

Budget Address
Governor Paul E. Patton
January 22, 2002

President Williams, Speaker Richards, and members of the General Assembly, members of the Judiciary, Governor Henry and other members of the Executive, my fellow Kentuckians.

For the fourth and final time I appear before you to discuss the financial status of the Commonwealth and to outline our budget proposal for the next biennium. I ask you to use this proposal as the starting point from which you can begin to develop Kentucky's budget for the 2003 and 2004 fiscal years.

This proposal will be dramatically different from the three previous recommendations I've made to you. For the first time since at least 1981, the state will be required to enact a budget with less General Fund revenue in the next fiscal year than we're spending in the current fiscal year because our economy is the worst it's been in at least 20 years; the growth of personal income is down 57 percent from expectations, corporate income tax collection is down 20 percent from the estimate of two years ago and the unemployment rate is up 40 percent since last December!

This national recession is affecting more than just state revenue; it's impacting the lives of thousands of Kentuckians even more dramatically. We've lost over 20,000 good-paying manufacturing jobs in just the past two years!! Bob Jackson and Buddy Buckingham, you know the personal and community trauma caused by the 980 jobs that are being lost in Murray as Mattel closes. Richie Sanders and Rob Wilkey, you know the impact of Sumitomo's workforce reduction of 926 jobs in your part of the state; and Robert Stivers and Barbara Colter, the loss of the 110 jobs in Clay County caused by the closing of Columbia Forest Products is a major blow to your community.

The effect of this economic slowdown on our budget is a current-year revenue of \$533 million, or 7.4 percent below our originally budgeted level of expenditure. How did we cope with this shortfall? We cut administrative expenses, we used some of our reserves, and we improved efficiency; we didn't slash and burn.

Most of our cuts to the original appropriations for this current fiscal year have been absorbed within our cabinets. I've been extremely cautious about trying to push the problems off to other agencies like our public schools, colleges or contract social service agencies. In fact, we haven't cut elementary and secondary education at all. The two percent cut to our colleges and universities hurt me deeply but I believe these institutions can tighten up their administrative costs just like we have and not affect student services. The two percent cut in Medicaid hasn't yet resulted in a direct cut in essential services to needy people but I fear that such cuts will be inevitable sometime in the next two years. All the rest of our part of state government has been cut on average 5%. The bottom line is that with these cuts and using some of our reserves, we've absorbed this revenue shortfall without substantially affecting direct services.

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Other states are experiencing similar revenue shortfalls. How are they coping? Ohio laid off 200 mental health workers. Michigan laid off 500 prison employees. We laid off no employees. Tennessee shut down state parks. Ours are still open. South Carolina cut elementary and secondary education 5 percent. We haven't cut our local school boards.

And Indiana, Iowa, Kansas, North Carolina, West Virginia and Tennessee have or are considering raising taxes!

Our highest priority has been to keep our current commitments. Just as I value my word as an individual, I expect government to provide its citizens the services its leaders have agreed to provide. It's the legacy of my parents and their constant admonishment, "Paul Edward, always do what you say you'll do. Keep your promises." To the people of Kentucky who depend on Kentucky State Government, which is all of our four million people, I say to you, this is a document of promises kept! I ask this legislature to work with me to make these promises a reality, even if a few have to be delayed to the next biennium.

Our economy measures have had minimal affect on services for the current year but we've had to be creative to achieve this goal. We've cut \$255 million in expenses but we're also using \$278 million of our reserves. In addition to \$159 million from our Budget Reserve Trust Fund, we've taken \$119 million from other programs which won't need those funds to carry on their work at present levels. We can't do that forever so all of the revenue growth next year, in fact for the next two years, will go to pay for services that are currently being provided with non-recurring funds, creating a condition I've preached against for six years, a structurally imbalanced budget. This is bad fiscal policy if used to increase services beyond a level which can be sustained. It's a sound, humane policy, if used temporarily to keep from cutting services that our people have come to depend on.

I want to emphasize that this proposal anticipates that the nation will come out of this recession and we'll have General Fund revenue growth of 3.3 percent in 03 and 4.1 percent in 04 but this revenue increase will be needed to replace the one-time money we're taking from our reserves to keep from cutting services. There will be no money for new services in the next biennium.

After having served as your governor for over six years, I think I know the needs of the people of Kentucky as well as anyone who's ever held this office. I know as clearly as I've ever known anything in my life that we need to provide more services for our needy people. I know that we need to provide more infrastructure like roads and water and sewer and community facilities all over Kentucky if we're going to be the world-class society that we want to be. I know that we need to provide more education for our children if they're going to be able to succeed in a world where other children are getting more education.

But our challenge during these next two years is going to be to keep the commitments we've already made and to not lose ground in the key areas of education and economic development that are critical to Kentucky's long-term future. I want you to realize the magnitude of the problem! In the second year of the next biennium, General Fund revenue is estimated to be less than the expenditures which we originally budgeted for the current fiscal year.

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How can we even hold our own, under these circumstances? By managing wisely, by being more efficient and by spending down our reserves. That's what I propose.

These past eight months have been very difficult as we've had to reduce, using the criteria you provided, the appropriations in the budget you adopted two years ago.

The exact opposite was true in my first two budgets. Revenue exceeded estimates. We had money left over at the end of the year and you and I both were able to go about the state announcing major state investments in the infrastructure of the Commonwealth. That is not the case this year.

Perhaps the most important thing we didn't do during times of plenty was commit all of these excess revenues to ongoing programs. Some other states are finding their fiscal situation much worse than ours. Indiana is proposing to cut the state's contribution to Medicaid by 10%; Idaho is cutting its appropriation to state police by 15%; and Michigan is considering rescinding previous tax cuts.

One reason we've been able to cope better than some of our neighbors is that when the economy was strong, we built our Budget Reserve Trust Fund, what some people call our rainy day fund, to an unprecedented high, 279 million dollars, 3.7 percent of our General Fund revenue. And we had reserves in other funds of nearly 220 million dollars. It's a good thing we did because these reserves have allowed us, with few exceptions, to keep the commitments we jointly made over the past six years. Using these reserves until state revenue catches up with the level of expenditures needed to fund programs we've already established will allow us to keep our promises.

Let me emphasize that we aren't proposing a deficit because our reserves and some one-time revenue will allow us to meet our obligations. Some of the major fund sources we propose to use include \$92 million from the Petroleum Storage Tank Removal Fund. This will still leave the fund with enough revenue to continue their expenditure at the average level of the past few years.

We'll also use 49 million dollars from the Kentucky Access Health Insurance Fund, again leaving the fund more money than it expects to need during the biennium. We won't transfer the \$38 million of coal severance tax to the Special Fund but we do prohibit any increase in the assessment on workers' compensation insurance premiums during the biennium. We credit \$30 million worth of the Blue Cross-Anthem stock received by the Kentucky Employees Retirement System against the state's obligation to the System in fiscal 03. This will in no way affect employee benefits or endanger the fiscal integrity of the Pension Fund. We declare a tax amnesty which will net \$30 million over the biennium. We propose to sell the NOx credits set aside for merchant power plants for about \$13 million. And we've used about \$45 million from other sources.

We've worked harder this time than we have on any of our three previous budget proposals. I've never presented to you a starting point for a budget that's been examined in such detail by our cabinets, the Governor's Office for Policy and Management and by me and the staff in the Governor's Office.

This proposal has no new programs. It also doesn't have any substantial cuts of essential services. It spends down our reserves. It doesn't have a deficit. That's the best balance I can achieve under these

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adverse fiscal conditions.

This has been the most difficult fiscal challenge I've faced as governor; but as difficult as it's been, our administration was better prepared to meet it than any you've ever worked with before.

Because of succession, this budget proposal has been prepared by the most experienced and capable group of public administrators ever to serve the people of Kentucky. Five of our fourteen cabinet secretaries have been on the job six years and have prepared their fourth budget, an unprecedented record. The rest of our cabinet secretaries are experienced, capable individuals with an average of over 11 years in state government. And my core leadership team - Skipper Martin, Crit Luallen and Jim Ramsey - has been here since day one.

It's because of this dedicated, experienced team that I can propose to you tonight a budget which, in almost every respect, keeps the commitments we've already made, with less revenue than we're spending in the current fiscal year. And I remind you that we've already cut the expenditure of all state government except education and Medicaid to five percent below the level you authorized two years ago.

As we began to prepare this proposal, we had five goals in mind. We were hopeful we wouldn't have to substantially cut services. We were determined to protect the purchasing power of our teachers and state employees. We were committed to keeping Kentucky safe by keeping criminals off the streets. We were keenly aware of our promises to our most vulnerable people, our mentally ill and mentally retarded. And for the sake of the future of Kentucky, we knew we had to keep our support for education at an acceptable level.

In general we asked our cabinets to prepare a budget for the next two years with the same amount of money they have in this fiscal year, after the 5 percent cut; essentially a flat-funded budget, with some exceptions. We know that some costs are going to increase which means other costs will have to be cut. But to minimize the impact on services, we instructed our cabinets to look at every single dollar being spent on administrative costs before touching a dollar going to critical programs or services. Each cabinet identified specific cost savings that would result from these management initiatives. We began in July by limiting overtime and this change alone is saving nearly a million dollars every two weeks.

Let me summarize for you just some of the other administrative cuts that we've made this year and the next two years to reduce the impact on direct service delivery.

We've cut the use of cell phones, pagers and other communication services - \$2 million; we've cut travel - \$2.5 million; we've cut printing - \$5.5 million; we've cut the use of state cars - \$3.5 million; we've eliminated or reduced almost \$12 million worth of contract services; we've cancelled \$5.5 million in purchases of furniture; we've eliminated \$1.3 million in rent and utilities and there are other similar cuts totaling over 90 million dollars over a three-year period. And while we propose no layoffs, we do reduce the number of authorized personnel in the executive branch by 4,500.

Even though our actions will require existing employees to work more efficiently, we haven't called on them to bear the brunt of the revenue shortfall because building and retaining a qualified professional

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workforce is essential to maintaining quality service. This is true of any organization and it's especially true of our government and schools. Job security and wage stability are two of the essential characteristics of employment which build loyalty and continuity in a workforce. That's the reason we worked so hard to meet this crisis with no layoffs and to assure a cost-of-living wage adjustment for all employees of state government and local schools boards.

If you'll remember, the cutbacks of the early 80's resulted in thousands of layoffs which created a sense of insecurity in the state workforce that reverberates even today. One of my highest priorities for public employees since I've been a public manager has been to not endanger the job security or cut the purchasing power of the people I work with because to do so is to bring on personal stress and will lower their standard of living. Nothing can be more destructive of morale and commitment than to think your employer is insensitive to your peace of mind or your increased costs at home.

And while some private employers are reducing their commitment to employee health insurance, we continue to fund the entire cost of a high-quality health care plan for our 44 thousand state employees and for all of the 130 thousand of our retirees and the employees of our local school boards and other government agencies.

Some agencies have absorbed the increased labor costs and the eleven percent annual increase in the cost of health insurance within their flat-funded base budget. Others have had to have more money to cover some or all of these costs. After all, once you've already absorbed a 5 percent budget cut, your options to absorb increased costs without cutting services is somewhat limited.

The employees of our school boards are equally important to the welfare of our people and are equally deserving of protection from cuts in their purchasing power and our budget does that!!!

Service to its people is the essence of government and our employees are essential to our efforts to provide services to our people. One of these important services is our criminal justice system. As I've often said, protecting the lives and the property of its citizens is the first responsibility of government, and the improvements we've made in our criminal justice system over the past 6 years are making Kentucky safer every day. But these improvements also result in more people in our prisons and this is a cost increase we can't avoid. We can't tell judges to impose stiffer sentences and then refuse to provide prison space. One of the largest increases over this year's adjusted budget, 7.3 percent for the biennium, goes to Corrections; for more parole officers and more prison beds.

While we're legally required to house convicted felons, we're morally obligated to care for our mentally retarded and mentally ill. One of the most important pieces of social legislation passed while I've been governor is House Bill 144. In that law we agreed to reduce the backlog of underserved mentally retarded and developmentally disabled people eligible for community-based services. We're providing 500 placements for these vulnerable Kentuckians in the current biennium and our proposal provides for another 500 in the next biennium!!!

To better serve our mentally ill neighbors and those suffering from substance abuse, we fund the recommendation of the commission established by House bill 843 which requested that we complete our

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system of crisis stabilization centers by adding ten to the already existing eighteen centers around the state. Our proposal does that!!!

We also address issues raised in the Olmstead Supreme Court decision by providing new dollars to the Department of Aging for important home care services and new dollars to the Workforce Development Cabinet for supported employment and more money for wrap-around services for the mentally ill in their community. Overall these programs for our most vulnerable people receive an increase of 7.1 percent over the biennium. We are keeping our promises.

As vital as our social service and criminal justice programs are, our largest and most important job in state government is education and we've kept our commitments there.

While our proposal pays for the increased cost of health insurance for school board employees in both years and for the cost-of-living wage adjustment in the second year of the biennium, it does require local school boards to provide a cost-of-living wage adjustment to all their employees in the first year of the biennium with current funding and to pay the cost of health insurance for federally funded employees out of their new federal dollars. Our local school boards will have almost twice as much new federal money as this health insurance will cost. The excess new federal money will help these districts absorb some of the employee wage adjustment so that the overall impact on school services will be minimal. Let me assure you that no other program impacted by this budget will be that fortunate.

I understand that states like California, Oregon, Florida and Georgia are considering cutting their support for elementary and secondary education. We've certainly treated our schools better than these states.

Not only have we provided for our teachers and other school employees, we've maintained our commitment to pre-school, school technology and school rewards and our commitment to build 100 million dollars worth of new school buildings in the next biennium. We've kept our promises to our school children!!!

We've certainly not been able to treat our colleges and universities quite as well. In the most important initiative of my administration, we've challenged our institutions of higher learning to create the intellectual capital we need to build a new economy where we can have the increased standard of living and quality of life that we all want.

My proposal doesn't do all we need to do to enable them to make the progress they need to make over the next two years, but we do fund the two most important parts of the Council on Postsecondary Education's recommendations.

We fully fund the Council's recommendation for the enrollment and retention fund. After all, we've charged all of these institutions, but especially our community and technical colleges and our comprehensive universities, to increase enrollment and to keep the students they enroll in school. We can't expect them to continue to pursue our goal of college completion rates equal to the national average if we can't keep our promise to reward them if they do the job.

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And similarly with our two research universities, and our comprehensive universities' programs of excellence. That's why we propose to continue the Bucks for Brains program at the level of 100 million dollars for the University of Kentucky and the University of Louisville and \$20 million for our six comprehensive universities, only this time we revert to our original 1998 proposal of Bonds for Brains. We also authorize \$67 million of bonds for agency-supported capital construction at our universities.

Of course, the most important element of our postsecondary education program is our students. And we fully fund our commitment to their scholarships. We've increased the appropriation to our needs-based and merit-based scholarship programs by 52 percent. This demonstrates how important these programs are and how well they're working! Overall enrollment in postsecondary education is up 14 percent! The really amazing statistic is that enrollment in our community and technical colleges is up 38 percent! We're ahead of schedule on our quest to achieve a college-going rate equal to the national average by 2020!!!

This budget also maintains our commitment to move forward on the next critical step of building on higher education reform and that's ensuring that Kentucky is competitive in the New Economy. By providing continued funding to begin implementation of our New Economy strategic plan, we'll be growing the quality jobs we need to keep our quality graduates here in Kentucky.

We keep our promise to the coal regions, made in 1992, to return 50 percent of the coal severance tax to help grow their economy and bring their infrastructure up to par.

And we keep our commitment to spend 50 percent of the tobacco settlement proceeds on maintaining our rural way of life and 25 percent on our youngest citizens to give them a better start in life.

Our agricultural economic revitalization program is by far the most progressive in the nation and will enable us to maintain our unique family farms and our high quality rural lifestyle.

Early childhood development is another area where Kentucky leads the nation. Only California, according to nationally known child advocate Rob Reiner, does more. This is really a matter of pay now or pay later. Children with high-quality childhood programs go on to earn 60 percent more when they reach adulthood. Low-income children who receive high quality, early child care are more likely to remain in school, attend college and get good jobs. For every one dollar invested in early childhood development, seven dollars is saved in the cost of remedial education, welfare and incarceration. No program we're operating now will have a higher rate of return to our society in 20 years!!!

And as far as the other 25 percent of the tobacco settlement money goes, we continue to fully fund the lung cancer research program and the smoking cessation and substance abuse programs and adequately fund the Kentucky Access Health insurance program for high risk individuals.

Yes, in many ways, and in spite of the most dire financial problems we've experienced in a generation, this is a budget of promises kept. But not all promises can be kept in this biennium. The three capital construction projects not funded that trouble me the most are the Lexington Convention Center and the Muhammad Ali Center in Louisville and the suspension of work on the multi-year, multi-administration renovation of the state Capitol complex.

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To the supporters of these projects, we made our promise to you believing that we would continue to have a community development program large enough to fund these and other needed projects throughout the Commonwealth. We were too optimistic. Considering our financial circumstances, I cannot, in good conscience, recommend construction projects while so many human needs go unmet. The General Assembly has endorsed these projects by partially funding them, knowing that more money was needed. I trust they'll be fully funded in 2004.

And there are other important areas that this budget doesn't address. It certainly doesn't do all we need to do to reach our education goals for the year 2020. It contains no state funds for construction at our colleges and universities; no new classrooms, no new research laboratories, no new student service facilities. While our proposal funds the cost of utilities and janitorial services for the new construction in progress as a result of our past capital construction programs, it doesn't adequately fund the cost of the additional faculty that'll be needed. And it makes no progress towards achieving benchmark funding.

For our elementary and secondary schools our proposal provides no money for real wage increases for our teachers and no money to extend the school year to the national average or to provide more pay to teachers in hard to fill disciplines or difficult schools.

For state employees, we still can't put those 18,000 people who are in a grade lower than they should be into the correct grade and we can't give a fair raise to the long-time employees who may have had their job grade raised but received no raise because they're still above the entry-level wage.

But most of all, I'm very concerned about our Medicaid program. During the past six years we've increased funding for Medicaid by forty-six percent, more than any other major program except juvenile justice. This proposal will recommend no increase in state funds for Medicaid over the biennium but we do anticipate actual spending increases of nearly 190 million dollars through efficient management of resources. The problem is that we're still about 200 million dollars short of the money required to pay for the anticipated needs in the second year of the biennium. Absent a source of this money, our only recourse will be to reduce the optional services available in our Medicaid program and eliminate coverage for some optional demographic groups. There's no doubt about it, Medicaid is the most seriously underfunded program in our proposal. The funds we recommend won't cover the inevitable and unavoidable increase in the cost of healthcare and the constantly increasing demand for services created by an aging population and the new pressures occasioned by a deteriorating economy.

This pains me more than any other part of this proposal but I can find no other option. I know many of you will be equally anguished but you'll also find it difficult to propose a less painful alternative.

Another deficiency in this proposal that'll affect you and your communities in a more visible way is the lack of funding to continue to improve our community infrastructure. There are no community development projects; no arena for Northern Kentucky, no money for the Center for Women and Families in Louisville, or no money for the Clay Community Center in Mount Sterling, or for any of the hundreds of other recreational, service or life-safety facilities that our communities need and you legislators want to provide for your constituents.

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Even though we propose 11.2 million dollars to match available federal funds for water and sewer programs, we don't have other General Fund appropriations to continue our 2020 program to provide safe adequate water to our rural areas by the year 2020.

Nothing for the Fairgrounds, nothing to complete our golf courses under construction, and nothing for the proposed regional business park in the Purchase. The fact of the matter is that we just don't have the money!

We're presenting you with a proposal which increases General Fund expenditures in fiscal year 03 over the reduced fiscal year 02 base by only \$65 million or .9 percent. This is 146 million, or 2 percent below what you appropriated for fiscal 02 in the budget enacted in the 2000 session. This expenditure level is \$100 million more than we expect to receive in recurring revenue in fiscal 03; a structural imbalance of 1.4 percent.

As we look at the 04 proposal, it anticipates a level of expenditure above the proposed 03 budget of \$247 million, or 3.5 percent, with a structural imbalance of \$58 million, or 0.8 of one percent.

The \$298 million of new bonded indebtedness recommended for the next biennium is the lowest amount authorized in any biennium that we can find in the records available. This maintains our debt service at 6 percent of state-generated revenue, which is the guideline I've used to gauge the level of debt we should carry.

This proposal seriously depletes our reserves and so we must act as quickly as we can to rebuild them, especially our Budget Reserve Trust Fund. We don't use any of the remaining \$120 million in the Budget Reserve Trust Fund because to budget this money to fund ongoing expenses would be the worse of all fiscal policies and would in fact be a mockery of the principle of a reserve fund. I will resist all efforts to use any of this money. At the same time, we don't make a direct appropriation to the fund, directing only that all of any lapses or excess revenues be appropriated to it.

Our current experience demonstrates that we need a Budget Reserve Trust Fund of at least five percent of General Fund Revenue, about \$360 million based on our 2004 estimate of revenue. Let me urge you to make direct appropriations to the Budget Reserve Trust Fund in the next biennium and continue to appropriate all lapses and excess revenues to the fund until it's reached this 5 percent level.

Now we don't need to get to 5 percent in the next budget but we should be determined to get there in eight to ten years. Hopefully, it'll be that long before we have another recession like we're in now.

I know this proposal doesn't do everything we want or need to do but to my friends in the legislature who want to improve other services for your constituents, let me assure you that I share your concerns, but in my opinion, it's going to be difficult with current revenue. I ask for you to not raise expectations of more money for important programs without providing a source of that money. I call upon the leaders of each body of the legislature to join with me and not allow the passage of a law calling for an expenditure which is not in the budget and to resist those who try, regardless of party.

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In summary, we face the most severe revenue shortfall since 1981. But we've managed our way through it and we've presented to you a proposed budget that cuts administrative costs, maintains faith with our employees and teachers, keeps criminals off the streets, protects our most vulnerable citizens and ensures continued progress in education.

We won't be able to start new programs that our people need or fund the many projects that are important to your local communities but this proposal does, with very few exceptions, keep the promises we've already made. There's nothing in this proposal that hasn't been endorsed by previous legislative action. We have kept faith with our people. This is a document of promises kept.

I fully realize that you must make the final decision. We stand ready to provide you any information in our possession. We caution you against reducing any item in this proposal without carefully evaluating the impact. We recognize our responsibility to work with you to do the best we can for our people during these difficult times.

Again, I thank the people of Kentucky for the opportunity to work with you to serve them and generations to come.

Good night and God bless you, God bless America.