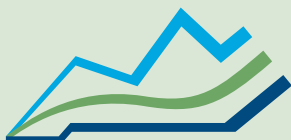




THE LEAKY BUCKET



Kentucky Chamber
Uniting Business. Advancing Kentucky.

State spending priorities shifting away from education

The state's budget is leaking tax dollars in three major areas — taking millions away from Kentucky's schools. State spending on corrections, Medicaid and public employee health benefits is growing at an alarming rate, and we simply can't afford to let this continue. We need to invest more in our young people — and our future — but these three big "leaks" are taking critical funds away from public education.

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INTRODUCTION

Kentucky's revenue shortfall has dominated the news about state government for the past several months, with headlines focusing on the impact of the international economic downturn on tax receipts and public services.

Without question, the commonwealth's fiscal situation is precarious and – like many other states – Kentucky has welcomed federal stimulus money as a means of plugging some sizeable budget holes. But it is important to note that Kentucky's problem with revenue shortfalls existed long before the current downturn, and the situation will probably get even worse when the federal money is no longer available.

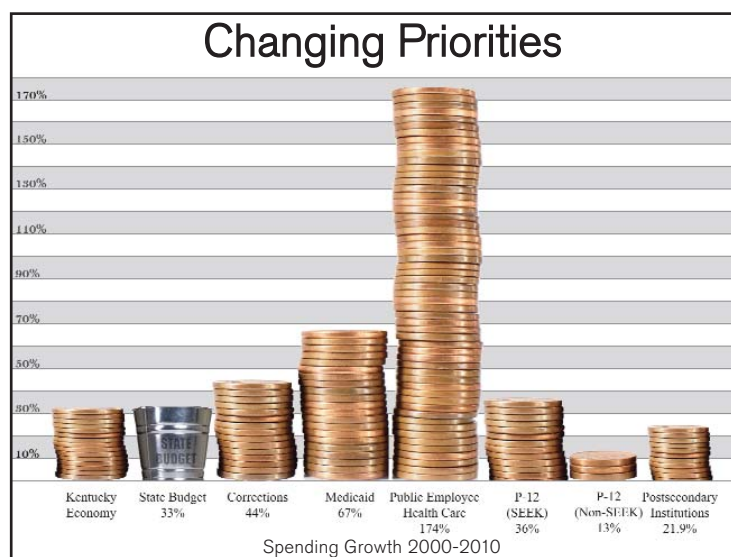
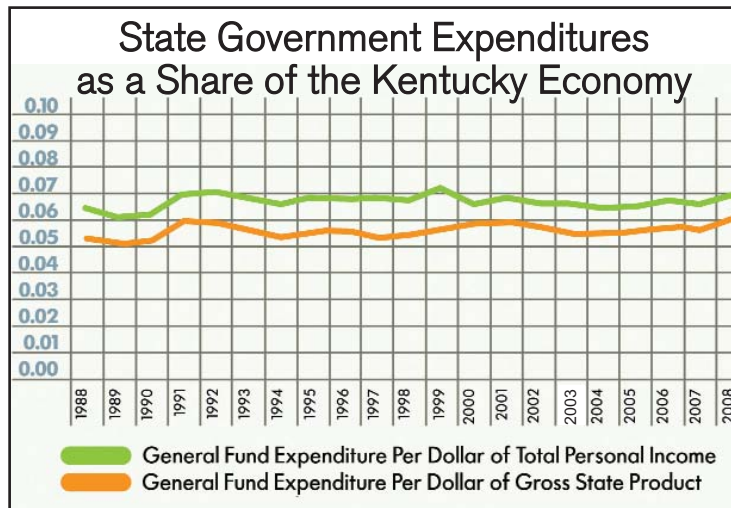
Arguably more troubling, however, is the fact that state spending in recent years shows Kentucky's budget priorities shifting away from investing in education and toward providing more money for jails, public employee health benefits and Medicaid.

That new reality is the most significant conclusion of research that the Kentucky Chamber has undertaken in recent months. The numbers tell us that Kentucky is now spending an increasing amount of money on what happens when you fall short on education attainment – more people in jails and more people on Medicaid – in addition to the escalating costs of public employee health benefits. We describe what we found as a “leaky bucket” of state revenue – a vessel that can never be filled because of major leaks (the unsustainable spending growth in those three major areas).

The state shortfalls have led some people to conclude that revenue collections are not keeping pace with the economy and that Kentucky needs to modernize its tax system to address that situation.

As a result, we took particular note of two major findings of research conducted for the Chamber by the University of Kentucky's Center for Business and Economic Research:

1. The size of state government relative to the state's economy has remained consistent over the years (about 6% of the Gross State Product).
2. State revenue has essentially been growing with the economy.



FACT: If P-12 Education had held its own in the state budget since 2000 we could have invested \$307 million more in P-12 in 2008.

With those facts in mind, we took a closer look at the state budget to get a better sense of where the money is actually going. We found that spending in the three areas mentioned earlier – corrections, Medicaid and public employee health benefits – is growing faster than both the state budget overall and the state economy, as illustrated in the chart below.

In fact, more than half of the growth in the state budget since 2000 has been in those three areas. The result is that education's share of the budget has declined, and education has the greatest potential to help us grow a stronger economy.

The Chamber's efforts to raise awareness about this budget reality should not be interpreted as being dismissive of the needs reflected in the areas of high-growth spending. Medicaid, in particular, is an important part of Kentucky's health-care system and is a vital program for many of the state's citizens and health care providers.

But this level of spending clearly is unsustainable, and the state must act deliberately to institute management strategies that work. The Kentucky Chamber has offered the ideas that you will find in the following pages for consideration by the state's policymakers.

In tough economic times – and all the time – state government must do what every family has to do around the kitchen table and every business person has to do at the office. We have to establish spending priorities, make tough decisions and fix the leaks that drain the money away from financing the priorities we have established to ensure progress for Kentucky.



Skyrocketing inmate costs hurt school funding

Kentucky's corrections budget is growing much faster than total state government spending. The Kentucky Chamber has offered to partner with the General Assembly to help find solutions to this growing problem.

THE PROBLEM

Corrections Costs Skyrocketing: Recent research by the Chamber on state budget trends revealed that Kentucky's corrections budget is growing much faster than total state government spending. Since 2000, Kentucky's total General Fund spending has increased by 33%, compared to a 44% increase in corrections (from \$619 million in FY 2000-02 to \$894 million in FY 2008-10).ⁱ

More Spending on Inmates than Students: Kentucky is spending an average of \$52.14 a day to house an inmate in a state-operated facility. That means it costs taxpayers more than \$19,000 per year to keep one inmate locked up.ⁱⁱ Compare that to how much tax money Kentucky spends on a student in elementary or secondary education – just over \$9,200 a yearⁱⁱⁱ – or on a full-time higher education student – just under \$7,000 a year.^{iv} The point makes itself – Kentucky is spending more to address the costs of failing to invest in education than it is on the students who represent its hopes for the future.

Shift in Priorities: The increased spending on corrections isn't entirely responsible for our shifting priorities. Growth in Medicaid and public employee benefits clearly outpace corrections spending. But the Chamber believes the redirection of tax money is cause for alarm. In terms of the state budget, education's share is getting smaller and smaller. K-12 education's share of General Fund appropriations has declined from a high of 48.2% in FY 1986-88 to 43.8% in the current fiscal year.^v Postsecondary education's share declined from 16.9% 1986-88 to 13.7% in the current fiscal year.^{vi}

Fastest Growth in Nation: Meanwhile, Kentucky has the fastest growing prison population in the country, according to a 2008 re-

port by the Pew Center on the

States.^{vii} From 1987 to 2007, Kentucky's imprisonment rate grew nearly 250%, from well below the national average in 1987 to above the national average in 2007.^{viii} Kentucky's prison population has surged since 2000, increasing by 50% to 22,000 inmates.^{ix}

Low Crime Rate: Although Kentucky's rate of incarceration has increased dramatically, Kentucky has a relatively low crime rate compared to other states. In fact, while Kentucky's incarceration rate was growing at a faster rate than the nation's, both its violent and property crime rates fell, by 13 and 14% respectively.^x According to FBI crime reports, Kentucky ranked 40th in the rate of violent crime in 2006, the most recent year data is available.^{xi}

What is Wrong With This Picture?: These statistics raise a very basic question: Why is Kentucky, with a relatively low violent crime rate, putting people in prison at a rate faster than any other state in America?

POTENTIAL SOLUTIONS

Potential solutions to stemming these costs lie in some of the reasons identified in the Pew report for their rapid increase:

Persistent Felony Offender Law: The Pew report found Kentucky's prison growth has been fueled in part by a series of "tough-on-crime" measures such as the state's persistent felony offender law, under which offenders receive mandatory sentences for repeated offenses.^{xii} This law should be reviewed to determine if the number of offenses required to trigger the statute is too low, and whether it is too broad in terms of including offenses for non-violent crimes.

Classification of Offenses: Another factor identified by the Pew report is that in the 1990s a number of measures elevated some misdemeanors to felonies, reclassified some offenses as higher level

felonies and enhanced the penalties for a variety of crimes.^{xiii} The result is that more people went to jail without a corresponding increase in the crime rate.

Underinvestment in Community Corrections: Pew found Kentucky has spent only 10% of new corrections dollars on probation and parole. Considering one in six of Kentuckians on parole in 2007 returned to prison for committing a new crime or violating their parole, Pew suggests that a stringent community supervision system could have prevented some of these parolees from returning to prison at a fraction of the cost.

Attacking Drug Abuse: Statistics from the Kentucky Department of Corrections show that 25% of our inmate population is incarcerated for a drug-related offense.^{xiv} This is another significant reason for our increased prison growth. The Kentucky General Assembly is to be commended for passing Senate Bill 4 in 2009 that allows people charged with a felony to be treated for substance abuse problems before their trial and allows judges to order treatment as a condition of bail.^{xv} Finding additional approaches to address the problem of substance abuse among criminal offenders could go a long way toward addressing our corrections problem.

Increased Privatization: The current average daily cost of incarceration in Kentucky is \$19,031 for the 13 state-operated facilities and \$16,494 for the three privately-operated facilities.^{xvi} The lower cost of private facilities suggests Kentucky should consider expanding the use of private facilities where possible.

THE BOTTOM LINE

The current rate of growth of putting people in prison in Kentucky is not sustainable. The potential solutions are not about being soft on crime, but are about rethinking how we deal with offenders in a way that lowers costs without jeopardizing public safety. Failure to do so will make it increasingly difficult to invest adequately in improving the educational attainment of Kentuckians, the one area that holds promise to prevent crime, increase income and improve the quality of life at all levels.

The Chamber does not think its role should be limited to just identifying problems. The organization is very concerned about spending priorities shifting away from education and stands ready to be a partner with the General Assembly in efforts to address the spiraling costs of our corrections system to make sure Kentucky is making the wisest possible investments of its tax dollars.

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ⁱⁱ Kentucky Department of Corrections, Cost to Incarcerate, FY 08

ⁱⁱⁱ National Center for Education Statistics, Digest of Education Statistics

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^v Overview: Kentucky State Government Budgets, Fiscal Years 1986-88 through 2008-10, Taylor-Gray Associates, September 2008

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^{vii} One in 31: The Long Reach of American Corrections, The Pew Center on the States, 2008

^{viii} Ibid

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Medicaid costs growing at twice the rate of state budget

The Kentucky Chamber of Commerce is addressing Medicaid spending as part of its review of how the state spends its tax dollars. Its conclusions are based on the following points.

THE IMPORTANCE OF MEDICAID

The Chamber understands that Medicaid is a vital program for many of Kentucky's citizens and health care providers and plays an important role in providing health coverage in Kentucky:

Medicaid provides coverage to more than 745,000 Kentuckians—approximately 17% of our total population, many whom represent vulnerable populations—the disabled, mentally ill, elderly and children.

— At \$31,111 per year, Kentucky's per capita income is 80% of the national average—ranking Kentucky 46th among the states.ⁱ Given the fact that Medicaid eligibility is based in part on income, there is strong reliance on Medicaid in Kentucky.

— Medicaid provides approximately \$5.4 billion annually to the Commonwealth's health care economy and is important to the revenue stream of many hospitals, nursing homes, pharmacies, physicians and other health care providers.

The following offers the Chamber's perspective and suggestions for addressing rising Medicaid costs.

THE PROBLEM

Medicaid Costs Soaring: Kentucky's Medicaid budget is growing more than twice as fast as total state government spending. Although about 77% of total Medicaid funding is provided by the federal government, the remainder comes from the state General Fund. Recent research by the Chamber on state budget trends revealed that Kentucky's total General Fund spending has increased by 33% since 2000, compared to a 67% increase in General Fund appropriations for Medicaid in the same period (from \$1.5 billion in the FY 2000-02 biennium to \$2.5 billion in FY 2008-10).ⁱⁱ This

rapid increase in Medicaid spending means the program frequently experiencing shortfalls, with a deficit of over \$280 million last year alone.

Reasons for Increase: Medicaid spending has increased for many of the same reasons that the cost of private health insurance premiums has grown: the cost of prescription drugs, enrollment growth, and medical inflation and utilization.ⁱⁱⁱ Kentucky Medicaid enrollment has increased approximately 25% in the past nine years, from around 560,000 recipients in FY 2000 to more than 700,000 today.^{iv} The program is currently growing at a rate of 3,000 new recipients per month—three times the rate anticipated in the current budget.^v The current economic downturn is a major culprit in this enrollment growth. Research by the Kaiser Family Foundation reports a 1% increase in Medicaid enrollment for every 1% increase in the national unemployment rate.^{vi} Kentucky's unemployment rate currently stands at 11%—the highest in 26 years.

Federal Funds to Decrease after 2010: Under the federal stimulus legislation (the American Recovery and Reinvestment Act of 2009) all states received a temporary increase of 6.5% in their federal Medicaid match. Kentucky's increased to 77%, up from about 70%—representing almost \$1 billion in additional federal funds.^{vii} Unless Congress takes additional action to extend this increased matching rate, Kentucky's rate will return to the 70% level in 2011. One state Medicaid administrator referred to this eventuality as “falling off a financial cliff”.^{viii}

Low Health Status Despite Increased Medicaid Spending: One of the more perplexing aspects of the rapid rise in Medicaid spending is that, although it provides more Kentuckians with health coverage, the state's health status is still among the worst in America. Consider a few findings from a 2007 University of Kentucky assessment

of Kentuckians' health:

- Kentucky has the highest total mortality rate in the United States—987 per 100,000 population vs. 842 nationally—largely due to high cancer and heart disease death rates.

- Kentucky's cancer death rate per 100,000 population is 237, compared to the U.S. average of 202, ranking Kentucky the worst among the states for cancer burden.

- Cardiovascular disease is the leading cause of death in Kentucky. Nationally, Kentucky ranks 4th highest for cardiovascular mortality, 5th highest for heart disease mortality, and 12th in the nation for stroke mortality.^{ix}

Priorities Shifting from Education: In terms of the state budget, Medicaid's share is growing while education's share is getting smaller. Since 1986, Medicaid's share of the General Fund has doubled—from 6.5% in FY 1986-88 to more than 13% in the current fiscal year. Meanwhile, K-12 education's share of General Fund appropriations has declined from a high of 48.2% in FY 1986-88 to 43.8% in the current fiscal year.^x Postsecondary education's share declined from 16.9% in 1986-88 to 13.7% in the current fiscal year.^{xi} The increased spending on Medicaid isn't entirely responsible for our shifting priorities. Growth in corrections and public employee benefits also outpace overall government spending.

Better Education Improves Health: Why is the Chamber concerned about the redirection of tax money away from education? Because a significant body of research links higher levels of education with better health. People with more education experience better health than those with less education in terms of higher levels of perceived health, physical functioning, and life expectancy, as well as lower levels of disability, morbidity and mortality.^{xii} We believe improving the education attainment of Kentuckians will improve health, which can lead to lower health costs. The evidence is also clear that increased education attainment increases employment opportunities and income for Kentuckians, which can reduce our reliance on Medicaid and other social programs.^{xiii}

POTENTIAL SOLUTIONS

The key question concerning Medicaid is how to slow unsustainable spending growth without inflicting harm on Medicaid recipients and providers. We think some of the potential answers lie in expanding current aspects of Kentucky's program and by looking to best practices in other states:

Expand Medicaid Managed Care: Studies strongly suggest that Medicaid managed care programs can save anywhere from 1% to as much as 20% over the traditional fee-for-service Medicaid model.^{xiv} Fortunately, Kentucky is no stranger to the Medicaid managed care. Starting with the Citicare program in the early 1980s, up to the Passport Health Plan today, Kentucky has been a national leader in using managed care principles in Medicaid.

The Passport Health Plan was created 10 years ago under a federal waiver as a partnership between local providers using a managed

care model for 159,000 Medicaid and KCHIP (Kentucky Children's Health Insurance Program) recipients in Jefferson and 15 surrounding counties.

Passport has achieved a number of impressive accomplishments:

- Average growth in medical costs of 5% annually compared to more than 10% in the region.
- Saved more than \$200 million in Medicaid costs, with savings amounting to as much as 10% in some years.^{xv}
- Increased the use of generic drugs from 22% of prescriptions in 2000 to more than 79% in 2009.
- Payments to providers have consistently equaled or exceeded those of the regular Medicaid program.
- Passport was rated the 9th-best Medicaid plan in the country in 2008, based on quality and member satisfaction, by *U.S. News and World Report*.
- Passport was awarded the Excellent level of accreditation by the National Committee for Quality Assurance, the highest level possible.^{xvi}

One of the best practices identified by the National Governors Association for controlling Medicaid costs is for states to make their Medicaid programs "resemble a private insurance model".^{xvii} We think Passport fills the bill in this regard as it is more like private insurance than traditional fee-for-service Medicaid. Given this best practice and the demonstrated results, the Chamber recommends that the General Assembly work to expand managed care similar to the Passport model as soon as possible in the more populous areas of Kentucky and to look for appropriate ways to incorporate managed care in other areas of the state based on regional demographics and the number of health providers.

Incorporate Wellness Into Medicaid: Another best practice identified by the National Governor's Association Center for Best Practices is for states to incorporate more wellness activities into their Medicaid programs. A number of states use financial incentives for Medicaid recipients who maintain healthy behaviors. In Florida, credits are awarded to recipients who meet specific goals that can be used to purchase services not covered by the program (such as smoking cessation and weight loss programs) and medical supplies (bandages and over the counter drugs).^{xviii}

The Chamber fully recognizes the value of wellness activities in reducing health costs having recently developed a Workplace Wellness Tool Kit to help employers set up effective wellness programs for their employees. Recognizing that smoking-related illness costs Kentucky more than \$1.5 billion per year in health costs (over \$500 million per year of this is in Medicaid costs) the Chamber also supported an increase in Kentucky's cigarette tax to discourage smoking.

The Chamber recommends that:

- an increasingly larger portion of Medicaid expenditures be shifted from treating illness to promoting wellness

- higher co-pays be required for recipients who smoke
- health care providers be given incentives to order wellness or preventive services for Medicaid patients
- Kentucky provide a statewide smoking cessation program for Medicaid recipients (Kentucky is one of only five states without such a program).

Program Administration: Other potential areas for possible savings in Medicaid include:

Improving the “error rate”, meaning reducing overpayments to providers as well as the number of recipients who are incorrectly determined to be eligible for participation.

Ensuring that child support orders require that noncustodial parents who have access to health insurance provide coverage for their children (as permitted by Kentucky law).

Increasing the use of generic drugs by Medicaid recipients.

Revisiting the use of co-pays for recipients at higher income levels.

Questions to Consider: Finally, we would encourage state officials to consider six key questions when considering changes to Medicaid. The choices represented by these questions are identified in a recent report on state Medicaid reform by Deloitte Consulting and provide a good framework for discussion:^{xix}

- What should be the core functions of our Medicaid program?
- Are we going to manage the services in our program directly, or will we contract for them?

- Where do we want to be on the continuum between “traditional” Medicaid benefits and coverage and free health care for all low-income residents?
- Which cost savings and policy levers will we use to reduce, or at a minimum contain, the costs of our program?
- Will we go beyond simple program administration and use our Medicaid program to actively control the costs and quality of health care in our state?
- To what degree will Medicaid recipients share the state’s burden of cost reduction and quality?

THE BOTTOM LINE

Kentucky has been fortunate in that we have been able to balance the state budget without significant cuts in Medicaid eligibility and reimbursement. However, given the current rate of growth in Medicaid spending, the Commonwealth faces a “financial cliff” in 2011, when a billion dollars in additional federal Medicaid funding will expire.

The potential solutions are not about being punitive to recipients and providers, but are about using innovative solutions, such as the expansion of the Passport Health Plan, that resemble approaches found in the private sector. If we fail to confront these issues now, Medicaid spending will continue to spiral, and our ability to invest in education will be further reduced. In the long run, education is the one investment that can improve health, increase income and improve the quality of life for all Kentuckians.

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- ^v Medicaid programs feel weight of recession, Stateline.org, February 2009
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- ^x Overview: Kentucky State Government Budgets, Fiscal Years 1986-88 through 2008-10, Taylor-Gray Associates, September 2008
- ^{xi} Ibid
- ^{xii} Kunst, A. E., J. J. M. Geurts, and J. van den Berg. 1995. “International Variation in SES Inequalities in Self-Reported Morbidity.” *Journal of Epidemiology and Community Health* 49:117-123; Liao, Youlina, Daniel McGee, Jay Kaufman, Guichan Cao and Richard Cooper, 1999. “Socioeconomic Status and Morbidity in the Last Years of Life.” *American Journal of Public Health* 89:569-572; Manton, K. G., Eric Stallard and Larry Corder, 1997, “Education Specific Estimates of Life Expectancy and Age-Specific Disability in the U.S. Elderly Population.” *Journal of Aging and Health* 9:419-450; Carlson, Parham, 2000, “Educational Differences in Self-Rated Health During the Russian Transition.” *Social Science and Medicine* 51:1363-1374; Mirowsky, John and Catherine E. Ross. 1998. “Education, Personal Control, Lifestyle, and Health.” *Research on Aging* 20:415-449; Ross, Catherine E. and Chia-Ling Wu, 1995, “The Links between Education and Health.” *American Sociological Review* 60:719-745; Williams, David R. and Chiquita Collins, 1995, “US Socioeconomic and Racial Differences in Health: Patterns and Explanations.” *Annual Review of Sociology* 21:349-386
- ^{xiii} Healthier and Wealthier: Decreasing Health Care Costs by Increasing Educational Attainment, Alliance for Excellent Education, 2006
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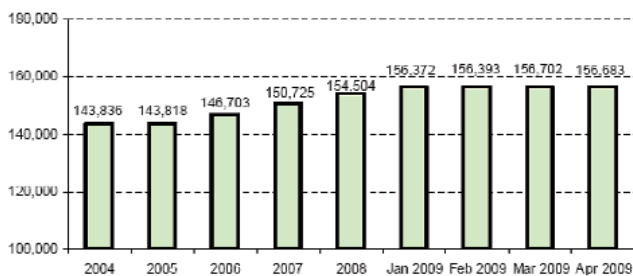
Reasonable changes in system could save \$200 million

One area of possible savings for Kentucky state government is public employee health benefits. The Chamber has identified how reasonable changes to the state's program could generate nearly \$200 million in additional funding for Kentucky's 2010-2012 budget. The Chamber's research and recommendations are detailed below.

THE PROBLEM

A Major Cost: At a cost of more than \$1.2 billion a year, Kentucky state government pays monthly health premiums for 156,683 active state employees, state retirees and teachers (depicted as number of contracts in the graph below).ⁱ The Kentucky Employees Health Plan (KEHP) covers more than 6% of all Kentuckians – more than 258,000 teachers, state employees, retirees and their dependents (depicted as the number of covered lives in the graph on the following page).ⁱⁱ An estimated 12% of Kentucky's General Fund budget now goes to pay these premium costs.

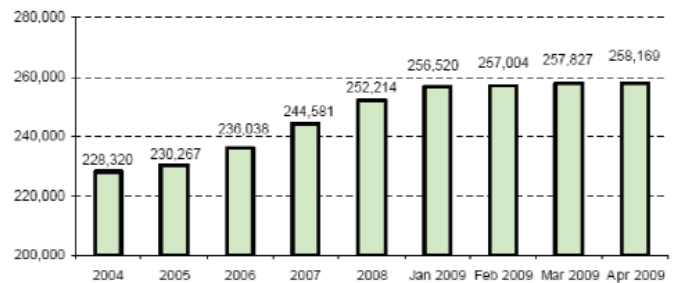
Number of Contracts
for 2004-2008 and by Month for 2009



Rate of Growth Unsustainable: State government's contributions for employee health insurance are growing at more than five times the rate of overall state spending. According to recent research by the Kentucky Chamber, total General Fund spending has increased by 33% since 2000. During the same period, the state's average monthly per employee contribution for health insurance has increased by more than 174% — from \$221/month in 2000 to more

than \$600 per month in 2010 (\$7,284/year).ⁱⁱⁱ

Number of Covered Lives
for 2004-2008 and by Month for 2009

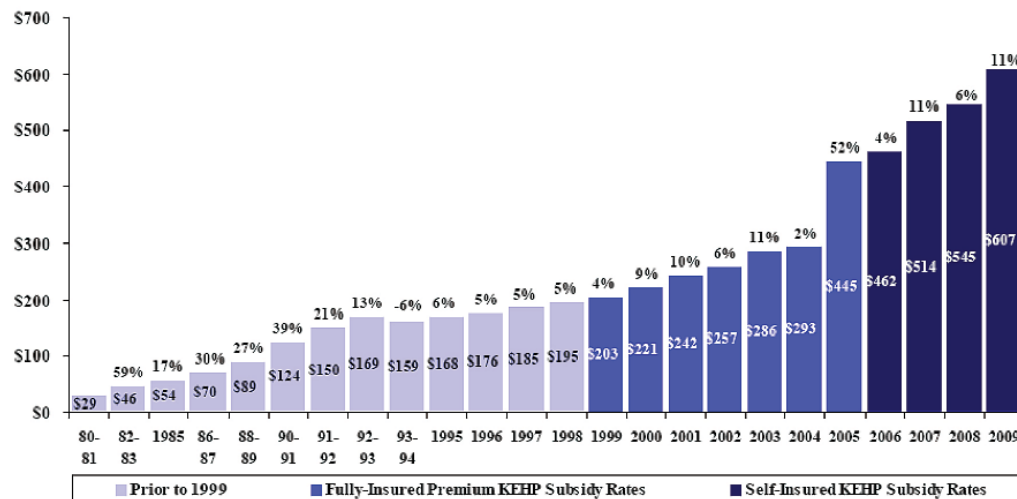


Health Costs Major Driver of Pension Costs: Retired public employees receive the same health benefits as active state employees in Kentucky. As a result, the cost of health care is a key driver of rising pension costs, accounting for 55% of state government's contributions to its pension system.^{iv} Kentucky's pension systems currently face unfunded liabilities of more than \$26 billion.

Kentucky Government Pays Higher Percentage of Premiums: Kentucky exceeds the national average in the percentage of employees' single-coverage insurance premiums that the state pays (97% vs. 88% nationally).^v Meanwhile, private employers who offer health coverage in Kentucky (about 60% of all employers) pay an average of 80% of their employees' single-coverage premiums.^{vi}

Government Employees' Premiums Higher than Private Sector: The Kaiser Family Foundation reports that the average monthly single-coverage premium for Kentucky's private-sector employees in 2008 was \$344, or \$4,009 per year.^{vii} With a monthly premium of \$545 in 2009, the Kentucky Employee Health Plan exceeds the average private-sector cost by 58%.

KEHP Monthly Health Insurance Subsidy Per Employee And Annual Percentage Increase: 1980-2009



Source: Kentucky Employees Health Plan, Eighth Annual Report, October 2009

State Salaries Higher than Average Kentucky Wages: A frequently heard argument is that state workers earn less than those in the private sector. However, the average annual salary of a state employee was approximately \$38,000 in 2008-2009.^{viii} This is significantly higher than the average annual wage for all occupations in Kentucky, which is \$36,855, according to statistics compiled by the Kentucky Workforce Development Cabinet.^{ix}

Health Coverage Costs as a Percent of Salary: With an average salary for state employees of \$38,000, the \$6,540 annual cost of health insurance in 2009 (which is paid in addition to salary) would be 17.2% of salary. In Kentucky's private sector, with an average annual salary of \$36,855, the \$4,009 annual cost of health insurance would be 10.8% of salary.

State Health Coverage Richer than Private Sector Plans: There are a number of reasons that public health plans are more expensive than private sector plans:

- Coverage levels tend to be richer in public plans.^x
- Co-payments, contributions and other sharing approaches are typically lower in public plans than in private plans.^{xi}

As noted earlier, governments pay a higher percentage of single-coverage premiums on average than private businesses in Kentucky (97% for Kentucky state government vs. 80% for private employers in Kentucky).^{xiii}

Here are two key examples from Kaiser Foundation's 2009 Survey of Employee Benefits that show how the Kentucky Employee Health Plan (KEHP) benefits are richer than the average health plan in America. The key factor is the amount of co-pays:

- Nationally, the average co-payment for a physician office visit is \$20, compared to a co-pay of \$10 to \$15 in the KEHP (depending on the plan chosen by the employee).
- Most health plans have a four-tier prescription drug benefit. The average co-payment for each tier is as follows:

	National Average	KEHP
Generic	\$10	\$5
Preferred	\$27	\$20
Non-Preferred	\$46	\$40
Fourth-tier	\$85	N/A

Priorities Shifting from Education: Increased spending on public employee health benefits means fewer dollars are available for what should be Kentucky's top priority—education. In terms of the state budget, the share going to employee health costs is growing while education's share is getting smaller:

Since 2000, the percentage of the General Fund going to public employee health coverage has more than doubled—from 6.5% in FY 2000 to 12.5% in the current fiscal year.^{xiii}

K-12 education's share of General Fund appropriations has declined from a high of 48.2% in FY 1986-88 to 43.8% in the current fiscal year.^{xiv}

Postsecondary education's share declined from 16.9% in 1986-88 to 13.7% in the current fiscal year.^{xv}

The increased spending on public employee health benefits isn't entirely responsible for our shifting priorities. Growth in corrections and Medicaid also outpace overall government spending.

POTENTIAL SOLUTIONS

The combination of escalating costs, generous subsidies, a looming state budget deficit, and the shift away from education funding raises serious questions about the long-term sustainability of the Kentucky Employees Health Plan. The Chamber believes the following strategies will lower costs and provide public employees with health coverage while bringing public benefits more in line with the private sector.

Require public employees to contribute a reasonable amount for health insurance: As noted above, Kentucky state government pays for 97% of the cost of single health insurance coverage. The amount contributed by the state covers the entire cost of single coverage for all but the most expensive level of coverage offered to state employees (rates are higher for smokers).

2010 KEHP Rates

Commonwealth Maximum Choice

	Total Premium	Employer Contribution	Employee Contribution*
Single	\$575.42	\$575.42	\$0.00
Parent Plus	\$851.46	\$742.60	\$108.86
Couple	\$1,177.68	\$843.02	\$334.66
Family	\$1,341.52	\$943.20	\$398.32
Family Cross Reference**	\$670.76	\$661.10	\$9.66

Commonwealth Optimum PPO

	Total Premium	Employer Contribution	Employee Contribution*
Single	\$616.28	\$588.78	\$27.50
Parent Plus	\$889.54	\$713.02	\$176.52
Couple	\$1,363.40	\$893.88	\$469.52
Family	\$1,515.36	\$954.20	\$561.16
Family Cross Reference**	\$757.68	\$729.34	\$28.34

Commonwealth Capitol Choice

	Total Premium	Employer Contribution	Employee Contribution*
Single	\$594.14	\$589.14	\$5.00
Parent Plus	\$896.06	\$752.04	\$144.02
Couple	\$1,347.50	\$903.38	\$444.12
Family	\$1,490.60	\$964.76	\$525.84
Family Cross Reference**	\$745.30	\$732.42	\$12.88

Commonwealth Standard PPO

	Total Premium	Employer Contribution	Employee Contribution*
Single	\$486.40	\$486.40	\$0.00
Parent Plus	\$749.84	\$741.56	\$8.28
Couple	\$1,127.80	\$845.62	\$282.18
Family	\$1,253.56	\$965.12	\$288.44
Family Cross Reference**	\$626.78	\$626.78	\$0.00

Source: Commonwealth of Kentucky, 2010 Rates, Kentucky Personnel Cabinet

It is common in the private sector to require employees to pay a portion of the premium. The average private sector employee now pays 20% of his/her health premium, compared to only 3% for state employees. With approximately 156,683 active employees and retirees, the following provides examples of the potential savings that could be generated by requiring state employees to contribute \$25 to \$50 per month toward health coverage:

- \$25 per month employee contribution = \$47 million total annual savings
- \$50 per month employee contribution = \$94 million total annual savings

This approach would not actually cost employees the full amount of their contribution. Because contributions for health insurance are not subject to tax, requiring employees to contribute \$25 to \$50 per month for health insurance would in turn reduce the employees' tax liability by \$300 to \$600 annually, a tax savings of up to \$149 per year for an average state employee.

Provide employees with a fixed dollar amount indexed for inflation:

Some local governments in Kentucky provide employees with a specific amount of money that they can use to buy life/health insurance and other fringe benefits. Kentucky could adopt a similar approach

and adjust the amount each year based on inflation or availability of funds rather than the cost of the benefit package (which is the current approach). This method would essentially require employees to contribute some additional amount for health coverage, depending on the level of coverage selected. Total savings would depend on the amount of subsidy provided.

Incentives for Wellness: More than half (60%) of the costs in the Kentucky Employees Health Plan result from treatment for a short list of health conditions (such as musculoskeletal, circulatory, digestive and other chronic problems). Kentucky has launched efforts to reduce these costs by promoting wellness and better management of chronic conditions. The state offers a voluntary "informed care management" program where nurses work with participants to lower their health costs. In 2008, more than 95,000 employees with chronic conditions were targeted for this program, and 15% were engaged in the program at some level (up from 10% in 2007), with 4% actively engaged with a nurse (up from 2.7% in 2007).^{xvi}

The Chamber believes Kentucky should promote personal responsibility to improve individuals' health and reduce health costs. A number of states are moving aggressively by offering incentives to employees who participate in wellness activities. The National Governors Association Center for Best Practices has identified several state programs as models:

Alabama: Starting in 2010, Alabama state employees will be required to pay a \$50 per month health insurance premium (an increase from the current \$25 per month). Employees can avoid this increase by participating in a health screening program which checks blood pressure, cholesterol, glucose and body mass index, etc.) If an employee is found at risk, he/she can still avoid the premium increase by participating in wellness and self-management programs. Employees who do not complete health screenings or manage conditions will be required to pay the higher premium.^{xvii}

Oklahoma: By completing a health risk assessment and attending two follow-up evaluations with primary care physicians, Oklahoma state employees can earn up to \$500 a year in cash awards. State agencies fund the awards and decide whether to participate in the program. Participating agencies can choose the level of awards to offer employees: \$100 (bronze level); \$300 (silver level); or \$500 (gold level) for completing the assessment and physician visits. More than 4,000 state employees and half of all state agencies have participated in this program.^{xviii}

South Dakota: State employees who meet exercise goals (exercising five days a week for three consecutive months) can receive \$100 per year in a Health Reward and Wellness Account. Funds in the account can be used in one of two ways: for co-payments, deductibles and coinsurance; or for exercise equipment and gym membership.^{xix}

Arkansas: Under the Healthy Lifestyle Program, state employees can earn vacation time by participating in health-related activities

such as quitting smoking, exercising and eating healthy diets. The maximum time awarded is three days of extra time off, which employees can earn by committing to exercise three days a week, eat five servings of fruits and vegetables five days a week, and not smoke for a year.^{xx}

The Chamber recognizes the value of wellness activities in reducing health costs and has recently developed a Workplace Wellness Tool Kit to help employers set up effective wellness programs. The Chamber also supported an increase in Kentucky's cigarette tax to discourage smoking in recognition of the fact that smoking-related illnesses cost Kentucky more than \$1.5 billion per year in health costs. The Chamber strongly supports state government adopting one or more

of these approaches to encourage public employees to participate in wellness programs.

THE BOTTOM LINE

The Chamber believes that public employees make a positive difference in the lives of Kentuckians every day. The spiraling costs of public employee health insurance make it essential that Kentucky find ways to ensure the ongoing sustainability of this important benefit. Rising insurance costs mean less funding will be available for the salaries of state employees, to improve schools, build roads, and pay for fire and police protection. Kentucky needs to act now to develop the long-term strategies needed to counter the threat that benefit costs represent to the basic services that its citizens must have.

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^{xviii} Ibid

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Ky. Chamber: State workers should contribute more for health insurance

From the *Lexington Herald-Leader* — Nov. 9, 2009

By Jack Brammer

FRANKFORT — The Kentucky Chamber of Commerce recommended Monday that state employees and retirees pay more for their health insurance, a move that could shave \$188 million from a potential \$1.2 billion state budget shortfall over the next two years.

The business group said Kentucky can no longer afford to provide generous health benefits that dwarf what most private workers receive.

The average state worker pays for only 3 percent of his or her health insurance premium, compared to 20 percent for the average private employee in Kentucky, said Dave Adkisson, president and chief executive officer of the chamber.

The total cost to provide health coverage for 258,169 teachers, state employees, state retirees and their dependents is more than \$1.2 billion a year — about \$607 a month for each of 156,683 state workers and retirees, Adkisson said.

Since 2000, the percent of the state budget going to public employee health coverage has more than doubled — from 6.5 percent to 12.5 percent this year, he said.

Lee Jackson, president of the Kentucky Association of State Employees, immediately blasted the plan.

“We would oppose any attempt to tinker

with state workers’ health care benefits,” he said.

Gov. Steve Beshear and legislative leaders voiced appreciation for the chamber’s work but took a wait-and-see approach on the proposal.

“We continue to research options for our own employees, and we always welcome additional input from our citizens,” Beshear said in a statement.

Senate State and Local Government Chairman Damon Thayer, R-Georgetown, said the state “is going to have to look at every option.

“We are not going to raise taxes, so we will have to look at reducing the size of government,” he said.

Thayer’s counterpart in the House, Rep. Mike Cherry, D-Princeton, said he would give the chamber’s plan “careful study ... but I can’t say I’m endorsing it.”

Adkisson said in a conference call with reporters that requiring state workers to contribute \$50 a month more for health coverage would save the state about \$94 million a year.

Such a move would not actually cost employees the full amount of their contribution, he said, because those contributions are exempt from taxes.

Employees would be able to reduce their tax liability by \$600 a year, a tax savings of up to \$149 a year for an average state worker, Ad-

kisson said.

A summary of the chamber plan also noted the “frequently heard argument” that state workers should get more benefits because they earn less than those in the private sector.

However, the chamber said the average annual salary of state employee was about \$38,000 in 2008 — higher than the \$36,855 average annual wage for all occupations in the state.

Another cost-cutting solution, Adkisson said, would be to provide employees with a fixed dollar amount indexed for inflation to buy life and health insurance and other fringe benefits.

This would require employees to contribute some additional amount for health coverage, depending on the level of coverage selected. Total savings would depend on the amount of subsidy provided.

Adkisson also suggested incentives to employees who participate in wellness programs.

He noted that Alabama will up its state health insurance premiums from \$25 a month to \$50 a month next year, but an employee can avoid the increase by participating in a health screening program and, if necessary, a wellness program.

Some states also provide cash awards and vacation time, he said.

From the *Courier-Journal*, Jan. 3, 2010

When the Kentucky General Assembly convenes Tuesday, lawmakers will face the formidable challenge of enacting a balanced budget for fiscal 2010-12 in the face of unprecedented revenue shortfalls and an economy whose performance offers little hope of immediate relief.

Like many other states, Kentucky has welcomed federal stimulus money as a means of plugging some sizeable budget holes, and it has a few hundred million more in federal funds to use for that purpose. But the state will need much more than that if projections of a shortfall exceeding \$1 billion are on target.

More troubling is the fact that state spending in recent years shows Kentucky's budget priorities shifting from investing in education and toward providing more money for jails, public employee benefits and Medicaid.

The state shortfalls have led some people to conclude that revenue collections are not keeping pace with the economy and that Kentucky needs to modernize its tax system to address that situation.

The size of state government relative to the state's economy has remained consistent over the years (about 6 percent of Kentucky's Gross State Product).

With those facts in mind, we took a closer look at the state budget to get a better sense of where the money is actually going. We found that spending in the three areas mentioned earlier — corrections, Medicaid and public employee health benefits — is growing faster than both the state budget overall and the state economy.

The Chamber's efforts to raise awareness about this budget reality should not be interpreted as being dismissive of the needs reflected in the areas of high-growth spending. Medicaid, in particular, is an important part of Kentucky's health-care system and is a vital program for many of the state's citizens and health care providers.

Expand Medicaid-managed care in the more populous areas of Kentucky and identify appropriate ways to incorporate managed care in other areas based on regional demographics and the number of health providers.

Incorporate wellness into Medicaid by shifting a larger portion of spending to promoting wellness, requiring higher co-pays from recipients who smoke, giving incentives to providers to order wellness or preventive services; providing a statewide smoking cessation program for recipients. (Kentucky is one of only five states without such a program.)

Review Kentucky's persistent felony offender law to determine whether it is too broad.

Consider the implementation of a stringent community supervision system to prevent parolees from returning to prison.

Consider expanding the use of privately operated prisons.

Require state employees to contribute a reasonable amount for their health insurance, a common practice in the private sector.

Provide employees with a fixed dollar amount, indexed for inflation, that they can use to buy life/health insurance or other fringe benefits.

Offer incentives to employees who participate in wellness activities.

In tough economic times — and all the time — state government must do what every family has to do around the kitchen table and every business person has to do if he or she expects to stay in business. We have to establish spending priorities, make tough decisions and fix the leaks that drain the money away from financing the priorities we have established to ensure progress for Kentucky.

No Free Insurance

Editorial from the *Frankfort State Journal* — Nov. 11, 2009

State workers undoubtedly are less than enthusiastic about a Kentucky Chamber of Commerce proposal that they pay more for health insurance to help the state balance its budget. The Lexington Herald-Leader reported Lee Jackson, president of the Kentucky Association of State Employees, promised to oppose any attempt to “tinker” with members’ health care benefits.

But the chamber has a point. With state government facing a budget shortfall that may top \$1 billion, can the public afford to continue subsidizing benefits far more generous than those found in the private sector? The Courier-Journal reported state government pays 97 percent of workers’ health insurance premiums while the state’s private employers cover only 80 percent of the cost their work forces incur. Chamber President David Adkisson said nearly \$200 million could be saved by having state workers pay a bigger share of their insurance bills.

This is not a new debate. Former Gov. Ernie Fletcher also proposed state workers

take on more of the insurance burden but had to back down when public employee and teacher groups protested. More recently, education advocates have complained about the state borrowing millions from teacher retirement funds to pay for retired teachers’ health insurance. The fact that state workers have received just a 1 percent pay raise each of the past two years will make them even less open to the idea of bailing state government out of its financial predicament.

Retired teachers who appealed to the state for help in dealing with their insurance shortfall stressed the importance of providing benefits that attract people to public-service careers. Somewhat the same argument has been made for those employed by state agencies. But after decades of upgrades in public pay and benefits, the rationale is no longer as persuasive as it once was. While there was a time when educators were practically expected to take vows of poverty out of dedication to learning, teacher salary growth

now outpaces what’s found in some private-sector fields that once had a slight edge.

The chamber reported the average state employee made \$38,000 last year while the average worker in all occupations statewide earned just \$36,855.

Adkisson figured the state would save \$94 million a year if its workers contributed \$50 more each month – no small amount for people subsisting on minimal salary adjustments, and yet their counterparts in the business world are enduring similar sacrifices.

Remember that the chamber sees things from a business perspective. It wants members to prosper, partly by holding down taxes and thereby enhancing their profits. Nevertheless, the benefit discrepancy between public and private sectors is real. There’s no such thing as free insurance, and taxpayers forced to cough up more for their own coverage understandably have little sympathy for government employees who get a virtually free ride.

Not sustainable: Chamber knows prison costs are threatening other programs

Editorial from the *Ashland Independent* — Aug. 10, 2009

At first glance, David Adkisson, president of the Kentucky Chamber of Commerce, would seem to be an odd advocate for reducing Kentucky's prison population.

After all, why should the organization that represents Kentucky's business community care about the number of people who are behind bars? Aren't those people there because they broke the law, including committing crimes against businesses? Doesn't having them locked up protect both businesses and individuals from becoming victims of crime?

But when one considers how much money state government spends on housing prisoners and how quickly those costs are rising, the Chamber's interest in this issue is understandable. After all, every dollar spent on prisons is less money for other state programs that have a more positive impact, including education.

"The current rate of growth of putting people in prison in Kentucky is not sustainable," Adkisson told a legislative panel on the judiciary Friday. "The potential solutions are not about being soft on crime, but are about rethinking how we deal with offenders in a way that lowers the cost."

It costs \$19,000 a year to house a prison inmate in Kentucky. In contrast, it costs only \$9,200 a year to educate a child in public school and \$7,000 a year to send him to a state university or technical and community college.

"The state is consciously or unconsciously shifting its priorities away from education toward some of these things that are driving the state budget," Adkisson said. "Kentucky is spending more to address the cost of failing to invest in education than it is on students."

Yet statistics show that the more education a person has the less likely he or she is to commit crimes. The prisons are full of high school dropouts, while the number of col-

lege graduates behind bars is relatively few.

Thus, Adkisson argues, it makes more sense to invest in giving young people an opportunity to learn the skills that will lead to gainful employment than to house them in prisons which do little to help inmates succeed once released. Thus, many commit new crimes and return to prison.

Of course, its burgeoning prison population is hardly a new problem in Kentucky. Unfortunately, most of the efforts to reduce prison populations have been met with opposition from state prosecutors. Sen. Robert Stivers, R-Manchester, chairman of the Joint Interim Judiciary Committee, said committee members are becoming frustrated with get-tough-on-crime prosecutors who have resisted nearly every effort aimed at reducing the prison population, without offering alternative proposals to reduce prison costs.

One sensible suggestion — once again opposed by prosecutors — is to amend the state's Persistent Felony Offender (PFO) law back to the way it was originally intended.

University of Kentucky law professor Robert Lawson, who helped write the first PFO law in the 1970s, said its original intent was to extend the length of sentences for those who have spent time in prison but committed new crimes soon after their release.

However, since then, the PFO law has been amended so that prosecutors now use it to extend sentences for less-serious underlying crimes committed during the commission of the primary crime for which the inmate is sentenced. Lawson cites the PFO law as a major reason why state's prison population has climbed from 3,000 in the early 1970s to some 22,000 today.

However, Chris Cohorn, president of the Kentucky Commonwealth's Attorneys Association, said the PFO law is working as intended. However, he did agree that legislators should take a look at what crimes should trigger the PFO law.

At least Cohorn, Commonwealth's attorney for Warren County, admits that the state sometimes is too tough on offenders. That's more than some of his colleagues will do.

Todd County Attorney Harold Mac Johns told the Interim Judiciary Committee that as a prosecutor, it's difficult to find people who are in prison who don't deserve to be there.

Adkisson said in addition to amending the PFO law, the state should consider an expansion of Kentucky drug courts and possible privatization of prisons. We're not so sure about privatizing prisons, but the best drug courts work well.

A year ago, the Kentucky Criminal Justice Council offered the legislature a report filled with recommendations on how the state may reduce its prison population while maintaining public safety. Among other things, the report said the state might change some of its drug laws to reduce penalties. It also recommended making possession of less than a gram of cocaine a misdemeanor instead of a felony and raising the felony theft threshold from \$300 to \$500.

The one positive step legislators took in response to that report was to approve legislation offering first time nonviolent drug offenders a diversion program that would offer long-term treatment. Since many crimes committed in Kentucky are to feed the perpetrators' drug habit, it only makes sense to offer treatment instead of punishment. If treatment is successful in getting individuals to kick their drug habit, the chances of them committing new crimes is greatly diminished.

Beyond that one law, however, legislators did little to implement the suggestions of the Criminal Justice Council. But this is a problem that cannot be ignored. If Kentucky does not find ways to reduce its prison population, the cost of housing inmates will continue to drain funding for other essential programs. That makes no sense.

State workers should pay more for health plans

Editorial from the *Bowling Green Daily News* — Nov. 14, 2009

The Kentucky Chamber of Commerce has a good suggestion when it says that state employees should be asked to pay more of their health insurance costs to help ease the strain on a state budget, which is facing very grim prospects.

The group says that state workers receive more generous benefits than most private employees and that state government costs for public employee health insurance soared by 174 percent in the past decade.

It doesn't seem unreasonable to expect some adjustments at a time taxpayers, as well as state government, have tightened their belts.

Chamber President Dave Adkisson had a very good point when he noted that requiring state workers to contribute \$50 a month more for health coverage would save the state \$94 million and would not cost employees the full amount because those contributions are exempt from taxes.

This proposal doesn't seem like too much to ask, although opposi-

tion is likely to be strong. Adkisson believes these changes could generate nearly \$200 million in savings in the 2010-12 budget. At a time when our state is struggling to stay afloat, why wouldn't the state consider an option that could generate these kinds of savings.

Spending for health insurance for state employees has increased dramatically in the past 10 years. According to recent research by the Kentucky Chamber, total general fund spending has increased by 33 percent since 2000. During the same period, the state's average monthly per employee contribution for health insurance has increased by more than 174 percent - from \$221 a month in 2000 to more than \$600 a month in 2010.

Adkisson called these trends "unsustainable."

A level playing field more on par with private employees is needed here and the Kentucky Chamber of Commerce's proposal merits serious consideration.

State workers should help with benefits fix

Editorial from the *Owensboro Messenger-Inquirer* — Nov. 13, 2009

Previous discussions about how to confront problems funding Kentucky's benefits programs for state employees have often included the pledge to uphold the "inviolable contract" the state has made with its employees.

That contract includes generous retirement and health coverage benefits that the state is struggling to cover, with the health benefits alone for next fiscal year carrying an estimated cost of \$1.2 billion to cover more than 258,000 state employees, retirees and teachers. To put that in perspective, the state's entire budget for the current fiscal year is roughly \$9.7 billion.

But if Kentucky is going to be able to get a handle on the rising costs to provide health care coverage to its past, current and future employees and teachers, those receiving the benefits must lend a hand.

That's what was proposed by the Kentucky Chamber of Commerce earlier this week. The suggestion is no doubt unpopular with state employees and teachers, but it could help guarantee the viability of their pension and health insurance system into

the future.

Chamber President David Adkisson has proposed that state employees and teachers begin bearing a larger cost of the health insurance they are provided through the state. Adkisson's idea is to require state employees and teachers to pay an additional, tax-deductible \$50 each month toward their health insurance premiums to help offset costs that have risen nearly 200 percent in the last decade.

The additional payment would bring Kentucky more in line with national averages for public employee insurance plans and shave an estimated \$188 million off the state's budget over the next two years. Kentucky, which currently pays 97 percent of premium costs, compared to 88 percent by other state governments around the country. The private sector pays 80 percent of health insurance premium costs on average, according to the chamber's figures.

Yes, current and retired state employees took their jobs with the understanding that the state would offer these generous benefits. Part of the rationale for such a generous

benefits package is to offset salary levels that lagged behind the private sector. That doesn't appear to still be the case, with the chamber noting that the average annual salary of a state employee was \$38,000 in 2008, which is higher than the \$36,855 average annual salary for all other occupations in Kentucky that year.

But the criticism that the chamber's suggestion only seeks to balance the budget over the next two years on the backs of state workers and teachers is off the mark. This is an effort to make the state benefits plan more sustainable for state employees in the future. The "inviolable contract" won't mean very much if the state's pension plan becomes even more grossly underfunded or health insurance costs continue to skyrocket.

Kentucky has been unable so far to make the changes to its public employee pension and health care plans to guarantee its public servants will be taken care of into the future. Taxpayers are being called on to meet that obligation, and state employees should be willing to offer their help, too.



Impacting your bottom line

When the Kentucky General Assembly meets in Frankfort each year, its actions can profoundly affect your bottom line. That's why every year the Kentucky Chamber — one of the most effective lobbying teams in Frankfort — is there, working for Kentucky business. We do whatever it takes to make sure that Kentucky businesses of every type and size have a powerful and respected voice in Frankfort.

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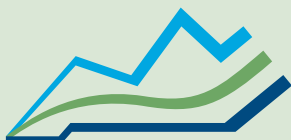
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