GOVERNMENT COMPETITION WITH PRIVATE ENTERPRISE

Prepared by Randolph Bacon

Issue

Should the state and local governments and universities be permitted to engage in programs which are in direct competition with private enterprise? If so, to what degree?

Background

This issue has been one with which the task force has wrestled for several years. Research Memorandum No. 432, *Government Competition with Private Enterprise*, was printed in July 1986 in response to House and Senate resolutions passed during the 1984 Session.

At the close of the 1986-87 Interim the task force took testimony from business people in Richmond, Bowling Green, Lexington, Louisville and from statewide trade organizations alleging unfair competition by public universities with local businesses. The committee also heard from university administrators, including the President of E.K.U., in response to these complaints. The Chairman indicated to those who testified that he would like for the committee to visit the university campuses during the 1988-89 Interim and examine the problems firsthand.

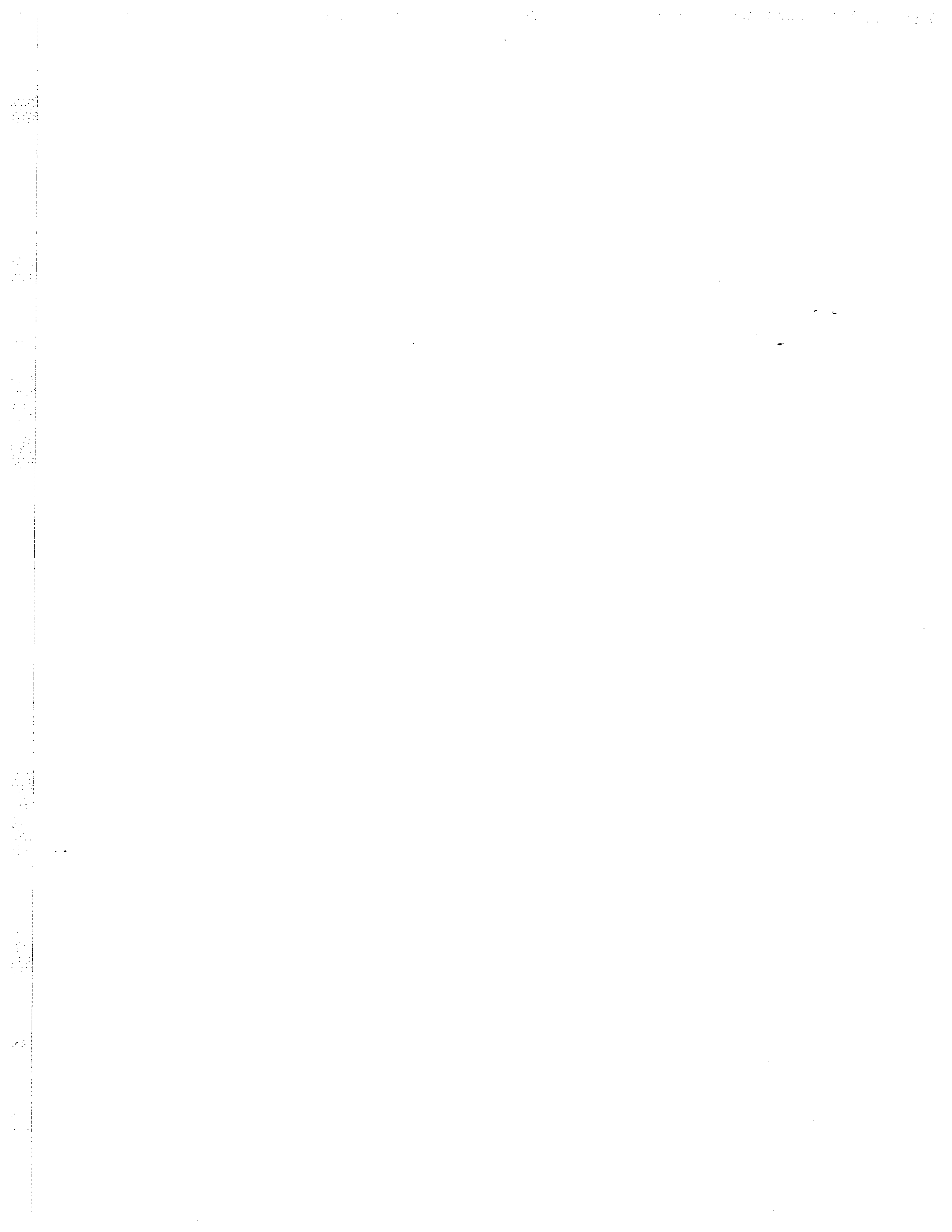
In response to the testimony received by the task force at the end of the last Interim, and in an effort to limit certain government activities, members of the Task Force introduced House Bill 636 during the 1988 Session. House Bill 636 generated a great deal of interest and controversy. It received a favorable vote and report from the House Committee on State Government. The House, by a vote of 61 to 24, passed an amended version which essentially called for the creation of a special committee to study the problem. The bill was not voted on in the Senate.

Discussion

During the current interim, the task force has visited Richmond, Bowling Green, and Lexington. It has toured Eastern Kentucky University, Western Kentucky University and the University of Kentucky, taking testimony from university officials and from businessmen who allege unfair competition. Also, the chairman has asked the Council on Higher Education to convene an ad hoc committee of university representatives to study the problem and make recommendations to the task force. The council agreed and submitted its report in May 1989.

In general, the point of view of the universities is that services which are seen as competition are actually either part of an academic program, e.g., hearing aids, or are necessary services to students, e.g., bookstores and food services. However, the business community, while agreeing that the student body needs various services, feels that universities go too far when they branch out into areas such as fast foods, convenience stores, and marketing of computer software. Business is also sensitive to the fact that tax dollars provide the space and utilities for such university enterprises and that often true market rates are not reflected in the prices charged for the services provided.

The task force will continue to search for a viable and equitable solution to this persistent problem and may prefile legislation on this issue.



STATE GOVERNMENT

LEGISLATIVE COMMITTEE ON PENSIONS

Prepared by William Wiley

Issue

Should the General Assembly create a standing committee on pensions?

Background

At its meeting of September 15, 1989, the **SCR 69** Study Commission on the Kentucky Teachers Retirement System and the Kentucky Employees Retirement System endorsed the concept of creating a standing committee on pensions in the Kentucky General Assembly. Their proposal was made after extensive study of all of the state-administered retirement systems during the 1988-89 interim. It was not the first proposal to create a pension committee, nor is the **SCR 69** Study Commission the only interim group to study pension issues during the past fifteen years.

In 1975 the General Assembly, pursuant to 74 HR 53 and 74 HR 39, created a 16-member commission, including 4 legislators, which conducted an extensive investigation of the benefit structures of all state-administered retirement systems. In 1977, a subcommittee of the Cities Committee conducted an extensive survey, pursuant to 76 HB 104, of city pension systems. During the 1978 Regular Session, HB 577 was introduced for the purpose of creating a standing pension committee. It failed to make it out of committee, but in June of 1978, the Legislative Research Commission created by resolution an LRC Subcommittee on Pensions. This subcommittee met five times, authored important pension reform legislation which was enacted by the 1980 General Assembly, and also reviewed other pension studies which were conducted during the 1978-79 interim. This subcommittee was not extended by the 1980 General Assembly, nor was it renewed by LRC after the legislative session.

Two other studies were conducted during the 1978-79 interim. There was a study, pursuant to 78 HR 72, on pooling of city pension funds for investment purposes, and another study on expanding the Judicial Retirement System to include related groups, conducted pursuant to 78 **HR 102**.

The 1982 General Assembly created, by HR 47, the Municipal Pension Study Commission, to study the actuarial soundness and administration of city pension systems. The 1986 General Assembly, by HCR 131, directed the LRC to study early retirement for teachers and state and local employees. This study was conducted by a special subcommittee consisting of 5 representatives and two senators. In 1988, in addition to the SCR 69 Commission, the General Assembly created, by SR 39 and HR 72, a Teachers' Retirement Study Committee.

Discussion

In Kentucky there are six retirement plans for public employees, administered by three agencies. Each of these retirement plans has its own constituent group which works for the improvement of its particular system. As in most states, there is in Kentucky an unplanned and uncoordinated process of enhancing retirement benefits, which stems from having these relatively independent systems. In this process, one employee group proposes an improvement, which is enacted. At the next legislative session another employee group seeks the same improvement, which is justified by the fact that the first group has it. This process can continue indefinitely, with scant attention to whether the results conform to any rational scheme of what pension programs are supposed to achieve, and what their similarities and differences ought to be.

This process, though disruptive to rational planning, can be allowed to continue so long as the costs do not impinge upon other public needs. Kentucky seems to have reached the point, however, where retirement costs are reducing the state's capacity to provide adequate basic compensation to its employees. During the 1988 legislative session, employee benefits were increased in KERS and CERS to the point that most career retirees have more net income when they retire than when they were working. Yet there was not enough money in the budget to give working employees any more than a 2% raise in 1988 and a 5% raise in 1989. At the same time health insurance costs required the initiation of self-insurance by the Commonwealth, with higher premiums and higher deductibles. Factors such as these indicate that it is necessary for the General Assembly to exercise tight control over pension policy, to ensure that pension policy itself is reasonable, but also to relate pension costs to other employee needs — basic compensation and health insurance. Given that pension policy is highly complex, that the costs are long-term and difficult to reverse, and that the six retirement systems are in some ways common to one another and in other ways unique, there are some obvious weaknesses in the Kentucky General Assembly's approach to pensions.

No single committee of the General Assembly reviews all pension legislation. Instead, teachers' retirement issues go to the Education Committee. Issues relating to KERS, CERS and the state police usually go to the State Government Committee. City pension bills often go to the Cities Committee. While the members of these committees may develop some expertise related to the plans which they review, retirement issues are only one among many issues they must address. In addition, there may not be enough consideration of how a decision in one committee will affect a retirement program in another committee. For example, granting "27 and out" to teachers, which was initially approved in 1988 in the Education Committee, will require the State Government Committee to consider in the future the same right for KERS and CERS members. Should not this issue have been discussed in its wider context in 1988?

As we have seen, the General Assembly has conducted many studies of pension issues. But there has been no coordination of studies or continuity of committee membership. As a result, the General Assembly has no institutional memory relating to retirement

policy. For example, in 1975, the Meidinger actuarial firm advised in LRC Research Report No. 128 that state employee retirement benefits, at a multiple of 1.6% of average salary for each year of service, were perhaps too generous, and ought not to be raised. Subsequently, the General Assembly raised the benefit level to 1.65%, 1.85% and finally to 1.91% (CERS went to 2.0%). The 1975 report was not considered when these decisions were made. During the 1986-87 interim, a Special LRC Subcommittee on Early Retirement studied the "27 and out" issue for teachers. But when the 1988 Session began, the Subcommittee terminated, and the results of their study were generally unavailable to the legislators who decided the "27 and out" issue.

Another problem is that the General Assembly has no articulated standards by which to evaluate pension bills. Retirement bills come at legislative committees from six different directions, and the question most frequently asked is "can we afford it"? This is certainly a very important question, but just as important is the question of appropriateness. For example, when is it appropriate for state employees to retire with no reductions in benefits for early retirement? Should the requirement be 25 years, 27 years or 30 years? Is it appropriate for a state employee to retire at age 65 on 130% of net income? Should public retirement benefits be reasonably related to what is available in the private sector? Should all state retirees receive the same cost-of-living increases? These are all questions the General Assembly has faced or will face in the future. The question is, can the General Assembly face these sorts of questions, session after session, and make the right decisions in the absence of standards for pension policy? This question is especially pertinent given the turnover in the General Assembly and on standing committees.

If all pension bills were reviewed by one committee, the committee members could educate themselves about the purposes which should be served by retirement plans for different employee groups, and about trends and theory relating to both public and private sector pension plans. They could familiarize themselves thoroughly with the six state retirement plans and the groups they serve. Then, they would be able to evaluate pension bills in terms of the appropriateness of the proposal, the needs of the particular group to be served, and the impact a particular bill would have on other state pension plans.

There are several approaches that could be taken. The pension committee could be a new one, or it could be an existing committee. It could be a joint committee, or each house could have a separate committee. It could review all pension bills and send them to the floor, or it could provide the initial review and send the bills to other standing committees, accompanied by the pension committee report. Finally, it could operate as an interim committee as well as during the session.

ADULT CORRECTIONS — ADEQUATE AND FEASIBLE PROGRAMS FOR STATE OFFENDERS

Prepared by Barri Christian

Issue

Kentucky's prison population is projected to increase by 500 each year through the 1990's. How should the state respond and at what cost?

Background

During the last decade, states have enhanced law enforcement, professionalized prosecutorial functions and lengthened sentences, with the result that already crowded prisons are stretched an average of 125 percent capacity. Nationwide the prison and jail population in December 1988 was 627,500 -- twice its size in 1978. Of these, 40 percent were first offenders and 50 percent were convicted of nonviolent crimes.

Today, one of every 420 Americans is in a state facility, and states — 42 of which are under court order — grapple with growth in corrections spending that exceeds state funds' growth.

In Kentucky, the state felon population has increased from approximately 4,000 in FY 1980 to 6,855 in FY 1987 and it is estimated to reach nearly 8,500 in FY 1990. Approximately 62 percent are incarcerated for a violent offense and 37 percent are convicted of a nonviolent or drug-related offense.

The 1988 General Assembly appropriated to the Corrections Cabinet $118.5 million for FY 1988-89 and $129.2 million for FY 1989-90 to accommodate the expected nine percent projected population increase each year of the FY 90-91 biennium. The budget's strategy combined expansion of institutional and community service beds, as well as continuation of approximately 900 state inmates backed up in local jails until additional program space could be developed.

In September 1988, the Kentucky Supreme Court ruled that in specific situations this procedure of housing inmates for indefinite lengths of time in local jails violated the inmate's rights to confinement within the state system.

Executive and legislative personnel met to develop an immediate strategy for housing these 1,000 inmates and to develop an intermediate and long-range plan for the Cabinet's six-percent annual growth through the 1990's, as well as to suggest a unified criminal justice policy for the state.

Discussion

While the most vocal public demands that we "get tough on criminals," data on what the public in general is thinking is scarce. Allen Breed, Chair of the National Council on Crime and Delinquency, reviewed all public opinion polls on crime and corrections for the past three years and concluded that the public " . . . is frightened, confused, and angry, and it wants greater protection from criminal activity . . . beyond that, one cannot legitimately generalize . . . ." According to Breed, less than 50 percent of the American people felt that prisons discourage crime, and two-thirds were in favor of alternatives.

While the emotions of crime and criminality may vary, the statistics and the dollars do not. Kentucky's inmate population is expected to grow indefinitely by at least 500 cases each year: a new 500-bed prison typically costs between $15 million and $60 million, depending on security level. In Kentucky, a medium-security facility for 500 is estimated to cost $25-$35 million, depending on site requirements, or an average of $50,000 per bed. In addition, personnel and operations for a new facility in Kentucky typically costs $7-9 million, and to house an inmate for one year costs nearly $14,000, excluding construction costs.

Several states have ongoing, successful experience with several "alternatives to incarceration programs" (such as intensive probation, house arrest, restitution, prison industries, work release) for nonviolent offenders, and annual costs range from $1,500 to $7,000. While programs are considered tough punishment by professionals and more stringent than straight time by many inmates, the perception of a particular voter may be that alternatives are "soft on crime," depending on his or her personal experience.

While no one can deny the severity and size of the criminal justice crises, the costs involved demand the attention of policymakers to link penal and legislative policy to capacity and resources.

MINORITY BUSINESS AFFAIRS

Prepared by Kenneth Carroll

Issue

Should the General Assembly enact legislation to develop and implement a minority business enterprise system?

Background

The 1988 General Assembly passed HCR 109, which directed the Interim Joint Committee on State Government to study state procurement policies as they relate to minority businesses. Many states and the federal government have passed legislation in recent years to aid and promote minority businesses. HCR 109 directs the Interim Joint Committee on State Government to consider and, as necessary, develop legislative proposals to establish and implement a minority business enterprise system in Kentucky.

Discussion

Currently, Kentucky's Small or Small Minority Business Purchasing Act authorizes the Finance and Administration Cabinet to set aside state contracts for small or small minority businesses. At this time, this is the only state-mandated Kentucky program available for minority businesses wanting to receive state contracts. Kentucky's set-aside law does not contain any mandatory or voluntary goals, such as many states and the federal government have included in their legislative packages. The study directed by HCR 109 is in progress, and the Interim Joint Committee on State Government has already received a preliminary report on this topic.

In January of 1989, the U. S. Supreme Court ruled on *City of Richmond v. J. A. Croson Co.*, striking down Richmond, Virginia's, minority business set-aside requirement. The Court also established new restrictions on the use of race-based preferences by state and local governments. State and local governments must now document past discrimination and then narrowly tailor their race-based remedies, if legislative proposals are to stand up to Court review. The Interim Joint Committee on State Government has reacted to the Supreme Court's ruling by assigning its Subcommittee on General Government the responsibility of conducting five two-day hearings across the Commonwealth to hear testimony on the existence and extent of discrimination in the state's procurement process.

HEALTH CARE FOR EMPLOYEES AND RETIREES

Prepared by Joyce Honaker

Issue

How can the Commonwealth control employees' and retirees' health care costs while maintaining an adequate level of benefits?

Background

The Commonwealth of Kentucky and local departments of health and boards of education provide a basic indemnity health care plan for state employees, employees of local school districts and local health departments, and retired state employees who are not yet eligible for Medicare. Prior to 1988, Blue Cross/Blue Shield of Kentucky was the carrier of the health insurance plan. Beginning in November, 1988, the state self-insured the indemnity plan and contracted with I.C.H. Corporation of Louisville to be its administrator. Self-insurance became necessary when the amount requested and appropriated for employee health care coverage in fiscal year 1988-89, $89.07 per employee for single coverage—rising to $102.97 in fiscal 1989-90—would not purchase an adequate health insurance benefit package from a regular insurance carrier. The employee's share of health care costs increased under the self-insurance plan, with higher deductibles and co-payments.

In 54 of Kentucky's 120 counties, covered employees and retired state employees may select the self-insured Kentucky Kare plan or one or more health maintenance organization (HMO) or preferred provider organization (PPO) options. In the remaining 66 counties, Kentucky Kare or Kentucky Kare Select (a superior benefit package for which the employee pays an additional $9 per month for single coverage) are the only employer-provided health insurance options.

In 1988-89, the state and local employers paid $89.07 of the monthly premium for single-person coverage for employees in all health plans. Premiums for three of the plans currently offered exceeded $89.07, and the employee paid the additional amount. Retired state employees pay from 0% to 100% of their single coverage premium, depending upon years of state service prior to retirement. The state pays all of the single coverage premium of a retiree with 20 or more years of service and retirees from hazardous jobs who were disabled in the line of duty. Employees and retirees, except retirees who served in hazardous positions and retired legislators, pay 100% of the additional cost of a family health care plan. Retired teachers are covered by a separate plan administered by Aetna for the Kentucky Teachers' Retirement System (KTRS). KTRS pays the premium for single retired teacher coverage and coverage of eligible dependent children; there is no cost-sharing based on years of service. The retiree or spouse of a deceased retiree must pay

for an eligible spouse's coverage. For Medicare-eligible retirees, KTRS and the Kentucky Retirement System (for retired state employees) offer Medicare supplement policies.

Discussion

Since the Commonwealth began providing partial funding of employee health care insurance in 1972, the monthly premium has increased from $9.75 per month to $102.97 per month per employee, beginning with the next contract year in November, 1989. An actuarial study of the Kentucky Kare program indicates that premiums must increase to $124.27 in 1990-91 and $150.00 in 1991-92 to maintain the current level of benefits.[1]

The escalation of employee health benefit costs is a nationwide trend with a variety of causes, many of which are not controllable by the employer or employee. Since the early 1980's, the Commonwealth has included a number of cost-control measures in the health care plans it offers, in addition to use of deductibles and co-payments. These have included pre-admission certification and concurrent review, mandating outpatient surgical services for certain conditions, second opinions prior to inpatient surgery, pre-admission (outpatient) testing before surgery, incentives for 24-hour maternity stay and hospital bill audits and coordination of benefits. In recent testimony before the Interim Joint Committee on State Government's Subcommittee on Personnel, the Commissioners of Personnel and Insurance suggested that the utility of such cost-containment measures has reached its limit.[2]

The 1988 Governor's State Health Insurance Commission found that the two factors having a particular impact on the cost of the State's indemnity plan are the increase in retirees under age 65 and the movement of active employees from the traditional insurance plan to HMO's and PPO's. In combination, the trends increase the average age of covered individuals and the per capita claim costs for the insurance plan. The Commission found that retiree coverage is costing 200% of contributions and it has recommended that Kentucky Retirement Systems pay premiums based on the actual cost of retiree health benefits if such a plan would not affect the fiscal soundness of the retirement fund. The Commission urged an evaluation of the impact of employee selection of HMO and PPO options, while encouraging the indemnity plan's efforts to negotiate with providers for cost discounts. The Commission and the Commissioner of Personnel have both identified the decentralized, unautomated system of enrollment and billing procedures used by local school boards and health departments as another potentially controllable factor contributing to the cost of the program.[3]

A consultant to the 1988-89 **SCR 69** Retirement Systems Study Commission has recommmended identifying long-term liabilities through actuarial studies of retiree health benefits as the basis for considering alternative funding approaches and benefit plans for retirees. Alternatives might include prefunding or partial prefunding of health benefits, granting defined dollar benefits for purchasing health care instead of the more open-ended defined medical benefits approach, as well as changes in the percentage of cost-sharing.[4]

An aging population, costs of malpractice insurance and defensive medical practices, technological advancements in health care, and federal health care cost-shifting to other public and private insurers, among other factors largely uncontrollable by the state and other employers, will continue to escalate the cost of health care. The 1990 and subsequent sessions of the General Assembly will be called upon to resolve the difficult issues of who will pay for what level of employee and retiree health benefits.

For more information, see "State Health Insurance Contract" in the Banking and Insurance section of this publication.

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1 Testimony of the Commissioner of Personnel to the Interim Joint Committee on Appropriations and Revenue, July 27, 1989.

2 Minutes of May 10, 1989, meeting, page 2.

3 Governor's State Health Insurance Commission, *Report on Commission Findings*, December 20, 1988, pp. 3-5 and 11-12; and Minutes of September 14, 1988 meeting, Interim Joint Committee on State Government.

4 Martin E. Segal Company, "Kentucky Retirement Systems: Preliminary Analysis of System Features, Major Benefit Design and Funding Issues: Report to SCR 69 Retirement Systems Study Commission, Commonwealth of Kentucky." May, 1989, pp. 60-65.

PROVIDING SPACE FOR THE COMMONWEALTH IN THE FRANKLIN COUNTY AREA

Prepared by Mike Greenwell

Issue

Should the Commonwealth construct or purchase office and storage facilities to provide for the state's increasing space needs, or continue to lease?

Background

The state is currently leasing approximately 1,211,000 square feet of space in the Franklin County area to house state agencies, at an annual cost in excess of $6,166,000. The leased square footage has increased approximately 21 percent since 1987, while the total cost for leased space has increased approximately 37 percent.

An LRC survey of state agencies performed in 1987 (Research Report No. 227, October, 1987) projected a need for approximately 1,000,000 additional square feet of office and storage space in Franklin County by 1991.

A major office building (500,000 square feet) was proposed in the 1988 budget request of the Finance and Administration Cabinet, but was not funded. If the space needs projection of the study is accurate, the construction of the 1988 proposed building would satisfy only one-half of the demand for new space after the 1990 session, and only one-fourth of the total space needed if presently leased space is to be eliminated as well.

State government currently is leasing space occupied for over eighteen years at a total rental cost far exceeding the applicable market value, with no retained value to the state and with the annual rental rate on the rise.

In the last four years over 200,000 square feet of new space has been constructed by the private sector in Franklin County in anticipation of state leases, and all of it now is occupied by state agencies. Currently, the private sector has 1,000,000 square feet of additional space under construction in Franklin County, in anticipation of state leases at an estimated annual lease cost of $7,000,000.

Discussion

If the state continues to lease new space needs in Franklin County, by 1991 the annual rental cost could be over $13,000,000, based on 1,750,000 square feet of office space at $7.00 per square foot and 250,000 square feet of storage space at $3.50 per square foot.

There is no question that Kentucky state government's space needs will continue

to increase, as they have done for over one hundred years, and that those needs will be met by either constructing or purchasing a state facility or by leasing space from the private sector.

Options for Provision of Space

A. Lease.

If space is rented, the state not only accepts whatever is available, but at present rates will pay for the buildings in approximately 10 to 13 years, with no acquired equity in the property for the state.

B. Construct.

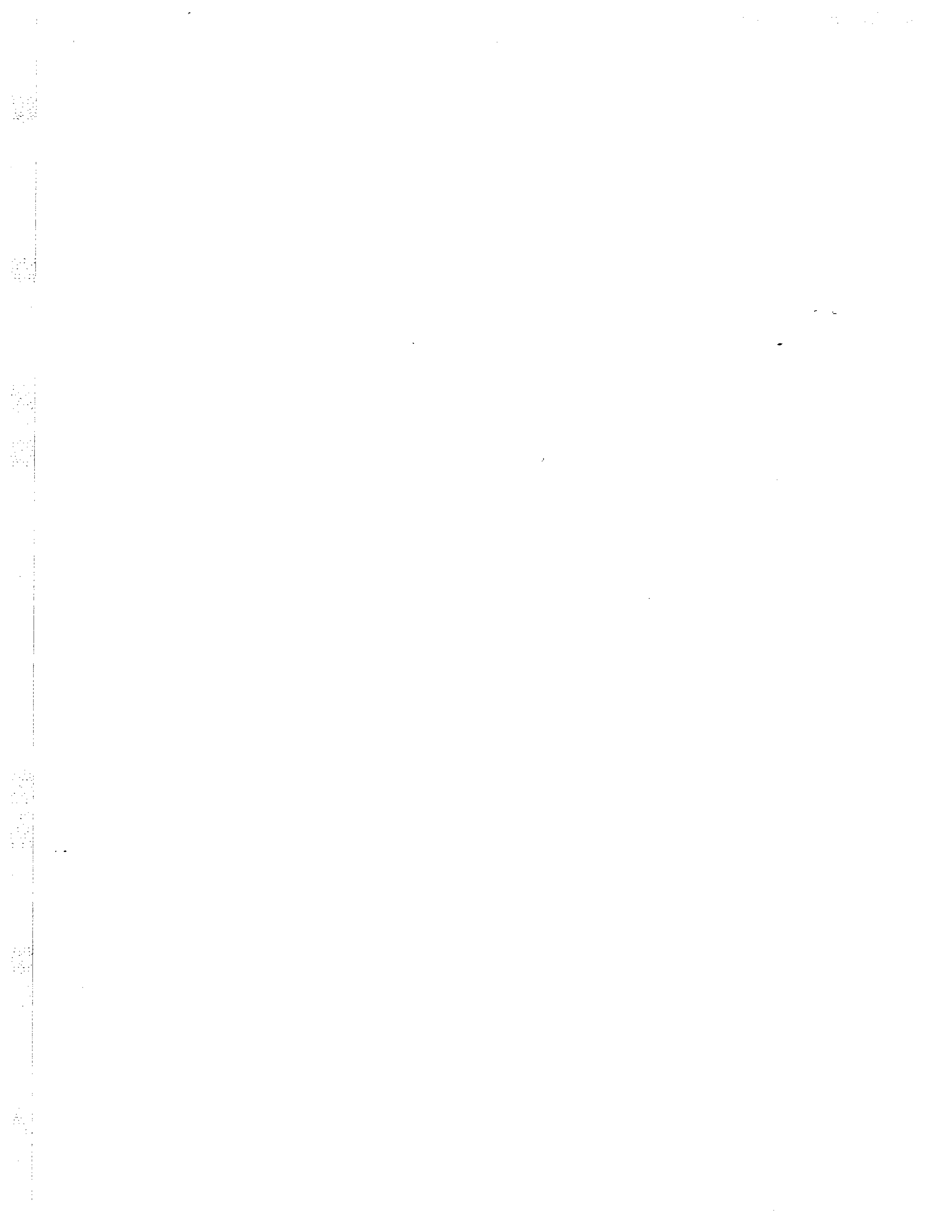
If the state chooses to build, at a cost of $75.00 per square foot for a utilitarian building (similar to the space being rented), approximately $13,000,000 in annual debt service would buy approximately 1,450,000 square feet of new office space. (This annual debt service figure is based upon rates anticipated by the Office for Investment and Debt Management for the Composite Issue No. 49, a bond issue scheduled for July 1989 to fund budgeted projects.)

C. Lease/Purchase or Direct Purchase.

If the state entered into lease/purchase or direct purchase agreements for its space needs, rather than lease, it would be able to acquire equity in the property while possibly taking advantage of the lower construction cost of the private sector. In addition, the space could perhaps be provided more timely than through a state construction project.

Removal of Property from the Local Tax Rolls

While it may be said that the state's purchasing, lease-purchasing or constructing its space needs would be taking property off the tax rolls and could deprive local governments of certain revenue, there are two factors which neutralize this objection. **First**, KRS 45.021 provides that the state shall contract with the City of Frankfort for city fire and police protection of state-owned property and to provide for other municipal services. This in lieu of taxes payment is increased each year; for the current year, the payment will be $185,000. **Second**, state government is the largest and most stable employer in Franklin County. Of the approximately 12,000 state employees working in the Frankfort area, over 5,200 live outside Franklin County yet pay the county occupational tax. Thus, the occupational tax paid by the 43% of the state workforce living outside Franklin County provides an unusually large and stable source of revenue for the local governments from non-residents.



TRANSPORTATION

SIX-YEAR HIGHWAY CONSTRUCTION PLAN

Prepared by James R. Roberts

Issue

Should the General Assembly amend the provisions of the six-year highway construction plan to place more stringent requirements on the Transportation Cabinet?

Background

The 1982 Regular Session of the General Assembly enacted statutes which required the Secretary of Transportation to submit a biennial plan for highway construction coupled with a four-year planning document which describes the projects for which construction is anticipated in the next two biennium budgets. Since the initial enactment of these provisions, three plans have been sent to the General Assembly. All of these plans were received late in the regular session, which prohibited any chance for a substantive review in compliance with the provisions of KRS 176.420 through 176.460. In addition, there have been complaints by members of the General Assembly that projects have been either moved back or deleted from plan to plan. The deletion of any project is in violation of statutory provisions relating to the plan.

Discussion

Critics of the current application of the six-year highway plan cite several problems. Among those problems most prominently mentioned are late submission of the plan, ignoring of statutory requirements designed to oversee the implementation of the plan, and failure of the Department of Highways to adhere to the proposal submitted to the General Assembly.

Individuals seeking changes to the laws governing the implementation of the six-year construction plan believe the current plan is a meaningless predictor of activity and that any effort to review projects currently in the plan is futile. The changes sought would convert the six-year plan into an actual budget and planning document which could be used as a viable predictor of departmental activity.

Proposals to accomplish this goal are varied, but the basic concept is to ensure that the appropriation for construction matches the total dollar expenditures proposed within the plan for each fiscal year. This goal could be accomplished by inserting language within the budget which would specify that only projects named in the plan are eligible for funding, or by placing each construction project as a line item in the budget. If the project does not appear in the plan or budget for funding, no money could be spent on the project.

There has been concern voiced that statutory amendments to the six-year construction plan could be too restrictive. By limiting the Cabinet's flexibility on construction projects, the ability of state government to meet demands of private sector plans to locate in Kentucky could be compromised. Negotiations for industrial location may hinge on highway access to the potential plant site. The General Assembly could not anticipate successful negotiations by the Executive Branch for a particular biennium and as a result would fail to include such roads as part of a construction document.

In addition, the restriction to balance funding and projects will cause difficulty in bringing expensive projects into the plan. Several projects in the current plan are being proposed to be built in segments, with completion of the total route costing more than $100 million. These types of projects could exceed a single fiscal year's funding allocation. However, if these roads are not acknowledged within the plan, a major gap would result in the assessment of the state's highway needs.

COMMERCIAL DRIVER'S LICENSE

Prepared by James R. Roberts

Issue

Should the General Assembly comply with the federally mandated provisions of the commercial driver's license law?

Background

On October 27, 1986, President Reagan signed into law the Commercial Motor Vehicle Safety Act of 1986. This law will alter the licensing procedures for operators of three types of vehicles. Motor carriers included under the new federal provision are those vehicles with a gross weight rating of greater than 26,001 pounds, vehicles which transport more than 15 persons, and vehicles which transport hazardous materials.

A second provision of this Act provides that after July 1, 1987, operators of the previously mentioned vehicle classifications may possess only one operator's license, which shall be issued by that operator's state of residence. In addition, the Federal Highway Administration was directed to develop minimum federal standards for testing drivers. These standards must be implemented by those state agencies involved with driver testing.

After April 1, 1992, it will be illegal for a person to operate these vehicle types unless he has passed written and driving tests which meet minimum federal standards. In order to meet these federal guidelines, it will be necessary for the General Assembly to amend various sections of the Kentucky Revised Statutes relating to the testing of motor vehicle operators currently under the jurisdiction of the Department of State Police and the issuance program of the Transportation Cabinet.

Finally, in order to assure state compliance with this legislation, any state that is not in total compliance by September 30, 1993 will have five percent of its federal-aid highway fund for fiscal year 1994 withheld. If non-compliance continues, that amount would be raised to ten percent in fiscal year 1995 and each year thereafter until conformity is achieved.

Discussion

The Commercial Motor Vehicle Safety Act enacted by Congress in 1986 stated the following goals:

(1) to improve driver quality;

(2) to remove problem drivers from the highway; and

(3) to establish a system that will prevent operators of a commercial motor vehicle from having more than one driver's license.

A national standard for commercial drivers has been created so that each driver will have a single license and a single record. The Secretary of the Federal Highway Administration is responsible for identifying requirements and procedures for state licensing agencies. Despite the fact that the act requires states to be in compliance with federal law, there are several areas in which the states may have some flexibility.

State Testing and Licensing

Under the Act, states retain their right to issue licenses to drivers of commercial vehicles. States will still determine fees and fee structure and most renewal procedures related to this license. In addition, states can determine the age and fitness of intrastate commercial vehicle operators.

States will also have the option to accept third party testing of applicants for a commercial driver's license. Currently, the state police tests license applicants, but the General Assembly could permit private sector testing of commercial drivers. If Kentucky wishes to embark on such a program, additional statutory changes will be necessary.

Waivers

Waivers from the commercial driver's license provisions were granted to military personnel driving military vehicles, operators of firefighting and emergency vehicles operated by municipalities or volunteer fire departments and operators of farm vehicles. Recreational vehicles used solely as personal or family conveyance for recreational purposes are not within the definition of a commercial motor vehicle, and not subject to federal regulation.

The farm vehicles exempted are required to be controlled and operated by the farmer; used to transport agricultural products, farm machinery or farm supplies to or from the farm; not used for common or contract carrier operations and used within 150 miles of the operator's farm.

The federal act also permits the grandfathering of drivers of commercial vehicles. These drivers must have commercial driving experience and a good driving record in order to waive the testing requirements.

Blood-Alcohol Content

The Federal Highway Administration has established 0.04 percent as the blood alcohol level for which a commercial driver is deemed to be driving under the influence. Violation of this provision would subject the driver to disqualification under the Federal Act.

States must adopt the 0.04 percent blood alcohol content and mandate sanctions, conforming laws and procedures necessary to enforce these requirements. In addition, states are required to provide a license sanction for refusal to submit to a chemical test that is no less stringent than the worst possible outcome of the test.

The sanctions imposed for non-compliance will probably ensure passage of some type of commercial driver's licensing law by the General Assembly. However, the debate will center around those issues on which states have some flexibility. These issues include third-party testing, grandfathering provisions, implementation of sanctions for violations and whether to impose more stringent standards than required by federal law.

BUS SAFETY ISSUES

Prepared by Jerry Deaton

Issue

Should the General Assembly enact stricter standards for safety on school buses and private buses used by charitable organizations?

Background

The tragedy of the May, 1988, Carrollton bus crash has generated debate on several highway safety issues. One of these issues is whether the General Assembly should enact stricter safety provisions for buses purchased by school districts and by private organizations which use buses to transport their members.

Issues on this topic range from establishing mandatory safety features, such as emergency escape features for newly acquired school buses, to retrofitting older buses with available safety features. Shortly after the Carrollton crash, the Governor established a Bus Safety Task Force. The Task Force has since offered the following recommendations: require all buses constructed for a Kentucky owner after November 1, 1990, to meet all Kentucky Department of Education and federal safety requirements; require left side emergency doors on all new school buses of 22 passengers or more constructed after October 31,1990; require bus chassis manufacturers to redesign the location of fuel tanks; formally request bus chassis manufacturers to recall all gasoline-powered buses; require retrofitting with push-out windows for any bus constructed before November 1, 1990; require additional marking around emergency exits; formally request the U.S. D.O.T. to increase research into less flammable bus seat material; recommend the 1990 General Assembly require bus drivers to meet the minimum medical requirements set forth in the Federal Motor Carrier Safety Requirements; require a minimum of an additional nine hours of hands-on school bus driver training for drivers with less than one year's experience; require four evacuation drills on each school bus each year; require all buses in current use to meet school bus seating capacity standards established by National Highway Traffic Administration; recommend installation of underfloor outside access storage compartments on buses constructed after July, 1989; formally request the National Highway Transportation Safety Administration and the Kentucky Department of Education to restudy use of seat belts on all buses; adopt a standard invitation to bid on surplus school buses; adopt a state-wide policy on surplus school buses; request that the Governor extend the Bus Safety Task Force indefinitely.

An annual bus inspection program has also been mandated by executive order for all buses transporting members of private organizations. As a result of this inspection program, some buses have been taken out of service.

Discussion

The General Assembly will have to decide whether to enact the recommendations of the Bus Safety Task Force into statute. Proposals relating to the increased safety features will undoubtably add costs to these buses, most of which are purchased by local school boards. A method to pay for these increased costs in an era of insufficient revenues will have to be addressed.

In addition, the annual bus inspection program has been implemented by executive order. The General Assembly will probably need to address the issue of whether to make the inspection program statutory.

PLACEMENT OF ADVERTISING DEVICES ALONG INTERSTATE HIGHWAYS

Prepared by Jerry Deaton

Issue

Should the General Assembly enact legislation to ease restrictions for the placement of billboards adjacent to interstate highways?

Background

Currently, state law prohibits the erection of outdoor advertising devices within certain distances of interstate highways. This legislation was adopted in accordance with the 1958 Federal Highway Act, which sought to control advertising devices on interstate highways by awarding a bonus payment to participating states amounting to one half of one percent of the total cost of construction of their interstates. This Act, however, was amended by a provision known as the "Cotton Amendment," which would allow signs to be placed in areas adjacent to interstate highways if the right-of-way of such areas was purchased before July 1, 1956. States which adopted the Cotton Amendment would not be eligible to receive all of their bonus money, but would be able to erect signs in these eligible areas.

Discussion

The issue of easing the restrictions regarding outdoor advertising will emerge again in the 1990 session. The basic issues which need to be resolved are: the costs to the State Highway Department if advertising restrictions are eased; the amount of additional tourism dollars which may accrue to Kentucky by use of outdoor advertising devices; and an assessment of damage done to the state's scenic beauty if proliferation of billboards occurs.

As this issue was debated in the 1988 session, the proponents and opponents for easing restrictions presented their arguments primarily along monetary lines. The monetary aspect of outdoor advertising comes from the fact that Kentucky is a bonus state with regard to placement of billboards. A bonus state is a state which has not adopted any of the provisions allowed by the Federal Highway Administration which would expand the eligible areas for placement of billboards. As a result of Kentucky's being classified as a bonus state, the Kentucky Department of Highways has received about $2.3 million of additional funding from the Federal Highway Administration.

Opponents cite the fact that all or part of this $2.3 million will have to be refunded to the Federal Highway Administration should laws be enacted which ease Kentucky's current restrictions on outdoor advertising. Proponents believe that if the money made

available by federal funds is forfeited, revenues could be replaced by attracting additional tourism dollars into Kentucky by use of the advertising devices.

The environmental versus economic development argument is manifested in two segments of interstate in Kentucky. Those two segments are I-65 between Elizabethtown and Louisville and I-24 between Paducah and Bowling Green.

Areas permitted for expansion are those areas which existed as state right-of-way prior to July 1, 1956. The first toll road in Kentucky was the Kentucky Turnpike between Louisville and Elizabethtown. Since then it has been incorporated into the interstate system as part of I-65. If outdoor advertising restrictions are eased, the entire corridor of I-65 beginning in Elizabethtown and ending at the Ohio River in Jefferson County would be eligible for signing in the areas zoned for commercial or industrial use. Environmentalists fear that this type of proliferation would detract from Kentucky's scenic beauty and discourage travel in the Commonwealth.

Interstate 24 is Kentucky's newest interstate highway. The newness and the rural nature of this road have combined to further restrict billboards along the route from Paducah to Bowling Green. Proponents of easing these restrictions believe that those recreational activities which complement the lake region are suffering because of an inability to advertise. In addition, other types of development such as retail outlets and other tourism-related businesses will hesitate to locate in the area because of the advertising restrictions.

In response to this argument, opponents believe most tourists have their destinations established and advertising dollars would be better spent in other media. An additional argument is that the state logo program is sufficient to attract those motorists who find it necessary to exit the interstate. This program allows area businesses which provide motorist such services as gas, food and lodging to place their logo or business name on a sign located on the right-of-way immediately before an exit .

Also involved in the discussion will be traffic safety issues. Advertising devices are obviously meant to attract the attention of the traveling public and some groups feel that in so doing, advertising devices represent a potential traffic hazard.

This issue was discussed a great deal during the 1988 session and the basic arguments for and against the easing of restrictions have changed little since then.