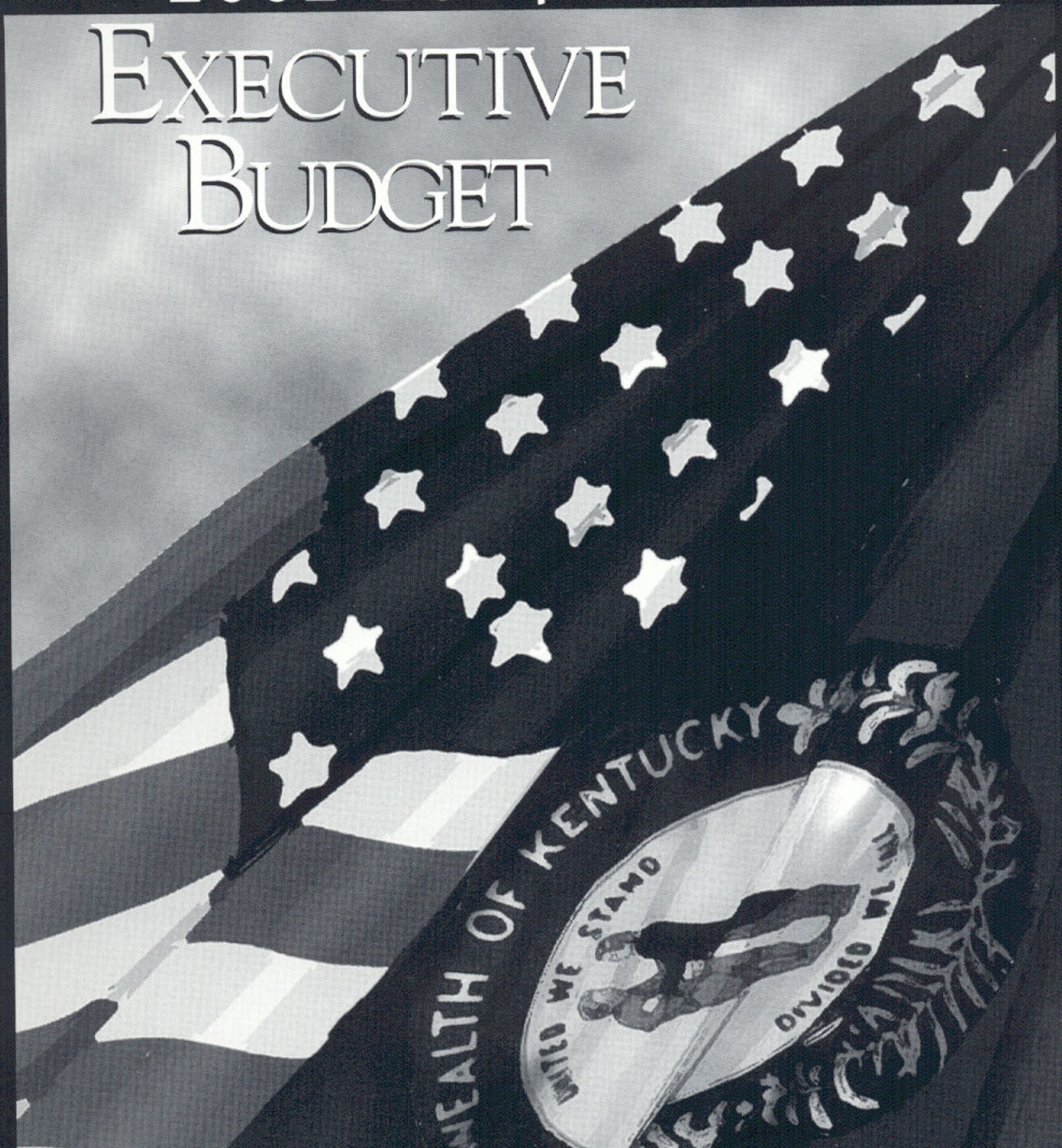
Staying the Course

2002-2004 Executive Budget



Paul E. Patton
Governor

James R. Ramsey
State Budget Director

"Although we face a biennium in which we must do more with fewer resources, we must not lose sight of our goal to raise the standard of living and quality of life for all Kentuckians. This budget proposal strikes a balance between honoring our commitments and maintaining the fiscal responsibility I've advocated since the first day I assumed the Office of Governor. This is a budget of promises kept."

Governor Paul Patton

Highlights of the Executive Budget and Legislative Priorities

Prepared by
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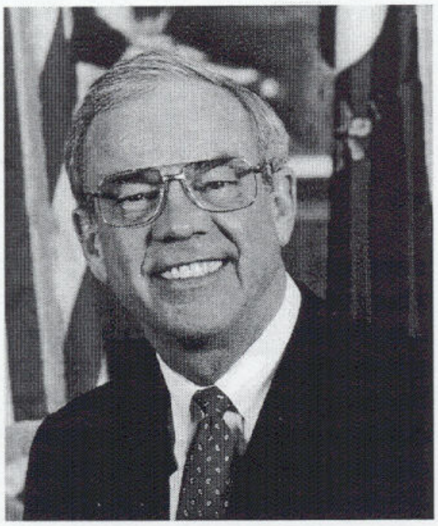


January 22, 2002

My Fellow Kentuckians:

I am proud to present to you my recommendations for the funding and program initiatives for the 2002-2004 Budget of the Commonwealth. While the fiscal environment we find ourselves in will not allow us to invest in the future at the levels that we have been able to do over the past several years, my budget recommendation puts the Commonwealth in a position to keep our promises and stay the course in our priority areas.

Like many states, we have sustained a slowdown in the economy which, along with our outdated tax system and tax cuts that have been implemented, has resulted in budget reductions of $180 million in fiscal year 2001 and $533 million in fiscal year 2002. We have been able to manage our way through these tough times without cutting funding to primary and secondary education, without laying off any state workers, without stopping any capital construction or community development projects, and without substantially impacting the direct delivery of services to our citizens.

To meet these objectives and minimize the impact of the budget cuts, we utilized one-time money in several cases to address recurring revenue shortfalls. A prime example is that we spent $158 million of our Budget Reserve Trust Fund, leaving a balance of only $120 million, or only 1.79% of our revenues. The fund was intended to be used for this very purpose, but we must commit to replenishing it for the future.

This budget is built on a belt-tightening principle of agencies and programs having to live with the same dollars for the next two years that they have to spend in the current fiscal year, which has already been cut by 5% from the amount originally budgeted. It will not be easy. We have the best management team possible in place to help us keep our promises, and we have worked diligently to cut every administrative dollar in the government before impacting services to our citizens. We have directed the few new dollars in the budget to pay for commitments we have made and obligations of the Commonwealth over which we have little control.

In education, our highest area of priority, for elementary and secondary education we provide for additional dollars to fund health insurance for our teachers and school employees for both years and a cost-of-living increase in the second year. Local school districts will be required to fund a cost-of-living increase in the first year. In postsecondary education, we continue to be committed to the Bucks for Brains program, support for enrollment growth at our universities, and fund our financial aid and scholarship commitments.

In other key areas we have obligations we must meet, such as funding the costs of an increasing prison population, paying the operational costs of facilities coming on line that were approved in the past two budgets, and paying the increased cost of health insurance for all state workers and all employees of our 176 school districts. These are just a few examples of our obligations and priorities. This document profiles the areas where we have dedicated additional resources and outlines our legislative agenda to keep Kentucky from losing ground.

The Executive Budget seeks to keep Kentucky on track toward our goal of "Setting Kentucky on the path to achieving economic opportunity and a standard of living above the national average in 20 years." We continue to be committed to our strategies to meet that goal:

- Improving Education
- Promoting Economic Development
- Building Self-Sustaining Families
- Strengthening Efficiency and Operations of Government
- Reducing Crime and its Costs to Society
- Improving Quality of Life

The next two years will challenge us all to do more with less, but we must maintain our focus to make the lives of our families and neighbors better. I look forward to working with the General Assembly in the development of the final budget and thank you for the opportunity you have given me to serve the Commonwealth.

Sincerely,

Paul E. Patton

Paul E. Patton

Table of Contents

FISCAL ENVIRONMENT

"The current recession is severely and negatively impacting the fiscal situation in the states. Nearly every state is facing revenues that have fallen far below original estimates, resulting in net budget shortfalls estimated to be as high as $25 billion. . . The widening gap between revenues and expenditures is forcing states to make serious fiscal adjustments by cutting enacted budgets, delaying expenditures, lowering revenue projections, utilizing rainy day funds, and, in some cases, increasing taxes."

The Fiscal Survey of States
National Governors' Association and
National Association of State Budget Officers
December 10, 2001

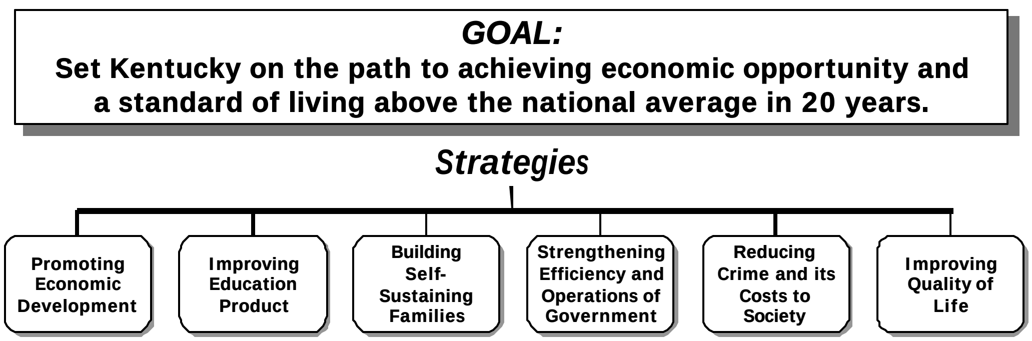
"PROMISES KEPT: STAYING THE COURSE"

Where We Began

Immediately following the 1996 Regular Session of the Kentucky General Assembly, Governor Paul Patton and his newly appointed Cabinet held a retreat to clearly define the policy initiatives and program directions that would guide the Patton Administration. Governor Patton articulated the vision to guide his Administration and these policy initiatives to be:

> "Implement the policies and programs to set Kentucky on the path to achieving economic opportunity and a standard of living above the national average in 20 years."

From this retreat in early 1996, a strategic plan was developed that identified strategic initiatives and the detailed strategies and tactics to be pursued to achieve each of these initiatives.



For example, policy discussion in Kentucky had focused for several years on our Workers Compensation program and its impact on the state's business climate. As part of his "Promoting Economic Development" strategic initiative, Governor Patton created a process for collecting and analyzing data on the impact of our Workers Compensation program. Hearings were held around the state; experts testified; business, labor, and other interest groups had the opportunity to participate in an assessment of our Workers Compensation program. At the end of this process, recommendations were made that became the basis for House Bill 1 of the 1996 Extraordinary Session of the General Assembly.

A similar process was initiated to review and analyze our postsecondary education system. A legislative/executive task force was created to gather data and to review issues; experts testified; the business community, university administrators, and others, had input into a process that resulted in the recommendation that became House Bill 1 of the 1997 Extraordinary Session.

These are two of many examples of strategies and tactics identified in the Patton Administration's Strategic Plan to provide an aggressive agenda for *Moving Kentucky Forward* - i.e., ensuring enhanced economic opportunities and an increased standard of living for all Kentuckians.

Progress has been made in our educational programs, our human services programs, our environmental stewardship, our courts and judicial system, our management efficiency of state government, and our infrastructure development.

It is not the purpose of this budget document to tout the achievements of the past six years. Rather, this document is intended to provide an overview of the policy and budget initiatives of the Patton Administration for the 2002-2004 biennium. Significant policy initiatives were begun and funded in 1997, 1998, and in 2000. Unfortunately, our financial capacities in 2002 are different, requiring the Governor to allocate our scarce resources to stay the course to ensure that our promises are kept.

A Changed Environment

Kentucky's economy experienced uninterrupted and unprecedented growth from the mid 1980's through early 2001. In fact, two years ago as the Executive Budget was being prepared by Governor Patton for submission to the General Assembly, the national and state economies were performing at near record growth levels. The Consensus Forecast Group realized two years ago that such growth could not be sustained and a slowdown in economic activity was assumed for the revenue projections for the current biennium. Unfortunately, both the national and state economies experienced marked slowdowns beginning in the 2001 fiscal year; slowdowns that were exacerbated by the events of September 11. These slowdowns were greater than anticipated two years ago. The National Bureau of Economic Research has now indicated that the national economy officially entered a recession in March-April, 2001, a recession that continues today.

This national recession has had significant implications for Kentucky. Over the past year our state has lost manufacturing jobs, especially durable manufacturing jobs, our highest paying jobs. While overall the Kentucky economy has continued to grow, the loss of jobs in manufacturing and in other key sectors (transportation, public utilities, communications) has resulted in the lowest level of personal income growth in Kentucky since 1983. Our two major General Fund revenue sources - the individual income tax and the sales tax- are highly correlated with economic activity, especially employment growth and state personal income. As a result, the state's revenue collections have been significantly less in both fiscal year 2001 and fiscal year 2002 than was forecasted by the Consensus Forecast Group two years ago; a forecast upon which the current biennial budget was based. Table 1 summarizes the impact of these revenue shortfalls on the budget management process for the current biennium.

Table 1

Budget Shortfalls
($ millions)

	Revenue Shortfall	Requirements Not Budgeted	Total Budget Shortfall
FY 2001	$ 159.4	$ 20.6	$ 180.0
FY 2002	$ 468.2	$ 64.8	$ 533.0
Total	$ 627.6	$ 85.4	$ 713.0

Managing Budget Shortfalls

House Bill 502, enacted by the 2000 Session of the Kentucky General Assembly, contained a Budget Reduction Plan that outlined a series of steps to be followed by the Executive Branch in managing revenue shortfalls that might occur in the current biennium. The steps outlined in the Budget Reduction Plan include:

- Transfer excess unappropriated and unbudgeted Restricted Funds to the General Fund;
- Capture excess General Fund appropriations resulting from personnel vacancies and turnover, and from reduced requirements for operating expenses, grants, and capital outlay;
- Apply the Budget Reserve Trust Fund in an amount not to exceed twenty-five percent (25%) of the Trust Fund balance in fiscal year 2001 and fifty percent (50%) of the trust fund balance in fiscal year 2002; and
- Take all other actions necessary to the extent that the actions above are insufficient to eliminate a revenue shortfall.

As can be seen, most of the steps outlined in the Budget Reduction Plan are of a one-time nature: e.g., the application of nonrecurring resources such as fund transfers, lapses, and withdrawals from the Budget Reserve Trust Fund.

Governor Patton firmly believes that education is the state's highest priority; the investment in human capital is the key to long term economic opportunity and prosperity. Governor Patton committed to exempting education from cuts and to manage our budget shortfalls by avoiding layoffs of our valued state employees.

As the Administration approaches the development of a new budget we must recognize that the budget is structurally imbalanced - recurring expenditures in fiscal year 2002 are greater than projected recurring resources in fiscal year 2003. The utilization of one-time revenues to balance the cuts in fiscal year 2001 and fiscal year 2002 has left recurring spending into fiscal year 2003 at levels which exceed the projected General Fund revenues. Adding to this structural problem is the requirement to pay in fiscal year 2003 and fiscal year 2004 for mandated obligations incurred in fiscal year 2001 and fiscal year 2002. For example, in the current biennium, the School Facilities Construction Commission (SFCC) was authorized to provide “Offers of Assistance” to school districts throughout the state for needed school construction and improvement projects. The “Offers of Assistance” allow the school districts to begin planning for projects. Yet bonds to finance the projects cannot be sold in the current biennium since the debt service for the bonds to finance these offers was not appropriated in the current biennium. It must be appropriated in the upcoming biennium. This is an example of a mandated commitment that is not “in the base” and must be included in the next biennial budget. The funding of such requirements adds to the structural imbalance.

Financial Management Principles

Governor Patton has adhered throughout his Administration to four fundamental financial management principles:

- Use of the revenue forecasts of the Consensus Forecast Group;
- Recommend a structurally balanced budget;
- Build and maintain the Budget Reserve Trust Fund; and
- Recommend a rational, consistent, and affordable capital improvement program.

The recent fiscal environment has created significant challenges to the achievement of these principles. Yet these important financial management principles have not been abandoned.

- The revenue estimates of the Consensus Forecast Group are the basis for the Governor’s budget recommendation;
- While significant one-time nonrecurring resources are proposed to be utilized to balance the budgets for fiscal year 2003 and fiscal year 2004; flat expenditure growth in both fiscal year 2003 and fiscal year 2004 ensure that recurring revenues and recurring expenditures are brought back in line by the end of the upcoming biennium;
- A plan for rebuilding the Budget Reserve Trust Fund is provided for in the Governor’s budget recommendations; and
- A rational, consistent and affordable debt management program is provided for in the budget recommendations. It is proposed that no more than six percent of our total resources are committed to debt service.

Among our most important external reviewers are the bond rating companies which recognize national and state economies will always experience alternating periods of rapid and slow revenue growth. Kentucky, as well as other states, has a fiduciary obligation to manage its way through the times of weak growth responsibly and to ensure that our most important policy priorities are funded so that we can stay the course. It is with these principles that Governor Patton makes his budget recommendations for the next biennium. These recommendations were formulated to ensure that “promises are kept” by staying the course to our vision and strategic initiatives.

EDUCATION
EDUCATION
EDUCATION
EDUCATION

"From our KIDS NOW early childhood development initiative to postsecondary education and our "Bucks for Brains" program, increased dollars for elementary and secondary education, new programs for improving teacher quality, establishment of the Kentucky Virtual University, and dramatic increases in enrollment in adult education, we've continued to advance toward our goal of achieving educational excellence in Kentucky on all levels."

Governor Paul Patton

EARLY CHILDHOOD DEVELOPMENT

In the 2000 legislative session, Kentucky made a significant investment in its youngest citizens. A Governor's Task Force was charged with creating a twenty year plan to address the needs of young children and their families, to ensure better education and social outcomes and to improve Kentucky's overall statistics on child outcomes. The plan, under the title KIDS NOW (Kentucky Invests in Developing Success), became House Bill 706, with funding provided by 25% of the Phase I Tobacco Settlement Funds.

KIDS NOW

Kentucky Invests in Developing Success

The KIDS NOW initiative is a case of "invest now, or pay later." To realize the dividends of Kentucky's Education Reform Act (KERA), children must arrive at school healthy, developmentally on target, and socially ready for the school experience. Research on the development of the brain has verified what many parents and educators have known for many years; that the first five years of life are absolutely critical to each individual's long-term development. Providing young children and their families with a firm foundation is a necessity if Kentucky is going to experience a prosperous future with a thriving population.

Failure to make that investment brings significant human and financial costs. There is clearly a high price to pay for neglecting to provide our youngest citizens a good start in life. By investing now in healthy babies, sound families, and stimulating child care environments, all Kentucky citizens will reap the benefits. It is, in the most basic sense, the right thing to do!

Invest Now or Pay Later

The economic return on investments in early childhood development can be detailed in hard facts:

- *Children from high-quality early childhood programs go on to earn 60 percent more than their peers. (RAND Institute, 1999)*
- *Low-income children who receive high-quality early child care are more likely to remain in school, attend college, and be employed than those who do not receive such care. (Carolina Abecedarian Project, 1999)*
- *For every $1 invested in early childhood development, $7 is saved in the cost of remedial education, welfare, and incarceration. (1999 RAND study)*

Early Childhood Successes

Great progress has been made since initial implementation in July 2000:

- The **Healthy Babies Campaign** has been launched and includes a public awareness campaign about the lifestyle choices that will deliver healthier babies.
- **Folic Acid** tablets and counseling about the importance of this B-vitamin have been distributed to over 49,000 women of childbearing age to prevent spina bifida in babies.
- **HANDS**, our voluntary home visiting program, has served more than 4,900 families with over 56,000 home visits. These first time families have fewer premature births and have fewer low birth weight babies. Preliminary data indicate lower incidence of substantiated child abuse and neglect cases.
- Over 24,000 newborns received **hearing screening** before leaving the hospital. Systems are in place for follow-up testing and early intervention services where needed.
- Over 10,000 **underinsured children have been immunized** fully and at the appropriate time.
- Currently, 136 child care centers are participating in the **STARS for KIDS NOW** quality rating system, with 7,695 children in these child care centers benefiting from the increased quality of the learning environment.
- Over 500 early childhood scholars are attending 25 public and five private colleges and universities through the **KIDS NOW Scholarship Program**.
- 88 **Healthy Start** consultants have completed over 23,000 on-site and phone consultations to early childhood centers and family child care homes about health, safety, and nutrition issues.

The current investments have enabled us to begin the work that will allow us to achieve the child outcomes that the Patton Administration desires. In order to maintain and continue the progress, continued funding is needed. There is still much work to be done!

This Executive Budget maintains a commitment to our successes and funding for full implementation of our programs in this critical development area. Twenty-five percent (25%) of Phase I Tobacco receipts are recommended for appropriation to the Early Childhood Development Fund in the amount of $31.4 million (fiscal year 2003) and $27.3 million (fiscal year 2004). While funds from these programs were reduced in fiscal years 2001 and 2002 in budget reductions, the amounts represented unneeded funding due to slower than expected implementation of programs. Full funding of these programs will be needed in fiscal years 2003 and 2004 as they reach full implementation.

ELEMENTARY AND SECONDARY EDUCATION

The Kentucky Education Reform Act (KERA) remains one of the most comprehensive and progressive changes to a single state's system of funding and delivering a high quality education to its school children. During the past year, a team of specialists in education finance assessed the workings of Kentucky's Support Education Excellence in Kentucky (SEEK) school funding program during its first ten years of existence. They concluded that "the formula is equitable, and the equity of revenues to school districts has improved over the life of SEEK." Governor Patton has provided funding in each of his budgets to enable the SEEK program to sustain the momentum begun by the General Assembly in enacting KERA in 1990.

In addition to meeting the mandate of fiscal equality on behalf of school children in every region of the state, there are indications KERA is indeed working to advance student achievement. Kentucky students are now performing above the national average in math, science, and language arts. In the National Assessment of Educational Progress (NAEP) report on science assessments administered during 2000, Kentucky is one of only three states to make statistically significant progress in eighth-grade science compared to their scores in 1996. In a January 2002 report from the nation's most prestigious education publication, *Education Week*, Kentucky was one of only three states to receive an "A" in educational learning standards and accountability.

Governor Patton has worked to maintain the strong foundation for progress in elementary and secondary education established by the General Assembly and has committed major portions of his budgetary resources toward continuing the progress made under KERA.

During fiscal years 2001 and 2002, when state government was forced to absorb $180 million and $533 million, respectively, in budget shortfalls, Governor Patton made it a priority to spare elementary and secondary education from budget cuts.

This Executive Budget continues the commitment to K – 12 education and the goals of the Kentucky Education Reform Act. In fiscal year 2003, the recommended budget provides the same level of funding for elementary and secondary education as in fiscal year 2002. In fiscal year 2004, recommended General Fund support increases by approximately $100 million – the largest dollar increase for any program area within state government.

The Good News in Education

- Elementary and secondary education in Kentucky was exempted from each of the four rounds of budget cuts made during fiscal year 2001 and fiscal year 2002.
- Kentucky has the most technologically advanced classrooms in the nation.
- Kentucky has the nation's first, largest and best virtual high school and every student has access to it.
- In the past nine years 35 Kentucky teachers received the coveted Milken Family Foundation National Educator Award.
- Since the passage of KERA in 1990 funding for K-12 education has increased a dramatic 88.4%.

"Kentucky is best known for blazing a new frontier in the movement to set standards and hold schools accountable for results."

Education Week
January 10, 2002

ELEMENTARY AND SECONDARY EDUCATION

Education Pays
$97 million

- A 2.7% cost-of-living salary increase for all local school district employees in each year of the biennium—$73 million in the second year of the biennium.
- $100 million for new school construction and renovation.
- $19 million in fiscal year 2003 and $31 million in fiscal year 2004 for local school district employee health insurance.

"According to Kentucky Education Commissioner, Gene Wilhoit, 90% of the President's education plan looks very much like KERA. Kentucky has pioneered the way for the rest of the nation!"

Governor Paul Patton
State of the Commonwealth
January 10, 2002

EDUCATION PAYS

POSTSECONDARY EDUCATION

Postsecondary education reform is working. With House Bill 1 in 1997, the collective will of the General Assembly and the Patton Administration put Kentucky on a new path for postsecondary education. The path leads to more Kentuckians learning and earning, better lives, more Kentucky businesses satisfied with their workforce, and a better future for our children. Despite limited new dollars in the General Fund, the Executive Budget provides new funding in the following critical areas to sustain reform.

Endowment Match Program – "Bucks for Brains"

The Endowment Match Program matches public money with private gifts to fund endowed chairs, professorships, fellowships, and scholarships at the public universities. This $120 million public investment represents the third round of investment in the program. While the first two commitments were made with surplus General Fund cash, this Executive Budget proposes the third round of investment be financed with bonds. Discussion with the rating agencies concluded that investment in intellectual capital is not an inappropriate use of debt financing; it's the state's decision. The funds will be endowed, not expended.

Enrollment Growth and Retention Trust Fund

The Enrollment Growth and Retention Program supports increased enrollment and retention at Kentucky's public postsecondary education institutions. The primary goal of this trust fund is to help Kentucky reach or exceed national averages of educational attainment by 2020.

Scholarship Funding

An increasing percentage of the Kentucky Lottery dividend is earmarked for the funding of merit-based and needs-based scholarships. The Executive Budget honors that commitment to invest greater amounts of Lottery receipts in intellectual capital.

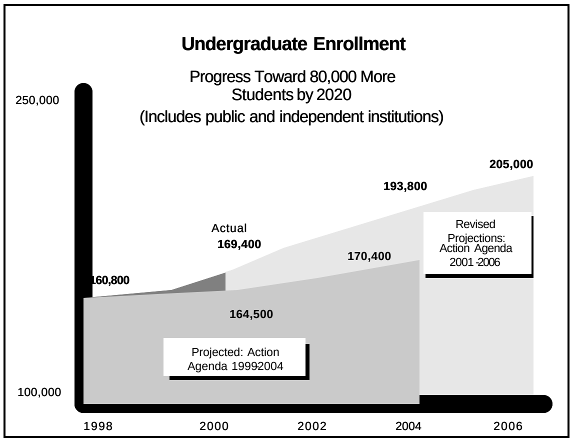
- **Merit-Based Scholarships**

  Governor Patton and the 1998 General Assembly provided Kentucky high school students a great opportunity to make their education pay with the Kentucky Educational Excellence Scholarship (KEES). The better students do in high school, the more they will earn toward college scholarships.

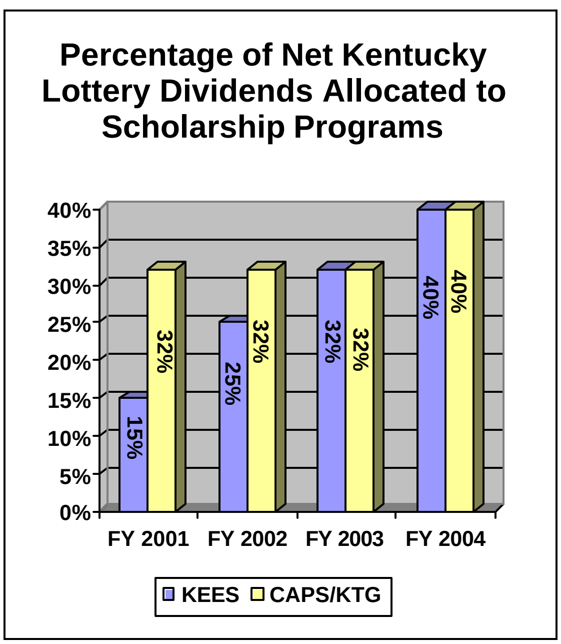
- **Need-Based Scholarships**

  The College Access Program (CAP) helps Kentucky's financially needy undergraduate students attend public and private colleges and universities, proprietary schools, and technical colleges.

  The Kentucky Tuition Grant (KTG) Program provides need-based grants to Kentucky residents to attend the Commonwealth's independent colleges.



- Undergraduate enrollment at Kentucky's public institutions has increased by 21,200 students, or 15.5% since reform. The postsecondary system is on track to enroll an additional 77,000 undergraduate students by 2015. The goal is 80,000 more students by 2020; we are ahead of schedule.
- As enrollment increased from fall 1998 to fall 2000, graduation rates increased at Kentucky's eight public universities from 36.7% to 39.8%.



POSTSECONDARY EDUCATION

"Bucks for Brains"

$120 million in Fiscal Year 2003

- $100 million for UK and U of L
  - 2/3 to UK, 1/3 to UL
- $20 million for comprehensive universities
- matched by equal amounts of private funds
- supports research in New Economy fields
- supported by $13.5 million debt service appropriation in 2004

Enrollment Growth and Retention Funding Program

$23.3 million in Fiscal Year 2004

- Funding to support increased enrollment and retention in postsecondary institutions

Scholarship Funding

KEES

- $21.7 million increase in fiscal year 2003 to support approximately 11,000 more students
- $16 .0 million increase in fiscal year 2004 to support approximately 6,100 more students

Need-Based Aid

- $11.6 million increase in fiscal year 2004 to support approximately 8,700 more students

HEALTHIER KENTUCKIANS

"We have not wavered from our dedication to meeting the health needs of our Kentucky families. While we do not have sufficient resources to meet all of these needs or increase services, we pledge to do our best to keep from losing ground in the quest to provide access to quality health care and improve the health of all of our citizens."

Governor Paul Patton

THE MEDICAID BUDGET

Medicaid is a means tested entitlement program financed by the states and federal government that provides medical care for about 40 million low-income persons. Medicaid spending accounts for approximately 20 percent of all states' spending. In Kentucky, over 600,000 persons were enrolled in either Medicaid or the Kentucky Children's Health Insurance Program (K-CHIP) in fiscal year 2001.

Medicaid Budget Imbalance

Kentucky, like many other states, is experiencing increasing problems balancing Medicaid. For the last few years, Medicaid expenditures have consistently outpaced revenues. In fiscal year 2001, spending exceeded budgeted amounts in 37 states. This is due to a return of double-digit inflation in many areas of health care combined with exploding pharmacy costs, increased costs for aged and chronically disabled populations, along with growing caseloads. Caseloads initially grew due to outreach and expansion of the Kentucky Children's Health Insurance Program (K-CHIP). With the downturn in the nation's economy, pressures on both revenues and caseloads have increased.

In response to Medicaid's worsening situation, Governor Patton created the Medicaid Steering Committee in March 2001. Composed of some of the Governor's top policy advisors, the Steering Committee was charged by the Governor with examining the Medicaid program from top to bottom.

It became clear immediately that the focus of efforts should be improved utilization management of Medicaid services.

Balancing Fiscal Year 2001

The projected shortfall for fiscal year 2001 was $95 million. The Administration was able to balance 2001 through a combination of measures:

- Increased funding through internal intergovernmental transfers (IGTs);
- Provider tax receipts above budgeted levels;
- Reduction in the interim payment for hospital outpatient services;
- Reduction in pharmacy dispensing fees; and
- Moving aged and disabled populations to the KenPAC managed care program assuring they have a medical "home."

Intergovernmental Transfers (IGTs) are a key strategy for the Administration. Through a transfer of funds between governmental agencies, Kentucky is able to obtain enhanced federal funding for health facilities owned by local governments throughout the Commonwealth as well as for the Medicaid program.

Balancing Fiscal Year 2002

In addition to continuing IGTs and the hospital outpatient interim payment, the Steering Committee authorized the following measures to help balance the projected $180 million shortfall for 2002:

- Freezing rates at 2001 levels for all non-cost-based provider rates;
- Maintaining Home and Community Based Waiver slots at 2001 levels;
- Eliminating payments beyond 100% of cost for primary care centers;
- Assuring program integrity through resumption of wage documentation;
- Reorganizing the Department of Medicaid Services;
- Reviewing programs for home health and hospital inpatient services; and
- Beginning reforms of the Medicaid outpatient pharmacy program.

There is no effort more important to bringing the Medicaid budget into balance than improving management of the pharmacy program. Spending has doubled since 1998 and legislative reforms currently being considered by the General Assembly are crucial to success.

The Biennial 2003-2004 Budget

Through a combination of aggressive strategies, it is expected that the Medicaid budget can be balanced for fiscal year 2003 without significant cuts to programs, eligibility, and rates. This scenario will only work with no additional expansions to Medicaid or increases in rates to providers.

The outlook for the second year of the biennium, 2004, is far less promising. Even with the most optimistic projections, a shortfall of more than $200 million is currently projected for fiscal year 2004. The Steering Committee will continue to work to manage programs to eliminate the shortfall. If expansions are mandated by the General Assembly or if cost containment efforts do not yield anticipated results, a resizing of the Medicaid program, with a reduction in enrollment, will be required to balance.

Strategies for balancing in the 2003-2004 biennium include:

- Intergovernmental Transfers (IGTs);
- Additional third party recoveries and cost avoidance;
- Savings from improved pharmacy management;
- Cost-sharing measures including co-pays for selected services;
- Cash management initiative;
- Improved collections and audit settlements; and
- Additional cost containment initiatives to be developed by the Steering Committee.

Mental Health/Mental Retardation
Meeting the Need

The Patton Administration recognized in the 2000 Session of the General Assembly that the Commonwealth's commitment to the health and welfare of individuals with mental retardation and development disabilities, the Commonwealth's most vulnerable citizens, was inadequate. Again in 2002, Governor Patton recognizes the needs of these citizens and proposes to increase funding to address them.

Supports for Community Living

House Bill 144, in the 2000 General Assembly, created a commission to advise the Governor and General Assembly concerning needs of persons with mental retardation and developmental disabilities, to develop a statewide strategy to increase access to community based supports, and to work on a comprehensive 10-year plan. State funds of $15 million were matched with $48.8 million in federal funds for Community Based Services (an alternative to institutionalization). These dollars were to provide funding for 500 people on the waiting list.

Status of Implementation:

- 343 of the 500 who received funding allocation letters are already receiving services. The others are working with case managers or department staff to develop a plan for services.
- The waiting list in 1999 contained 1,300 names, many of whom had been waiting since 1982. Currently, there are over 1,800 people on the waiting list.
- The number on the waiting list increases annually. In an average year between 75 to 150 individuals in emergency circumstances are placed on the emergency list, displacing those who have been waiting longer.
- Almost 30% of the individuals on the waiting list live with parents who are over the age of 60 and whose health is deteriorating.

Supported Employment

- Supported employment services are critical for individuals with disabilities transitioning to the community after living in an institutional setting.

Homecare for the Aging

- Currently 3,500 older persons are on a waiting list for Homecare services. These people are at risk of institutionalization without support services to allow them to continue to function in the community. Such services include home health, personal care, meals, respite, and transportation services.

Wrap Around Services for the Mentally Ill

- The U. S. Office of Civil Rights is reviewing individuals with mental illness living in state psychiatric hospitals for longer than one year. Those individuals who no longer need an acute hospital setting will be moved to the community with appropriate supports.

Crisis Stabilization Units

- These programs provide a critical, less expensive but equally effective treatment alternative to inpatient hospitalization for individuals in psychiatric units. The Kentucky Commission on Services and Supports for Individuals with Mental Illness, Alcohol, and Other Drug Abuse Disorders, and Dual Diagnosis, House Bill 843 Commission, recommended the addition of 10 units to meet the goal of 28 statewide.

The Commonwealth Expands Services to:

- Those individuals in institutions such as intermediate care facilities for the mentally retarded (ICF-MRs) who are appropriate for and desire to be in the community;
- Those at risk of institutionalization in an ICF MR;
- Those frail elderly at risk of institutionalization in long term care facilities, such as nursing homes; and
- Those who are mentally ill and have been institutionalized in state psychiatric hospitals for extended periods of time.

The Executive Budget Provides:

- $2.1 million in fiscal year 2003 and $7 million in fiscal year 2004 to expand supports for community living slots by 250 each year.
- $200,000 each year in the Department of Vocational Rehabilitation to support an estimated additional 125 persons per year for supported employment.
- $3.6 million over the biennium in the Department of the Aging to serve an additional 1,300 persons with Homecare Services for the aging.
- $1.9 million over the biennium to support an additional 24 mentally ill persons with wrap around services.
- $2 million to fund five new crisis stabilization units in fiscal year 2003 and $4 million in fiscal year 2004 to fund five more.

KENTUCKY ACCESS

Kentucky Access, Kentucky's high-risk health insurance pool created by the 2000 General Assembly via the enactment of House Bill 517, was designed and implemented as a statewide health plan to offer medical coverage to individual Kentuckians who have sufficient disposable income to afford health insurance premiums, but who find it difficult or impossible to obtain individual health insurance in the private market.

Kentucky Access has two primary goals:

- Provide access to health care coverage for individuals with major medical problems who cannot find coverage elsewhere; and
- Bring stability to the individual health insurance market in Kentucky.

"When health insurance premiums are taking so much more out of the family budget each year, we must do everything we can to give consumers more competitive premiums, choices, and benefits. Kentucky Access is a significant step in that direction because most individuals with high cost medical conditions are going to see a savings compared to the rates they were paying."

Governor Paul Patton
News Release Announcing
Kentucky Access Open for Business
December 6, 2000

Fulfillment of these goals benefits not only individuals with high cost medical conditions, but also those in the healthier segment of the individual market.

Since Kentucky Access became operational on January 1, 2001, three commercial carriers have joined Anthem and Humana in the individual market, and a fourth carrier has been approved and will begin operations in the spring of 2002. The return of these carriers has more than doubled the number of commercial carriers writing individual policies in the state, bringing the number of choices from two to seven, and has already had a significant impact on competition among carriers in the healthier segment of the market. A review of rate filings suggests that competition in the individual market is also benefiting consumers in terms of levels and moderation of rate increases for some individuals.

Kentucky Access

Organizations Selling Individual Health Insurance in Kentucky
(Before and After Kentucky Access)

Before Kentucky Access	After Kentucky Access
• Anthem Blue Cross Blue Shield	• Anthem Blue Cross Blue Shield
• Humana Health Plan	• Humana Health Plan
	• Fortis Insurance Company
	• John Alden Life Insurance Company
	• Physicians Mutual Insurance Company
	• Mega Life and Health
	• Kentucky Access

There is some early indication this year's rate increases have moderated and are more directly tied to underlying health care costs than in previous years. As a matter of general principle, Kentucky appears to be coming back in line with other states, where rate increases tend to be more closely tied to underlying medical inflation.

The program is funded from three revenue sources: premium income paid by policyholders; assessment revenue from all health insurance carriers in the state; and an appropriation of the state's Master Settlement Agreement proceeds (Phase I Tobacco funds) from the Kentucky Health Care Improvement Fund established by House Bill 583 of the 2000 General Assembly.

This Executive Budget maintains a commitment to our successes in this arena including increased competition and choice for all Kentuckians, continued stabilization of the individual health insurance market, and a commitment to adequately fund the Kentucky Access Program so that individuals with high cost medical conditions will have access to affordable health insurance protection. Twenty-five percent of the Phase I Tobacco receipts are recommended for appropriation to the Health Care Improvement Fund, of which $19.4 million (fiscal year 2003) and $16.9 million (fiscal year 2004) are recommended for the Kentucky Access Program.

Consistent with our commitment to adequately fund the Kentucky Access Program, fund transfers from the Kentucky Access Program to the General Fund in the amounts of $36 million in fiscal year 2003 and $13 million in fiscal year 2004 are provided as these fund balances are not needed to honor projected obligations of the program in these fiscal years. Note, however, that additional revenue sources will be necessary in future periods when the program reaches its projected enrollment of approximately 5,000 Kentuckians. Current program enrollment is approximately 840 and enrollments are occurring at the rate of nearly 100 persons per month.

ENHANCEMENTS TO KENTUCKY'S BLACK LUNG PROGRAM

The Patton Administration has worked hard to institute goals in the Workers Compensation system to:

- Assure adequate compensation for injuries and occupational disease – both medical and indemnity benefits for lost wages;
- Develop a predictable, consistent, affordable, and fair system of assuring that Kentuckians are insured against workplace injuries and disease; and
- Maintain a system that is administratively efficient so as to close claims quickly with minimal litigation – to get benefits to those who deserve them quickly and to minimize costs.

House Bill 1 of the First Extraordinary Session of 1996 significantly altered the Coal Workers Pneumoconiosis ("CWP" or "Black Lung") program in Kentucky. The system cost Kentucky employers approximately $100 million per year prior to House Bill 1, a system that compensated an additional estimated 1,900 miners per year for contracting the disease. Implementation of the reforms in House Bill 1 resulted in virtually eliminating the black lung program in Kentucky. Since enactment of House Bill 1, over five years ago, only 16 miners have been compensated through the CWP Fund which was established to pay black lung claims. The objectives of the House Bill 1 reforms were clearly met, yet they went too far.

Governor Patton, in the 2000 Session via House Bill 992, and in the 2001 Session via House Bill 132, proposed amendments to the Black Lung program to increase benefits to coal miners found to have the disease in its early stages so those individuals could be retrained and leave the work environment that contributed to their condition while simultaneously ensuring the consistency and predictability of both the cost and benefits of the system. Both of these efforts failed.

Governor Patton again supports legislation in the 2002 Session, House Bill 348, to increase benefits to coal miners. The proposal is the same proposal made in the 2001 Session (House Bill 132) with minor technical amendments as a result of a court decision and making adjustments for timing issues as the bill is being considered one year later.

"My proposal is not a return to the open-ended black lung program that operated before 1996. It's to train diseased coal miners for another occupation after they've contracted the disease but before they've become totally disabled. To take the position that a miner has to continue to work until he or she has become disabled and their life shortened before they can receive training for another occupation is ridiculous; and it's inhumane."

Governor Paul Patton
State of the Commonwealth
January 10, 2002

Major Provisions of the Bill

- Lower medical thresholds for Black Lung Awards.
- Reconsider claims made after House Bill 1 to the present under new standards.
- Extend the time allowed for the filing of post House Bill 1 claims to December 12, 2003.
- Provide a presumption that the cause of pulmonary impairment for miners with 15 years of service in the mines, who have black lung, is the exposure to coal dust.
- Provide that miners 55 years of age or older may take advantage of a permanent partial award in lieu of a retraining benefit.
- Require that all doctors evaluating miners for black lung be certified "B Readers."
- Require that a consensus on the diagnosis of black lung cases be reached before an award is determined.
- Utilize employer selected "B Readers" in lieu of university doctors to address concerns that workers have to travel to Louisville or Lexington for evaluations.
- Reconsider pre-House Bill 1 claims which were evaluated by the university doctors and denied due to the x-ray interpretation by having two "B Readers" interpret the x-rays filed on the claims.
- Allow miners who qualify for retraining benefits to request an exemption from the retraining requirements based upon educational, physical or mental limitations, resulting in income benefits of 25% permanent partial disability.
- Allow administrative law judges to order the payment of retraining benefits during an appeal by an employer.
- Make a technical correction to the permanent partial disability grid to reinstate 520 weeks of benefits instead of 425 weeks for serious injuries between 25% and 35% medical impairment.

Estimated Costs

Two sets of actuaries have estimated the costs of the proposed increases in benefits. The increased costs are estimated in two categories:

- One-time costs, which reflect the costs of the retroactive provisions of the bill; and
- Ongoing costs, which reflect the annual costs of the provisions of the bill.

- One-time increased costs are estimated to range between $14.7 million and $28.2 million, all of which would be paid from the Coal Workers Pneumoconiosis Fund (CWP Fund) which has a current fund balance of $16.6 million.
- Ongoing annual increased costs are estimated to range between $4.1 million and $6.5 million.

GROWING OUR ECONOMY

"Kentucky has the potential to become a full participant in the New Economy. If the New Economy initiatives are carried out, over the next five years Kentucky will be the most exciting state in the country in which to live and work."

Dr. William Brundage
Commissioner for the New Economy

BUILDING KENTUCKY'S "NEXT" ECONOMY
Budget Priorities

The passage of House Bill 572, the Kentucky Innovation Act, by the 2000 General Assembly signaled Governor Patton's and lawmakers' determination to position the Commonwealth to compete successfully in the new economy. Although business must lead the way to prosperity in the emerging or "next" economy, government can play an effective supporting role through public-private partnerships and by fostering an environment in which its new economy businesses, existing and new, can prosper.

New Economy: the global system of commerce and industry in which the keys to wealth and job creation are knowledge, innovation and speed.

Elements for Successful New Economy Creation

If Kentucky is to create the dynamic companies and jobs necessary to compete in the new economy, it must develop a strong research and development capacity, an entrepreneurial climate that encourages the commercialization of ideas, and a motivated and well-educated workforce.

Priority Funding Areas

During the 2000-2002 biennium, the Office of the New Economy (ONE) was formed and a state plan, *Kentucky Innovation,* was developed that defines goals, sets priorities and charts a strategy for success in the new economy. The plan was developed through a regionally based, grassroots effort involving hundreds of citizens across the Commonwealth. Each region developed a plan that reflects its unique character and underscores the contribution that it can make to the new economy effort. The state plan is broad-based and sets a bold course toward realizing the potential of all Kentuckians by including both rural and urban areas in the plan. One critical element of the state plan is the identification of five priority funding areas where Kentucky might gain national prominence, areas that can yield significant technology transfer and commercialization opportunities:

- Energy and Environmental Technologies
- Human Health and Development
- Biosciences
- Information Technology and Communications
- Materials Science and Advanced Manufacturing

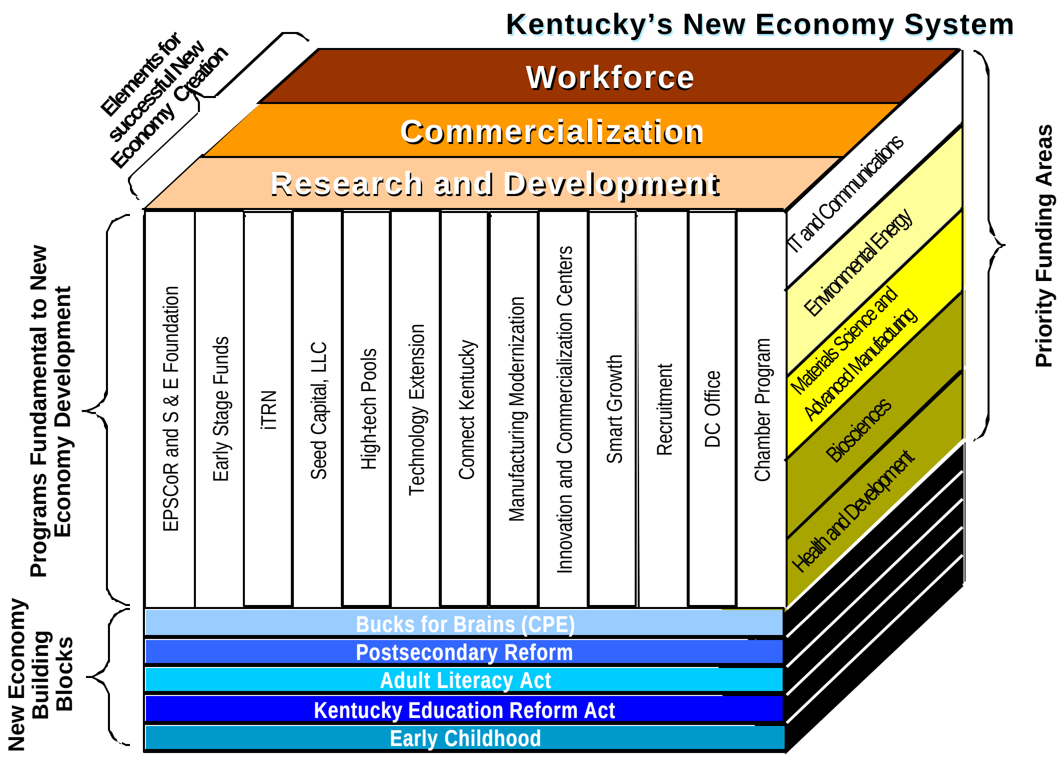
State resources will be deployed to bolster these targeted research areas to ensure the growth of centers of research excellence.

Programs Fundamental to New Economy Development

- Experimental Program to Stimulate Research (EPSCoR)
- Bucks for Brains
- House Bill 572 Early-Stage Funds
- New Economy Construction and Investment Pools
- Innovation and Commercialization Centers (ICC)

The Executive Budget Redirects Existing Resources to the New Economy

- $5 million each fiscal year of coal severance receipts to be used in coal impacted counties
- $10 million in each year from the Kentucky Economic Development Finance Authority



"The great fortunes of the future will be made not with physical labor and raw materials, but with intellectual capital."

Governor Paul Patton

NEW ECONOMY LEGISLATIVE PRIORITIES

The Kentucky Innovation Commission recommends, and Governor Patton supports, a comprehensive legislative package to update our existing "new economy" economic development tools as well as to make the overall business climate more attractive to new economy investments.

Providing Access to Capital

Capital is critical to the high-tech firms that fuel the emerging economy. Product development is expensive and many young firms find it difficult to raise capital. These proposals will attract venture capital not widely available in Kentucky today:

- Amend the Kentucky Investment Fund Act (KIFA) to permit "follow-on" investments, i.e. capital outlays in firms in which the financier or fund manager has a financial interest.
- Permit KIFA investors and fund managers to participate in managing a portfolio company.
- Change the definition of a small business as it applies to knowledge-intensive firms from a value of less than $3 million to a company with a value of less than $10 million.
- Permit the transfer of tax credits granted under KIFA by tax-exempt entities.
- Permit banks and insurance companies to participate in KIFA and tax credits to apply against insurance premiums, financial institutions deposits, and bank franchise taxes.
- Modify KIFA to permit fund investments outside Kentucky. Limit tax credits to qualified investments made by an approved fund rather than contributions to the fund.
- Remove certain administrative requirements in order to make creating and operating a KIFA fund more attractive (e.g., stringent investment schedules and investor management requirements, reporting requirements, liquidation approval).
- Amend the Kentucky Securities Act (KSA) to permit a manager of a venture capital investment partnership to receive a carried interest on the gains of the partnership.
- Amend KSA so that accredited investors are not counted in the 15 Kentucky purchaser limit and increase the maximum offering of securities from $500,000 to $1,000,000.
- Clarify the law governing the application of Kentucky state income tax on profits realized by non-residents from Kentucky investment partnerships.
- Clarify the Local Occupational Tax Law to expressly prohibit local governments from assessing occupational tax on investment income.

Increasing Research and Development

Research centers that produce cutting-edge scientific and technological advances are fundamental to successful economic development in the emerging economy. Kentucky currently ranks 42nd in per capita R&D spending. Well-targeted incentives to expand R&D infrastructure in Kentucky would be a boon to the new economy.

The Governor proposes to:

- Establish a research facilities corporate tax credit

Improving the New Economy Organizational Infrastructure

The newly created Innovation and Commercialization Center (ICCs) network will provide business-building services to Kentucky's faculty, entrepreneurs, and scientists. Twenty centers will link scientists and entrepreneurs with the commercialization–related funding tools created under the Kentucky Innovation Act, House Bill 572.

Legislative proposals include:

- Amend Kentucky Innovation Act to codify the ICC's into law
- Amend Kentucky Innovation Act to increase Rural Innovation Awards
- Create a Concept Phase Funding Pool to provide grants for businesses and individuals at the early stages of concept development
- Amend the appropriate statutes to give the Commissioner for the New Economy authority over contracts developed for new economy-related programs

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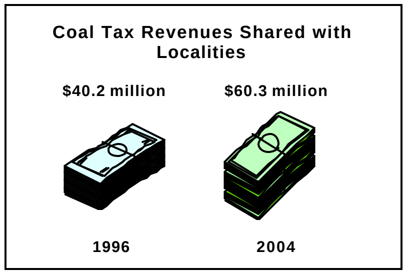
"We are experiencing what I think historians of the future will call the Third Industrial Revolution, a transition to a knowledge-based economy."

Lester Thurow
Former Dean of MIT's Slone School of Management

Coal Severance Fund Programs

Keeping the Commitment to Localities



Ten years ago state government made a covenant with its localities. It pledged to share 50% of coal revenue and processing taxes with local governments. This Executive Budget, for the first time, proposes to keep that promise and delivers more than $60 million in coal tax revenues to local governments in fiscal year 2004.

History of Local Mineral Tax Revenue Sharing

The Local Government Economic Assistance Fund (LGEAF) was created by the 1980 General Assembly to return a portion of coal and minerals severance tax receipts to local governments to stimulate economic development. The program shared only one-half of the coal revenue and processing taxes over a certain threshold with local governments. In addition, fifty percent of the taxes collected on natural gas, oil and other minerals were transferred from the state General Fund into LGEAF. In 1986, the law was amended to guarantee local governments a minimum of 12% of the coal severance taxes collected. Under the leadership of Governor Patton, the LGEAF share has grown to 14% of coal revenues. The Governor now proposes that the LGEAF allocation increase to 14.5% in fiscal year 2003 and a 15% share be codified into law effective with fiscal year 2004.

The 1992 General Assembly significantly increased the percentage of coal severance tax receipts returned to local governments with the creation of the Local Government Economic Development Fund (LGEDF). The LGEDF directed coal severance funds exclusively to coal producing counties. Beginning in fiscal year 1993, the schedule called for 3% of the coal severance tax receipts to be shared with these counties and the share was to grow until it reached 38% in 1996. This mandate was not met. It was not until Governor Patton took office that the LGEDF county allocation began to climb.

Local Share of Coal Revenues

Fiscal Year	LGEAF	LGEDF	Total
1996	12%	12.35%	24%
1997	**12%**	**16%**	**28%**
1998	**13%**	**18%**	**31%**
1999	**14%**	**21%**	**35%**
2000	**14%**	**24%**	**38%**
2001	**13%**	**27%**	**40%**
2002	**14%**	**30%**	**44%**
2003	**14.50%**	**32.50%**	**47%**
2004	**15%**	**35%**	**50%**

PATTON

For the first time in fiscal year 2004, under a new cost-sharing formula, 50% of coal tax revenues will be returned to localities.

COAL SEVERANCE FUND PROGRAM CHANGES

Many challenges remain in recruiting businesses to coal counties, and one significant hurdle is the lack of the telecommunications infrastructure necessary for businesses to operate in today's networked and global economy. The potential for telecommunications to help rural areas overcome some of their historic disadvantage is tremendous. Commercial wireless communication services have become the standard means of business communications and are expected to be available and affordable to businesses considering locating in coal-producing counties, as they are in more urban areas.

In order to allow the LGEDF program to address the "digital divide" and other issues faced by local leaders attempting to lure businesses to their counties, Governor Patton proposes changes to allow coal counties to address telecommunication infrastructure needs, authorize the Commissioner of the Department for Coal County Development to respond directly to opportunities in coal counties and prioritize eligible projects, and provide counties with a larger percentage of funds for the Local Government Economic Assistance Program.

Specifically, the changes would allow:

- Expenditure of funds for enhanced voice and data access and services within coal county regions;
- Direct approval by the Commissioner of the Department for Coal County Development for telecommunications and job training grant projects, in consultation with affected counties;
- The Commissioner of the Department for Coal County Development to prioritize the funding of projects in the following order: industrial development projects; job training projects; and any other eligible projects or projects funded out of the LGEDF; and
- Increase the percentage of funds transferred annually from the LGEDF into the LGEAF from 13% to 15%, to provide increased funds for eligible projects under the Local Government Economic Assistance Program.

THE AGRICULTURAL DEVELOPMENT FUND

Keeping Faith with Kentucky's Farm Families

Governor Patton and the General Assembly made history in the 2000 legislative session when they created the Kentucky Agricultural Development Fund, the largest state-financed agricultural development effort in the history of the United States. County-level agricultural development councils and the state Agricultural Development Board appointed by Governor Patton focused their initial efforts on increasing the efficiency and productivity of established agricultural sectors and providing seed capital for new and innovative farm-based businesses. Direct cash assistance to supplement Phase II payments to tobacco farmers, cost-share assistance for environmental compliance, water line extension investments, and hundreds of diversification projects count among the numerous early successes of this historic effort.

Renewing Our Vision

Renewing the commitment of half of Kentucky's proceeds from the Master Settlement Agreement is critical to the long-term prosperity of Kentucky's farm families and rural communities.

Actions from the Agricultural Development Fund:

- Development of both a near and long term strategic plan for the diversification and growth of Kentucky's rural economy;
- $36 million in direct, unrestricted cash payments to tobacco farmers;
- $18 million in cost-share assistance to farmers to assist with implementation of the Agriculture Water Quality Act;
- $50 million to support water-line extension projects in areas of high agricultural activity;
- $25 million to support local and statewide farmland preservation efforts;
- $60 million-plus to support over 350 agricultural diversification projects across the state; and
- Development of six model county programs aimed at improving the value and marketability of Kentucky's cattle herds, development of goat herds, and general niche agricultural diversification efforts.

INVESTING 50% OF KENTUCKY'S MASTER SETTLEMENT AGREEMENT PROCEEDS

Fiscal Years 2003 and 2004

$117.4 million

"We urge you, no matter what the temptation, no matter how great the need in other areas, no matter how great the pressure from other deserving constituents, to stay the course, to maintain the commitment, to keep faith with our farmers. And if we do, we'll be able to look back 10 years from now and say that we've helped preserve the unique rural culture of Kentucky which has been the mainstay of our values, the source of our work ethic, the strength of our people that has made Kentucky, Kentucky."

Governor Paul Patton
State of the Commonwealth
January 10, 2002

65% or $76.3 million to State Level Projects

- $18 million in environmental cost share assistance
- $8.3 million for debt service on water line extension bond issue authorized in 2000
- $4.1 million for debt service on farmland preservation bond issue authorized in 2000
- $3.6 million for administrative support
- $42.3 for agricultural development projects

35% or $41.1 million to County Level Projects

- Earmarked for counties on the basis of relative tobacco dependence for support of agricultural development projects

Kentucky's farm families have been devastated by changes in the tobacco economy and resulting drastic decreases in tobacco sales, Kentucky's most prevalent cash crop. Agricultural economists estimate that each dollar generated by tobacco creates seven times as much economic activity in rural communities. As economic challenges intensify, so do threats to the rural culture valued by so many Kentuckians and so influential in defining what it means to be a Kentuckian.

	1998	2000
Kentucky Tobacco Sales	$924 million	$674 million

Source: Kentucky Agricultural Statistics Service, 2001

ECONOMIC DEVELOPMENT MODERNIZATION

Kentucky's approach to incentives for economic development has shifted over the years to better meet the needs of the companies and industries looking to locate and grow in our state. Beginning in 1988 with the passage of the Kentucky Rural Economic Development Act (KREDA) at the urging of then Pike County Judge Paul Patton, Kentucky began to shift its focus away from direct up-front cash incentives and toward incentives that are targeted and performance-based.

Kentucky is well equipped with the economic development tools in its toolbox; however, several of the tools need to be modernized and sharpened to again refocus our efforts in a more targeted and performance-based manner and to better meet the needs of business in the emerging new economy.

"Set Kentucky on the path to achieving economic opportunity and a standard of living above the national average in 20 years"

Governor Paul Patton

Restructuring the incentive programs reinforces the Administration's policy of ensuring the state invests only in those companies that will assist in meeting its overall goals, while considering the economic conditions in each county. Economic opportunity and better paying jobs translate to economic growth and the building of self-sustaining families.

Kentucky Ranks Lowest in Overall Cost of Doing Business Among 15 Competitor States

Cost of Doing Business	*Overall*	*Labor Costs*	*Energy*	*Taxation*
KY's Rank	**1**	**2**	**1**	**11**

Source: Economy.com

"In the nation, Kentucky ranks second in new jobs created, fifth in new and expanded manufacturing facilities, tenth in capital investment, twelfth in value added per worker, ninth in manufacturing growth, fifteenth in per capita income growth, eighth in growth of exports, third in the production of light motor vehicles, and third in the decline in poverty rates. Kentucky has ten communities ranked in the 100 best small towns for corporate expansions."

Governor Paul Patton
State of the Commonwealth
January 10, 2002

ISSUES IN ECONOMIC DEVELOPMENT	GOVERNOR'S PROPOSAL
Kentucky's economic development tax credit programs (Kentucky Rural Economic Development Act (KREDA), Kentucky Industrial Development Act (KIDA), and Kentucky Jobs Development Act (KJDA)), have proven to be highly effective at fostering job growth, but earnings per job have lagged behind the national average.	Impose minimum thresholds for wages for companies receiving incentives under the Kentucky Rural Economic Development Act (KREDA), the Kentucky Industrial Development Act (KIDA), and the Kentucky Jobs Development Act (KJDA), based on county and state averages, no less than 150% of the federal minimum wage level. In addition, a minimum of 15% of wages must be provided as fringe benefits.
Economically distressed counties deserve the use of the best incentive package the state has to offer. In a 2000 survey of corporate executives by *Area Development* magazine, highway accessibility was rated very important by 54.2% of respondents and availability of skilled labor rated very important by 48.5%, first and third, respectively, among site selection factors.	Introduce three criteria for determining additional counties eligible for KREDA using three-year unemployment rate, high school educational attainment levels, and road quality indicators.
Smaller start-up and New Economy business may be hindered by KDJA minimum employee thresholds.	Reduce the number of full-time employees required for KJDA qualification from 25 to 15.
Local governments currently have the power to reduce state property taxes by issuing Industrial Revenue Bonds without state approval.	Require state approval through KEDFA when state property taxes are to be reduced by virtue of an Industrial Revenue Bond issuance.
Job training and telecommunications infrastructure are key factors for economic development success in the 21st century.	Revise Local Government Economic Development program by putting into law the job training grant program and allowing telecommunications infrastructure funding.
Technical revisions are required to improve the effectiveness of our economic development programs.	Remove language from KREDA, KIDA, and KJDA requiring debt service and replace with capital investment costs. Replace 90-day closing rule with language tied to the notice announcing a plant closing. Revise Kentucky Equal Opportunity Zone Act (KEOZ) to reflect changes in the tax credit legislation.

TAX INCREMENT FINANCING IMPROVEMENTS

Tax increment financing is a new economic development tool to be used at the state level provided for in several bills enacted in 2000 and 2001. Included in the legislative package of amendments to the other existing programs are programmatic changes to the tax increment financing laws to provide more clarity to the intent and use of this type of development tool.

Governor Patton proposes the creation of two types of tax increment financing vehicles with state participation, those which are project specific, or tied directly to the development of a single unique project or investment, and those which are more geographic in nature to provide for the infrastructure development of an area to prepare the area for industrial development.

Project Specific Development Areas

- Development area defined as linked to a single unique facility
- Requires minimum capital investment of $10 million.
- Must create at least 25 new jobs
- 25% of revenues must come from out-of-state
- Project must result in a unique contribution to the economic vitality of a region of the state
- Up to 80% of incremental taxes not to exceed 25% of the project costs may be granted to a local government in support of the project for up to 20 years
- Incremental withholding, sales, corporate and property taxes may be considered
- Provide for independent consultant to estimate net new incremental taxes. Budget Office and Revenue Cabinet to review
- Requires approval of Kentucky Economic Development Finance Authority or Kentucky Tourism Development Authority

Infrastructure Development Areas

- Development area defined as at least 100 acres of undeveloped land or at least one acre of a brownfield site
- Development area must be owned or under control of a public entity
- Eligible infrastructure improvements include:
  - ◊ Transportation
  - ◊ Utilities
  - ◊ Water
  - ◊ Sewer
  - ◊ Telecommunications
- 100% of incremental state property taxes may be granted to the public entity to cover eligible costs
- Incremental property taxes may be granted for activities that are eligible under existing tax credit programs
- Requires approval of Kentucky Economic Development Finance Authority

MEETING OUR OBLIGATIONS TO PROTECT KENTUCKIANS

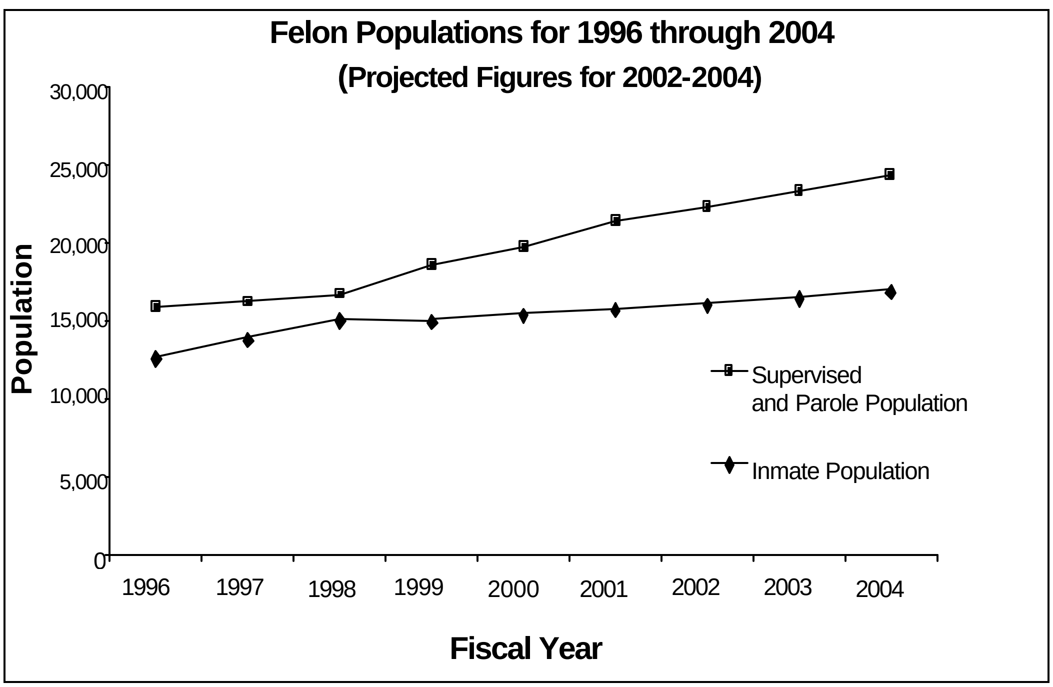
"Efforts to integrate criminal justice systems throughout the Commonwealth are even more important in light of budgetary constraints. We remain committed to enhanced public safety and efficient deployment of staff and resources. We support Governor Patton's efforts to meet this commitment while maintaining fiscal responsibility."

Robert F. Stephens, Secretary
Justice Cabinet and former
Chief Justice of the Kentucky Supreme Court

DEPARTMENT OF CORRECTIONS

Reducing crime and its costs to society has been a strategic focus of the Patton Administration. The Department of Corrections is responsible for a broad range of activities associated with the daily operations of the state correctional institutions. These include the multitude of community-based services associated with incarceration, public safety, rehabilitation, probation and parole, and criminal recidivism.

From fiscal year 1996 through 2002, expenditures for Corrections costs have increased by 43.6% as compared to growth in revenues for the General Fund as a whole of 25.8%. Over time, Kentucky is spending an increasing percentage of the General Fund in this area. While serious crime is in decline in Kentucky and nationally, the state felon population continues to grow at a modest rate driven in large part by increased drug and drug-related offenses.



Source: Department of Corrections

The <u>Executive Budget</u> Complements the Mission of the Department of Corrections by:

- Protecting the citizens of the Commonwealth and providing a safe, secure, and humane environment for staff and offenders in carrying out the mandates of the legislative and judicial processes
- Providing opportunities for offenders to acquire skills that facilitate non-criminal behavior

Operating Funds for New Facilities

Three projects authorized in previous budgets are funded for operation and maintenance when they come on-line in fiscal year 2004. These facilities include:

- 120-bed Transition Dorm at the Kentucky State Reformatory
- 50-Bed Segregation Unit at the Kentucky State Penitentiary
- 44-Bed Segregation Unit at the Western Kentucky Correctional Complex

DEPARTMENT OF CORRECTIONS
$15.8 million

$5.2 million in Fiscal Year 2003

$10.6 million in Fiscal Year 2004

Funding included to:

- Accommodate a projected prison population growth of 486 in fiscal year 2003 and 925 in fiscal year 2004
- Accommodate a projected probation and parole population growth of 1,093 in fiscal year 2003 and 1,017 in fiscal year 2004
- Provide operating and maintenance funds to previously authorized facilities coming on line in fiscal year 2004

JUVENILE JUSTICE

Statewide, State-Operated Detention System

Great strides have been made in the Commonwealth's system of providing detention and treatment for juvenile public and youthful offenders over the last six years. In January of 2001, the U.S. Department of Justice lifted the Consent Decree under which the Commonwealth had been placed in November of 1995 as a result of inadequate services, poor management practices and unacceptable confinement practices in state-operated treatment facilities.

"Kentucky has lived up to its agreement to improve conditions at its treatment centers for juvenile offenders . . . You said you would do it and you did it. Kentucky's program is a model for the rest of the nation."

Janet Reno, Former U.S. Attorney General
Lexington Herald Leader
January 17, 2001

The primary focus of this budget is to continue the process of implementing a statewide, state-operated juvenile detention system. This includes the construction of strategically located secure detention centers across the state, and insuring the availability of alternatives to detention for less serious offenders. Also, the budget will ensure that the Department continues providing high quality services for juveniles, both those remaining in their homes in the community and those placed in an appropriate treatment environment outside the home.

- Beginning in fiscal year 2003, counties sending juvenile public or youthful offenders to any state-operated detention center will no longer be charged a fee for services.

- All counties in the state that must still use a locally operated detention center will receive an increase in the per diem subsidy from $80 per day to $94 per day for juveniles. The Department of Juvenile Justice will cover this additional cost with its current level of funding.

- The Boyd County Regional Juvenile Detention Center is currently under construction and is planned to begin operations in the first quarter of fiscal year 2004. This will be the sixth regional detention center in the statewide system, and $2 million in additional funding is provided for operations in fiscal year 2004.

- The Fayette County Regional Juvenile Detention Center is scheduled to begin operations just prior to the end of fiscal year 2004. In fiscal year 2004, $500,000 is provided for start-up costs.

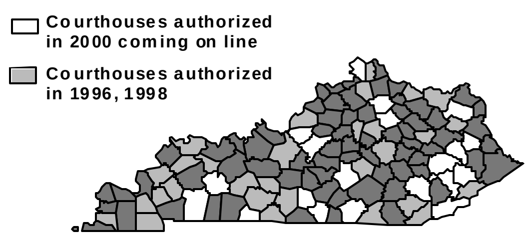
JUDICIAL BRANCH

The Patton Administration will continue to honor the commitments made by the General Assembly to reimburse our counties for the state's share of the costs of building, operating, and maintaining our courthouses, especially those new structures authorized in previous budgets. The recent dedication of the Robert F. Stephens Courthouse in Fayette County demonstrates our ongoing commitment to providing our citizens with new state of the art facilities in which to conduct the business of our justice system.

"We've invested more in new courthouses in the past six years than in the previous sixty years!"

Governor Paul Patton
State of the Commonwealth
January 10, 2002

Courthouse Authorizations	
1996	$147 million
1998	$148 million
2000	$145 million



Legislative Mandates:

- $3.7 million in fiscal year 2003 and $12.7 million in fiscal year 2004 for increased use allowance for courthouses authorized by the 2000 General Assembly.*
- $1.9 million in fiscal year 2003 and $2.0 million in fiscal year 2004 to fund additional judgeships authorized by the 2001 General Assembly.**

* Boone, Bourbon, Breathitt, Bullitt, Carter, Casey, Christian, Clay, Cumberland, Harlan, Harrison, Johnson, Knott, Magoffin, Metcalfe, Muhlenberg, Nelson, Perry, Simpson, Wayne.

** 57th Judicial Circuit, 41st Judicial Circuit, 51st Judicial Circuit, 5th Judicial District, and the 37th Judicial District.

BOARD OF ELECTIONS

Public Campaign Funds

The Public Financing Campaign Act, enacted in 1992, requires the state to make available funds to help offset the costs of gubernatorial campaigns for qualified candidates. The minimum threshold qualifying amount for a slate of candidates for Governor and Lieutenant Governor in a primary or regular election that chooses to receive matching funds from the General Fund is $300,000 and the maximum $600,000. The Executive Budget assumes there will be four qualifying slates in the 2005 primary, a primary run-off election, and two slates in the regular election. To cover these expenditures, $7 million is provided in fiscal year 2003 and $2 million is provided in fiscal year 2004.

Election Expenses

The state share of county election expenses and voter registration expenses is expected to increase over the next biennium. There are currently 3,361 voting precincts within the Commonwealth, and 2.7 million registered voters. The lines for voting precincts in Kentucky are redrawn after each national census and at various other times in the interim when population changes warrant. These lines are currently being redrawn based upon the 2000 census. Due to the creation of new or changed districts, as well as an increase in population and voter registrations, it is anticipated that approximately 150 new precincts will be formed over the next biennium, thus requiring an increase in funding to the State Board of Elections of $874,300 in fiscal year 2003 and $967,100 in fiscal year 2004.

MEETING OUR FISCAL RESPONSIBILITIES

"We are committed to maintaining the fiscal health of the Commonwealth, especially at this time when we are faced with expenditure requirements that are in excess of projected revenues. Despite our best efforts, we propose a budget that will have areas of structural imbalance. We pledge to do our best to manage our resources prudently, meet our obligations, and continue to move Kentucky toward a higher standard of living for its citizens."

Dr. James R. Ramsey
State Budget Director

STATE EMPLOYEE INITIATIVES

Fair and equitable compensation for state employees has been a priority for the Patton Administration. Significant progress has been made over the past six years. Governor Patton recognizes that the success of this administration is due to the ability, dedication, and hard work of more than 36,000 state employees. In order to recruit and retain a highly motivated and skilled workforce needed to serve the people of the Commonwealth, the Governor has worked hard to provide 5% annual increments every year, bring our antiquated classification and compensation system into line with market values, and maintain full coverage for health insurance for our employees.

Because of these and other efforts the Patton Administration has made in managing the state's resources, the Government Performance Project report card on Kentucky, published in January 2001, gave Kentucky a grade of B+ both in the area of Human Resources Management and as an overall grade. Only three states were ranked higher.

"We have invested in the intellectual capital of state government employees because it is they who truly make Kentucky government work."

Governor Paul Patton

The Governor recently established the Governor's Employee Advisory Council which provides advice and recommendations concerning state employee/employer relations and discusses matters pertaining to wages, hours and other terms and conditions of employment within the authority of the Governor to decide or recommend to the General Assembly. The Council's first meeting was held on January 4, 2002 and Governor Patton gained valuable input about the priorities of many of his employees.

In these times of economic recession and the need to exercise fiscal restraint, Governor Patton does not want to lose ground on these accomplishments. This Administration must not lose the momentum it has in terms of salaries and Governor Patton cannot allow employees to lose purchasing power. Therefore, this budget proposal includes cost-of-living increases for state employees of 2.7% per year for both years of the biennium.

The Executive Budget also includes a provision to continue paying the full cost of the lowest priced "Option A" single health insurance coverage for full-time employees even though double digit price increases are anticipated in each year of the biennium, and the trend in the private sector is to shift this cost burden to employees.

What We Have Done

- Provided 5% salary increments each year of this Administration. The Patton Administration is the only administration to honor this commitment

- Improved entry level wages by approximately 14.1% which brought them very close to market and provided some relief for our lowest-paid state government employees

- Moved 443 job classifications to the appropriate higher pay grades which brought their pay closer to market value

- Moved 4,145 employees to higher pay grades on July 1, 2000, and 6,637 employees to higher pay grades on July 1, 2001

- Brought mid-point salaries to within 6% of private sector salaries in Kentucky

- Experienced an increase of 55% in the average salary for the approximate 21,300 employees who were on the payroll in 1996 and who are still state employees

- Paid the full cost of the lowest priced "Option A" single health insurance coverage for full-time employees at a time when many employers began requiring employees to pay a portion of the cost

? Increased to $20,000 the amount of life insurance provided to employees free of charge

STATE EMPLOYEE INITIATIVES

State Employees Maintaining Purchasing Power

- 2.7% cost-of-living increments in fiscal year 2003 and fiscal year 2004

- Health insurance cost increases are fully funded in fiscal year 2003 and fiscal year 2004

"At last, many of our employees have an effective method, chosen by them, to communicate their desires about their terms and conditions of employment to their employer."

Governor Paul Patton
State of the Commonwealth
January 2002

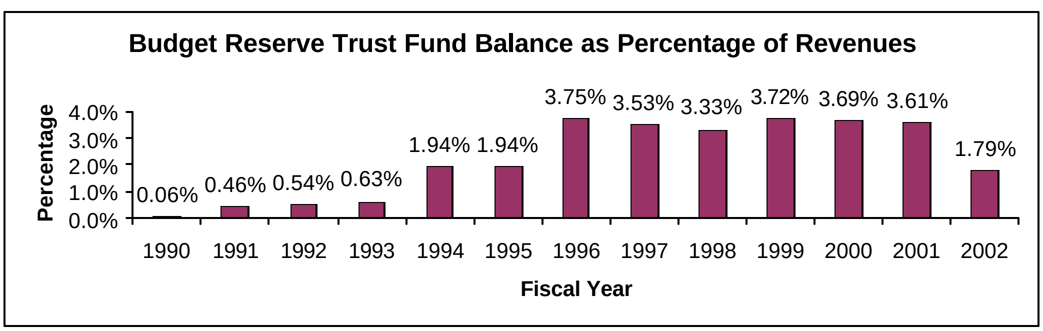
EDUCATION PAYS

MAINTAINING THE BUDGET RESERVE TRUST FUND

No one likes to have to dip into his or her savings, yet that is precisely why the Commonwealth of Kentucky has a Budget Reserve Trust Fund. In fiscal year 2001, $38.8 million was taken from the Fund and $120 million was tapped in fiscal year 2002 as part of budget balancing measures. Kentucky is not alone in drawing down its Budget Reserve Trust Fund. Thirty-six states are experiencing budget shortfalls in the current fiscal year, and in the last and current fiscal year, as many as 14 states tapped their budget reserve funds.

Without using the $158.8 million from the Fund, programs such as education would not have been able to be exempted from budget cuts. The intent of budget reserve funds is to sustain and salvage good programs that are already in place when bad times occur. These funds are meant to be long term strategic sources of reserve funds – funds that are only used in the event of major economic downturns. Budget reserve funds do not take the place of budgetary discipline; rather they provide the time necessary to make reasoned choices.

Formally established in 1987, Kentucky's Budget Reserve Trust Fund increased by more than $250 million after its inception. At its peak in fiscal year 2001, the Budget Reserve Trust Fund carried a balance of $278.6 million. Budget balancing measures in fiscal years 2001 and 2002 have taken a total of $158.8 million from the Fund, leaving a balance of $120 million or 1.79% of the General Fund. Attention must now be focused on rebuilding the Fund.



Source: Fiscal Year 1990-2000, Actual; Kentucky Financial Report; Fiscal Year 2001, Office of State Budget Director; Fiscal Year 2002, December 17, 2001 Consensus Forecast Group.

Note: Revenues for fiscal year 2000-2002 do not include tobacco receipts from the Master Settlement Agreement (MSA).

A budget reserve fund helps reduce the interest a state pays on its bond issues. The bond rating companies are especially interested in how states manage their financial affairs, including how they handle future contingencies related to economic growth and recession or slowdowns in the economy. The bond rating companies look to see if there are revenue balances or reserves, which could be called upon in the event of revenue shortfalls.

Kentucky's achievement of receiving an "AA" rating (June 1999) from all rating agencies is an important development. With this rating, bonds issued by the Commonwealth enjoy a greater market demand and lower cost of borrowing.

In addition to a credit rating, the rating agencies provide an "outlook" for each state or issuer of debt. An outlook is an indicator of the potential change in the economic or business conditions in the economy of a state over the intermediate to longer term. A change in a rating agency's outlook is not necessarily a precursor of a rating change.

In October of 2001, Standard & Poor's revised the outlook for the Commonwealth from "stable" to "negative." At the same time, Standard & Poor's affirmed its "AA-" credit rating of the Commonwealth. The outlook revision reflects the reduction in the Budget Reserve Trust Fund and the potential economic difficulty the state may face in the future. While the change in the outlook does not automatically mean a change in our credit rating, failure to replenish the Budget Reserve Trust Fund and establish structural balance could lead to a downgrade in the credit rating of the Commonwealth.

Kentucky's Current Bond Ratings

Standard & Poor's	AA-
Moody's Investors Service	Aa3
Fitch, Inc.	AA-

To preserve the Commonwealth's favorable credit rating and as a matter of policy, any transfers made from the Budget Reserve Trust Fund to facilitate cash flow should be repaid as soon as possible. The use of rainy day funds by states in times of economic downturns is not viewed negatively by the bond rating agencies if the funds are replaced.

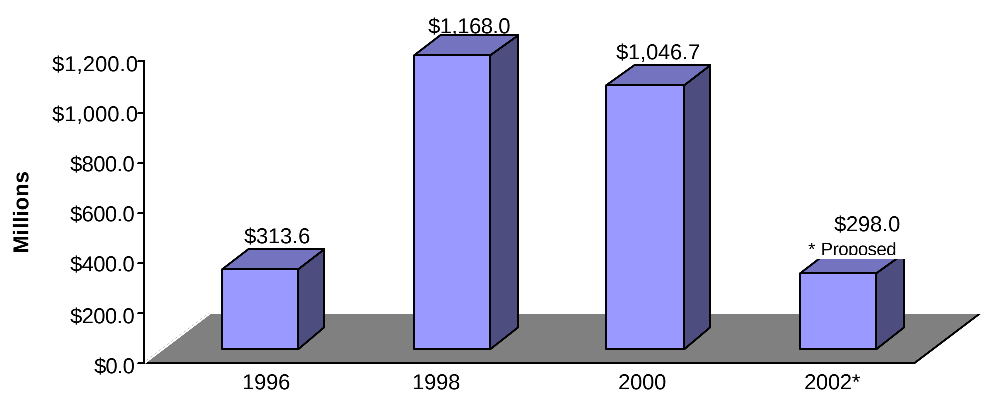
The Executive Budget is built on the foundation that no further withdrawals from the Budget Reserve Trust Fund are made in fiscal year 2002. It also provides that all surplus funds identified pursuant to the Surplus Expenditure Plan for fiscal years 2002 and 2003 shall be transferred to the Budget Reserve Trust Fund to begin replenishing the Fund. The Capital Projects and Bond Oversight Committee of the Legislative Research Commission has stated that "The top capital funding priority for the 2002 Regular Session should be to replenish the Budget Reserve Trust Fund."

INVESTING IN OUR FUTURE

The Patton Administration has advocated as one of its fundamental financial management principles that the Commonwealth should, on average, invest approximately 6% of its available revenues in its capital program to provide for the long term capital needs of the state. Governor Patton has recommended, and the General Assembly has enacted, three consecutive budgets based upon this principle.

The revenue outlook in the first biennium, fiscal years 1996 through 1998, did not allow for a significant capital investment program. However, both the 1998 and 2000 budgets provided for large investments in community development, educational facilities, technology, criminal justice facilities, water and infrastructure investments, environmental protection, and basic maintenance and renovation needs of state government.

Bonds Authorized During the Patton Administration



Consistent with the principle of investing approximately 6% of revenues in the future of the Commonwealth, the <u>Executive Budget</u> provides a recommended $298 million in debt financed programs as shown below. This recommendation will result in the lowest amount of bonds authorized in a biennium in over 20 years.

	($ Millions)
Postsecondary Education	
Research Challenge Trust Fund - "Bucks for Brains"	$100.0
Regional University Excellence Trust Fund - "Bucks for Brains"	$20.0
Agency Bond Pool	$66.8
Elementary and Secondary Education	
School Facilities Construction Commission	$100.0
Kentucky Infrastructure Authority	
Wastewater Revolving Fund (Fund A)	$6.2
Drinking Water Revolving Fund (Fund F)	$5.0
Total Recommended Bond Authorization	$298.0

PROTECTING OUR ENVIRONMENT

"In this age when many of the people we want to attract can work where they want to live rather than have to live where they want to work, quality of life, a clean environment, is even more important."

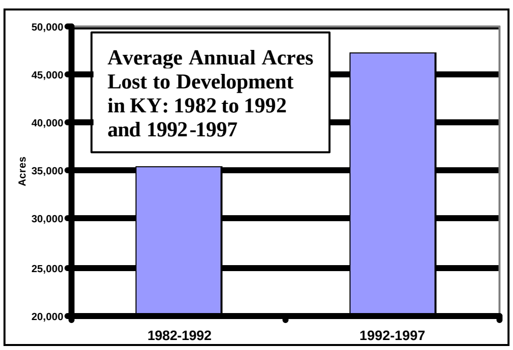
Governor Paul Patton
January 25, 2001
Clean Up Kentucky Speech

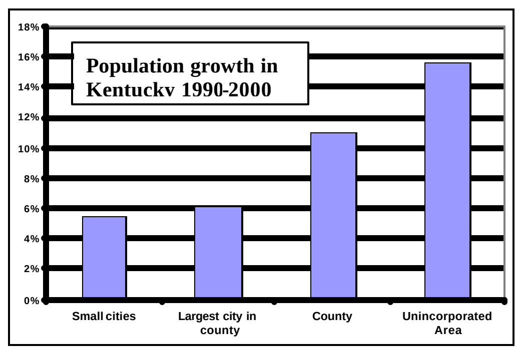
SMART GROWTH

Between 1982 and 1997, Kentucky's growth in developed acres outpaced the national average by 27 percent, making it the second highest rate of growth in the nation. This development has accelerated in recent years, leading more Kentuckians to question whether it is occurring in a way that is protecting or preserving the state that we love.

Growth has led to poorly planned incursions into rural areas that prompt the construction of new buildings when historic structures are standing vacant in our declining downtowns. A pattern of growth described as sprawl is becoming more common, requiring longer driving distances for work or personal reasons and raising costs of providing public services.

Smart growth is a means of ensuring we grow in ways that preserve our unique heritage and quality of life. Managing how we grow can ensure we maintain our ability to compete successfully for quality jobs in a new economy.





In May 2001, Governor Patton established the Governor's Smart Growth Task Force, which outlined over sixty options that address issues related to growth and land use. Several themes were clear:

- Private property rights must be protected
- Local decision-making must be preserved
- State's role should be to:
  - ◊ lead by example;
  - ◊ use incentives rather than mandates;
  - ◊ provide technical assistance to localities; and
  - ◊ provide funding for preservation of land, educational programs, planning initiatives, etc.

Governor Patton proposes establishing a framework for quality growth in this legislative session. Given current fiscal restraints, much can be done to build the foundation for a long term commitment.

Smart Growth Legislation

Establishes a State Planning Office To:

- Coordinate and staff services for, and advise the State Planning Committee
- Provide a one-stop resource site for local communities
- Provide technical assistance to local communities
- Promote training and continuing education
- Develop a public education campaign on Smart Growth principles

Re-Establishes the State Planning Committee To:

- Review siting of state projects in excess of $2 million or which affect 50 acres or more of prime farmland
- Provide support and recommendations to the Governor's Executive Cabinet
- Review state policies and programs that relate to or affect land use
- Review infrastructure and capital development plans for long-term impact

Creates Tax Credits to Promote:

- Rehabilitation of historic properties
- New construction in historic districts
- Redevelopment of distressed areas

Requires State Capital Projects to Comply with Local Comprehensive Plans, Unless the State Planning Committee Determines There is an Overriding State Interest in the Selected Location.

"The new economy enables people to live where they want to work and companies are driven to locate where there is a high concentration of skilled workers. Those workers want to live in areas that are attractive, clean and free of congestion. Smart growth is the key to allowing us to remain competitive now and prosperous in the future."

Governor Paul Patton

"The technology revolution is allowing workers to do their jobs from nearly anywhere in the United States. And the quality of life in cities, towns and states is the main factor when people determine where to live. Kentucky has what a lot of people have already lost."

Joel Kotkin
Author of *The New Geography*
2001 Shakertown Roundtable

SOLID WASTE

An Issue We Cannot Afford to Ignore

Despite actions taken at the beginning of the last decade, solid waste disposal continues to be a problem in Kentucky. Thousands of illegal dumps in the state negatively impact public health and safety, tourism, economic development, and our quality of life.

Currently, only 29 of the 120 counties have a mandatory waste collection ordinance in place. The state needs to channel the waste stream into proper disposal methods that will ensure that Kentucky is not faced with clean-up of the same areas on a recurring basis. The state must provide incentives to counties to develop practices that curtail illegal dumping and require compliance with existing laws. Additionally, it is vitally important to the health of our citizens and the environment that we recognize the need to mitigate the negative effects of those pre-law landfills that continue to contaminate groundwater and soil.

Recommendations:

- Eliminate open dumps and roadside litter
- Create or improve solid waste management infrastructure
- Enhance the recycling infrastructure in some areas of the state
- Expand solid waste education through the program entitled “Land, Legacy and Learning” developed by the Environmental Educational Council
- Permanently close pre-law landfills

“We see everyday the litter that despoils our scenic highways and we know we need to encourage curbside pick-up and recycling . . . and we the people of Kentucky will have to bear that cost.”

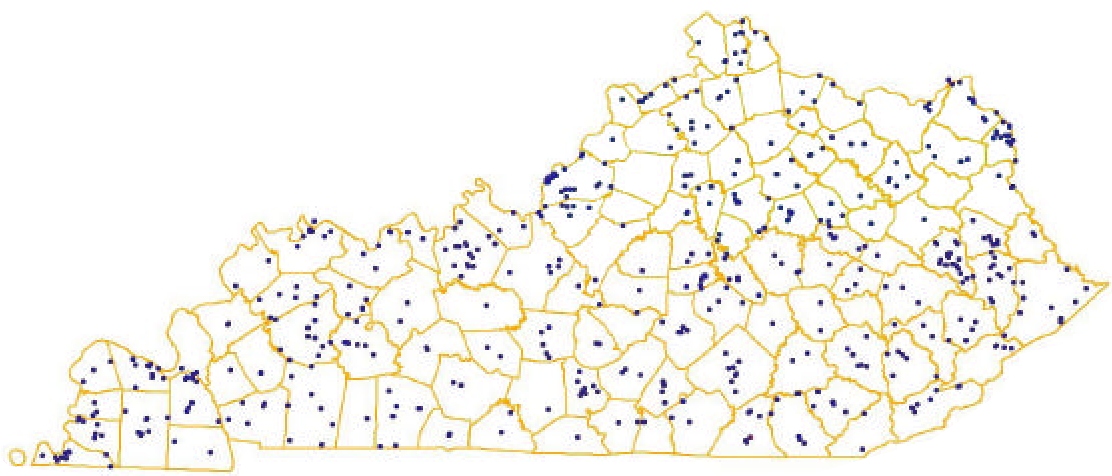
Governor Paul Patton
State of the Commonwealth
January 10, 2002

The Ugly Truth

- Kentucky has an estimated 10,500 illegal, unsightly, and unhealthy open dumps.
- There are at least 550 pre-law landfills which were never properly closed.
- Kentucky recycles 50% less glass, steel, and plastic than the rest of the nation.
- Kentucky imports 500,000 tons of garbage every year.

"Kentucky spent $18.5 million from 1996 to 1999 to cleanup illegal dumps, and could have spent 10 times that much and not gotten them all . . . The state and counties spent $8 million last year to remove roadside litter."

James Bickford, Secretary
Natural Resources and
Environmental Protection Cabinet
Lexington Herald-Leader
January 5, 2001



Pre-Law Landfills in Kentucky in 2002

ENERGY POLICY

Kentucky sits at a critical crossroad for natural gas pipelines and electricity transmission networks that make it attractive to companies seeking to build new power plants to export electricity to the Southeast and Midwest. Over an 18-month period, 24 new merchant power plants filed for permits or were in the permitting process to begin generating electricity in Kentucky for export to the wholesale market outside of the Commonwealth.

On May 16, 2001, the Kentucky Energy Policy Advisory Board was established by Executive Order to develop a coordinated statewide energy policy, devise a strategy for minimizing Kentucky's low cost advantages in supplying affordable and reliable power, and improve the utilization of Kentucky coal as an electricity generating source both nationally and internationally. On June 19, 2001, Governor Paul Patton declared a 180-day moratorium on permits for new power plants to fully address the impacts on the economy, environment, and existing transmission grid of the proposed new electric generating units.

The Public Service Commission reviewed the need for new generation in the state and the impact upon the existing transmission grid associated with 24 new power plants. The study found that Kentucky has adequate electric generation capacity for the foreseeable future and that the majority of the new load from the merchant power plants could be accommodated by the existing infrastructure.

The study completed by the Natural Resources and Environmental Protection Cabinet addressed the environmental impact of the proposed new power plants. Its findings showed that the new merchant power plants would not create serious negative environmental impacts. However, the study did show that the air shed in three counties may become worse and may be out of compliance with ambient air quality standards as a result of operation.

On January 11, 2002, citing the need for legislation to address location criteria for power plants and transmission lines, Governor Paul Patton announced an extension of the moratorium on the issuance of power plant permits in the Commonwealth. The moratorium extension will continue through July 16, 2002.

Proposed legislative changes will address power plants wishing to locate in the Commonwealth, as well as require regulatory approval for interconnections to the state's electricity grid and the transfer of utility assets. The Governor's energy proposal also calls for priority treatment of electricity service to utility ratepayers in the state.

Energy Legislative Proposal

- Establishment of a seven-member "siting" board, which would include the three commissioners of the Public Service Commission, the Secretary of the Natural Resources and Environmental Protection Cabinet, and the Secretary of the Economic Development Cabinet. The board would also include two seats that would be reserved for local representatives and would change based on the location of the proposed facility. The board would approve the siting of all power plants locating in Kentucky.
- Require priority treatment of electricity generated and transmitted for in-state use. A utility will have to curtail or terminate service to out-of-state customers before curtailing or terminating service to Kentucky ratepayers.
- Merchant power plants will be required to get Public Service Commission approval before they may connect to the transmission grid. In addition, utilities will need the approval of the Public Service Commission before selling or transferring major assets used to provide service in Kentucky.

"The steps we are announcing today will help ensure that as our economy grows we are preserving what is best about our environment and our quality of life."

Governor Paul Patton
Press Conference
January 11, 2002

"Governor Patton's proposed energy package will create a level playing field and will be beneficial to the state and to the future of Kentucky's energy industry."

Annette DuPont-Ewing
Executive Director
Ky. Energy Policy Advisory Board
January 11, 2002

PINE MOUNTAIN TRAIL STATE PARK

Pine Mountain came into existence more than 275 million years ago. Situated in the southeastern corner of the Commonwealth, it sits atop the Pine Mountain Thrust Fault and provides views that rival any in America. More importantly, Pine Mountain is home to an outstanding diversity of native plant life in Kentucky including rare plants inhabiting upland bogs that are unique to the mountain. Pine Mountain is one of the few largely intact landscape scale ecosystems in Kentucky and can serve as the basis for an eco-tourism industry that would enrich all of Kentucky. Governor Patton proposes to preserve this most unique ecological area of the Commonwealth by creating the 120-mile Pine Mountain Trail State Park. In September 2001, Governor Patton suspended the issuance of new permits for non-coal mining operations and ordered a review of permit applications for oil and natural gas wells in the vicinity of the Pine Mountain area. The appropriate agencies were also requested to assess the negative impact such operations could have on the eco-tourism industry and the environment, especially in the Pine Mountain area. The creation of the Pine Mountain Trail State Park would permanently ensure that these activities would not occur within its boundaries.

The Pine Mountain Trail will follow the crest of Pine Mountain from Breaks Interstate Park to Pine Mountain State Park – the oldest state park in Kentucky – and then turn south to Cumberland Gap National Park. The distance is approximately 120 miles with a 500 foot corridor on either side. The trail will be administered by the Department of Parks. Tennessee has established a similar linear trail state park, the 280 mile Cumberland Trail State Park. Each was designated as a Millennium Legacy Trail by the White House in 1999. Together the two trails, which will meet at Cumberland Gap National Park, will traverse nearly 400 miles. Congressman Hal Rogers has recently secured federal transportation (TEA-21) funding of $1,000,000 earmarked for the Pine Mountain Trail.

Land and easement acquisition will begin with the establishment of the Pine Mountain Trail Fund. The Fund will consist of revenues from both private and public sources such as gifts, contributions, concession and contract revenue, and grants, both public and private. Existing resources such as the Land and Water Conservation Funds and the Kentucky Heritage Land Conservation Fund will also be used to help fund this project as well as future appropriations.

"The time has now come to address the entire Pine Mountain Range, Kentucky's most unique geological feature."

Governor Paul Patton
State of the Commonwealth
January 10, 2002

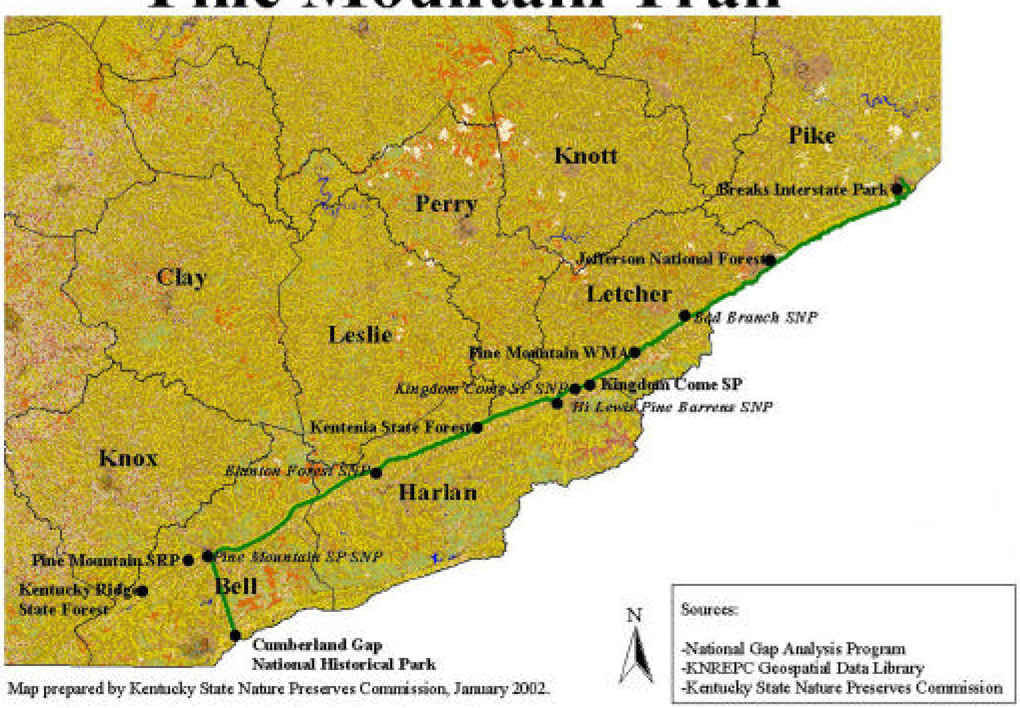
Preserving the Priceless

- Pine Mountain is home to an outstanding diversity of native plant life in Kentucky.
- Approximately 38 miles of the Pine Mountain Trail have been constructed by citizen volunteers.
- The trail would serve as a basis for an eco-tourism industry that would benefit all of Kentucky.
- The Pine Mountain Trail is supported by public and private organizations and groups.
- Hikers and nature lovers from across the country flock to Pine Mountain to experience its beauty and rich diversity.

"We've gotten ringing endorsements from everyone who has heard of it – political groups, county officials, state representatives and senators, and they all think it's a worthy project."

Ross Keegan, Vice President
Black Mountain Resources

Pine Mountain Trail




COMMONWEALTH OF KENTUCKY
UNITED WE STAND
DIVIDED

“We face the most severe revenue shortfall since 1980 and we won’t be able to start new services that our people need, but we have managed our way through this and presented you with a budget that cuts administrative costs, maintains faith with our employees and teachers, ensures continued progress in education, and protects our most vulnerable citizens.”

Governor Paul Patton