Modernizing state government emerged as a goal for the Kentucky Chamber of Commerce in its 2007 New Agenda for Kentucky initiative. One key to achieving that goal emerged as an imperative: identifying trends in state spending to determine whether tax dollars are being invested in areas that ensure future prosperity. That was the focus of state spending research commissioned by the Chamber in 2009 – research that found that three major areas of unsustainable spending – Medicaid, corrections and public employee health benefits – were taking money away from education and other key programs. With education being the top public policy priority for Kentucky’s business community, the Chamber began a year-long campaign to raise lawmaker and public awareness of The Leaky Bucket of state spending and its negative implications for the future.

The Leaky Bucket campaign was anchored by research detailing spending trends in Kentucky and the state’s relative position in the nation. A reader-friendly document, with a cover illustration of a leaking water bucket, was distributed statewide – to Chamber members, state legislators, opinion leaders, news reporters and others – and the message was promoted through speeches and press conferences across the state.

SYNOPSIS
Needs Identification

In 2009, a major state revenue shortfall in the Commonwealth of Kentucky led many Kentuckians to conclude that revenue collections were not keeping pace with the economy and that the state needed to modernize its tax system to address the situation. Before joining the call for tax changes that would have drastically affected the state’s business climate, the Kentucky Chamber asked the University of Kentucky’s Center for Business and Economic Research to study how state spending was tracking the state economy. The research concluded that:

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.
Armed with that information, the Chamber conducted a close review of spending trends and found three areas of spending to be growing at an unsustainable rate: corrections, Medicaid and public employee health benefits.

From 2000 to 2010, state spending on corrections grew 44%; spending on Medicaid grew 67%; and spending on public employee health care grew an alarming 174% -- all of this while the overall budget was growing by 33%. This represented a shift in Kentucky’s spending priorities – away from education.

To help lawmakers find solutions to reverse the unsustainable spending trends, the Chamber defined some solutions to help “plug the leaks.”

**Objective**

The main objective of *The Leaky Bucket* was to change the dialogue from “tax reform” to “spending reform” in Kentucky. It was the Chamber’s hope that a change in dialogue would encourage lawmakers to enact legislation that would lead to more responsible spending in the areas of corrections, public employee health benefits and Medicaid, ultimately leaving more tax dollars available for education.

**Communications Piece**

*Branding*

The title “The Leaky Bucket” was chosen to illustrate how state revenue was quickly leaking from the budget due to the unsustainable spending in three key areas – and that no amount of revenue would ever be enough until the leaks were plugged. The title was illustrated simply with modified stock photography -- creating a dynamic cover for the piece and an easily recognizable image that also worked as a logo throughout the campaign.

*Printed Document*

The printed document contains the results of the research conducted by the University of Kentucky and the Chamber’s researchers as well as recommendations on ways to curtail spending in the three major “leaks.”

*Media Efforts*

Staff of the Chamber held several news conferences, attended editorial board meetings, appeared on several Kentucky news talk shows, authored op-eds and distributed news releases to media outlets (print, television and radio) across the state during the campaign. *(Note: News clippings from throughout the campaign are in section 1 of this binder.)*

*Presentations throughout state*

Kentucky Chamber President and CEO Dave Adkisson testified before legislative committees and made more than 20 presentations on *The Leaky Bucket* to local chambers of commerce, rotary clubs, and associations throughout the state. The presentation was also featured during the Kentucky Chamber’s two largest events – the Economic Summit and Annual Meeting (held in July) and Kentucky Chamber Day (held in January).

*Ancillary Use*

*The Leaky Bucket* quickly became a buzzword among policymakers and opinion leaders and was cited numerous times by legislators in their comments on state spending and by editorial writers in addressing the state’s revenue situation.
Methodology

The Chamber commissioned research by the University of Kentucky’s Center for Business and Economic Research to determine the size of state government relative to the state’s economy and rate of growth in state revenue and the state economy.

To identify trends in state spending over the previous decade, the Chamber engaged the research services of consultants with combined experience in state government exceeding five decades (including work in executive and legislative budget offices, executive policy development, and drafting legislation for and advising the General Assembly). Their work documented state spending between fiscal years 2000 and 2010, the increases in specific spending categories relative to the overall budget, and Kentucky’s performance versus that of other states and the nation as a whole. The research further defined contributing factors to each of the “Leaky Bucket” areas of unsustainable spending, identified strategies and best practices in other states, and developed recommendations to “plug the leaks.”

Three individual reports were prepared for corrections, Medicaid and public employee health benefits as well as an overview of the entire research project. These were combined into *The Leaky Bucket* report – the basis of the campaign.

Budget

Research by the University of Kentucky Center for Business and Economic Research: $5,000  
Consultant fees for research and development of project: $7,650  
Design and artwork for document: $1,000  
Printing costs: $5,750  
Postage and mailing costs: $1,200  
Production of audio news release: $950  

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Total cost of campaign: $21,550

Evaluation

The Leaky Bucket campaign succeeded in changing the dialogue in the state Capitol to place a greater emphasis on the need for spending reform. The 2010 General Assembly, whose members made numerous references to *The Leaky Bucket* in their public comments, incorporated specific savings in public employee health insurance into the 2010-2012 biennial budget.

During the Chamber’s largest legislative event, Kentucky Chamber Day, Senate President David Williams said the following about *The Leaky Bucket*:

“This Leaky Bucket document is a tremendous document and the Chamber and the people who worked on it ought to be commended on it. There’s some vision in here.”

Both proponents and opponents of the Leaky Bucket approach to state spending have acknowledged the impact it has had in framing the conversation about state budget problems. It was recently reported that Speaker of the House Greg Stumbo (who is not always on the same page as the Kentucky Chamber) carries a laminated list of talking points in his suit pocket entitled ‘Fixing the Leaky Bucket’.

Kentucky legislators also created a task force, assisted by the Pew Center on the States, to review Kentucky’s corrections system with a goal of curtailing spending increases while protecting public safety. During the 2011 legislative session, lawmakers passed [Senate 161](#) and [House Bill 463](#) which were based
on the task force’s recommendations. The state budget office estimates the changes will generate gross savings of $422 million over 10 years from a reduction in incarceration.

Finally, another legislative task force was convened to review possible areas of saving in the state’s Medicaid program. That report had not been issued by February 2011.

The Leaky Bucket was also successful in changing the dialogue from “tax reform” to “spending reform” in Kentucky newspapers across the state. Editorials in almost every daily newspaper in Kentucky wrote favorably about The Leaky Bucket. Some editorial quotes are below. Full news stories and editorials appear on pages 11 through 16 of The Leaky Bucket.

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 Ashland Daily Independent
Aug. 11, 2009

There is no arguing the important role that Medicaid plays in the state’s health care system, and we need jails and prisons to house the bad guys. State workers are also entitled to health benefits. But spending in these three areas is out of control and lawmakers should consider some of the chamber’s suggestions for slowing it down.

Business First of Louisville
Jan. 8, 2010

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

Bowling Green Daily News
Nov. 14, 2009

Also, since the release of the Leaky Bucket local chambers of commerce in Kentucky have incorporated the “Leaky Bucket” recommendations into their legislative agendas. Chamber President and CEO Dave Adkisson has also been asked by several national groups to present the Leaky Bucket to other state chambers as an example of how a chamber can proactively affect the public policy dialogue in the state capital.

The Kentucky Chamber of Commerce is now preparing a follow-up to The Leaky Bucket to track developments, measure progress and identify areas of state spending that require further attention. The update will be released in July.
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.
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.

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).1

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.2 Compare that to how much tax money Kentucky spends on a student in elementary or secondary education – just over $9,200 a year3 – or on a full-time higher education student – just under $7,000 a year.4 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.5 Postsecondary education's share declined from 16.9% 1986-88 to 13.7% in the current fiscal year.6

Fastest Growth in Nation: Meanwhile, Kentucky has the fastest growing prison population in the country, according to a 2008 report by the Pew Center on the States.7 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 2007.8 Kentucky's prison population has surged since 2000, increasing by 50% to 22,000 inmates.9

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. According to FBI crime reports, Kentucky ranked 40th in the rate of violent crime in 2006, the most recent year data is available.10

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.11 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.\textsuperscript{iii} 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.\textsuperscript{iv} 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.\textsuperscript{v} 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.\textsuperscript{vi} 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.

**SOURCES**

\textsuperscript{i} Overview: Kentucky State Government Budgets, Fiscal Years 1986-88 through 2008-10, Taylor-Gray Associates, September 2008
\textsuperscript{ii} Kentucky Department of Corrections, Cost to Incarcerate, FY 08
\textsuperscript{iii} National Center for Education Statistics, Digest of Education Statistics
\textsuperscript{iv} http://www.higheredinfo.org/dbrowser/index.php?submeasure=67&year=2007&level=nation&mode=graph&state=0
\textsuperscript{vi} Ibid
\textsuperscript{vii} One in 31: The Long Reach of American Corrections, The Pew Center on the States, 2008
\textsuperscript{viii} Ibid
\textsuperscript{ix} Ibid
\textsuperscript{x} Crime in the United States, 2006, Federal Bureau of Investigation
\textsuperscript{xi} One in 31: The Long Reach of American Corrections, The Pew Center on the States, 2008
\textsuperscript{xii} Ibid
\textsuperscript{xiv} Kentucky Department of Corrections, Annual Report, 2005
\textsuperscript{xv} 09 RS SB 4, Kentucky General Assembly
\textsuperscript{xvi} Kentucky Department of Corrections, Cost to Incarcerate, FY 08
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.

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). 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. 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. The program is currently growing at a rate of 3,000 new recipients per month—three times the rate anticipated in the current budget. 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. 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. 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.”

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.xi

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.xii

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 that 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 morality.xiv 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.xv

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.xvi 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.xvii
— 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.xviii

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”.xix We think Passport fills the bill in this regard as it is more like private insurance that 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).xx

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 illnes 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 programs feel weight of recession, Stateline.org, February 2009
— 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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4. MS-264 Report Series, Kentucky Cabinet for Health and Family Services
5. Medicaid programs feel weight of recession, Stateline.org, February 2009
7. kentuckyatwork.ky.gov
9. The Health of Kentucky: A County Assessment, Kentucky Institute of Medicine, 2007
11. Ibid
17. Plan Overview, Passport Health Plan, October 2008
20. Medicaid Makeover: Six Tough (and Unavoidable) Choices on the Road to reform, Deloitte Research and Deloitte Center for Health Solutions
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). 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). An estimated 12% of Kentucky’s General Fund budget now goes to pay these premium costs.

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. 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). 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.

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. With a monthly premium of $545 in 2009, the Kentucky Employee Health Plan exceeds the average private-sector cost by 58%.
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. 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.

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.
- Co-payments, contributions and other sharing approaches are typically lower in public plans than in private plans.

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).

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:

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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.

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.

Postsecondary education’s share declined from 16.9% in 1986-88 to 13.7% in the current fiscal year.

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).
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).

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.

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.

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.

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.

SOURCES

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ii Kentucky Employees Health Plan, Eighth Annual Report, October 2009
iii Ibid
iv Kentucky Public Pension Work Group, State Funding Final Report, October 2008
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vi Average Single Premium per Enrolled Employee For Employer-Based Health Insurance, 2008, and Percent of Private Sector Establishments That Offer Health Insurance to Employees, 2008, Kaiser Family Foundation, statehealthfacts.org
vii Ibid
viii Certification of Actuarial Results, Cavanagh Macdonald Consulting for the Kentucky Retirement Systems, October 2008
ix Occupational Wages (OES), Kentucky Office of Employment and Training, 2009
x Public Employees’ Health Benefits Survive Major Threats, So far, Health Affairs, April 2006
xi Ibid
xii Average Single Premium per Enrolled Employee For Employer-Based Health Insurance, 2008, Kaiser Family Foundation, statehealthfacts.org and Kentucky Employees Health Plan, Eighth Annual Report, October 2008
xiv Ibid
xv Ibid
xvi Kentucky Employees Health Plan, Eighth Annual Report, October 2009
xvii State Employee Health Management Initiatives, Center for Best Practices, National Governors Association, July 2009
xviii Ibid
xix Ibid
Section 1:
Press Coverage
THE LEAKY BUCKET

Media Presence & Press Highlights

July 2009 — January 2010
EDITORIALS

1. **Health care and Kentucky’s budget: State’s plight makes case for reform**
   Lexington Herald Leader – Dec. 9, 2009
2. **A good proposal: Having public workers to pay part of insurance makes sense**
   Ashland Daily Independent – Nov. 23, 2009
3. **National Chamber has misstepped**
   Dawson Springs Progress – Nov. 19, 2009
4. **‘Tough on crime’ drains state funds: Change penal codes, add treatment**
   Lexington Herald Leader – Nov. 17, 2009
5. **State workers should pay more for health plans**
   Bowling Green Daily News – Nov. 14, 2009
6. **State workers should help with benefits fix**
   Owensboro Messenger Inquirer – Nov. 13, 2009
7. **Rein it in: State chamber’s proposal on benefit costs sensible**
   Paducah Sun – Nov. 13, 2009
8. **No free insurance**
   Frankfort State Journal – Nov. 11, 2009
9. **Not sustainable: Chamber knows prison costs are threatening other programs**
   Ashland Daily Independent – Aug. 11, 2009
10. **Business as role model**
    Frankfort State Journal – July 18, 2009

NEWS ARTICLES

1. **State must fix budget woes**
   Ashland Daily Independent – Nov. 20, 2009
2. **Candidates debate for Senate seat**
   Springfield Sun – Nov. 18, 2009
3. **State chamber president: Budget is a ‘leaky bucket’**
   Elizabethtown News Enterprise – Nov. 13, 2009
4. **Chamber: Raise Ky. workers’ health costs**
   Lexington Herald Leader – Nov. 11, 2009
5. **Chamber: State workers pay too little for insurance**
   Associated Press – Nov. 11, 2009
6. **Kentucky Chamber draws attention to effects of state budget shortfall**
   Paducah Sun – Sept. 24, 2009
7. **Chamber targets rising Medicaid costs**
   Paducah Sun – Sept. 23, 2009
8. **Lawmakers again look at corrections costs**
   Olive Hill Times (CNHI News Service) – Aug. 19, 2009
9. **More private prison use urged**
   Louisville Courier Journal – Aug. 9, 2009
10. **Chamber of Commerce: Ky. spending ‘unsustainable’**
    Associated Press – July 13, 2009
11. **Adkisson: State government needs to change**
    Owensboro Messenger-Inquirer – July 3, 2009
OP-EDS

1. ‘Leaks in the bucket’ threaten Kentucky’s progress
2. A closer look at state spending: Kentucky’s priorities are shifting away from education
   The Lane Report – November 2009
3. State budget: Chamber has $200 savings idea
   Four Rivers Business Journal (Paducah Sun) – November 2009

LETTERS TO THE EDITOR

1. Don’t meddle with insurance (From Jim Rice)
   Frankfort State Journal – Nov. 22, 2009
2. From Alma Markum
   Todd County Standard, Elkton Ky. – Nov. 18, 2009
3. Chamber proposals unwelcome (From Bill Wooldridge)
   Elizabethtown News Enterprise – Nov. 12, 2009
Section 2:
PowerPoint
2/25/2011

Dave Adkisson, President & CEO
Kentucky Chamber of Commerce

U.S. Economy
2009 GDP  - 2.7%

Kentucky State Government
2009 Tax Receipts  - 2.7%
State Government Expenditures as a Share of the Kentucky Economy

- General Fund Expenditure Per Dollar of Total Personal Income
- General Fund Expenditure Per Dollar of Gross State Product

Source: University of Kentucky Center for Business and Economic Research

Changing Priorities

<table>
<thead>
<tr>
<th>Category</th>
<th>2000-2010 Spending Growth</th>
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</thead>
<tbody>
<tr>
<td>Kentucky Economy</td>
<td>33%</td>
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<tr>
<td>State Budget</td>
<td>44%</td>
</tr>
<tr>
<td>Corrections</td>
<td>4%</td>
</tr>
<tr>
<td>Medicaid</td>
<td>67%</td>
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<tr>
<td>Public Employee Health Care</td>
<td>174%</td>
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<tr>
<td>P-12 (SEU)</td>
<td>36%</td>
</tr>
<tr>
<td>P-12 (Non-SEU)</td>
<td>13%</td>
</tr>
<tr>
<td>Postsecondary Institutions</td>
<td>21.9%</td>
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</tbody>
</table>
If education had held its own…

- $309 million more for K-12 education
- A 7.4% increase for education in 2008

The Leaky Bucket

Spending growing faster than state budget or economy

- Public Employee Health Benefits
- Medicaid
- Corrections
**Corrections**

- Persistent Felony Offender Law
- Classification of Offenses
- Underinvestment in Community Corrections
- Attacking Drug Abuse
- Increased Privatization

**Medicaid**

- Expand Medicaid managed care
- Incorporate wellness activities
- Improve Medicaid administration
- Incentivize responsible behavior
Public Employee Health Benefits

$ Require reasonable contributions from employees for health benefits
$ $50 per month employee contributions = $94 million annual savings, or nearly $200 million for the 2010-12 budget
$ Give employees a fixed dollar amount for benefits, indexed for inflation
$ Provide incentives for wellness
Section 3: Marketing piece for members and prospects
Kentucky's state government has a $1 billion hole.
Since 2000:

- Kentucky’s General Fund has grown 33%.

- Kentucky spends more than $19,000 per year per prison inmate yet just over $9,200 per year for each primary and secondary student.

- Spending on Medicaid increased by more than 2 times the rate of overall state spending.

- The per-employee cost of health insurance for public employees increased by 174% — more than 5 times the rate of overall state spending.

“\text{The increases and expenses state government has had in the last five to 10 years do not represent any business model that could or would be successful.}”

– Bill Jones, 2009-10 chairman, Kentucky Chamber of Commerce
When we achieve and promote

SMARTER GOVERNMENT SPENDING

- 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.

- Incorporate wellness into Medicaid and the public employee benefits system. According to the Wellness Council of America, a $1 investment in wellness can save $3 in health care costs.

- Require public employees to contribute a reasonable amount for health insurance. Kentucky pays for 97% of the cost of single health insurance coverage for state employees. The average U.S. state contribution to public employee health insurance is 87%, while the average private business contributes 80% toward employee health insurance.

EDUCATION

“If you want individuals to be able to take care of themselves, to benefit from the great America that we have and the economic opportunities that are here, education is the absolute key.”

– Darby Turner, Greenebaum Doll & McDonald, PLLC

and promote

GLOBAL COMPETITIVENESS

so we can invest in

A large body of research links higher levels of education with better health.

HEALTHIER KENTUCKIANS

- Kentucky is currently ranked 44th in the nation in science and technology degrees awarded per 100,000 population, and 45th in scientists and engineers as a percent of the labor force.

- In 2007, the industrial sector consumed twice as much energy nationally as all residential and commercial entities combined.

ENERGY LEADERSHIP

“It’s very important, as our whole energy concept here in America changes, that Kentucky be at the forefront.”

– Dave Adkisson, president & CEO, Kentucky Chamber of Commerce

Incorporate wellness into Medicaid and the public employee benefits system.
The Kentucky Chamber’s strategic plan is based on five goals to transform Kentucky:

1. To improve the education attainment of Kentuckians at all levels
2. To modernize government at all levels
3. To promote wellness and healthy Kentuckians
4. To prepare Kentucky to successfully compete in the global marketplace
5. To expand Kentucky's role as an energy leader

WHAT CAN YOU DO?

“It takes a combined effort. It takes a commitment on the part of a business to have your voice heard in Frankfort.”

– Wayne Knewasser, Premier Home Care, Inc.