



COMMONWEALTH OF KENTUCKY
OFFICE OF THE GOVERNOR

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December 29, 2009

Dear Leadership of the General Assembly:

Now that we have official revenue estimates from the Consensus Forecasting Group (CFG) for the current and next two fiscal years, it's imperative that we begin to work together on the unprecedented challenge of balancing the budget. I'm writing you today to lend momentum to that process and to make sure all of us recognize the magnitude of the problem.

Let me start by offering two cautions. One, while it's encouraging that the dismal CFG numbers were an improvement from the even more dismal October forecast, any relief we feel should be short-lived. The bottom line is we are still confronted by a huge revenue shortfall made worse by the increasing obligations of state government. My second caution relates to those obligations. Some people have taken the so-called revenue shortfall detailed by the CFG – the difference between projected revenues and current year spending – as the definition of the problem. But they're failing to take into account an array of rising costs such as debt service and Medicaid obligations, obligations we cannot avoid.

So it's important that we recognize that the CFG numbers represent just one facet of the problem -- the challenge before us is actually a lot tougher.

Nevertheless, our decisions for how to address the budget over these next two and a half years should be guided by both our priorities and the actions we have already taken over the past two years to deal with the multiple revenue shortfalls resulting from the national economic crisis.

Actions to date

Since I became Governor, we have reduced our budget five times, cutting spending by over \$850 million, and in the coming days, we will address the additional revenue shortfall this fiscal year of \$100 million. We are operating state government with sixteen-hundred fewer state employees than when I took office, the smallest state government workforce in 20 years.

Despite these revenue shortfalls, we have managed to preserve funding for the SEEK formula in our K-12 education system, healthcare for our most vulnerable citizens, and public safety. In the most recent, and largest of the reductions, which occurred last June, eighty-five percent of General Fund spending was deemed to be a priority that could not be cut. Attachment A reflects a listing of those agencies and programs. As a result, the burden of cuts fell on the spending of just fifteen percent of the government.

Unlike many other states, we have managed to stave off mass layoffs of state employees, and we have been able to maintain service levels in most areas of state government. Our ability to do that has been dependent on federal stimulus assistance, spending down all of our reserves, raising revenue from tobacco and alcohol sales, making efficient spending reductions, and asking all of our state employees to do more with less.

We cannot ignore, however, the cumulative impact to much of the government of these five (and soon to be six) successive budget cuts. Many agencies have been cut by as much as twenty to twenty-five percent over the last two years. Many of these agencies are to the point where any additional significant cuts will cause the elimination of vital services and personnel. Attachment B includes a summary of the cumulative impact of budget cuts to these important state programs and agencies.

Daunting outlook for the next biennium

The numbers we received last week from the CFG paint a challenging picture for the upcoming biennium. The good news is that revenue growth is predicted over the next couple of years. The bad news is that the revenues predicted to come in the door are not sufficient to meet our current expenditure levels. Moreover, we must address several areas of government where costs are going up and the obligation to maintain the services must be fulfilled.

The newspapers have been reporting a gap between projected revenues and current spending levels as the "budget shortfall" that must be addressed. Unfortunately, the challenge is much greater than that. Just to name a couple of examples, the increased amount of debt service needed to pay for bonds already authorized in the prior budget and the increased cost to maintain our Medicaid program which is growing in both costs and those eligible for the program during this recession, are budget requirements not acknowledged in the "budget shortfall" being expressed in the media.

Let's look at some numbers.

	(\$millions)	
	FY 11	FY 12
General Fund Revenue Estimate	8,490.8	8,808.8
Stimulus - State Fiscal Stabilization Fund	293.0	0.0
Stimulus - Medicaid	257.0	0.0
Resources	9,040.8	8,808.8
Base Level of Spending in Current Year	9,107.0	9,107.0
Medicaid Requirements*	248.0	353.0
Debt Service for Already Authorized Bonds	242.0	239.0
Spending Needs	9,597.0	9,699.0
Shortfall	(556.2)	(890.2)

Shortfall Does Not Include Items Such as:

- Increased retirement contributions
- Health insurance increased costs
- Courthouses under construction
- Prison population growth
- Any increases in education funding
- Raises for teachers or state employees

* Medicaid numbers reflect Cabinet base budget request

As you can see, under this scenario, we have a shortfall of over \$550 million in FY 11 and almost \$900 million in FY 12.

And this scenario does not yet include any increase in retirement system contributions, the challenge in the Teachers' Retirement System to fund health insurance, the increased cost of funding our health insurance program for state employees and teachers, the cost of opening new courthouses coming on-line, prison population growth, any increases in education funding, or raises for state employees and teachers. It likewise does not address the capital budget or projects in any way.

Continuing with this scenario as an example, if we balance this shortfall solely with cuts, and if the same eighty-five percent of the General Fund were exempt as was the case earlier this year, the cuts to the fifteen percent "rest of government" would be over forty-two percent in FY 11 and another twenty-five percent in FY 12, for a total of sixty-seven percent less than the current year. And this would be on top of the twenty to twenty-five percent cuts already absorbed.

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The bottom line is that we face a challenge much greater than many have anticipated. We will be working over the coming weeks to develop a budget plan for your consideration. We will have to consider many options on both the revenue and the spending side to close the gap that exists between the resources we have and the needs of our state over the next two years.

As a courtesy, I will be providing this same information to all members of the General Assembly. I look forward to working with you in the coming weeks and months as we find ways to meet the needs of our citizens with fewer resources.

Sincerely,

A handwritten signature in black ink, appearing to read "Steve Beshear", written in a cursive style.

Steven L. Beshear

Attachments

Attachment A

85% of General Fund Spending was spared from FY 10 cuts

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|-------------------------|------------------------|
| ▪ SEEK | ▪ Debt service |
| ▪ Medicaid | ▪ State Police |
| ▪ Universities | ▪ Public Advocacy |
| ▪ Health Insurance | ▪ Prosecutors |
| ▪ Corrections | ▪ PVAs |
| ▪ KTRS | ▪ Parks |
| ▪ Student Financial Aid | ▪ Economic Development |
| ▪ Mental Health | ▪ Veteran's Affairs |
| ▪ Coal Severance Funds | ▪ Career & Tech Ed |
| ▪ Local Jail support | ▪ Adult Education |
| ▪ KET | ▪ Others |
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Attachment B

Cumulative impact of cuts to agencies is troubling

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|---|-----|
| ▪ Finance and Administration | 28% |
| ▪ Economic Development | 24% |
| ▪ Constitutional Offices | 24% |
| ▪ Arts & Heritage Agencies | 24% |
| ▪ Military Affairs | 23% |
| ▪ Non-SEEK K-12 Education (excluding health insurance) | 20% |
| ▪ Council on Postsecondary Education | 18% |
| ▪ Education & Workforce Dev. Cabinet | 18% |
| ▪ Environmental Protection | 18% |
| ▪ Justice & Public Safety (excluding Corrections & Public Adv.) | 13% |
| ▪ Natural Resources | 12% |
| ▪ Non-Medicaid CHFS | 10% |
| ▪ Universities | 7% |
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