

JULY 2011



BUILDING A STRONGER BUCKET

PROGRESS AND CHALLENGES IN REPAIRING THE LEAKS IN KENTUCKY'S BUDGET



Kentucky Chamber
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CHANGING THE FOCUS IN FRANKFORT

Changing the focus in Frankfort is a challenge. But it's possible when a compelling argument is made based on documented research reinforced with recommendations for practical solutions.

That, in brief, has been the impact of the *Leaky Bucket*, the Kentucky Chamber's groundbreaking 2009 study that found spending on corrections, Medicaid and public employee health insurance to be growing at a faster rate than the overall state budget and Kentucky's economy. The alarming trend had a particularly disturbing bottom line: more money for the unsustainable leaks in the state revenue bucket meant a diminishing commitment to education – the key investment the state can make in its future.¹

Since the report's release, Kentucky's elected leaders and policymakers have made important progress in addressing the areas of unsustainable spending. Of perhaps equal significance is the fact that smarter spending has become a bigger part of the conversation about Kentucky's budget challenges. The Chamber believes this is in recognition of the fact that, no matter how much revenue the state collects, the bucket will continue to leak until the areas of unsustainable spending are addressed.

SUBSTANTIAL PROGRESS, BUT NOT ENOUGH

As detailed in this report, substantial progress has been made in reining in some of the unsustainable spending identified in the *Leaky Bucket* report. But the state faces continuing – and significant – challenges in curtailing the skyrocketing spending increases that undermine prospects for economic growth.

A compelling case for the need to address spending was made in March of this year when Moody's Investors Service downgraded its rating on Kentucky bonds to AA2 (which is below AAA or prime) and maintained a negative outlook for Kentucky.² Moody's noted Kentucky's "significant fiscal stress related to the economic downturn, a large and growing unfunded pension liability and a trend of reliance on non-recurring budget balancing measures." Moody's action followed that of Fitch Ratings, which downgraded Kentucky from stable to negative, indicating concerns about the state's financial direction.³

Kentucky's pension performance continues to be of great concern, with a study by the Pew Center on the States finding the state's system to be funded at only 58% of its liabilities compared to a national average of 78% in fiscal year 2009.

No matter how much revenue the state collects, the bucket will continue to leak until the areas of unsustainable spending are addressed.

Spending Principles



The need for spending principles to guide budget decisions is evidenced by the continuing challenges Kentucky faces in controlling spending in the three major budget leaks: corrections, Medicaid and public employee health insurance. Further undermining the state's fiscal condition are the continuing issues related to a structural deficit and the under-funded pension system.

IF KENTUCKY is ultimately to get and keep its financial house in order, it needs not only to address the leaks in state spending, but also to follow disciplined spending principles to set the state on a path to prosperity. Toward that end, the Kentucky Chamber encourages the state's policymakers to adopt the following guidelines for state spending.

- 1. LIMIT SPENDING TO 6% OF THE STATE'S ECONOMY.** The size of the state General Fund should be maintained within 6% of the gross state product (the official measurement of Kentucky's economic output). For nearly two decades the average has been between 5% and 6% of GSP, dating to the 1990 passage of the state's last broad-based tax increase to support the Kentucky Education Reform Act. (The contracting economy resulted in the General Fund exceeding 6% of GSP in 2009.) Establishing this ceiling does not mean spending should necessarily be sustained at that level if economies or other measures make it feasible for the General Fund to be less than 6% of GSP.
- 2. LIMIT BORROWING COSTS TO 6% OF TOTAL STATE REVENUE.** Spending for payments on state debt (supported by a state appropriation) should be held to 6% of total state revenue. Imposing this debt ceiling will provide credit rating agencies with a basis on which to evaluate the state's fiscal discipline and also will diminish the extent to which higher debt payments reduce education funding.
- 3. ELIMINATE THE STRUCTURAL DEFICIT** by adopting a five-year plan to spend only recurring revenues for recurring obligations. If non-recurring revenues are available, they should be spent for purposes that do not have long-term obligations.
- 4. PRIORITIZE SPENDING ON AREAS THAT INVEST IN THE FUTURE** (e.g. education and economic development), ensure a greater proportion of education funds are spent to improve student performance, and work to responsibly contain spending on programs that have had unsustainable growth (e.g. corrections and escalating pension and health care costs).
- 5. ELIMINATE THE PRACTICE OF APPROPRIATING ALL ANTICIPATED REVENUE** during every budget cycle and re-establish a "rainy day fund" to ensure money is available to meet the state's emergency needs.

STATE SPENDING TRENDS 2000 TO 2012

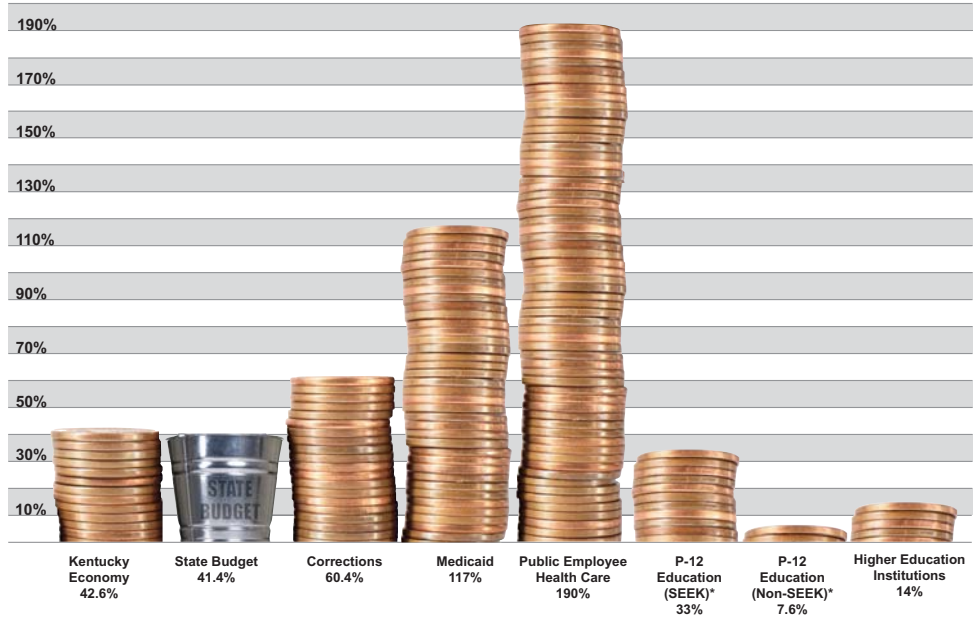
The 2010-2012 enacted budget continues the spending trends identified in the Chamber's earlier research. From fiscal year 2000 to fiscal year 2012 (budgeted):

- Kentucky's overall General Fund budget is growing at about the same rate as the state's economy.
- Corrections spending is growing about 50% faster than the overall budget (60.4% vs. 41.4%).
- Medicaid spending is growing about three times faster than the overall budget (117% vs. 41.4%).
- Public employee health insurance costs are growing 4½ times faster than the overall budget (190% vs. 41.4%).

It is important to note that the economic downturn had a significant impact on both revenue and spending in FY 2009 and FY 2010. As illustrated in the chart on the right, spending declined 3.3% in 2009 and 6.2% in 2010.

State revenue levels were down 2.7% in 2009 from 2008 and another 3.3% in 2010. This trend has improved in 2011, with state revenues anticipated to be significantly above levels estimated by the Consensus Forecasting Group. (State officials' last assessment before the publication of this report predicted collections to exceed the forecast by \$95.7 million.)

Changing priorities: 2000-2012 State Spending Growth



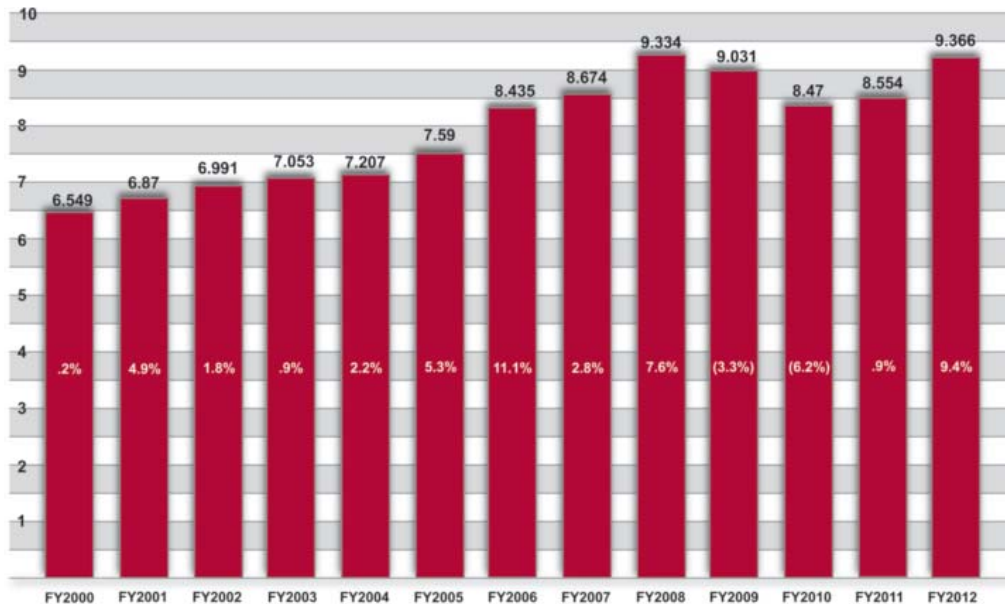
* SEEK is the primary funding source for P-12 education.
Source: Budget In Brief, Governor's Office of Policy and Budget, 2010 (Spending trends represent state General Funds)

\$276 Million More for Education

If P-12 education had held its own in the state budget since 2000 we could have invested \$276 million more in P-12 in 2012.

Kentucky General Fund Expenditures: Fiscal Years 2000 to 2012

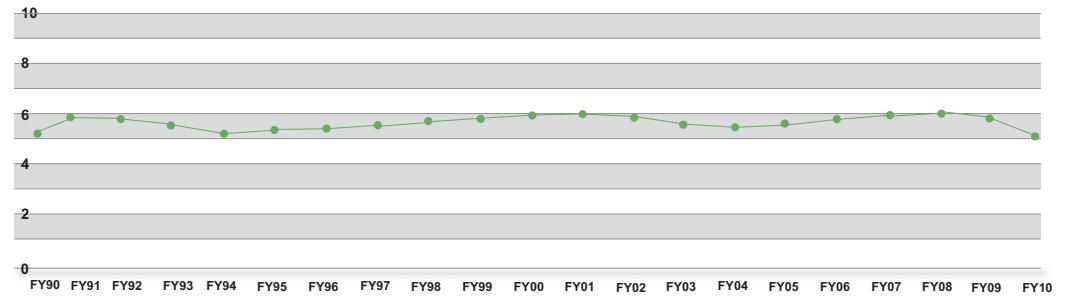
Billions of dollars, excluding federal stimulus funds



Source: "General Fund Expenditures, FY 1995-2012," GOM and 2010-2012 Budget of the Commonwealth, General Fund Summary, GOM

Meanwhile, Kentucky's economy as measured by the gross state product was \$163.2 billion in 2010, an increase of 4.8% over 2009. State spending as a percent of the gross state product has remained relatively consistent at between 5-6% since 1990 (see top chart).

Kentucky General Fund Expenditures as a Percent of Gross State Product: 1990 to 2010

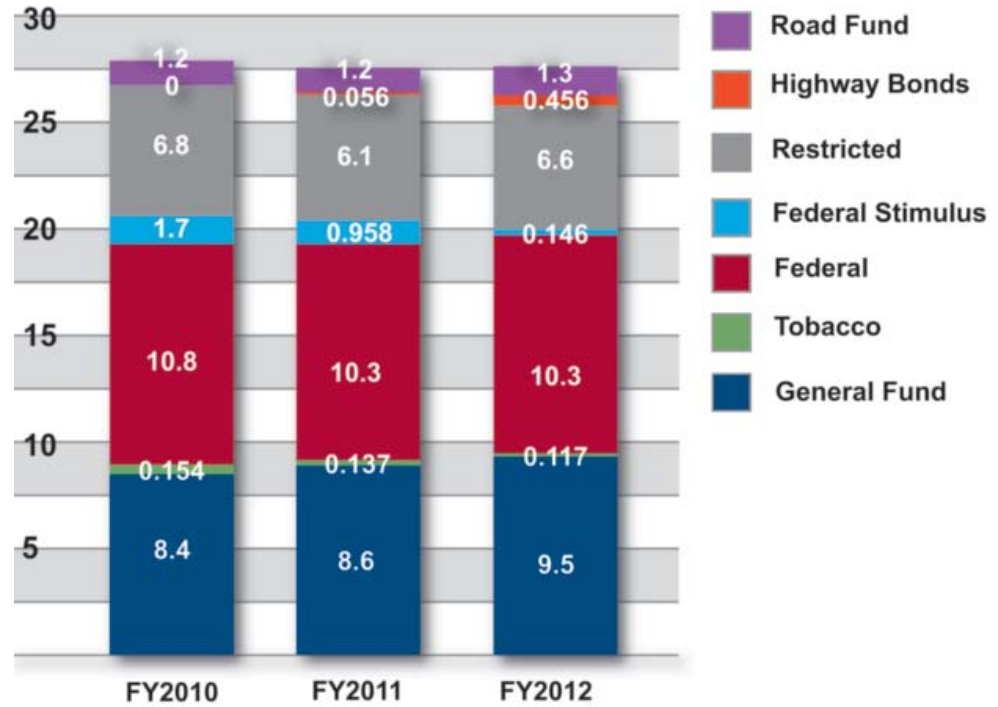


Source: Governor's Office of Policy and Management (Expenditure Data); Bureau of Economic Analysis (Gross State Product)

State government has taken several steps to make up for the declining revenue, including employee furloughs, awarding no employee pay raises for two years and across-the-board spending cuts. But one key factor that has moderated the impact of budget cuts is \$3 billion in federal stimulus funds: \$1.7 billion in 2010, \$958 million 2011 and \$146 million in 2012. These funds are supplementing the budget by more than 10% in 2010-2012. The bottom chart of all funds in the Kentucky budget shows the impact of stimulus funds, which are set to expire in 2012.

All Funds By Source in Kentucky's State Budget, Fiscal Years 2010 to 2012

Billions of dollars



Source: Budget in Brief, 2010-2012 Biennium, Office of State Budget Director, January 19, 2010

THE STRUCTURAL DEFICIT

Another reality of Kentucky’s budget looms as a significant challenge for 2012. The enacted 2010-2012 budget included a significant amount of so-called one-time money (see sidebar), which means fiscal 2012 will end with an approximately \$475 million budget hole, or structural deficit.

To fully appreciate the state’s current financial situation, it is important to understand that a structural deficit is created when a budget is balanced using non-recurring revenue—commonly called “one-time money”—to fund ongoing obligations. To put this in the perspective of a family’s budget, imagine that a couple inherited \$10,000 from a relative and then bought a new home that required house payments costing \$10,000 more per year than the family earns. This means 12 months later, after the inheritance runs out, the family will have a structural deficit of \$10,000 for the following year. They will have to find \$10,000 from other sources, reduce their current spending by \$10,000, sell their house and buy a cheaper one or borrow money to make their new house payment.

Components of the Structural Deficit

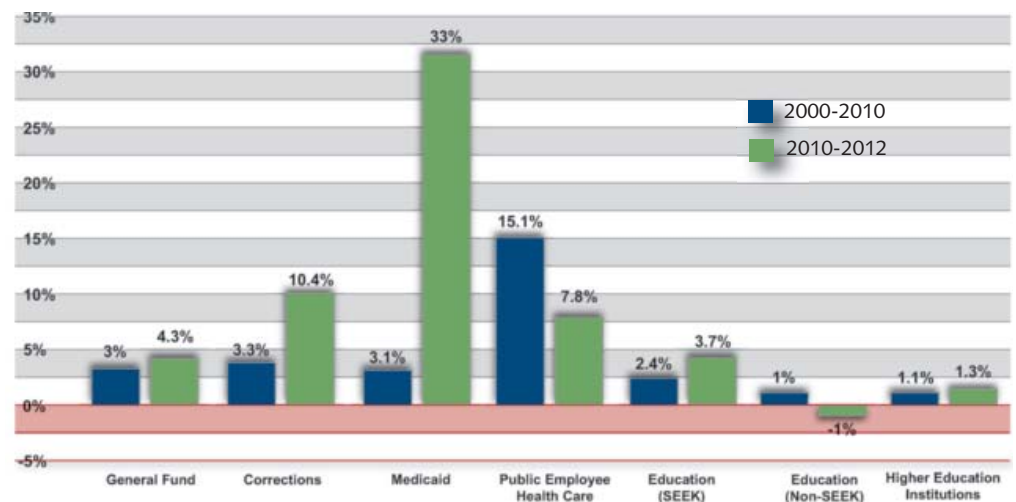
- This one-time money includes:*
- \$122 million in fund transfers (transferring money collected by state agencies for licensing and other functions into the state General Fund)
 - \$281 million carried forward from the previous year
 - \$72 million from delaying state pay checks until the next fiscal year

State government has a similar problem. It is spending more than it can afford based on its tax revenues. Kentucky’s current structural deficit, combined with the expiration of the federal stimulus funds, will combine to make the 2012-2014 budget a particularly difficult one to write. Even with the anticipated additional revenue from higher-than-expected growth, the governor and General Assembly will face replacing more than \$400 million in FY13 to keep spending at current levels. In the Chamber’s view, this creates an even greater incentive to address unsustainable spending in the three major areas that have been identified.

PROGRESS ON PLUGGING THE LEAKS

This chart compares average annual growth in Medicaid, corrections and public employee health insurance from 2000 to 2010 with the growth in the 2010-2012 budget. The General Assembly made significant progress in stemming the growth in public employee health insurance, cutting the rate almost in half (more details on the specific actions are included later in this report). The spike in current General Fund appropriations for Medicaid and corrections is largely due to the fact that the state has to replace a significant amount of federal stimulus funds that will no longer be available. Medicaid funding included \$503 million in stimulus money in FY 2010 and \$468 million in FY 2011. The corrections budget included \$78 million in stimulus funds in FY 2010 and \$16 million in FY 2011.

Average Annual Growth In General Fund Expenditures In Selected Programs Fiscal Year 2000-2010 Compared to Fiscal Year 2010-2012



Note: FY 2010-2012 figures based on the enacted budget

CORRECTIONS

As noted in the original *Leaky Bucket* report, spending on corrections has grown about 50% faster than spending overall. Despite Kentucky's relatively low violent crime rate, our prison population is one of the fastest growing in the nation. To address this problem, the General Assembly directed savings of \$30 million in the Department of Corrections' FY 2011-2012 budget.

Even more promising was the 2011 General Assembly's enactment of major legislation to stem the growth in Kentucky's prison population. The legislation was the work of the Task Force on the Penal Code and Controlled Substances Act that was created with the support of the Governor, the Chief Justice of the Supreme Court, the President of the Senate and the Speaker of the House. This group, with the assistance of the Pew Center on the States, collected and analyzed data to determine what is driving the rapid growth in our prison population. The Pew Center identified several key reasons:⁵

- **Increase in Arrests and Court Cases:** Although Kentucky's crime rate remained unchanged between 2001 and 2009, arrests increased 32% (mostly for drug offenses).
- **High Percentage of Offenders Being Sent to Prison:** In 2009, Kentucky's circuit courts sent 60% of convicted offenders to prison, compared to 41% nationally.
- **Technical Parole Violators:** Almost 20% of the people sent to prison in fiscal 2010 were incarcerated for technical parole violations; they had not committed a new felony.
- **Drug Offenders:** Between 2000 and 2009, the percentage of all people going to prison who were drug offenders rose from 30% to 38%. Currently, 25% of the inmates in Kentucky's prisons are there for drug offenses.

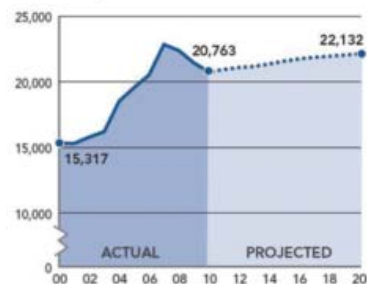
The landmark bipartisan legislation, HB 463, enacted in March 2011, focuses on four key goals:⁶

- 1. Strengthening probation and parole by**
 - Basing key decisions on risk and needs data
 - Boosting the chances that offenders will successfully transition to the community
 - Improving parole and probation supervision
- 2. Adopting common sense sentencing reforms by**
 - Adjusting penalties for possession of small amounts of drugs
 - Reinvesting savings in drug treatment programs
 - Expanding medical parole
- 3. Supporting and restoring victims by**
 - Developing a web-based system to track offenders
 - Supporting the statewide automated restitution system
- 4. Improving government performance by**
 - Defining success as reducing recidivism and criminal behavior
 - Establishing mechanisms to measure and incentivize success
 - Improving the fiscal impact statement for legislation that affects incarceration
 - Require prior approval for the construction of new county jail cells

A fiscal analysis of HB 463 determined that the reforms would bring gross savings of \$422 million over 10 years from a reduction in incarceration. A net savings of \$218 million over 10 years would be realized while \$204 million would be reinvested in strengthening probation and parole, expanding treatment programs and adding pre-trial officers. The legislation also reauthorized the task force for another year to continue its review of Kentucky's criminal law.

Prison Population Growth

Kentucky's prison population is projected to grow by nearly 1,400 inmates during the next 10 years at an estimated cost of at least \$161 million in operations and construction.



SOURCE: Projections were calculated by JFA Institute, 2010

(Projections made prior to 2011 legislation)

CHAMBER RECOMMENDATION ON CORRECTIONS

The General Assembly is to be commended for enacting HB 463, the provisions of which are consistent with the goals of the *Leaky Bucket*, particularly sentencing reform, improving community corrections and diverting more drug offenders to treatment programs.⁷ The Chamber supports full implementation of these and, to ensure the potential savings are fully realized, urges the General Assembly to reinvest the savings as required by HB 463 and not divert them to other areas.

MEDICAID

The Kentucky Medicaid program provides health coverage to more than 800,000 low-income and disabled Kentuckians through more than 40,000 participating health providers. Since 2000, state Medicaid expenditures have grown by 117% — almost three times the rate of the overall state budget.

Enrollment has been growing by approximately 3,000 new recipients per month in the current biennium, compared to only 930/month previously. This unprecedented growth has been attributed to the weakened economy.⁸

Medicaid Eligibility Growth



Source: Kentucky Department for Medicaid Services

The 2010 General Assembly created the Medicaid Cost Containment Task Force to examine the operations of the program and to identify areas of potential savings. The task force recommendations had not been issued by the publication deadline for this report, but the Chamber is encouraged that the General Assembly is taking action to review Medicaid expenditures.

The Medicaid program faces a budget deficit of approximately \$166 million in state funds for FY 2011 due in part to congressional action that resulted in Kentucky and other states receiving less federal funding than expected and reductions mandated by the budget. State Medicaid officials announced a “rebalancing” plan in November 2010 to address this deficit. Actions included:⁹

- Not requesting additional state funds
- Transferring funds from FY 2012 to balance the program in FY 2011
- Increasing anti-fraud initiatives
- Issuing a request for proposals to expand Medicaid managed care statewide

The 2011 General Assembly ended in stalemate on the Medicaid shortfall, with the Governor and House of Representatives favoring shifting money from 2012 and filling the hole in next year’s budget with projected savings resulting from efficiencies and expanded managed care. The Senate argued the only responsible approach was to implement cuts across state government and replace those funds only if the savings could be realized. After several line-item vetoes by the governor and a subsequent special session, the shortfall was addressed by shifting money from next year’s Medicaid budget and spending it in the current fiscal year. If savings are not realized by managed care, there will be a significant Medicaid budget problem next year.

In April 2011, the administration issued a request for proposals to private vendors to implement a statewide managed care system for Medicaid. The Cabinet for Health and Family Services anticipated contracts would be in place by July 1, 2011.

CHAMBER RECOMMENDATIONS ON MEDICAID

The Kentucky Chamber believes savings could be realized from making the program more closely resemble a private insurance model. As it has consistently done in the past, the Chamber supports the expansion of managed care in the Medicaid program and less reliance on the traditional fee-for-service health insurance model, which has been abandoned by the private sector as not being cost effective. The Chamber also urges that more wellness activities and incentives be included in the program—a best practice identified by the National Governor’s Association Center for Best Practices.¹⁰ Finally, we think it is essential that a top-to-bottom, data-driven review of the Medicaid program be conducted by a nationally recognized consulting firm with expertise on Medicaid—similar to the review of Kentucky’s corrections funding challenges that was conducted with the assistance of the Pew Center on the States. This review should include an evaluation of the scope of services covered by Medicaid compared with other states as well as outcomes for Medicaid patients.

PUBLIC EMPLOYEE HEALTH INSURANCE

Growing at a rate of 190% since 2000, state spending on public employee health insurance has increased at almost five times the rate of overall state spending. An estimated \$1.4 billion is spent each year on more than 250,000 state employees, teachers, retirees and their dependents in the Kentucky Employees Health Plan. Recognizing the need to control these costs, the 2010 General Assembly reduced requested funding for health insurance by \$100 million over the FY 2010-12 biennium and mandated savings in the health plan.

This legislative action reduced the growth in health insurance spending by almost half in the FY 2010-12 biennium. From 2000 to 2010, spending on public employee health insurance increased an average of 15% per year. In 2011-12, this growth is reduced to 7.8% each year.

These savings are also reflected in the four health insurance plans from which public employees and teachers can choose for 2011 (see chart in appendix for details):¹¹

- Premiums increased about 5% in 2011 over 2010 rates, with the employee being required to pick up the increased cost.
- State government's contribution is the same in 2010 and 2011 for all plan levels, with one exception.
- The employee contribution for the least expensive plan is \$0 in both 2010 and 2011 (less than 3% of employees selected this plan last year).
- The employee contribution increases by about \$30/month for single coverage for all other plan levels.
- Annual deductibles increase in 2011 by approximately \$300 to \$500 depending on the level of coverage.
- Co-pays for prescriptions increase by \$5 per prescription.
- Currently, about two-thirds of employees select single coverage under one of the three highest options (Maximum, Capitol or Optimum).

TEACHER RETIREMENT FUND DEVELOPS PLAN FOR SUSTAINABILITY

Another significant development in 2010 was a collaborative effort among teachers, school administrators and legislators that resulted in the General Assembly's approval of a long-term sustainable method for funding health insurance for retired teachers.¹² Health insurance for retired teachers is "pay as you go"—the Kentucky Teachers' Retirement System has no reserve in its health insurance fund like the Kentucky Employee Retirement System and depends on cash flow from monthly contributions paid by active teachers to finance health benefits. The state has been redirecting contributions from the KTRS pension fund to pay for KTRS retirees' health care since 2004 in an amount totaling approximately \$562 million. Although the state is repaying these funds over a 10-year period with interest, this practice has left the retired teachers insurance fund unable to cover the cost of health benefits. HB 540, enacted by the 2010 General Assembly, employs a "shared responsibility" approach that requires additional contributions by active and retired teachers to make the fund solvent.¹³

CHAMBER RECOMMENDATIONS ON PUBLIC EMPLOYEE HEALTH INSURANCE

The changes in the 2011 public employee health plan are encouraging and consistent with the recommendations made by the Chamber in the *Leaky Bucket* to require employees to contribute a reasonable amount for health insurance. We recommend that this trend of increased employee cost sharing continue, and also would urge more aggressive efforts to provide incentives for wellness activities that give public employees a greater financial stake in their individual wellness.

PUBLIC EMPLOYEE PENSIONS

Public employee pensions, although not addressed in the original *Leaky Bucket* report, have been of concern to the Kentucky Chamber for several years. Given the substantial challenges faced by our state pension system, the Chamber believes additional action is required to ensure the system's long-term viability.

State employees participate in the Kentucky Employee Retirement System—a defined-benefit pension plan that provides employees a fixed monthly pension upon retirement. The amount of a retiree's pension benefit is based on his/her salary and length of time worked, but equates to roughly two-thirds of an individual's working salary. The average pension benefit for state retirees was \$20,292 per year in 2010.

In contrast, the Employee Benefit Research Institute reports that in 2009 only 35% of all Americans age 65 and over and 20% age 50 and over received some form of employment-based pension. The average annual private pension in 2009 was \$17,936 for those age 50 and over and \$16,215 for retirees age 65 and over.¹⁴

As of 2009, there were 456,032 members of the Kentucky Retirement Systems (state, county, state police and teachers). The chart (above right) shows the membership levels of each system.

In February 2010, the Pew Center on the States released a 50-state survey comparing state pension systems on a number of factors and grading the performance of each state. Kentucky fell below the U.S. average in terms of total liabilities, funds set aside, percent of liabilities funded and 10-year funding high and low. The Pew report graded Kentucky as being Below Par (grades assigned were Top Performer, Needs Improvement and Below Par) and deemed Kentucky as one of 19 states about which the report had “serious concerns” about adequately funded pensions.¹⁵

The Pew report had this to say about Kentucky's funding levels: “Kentucky had one of the most dramatic declines in pension funding levels from 2000 to 2006 of the 50 states—a recent trend that could cause trouble if it persists. Government contribution rates fell short [of the actuarially required contribution] ... in nine of the past 15 years. The Commonwealth has done a better job keeping up with funding requirements in its teachers' fund.”¹⁶

Total Members in Kentucky Retirement Systems, 2009

| SYSTEM | ACTIVE ^a | INACTIVE ^b | RETIRED ^c | TOTAL |
|--------------------|---------------------|-----------------------|----------------------|----------------|
| KRS Non-Hazardous | 46,060 | 34,515 | 37,883 | 118,458 |
| KRS Hazardous | 4,3334 | 3,056 | 2,648 | 10,038 |
| CERS Non-Hazardous | 83,724 | 60,275 | 39,756 | 183,755 |
| CERS Hazardous | 9,757 | 2,522 | 5,808 | 18,087 |
| State Police | 946 | 332 | 1,184 | 2,462 |
| KTRS | 75,937 | 5,245 | 42,050 | 123,232 |
| TOTAL | 220,758 | 105,945 | 126,684 | 456,032 |

^aMembers who are currently employed by state or local government and are paying into the system with the state matching employee contributions. ^bFormer employees who are not retired, did not withdraw their retirement contributions when they left public employment, and could eventually draw a pension. ^cMembers who are currently drawing a pension.

Source: Kentucky Combined Audit and Final Report (CAFR), 2009

Pew Study Comparison: State Pension Liability and Funding

| BENCHMARK | KENTUCKY | U.S. |
|--------------------|----------------|-------------------|
| Total liabilities | \$30.7 billion | \$2.35 trillion |
| Funds set aside | @21.4 billion | \$1.99 trillion |
| Funded | 70% | 85% |
| 10-yr funding high | 111% in 2000 | 97% in 2000 |
| Funding low | 70% in 2006 | 82% in 2006 |
| PEW Grade* | Below par | Needs improvement |
| TOTAL | 220,758 | 105,945 |

Source: Promises with a Price: Public Sector Retirement Benefits, Pew Center on the States, July 2010

A 2011 update of the Pew report found that Kentucky's poor pension performance has continued, with the system funded at only 58% of its \$35.6 billion liabilities, compared to a national average of 78% in fiscal year 2009. Kentucky also paid only 58% of its required employer contributions for pensions, compared to 64% nationally.¹⁷

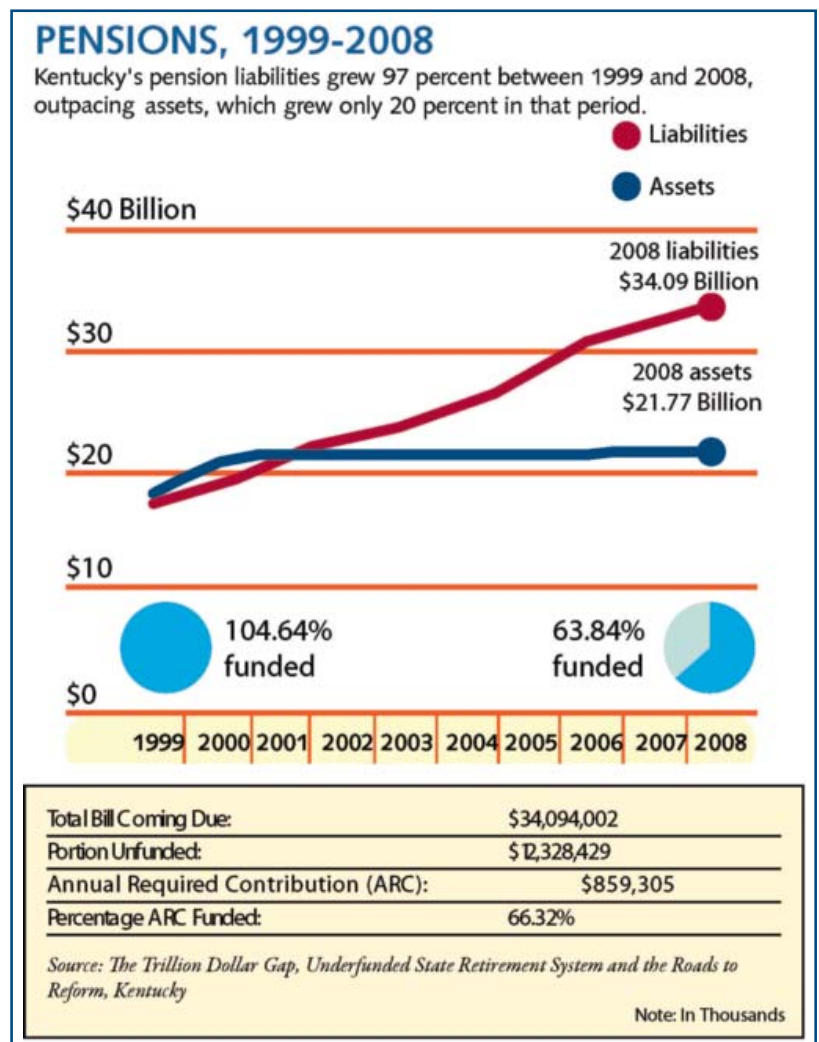
Kentucky is not alone in experiencing difficulty in funding pension contributions; Pew found that only nine states had paid the full actuarially required contribution (ARC) from 2003 to 2008.

Recognizing Kentucky's relatively poor pension system performance and outstanding liabilities, the General Assembly enacted a number of reforms in 2008. In addition to establishing a schedule to increase pension funding, the legislation made significant changes for new employees hired effective September 1, 2008, including:¹⁸

- the employee retirement contribution was increased by 1%
- final compensation is based on average high five-year salary (instead of high three)
- to be eligible to retire, a state employee's age plus years of service credit must equal 87, and the employee must be a minimum of 57 years of age
- limits were placed on the use of sick leave in the retirement calculation
- overtime can no longer be used in determining final compensation in the retirement calculation
- health insurance is based on a benefit of \$10/month for each year of service
- a revised formula was developed resulting in a reduced pension benefit based on years of service

Legislation was also enacted in 2010—supported by the Chamber—that required two of the three members appointed by the Governor to the Kentucky Retirement Systems board of trustees to have ten years of investment experience.¹⁹

Unfortunately, the 2011 General Assembly failed to enact legislation to address Kentucky's pension problems. Legislation to put new employees into a 401k-style defined contribution retirement program was passed by the Kentucky Senate but died in the House.



CHAMBER RECOMMENDATIONS ON PUBLIC EMPLOYEE PENSIONS

While some progress has been made to address Kentucky's pension challenges, the Chamber believes more aggressive actions are required, including:

- **Reduce Health Insurance Costs:** Continue to focus on reducing health insurance costs, as they constitute 55% of pension costs.²⁰ This approach has already been adopted by the 2010 General Assembly and has the added benefit of reducing costs for active as well as retired employees.
- **Suspend COLA:** KRS 61.691 (2) provides for a 1.5% annual cost-of-living increase for retirees, unless suspended by the legislature. The General Assembly should consider suspending this provision in the budget until the system is more adequately funded.
- **Adopt a Defined Contribution Plan:** Move to a defined contribution plan for new employees and use a portion of the employer share of the contribution to fund a bond issue to help finance the transition from the current defined benefit program. The Pew report identified this hybrid model as a promising approach that had been adopted by at least five states. Oregon estimated a new hybrid program adopted in 2003 contributed to \$400 million in pension reform savings.²¹
- **Emphasize Total Compensation:** It is important to remember that the amount the state contributes for each active employee's pension will continue to increase to address the shortfall in the pension system. Health insurance costs will also continue to increase, although at a slower rate due to recent changes, so the total compensation of state employees will continue to rise. State government should do a better job of explaining to its employees that, although pay raises have been limited in recent years, the total amount of compensation they receive, which includes pension and health insurance benefits, continues to increase. Emphasizing total employee compensation would promote understanding of the value of all benefits provided.

CONCLUSION

The fact that state revenues in 2011 are above projected levels might give rise to the notion that Kentucky's budget problems have been resolved. It is important to note, however, that the state will still face an estimated \$400 structural deficit in 2012, even with the increase in revenue collections. Although meaningful work has been done to address spending growth in Medicaid, corrections and public employee health insurance, these costs continue to increase dramatically. The Kentucky Chamber believes the key to Kentucky's long-term economic recovery is an even greater emphasis on controlling unsustainable growth in state spending. If taxpayers, businesses and the financial markets are to have confidence in Kentucky's financial future — and if the state is to follow a path to true prosperity — policymakers must remain vigilant in their efforts to ensure that Kentucky is not spending beyond its means.

APPENDIX

Kentucky Employee Health Plan Coverage Options
2010 Monthly Rates vs. 2011 Monthly Rates

| Commonwealth Standard PPO | | | | | | | | | |
|-----------------------------|---------------|------------|------------|-----------------------|----------|------------|-----------------------|----------|------------|
| Type | Total Premium | | | Employer Contribution | | | Employee Contribution | | |
| | 2010 | 2011 | Difference | 2010 | 2011 | Difference | 2010 | 2011 | Difference |
| Single | \$486.40 | \$486.40 | \$0 | \$486.40 | \$486.40 | \$0 | \$0 | \$0 | \$0 |
| Parent Plus | \$749.84 | \$749.84 | \$0 | \$741.56 | \$741.56 | \$0 | \$0 | \$0 | \$0 |
| Couple | \$1,127.80 | \$1,127.80 | \$0 | \$845.62 | \$845.62 | \$0 | \$0 | \$0 | \$0 |
| Family | \$1,253.56 | \$1,253.56 | \$0 | \$965.12 | \$965.12 | \$0 | \$0 | \$0 | \$0 |
| Cross Reference | \$626.78 | \$626.78 | \$0 | \$626.78 | \$626.78 | \$0 | \$0 | \$0 | \$0 |
| Commonwealth Maximum Choice | | | | | | | | | |
| Type | Total Premium | | | Employer Contribution | | | Employee Contribution | | |
| | 2010 | 2011 | Difference | 2010 | 2011 | Difference | 2010 | 2011 | Difference |
| Single | \$575.42 | \$605.40 | \$30.00 | \$575.42 | \$575.42 | \$0 | \$0 | \$29.98 | \$29.98 |
| Parent Plus | \$851.46 | \$861.26 | \$9.80 | \$742.60 | \$742.60 | \$0 | \$108.86 | \$118.66 | \$9.80 |
| Couple | \$1,177.68 | \$1,207.80 | \$30.18 | \$843.02 | \$843.02 | \$0 | \$334.66 | \$364.78 | \$30.12 |
| Family | \$1,341.53 | \$1,377.36 | \$35.83 | \$943.20 | \$943.20 | \$0 | \$398.32 | \$434.16 | \$35.84 |
| Cross Reference | \$670.76 | \$688.68 | \$17.95 | \$661.10 | \$644.34 | -\$16.76 | \$9.66 | \$44.34 | \$34.68 |
| Commonwealth Capitol Choice | | | | | | | | | |
| Type | Total Premium | | | Employer Contribution | | | Employee Contribution | | |
| | 2010 | 2011 | Difference | 2010 | 2011 | Difference | 2010 | 2011 | Difference |
| Single | \$594.14 | \$625.68 | \$31.54 | \$589.14 | \$589.14 | \$0 | \$5.00 | \$36.54 | \$31.54 |
| Parent Plus | \$896.06 | \$909.02 | \$12.96 | \$752.04 | \$752.04 | \$0 | \$144.02 | \$153.98 | \$9.96 |
| Couple | \$1,347.50 | \$1,387.36 | \$39.86 | \$903.38 | \$903.38 | \$0 | \$444.12 | \$483.98 | \$39.86 |
| Family | \$1,490.60 | \$1,537.92 | \$47.32 | \$964.76 | \$964.76 | \$0 | \$525.84 | \$573.16 | \$47.32 |
| Cross Reference | \$745.30 | \$768.96 | \$23.66 | \$732.42 | \$717.22 | -\$15.20 | \$12.88 | \$51.74 | \$38.87 |
| Commonwealth Optimum PPO | | | | | | | | | |
| Type | Total Premium | | | Employer Contribution | | | Employee Contribution | | |
| | 2010 | 2011 | Difference | 2010 | 2011 | Difference | 2010 | 2011 | Difference |
| Single | \$616.28 | \$650.30 | \$34.02 | \$588.78 | \$588.78 | \$0 | \$27.50 | \$61.52 | \$34.02 |
| Parent Plus | \$889.54 | \$905.42 | \$15.88 | \$713.02 | \$713.02 | \$0 | \$176.52 | \$192.40 | \$15.88 |
| Couple | \$1,363.40 | \$1,405.66 | \$42.26 | \$893.88 | \$893.88 | \$0 | \$469.52 | \$511.78 | \$42.26 |
| Family | \$1,515.36 | \$1,565.88 | \$50.52 | \$954.20 | \$954.22 | \$0.02 | \$561.16 | \$611.66 | \$50.50 |
| Cross Reference | \$757.68 | \$782.94 | \$25.26 | \$729.34 | \$782.94 | \$53.60 | \$28.34 | \$68.40 | \$40.06 |

Data Source: Kentucky Employee Health Plan Handbook, Kentucky Personnel Cabinet, 2010 and 2011

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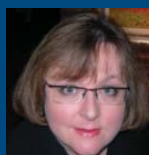
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