



STATE OF MISSISSIPPI
OFFICE OF THE GOVERNOR

December 20, 2011

To the Members of the Mississippi Legislature:

For the ninth time since becoming Governor, I transmit to you my balanced Executive Budget and Combined Funds Recommendation. This Fiscal Year (FY) 2013 balanced budget includes some tough, but necessary, decisions on ways to streamline state services, reduce spending and position Mississippi to emerge from this economic downturn stronger than ever.

When I took office in 2004, the state's budget was headed for disaster. The previous governor and legislators created a more than \$700 million budget hole by relying on too much one-time money and overly optimistic revenue estimates. The Legislature shortchanged the state's debt payments and slashed public safety budgets. Medicaid was chronically underfunded. The media reported a tax increase was inevitable. However, we attacked the problem on several fronts – revenues streams, responsible budgeting and controlled indebtedness – and balanced the budget within two-and-half-years without raising anybody's taxes.

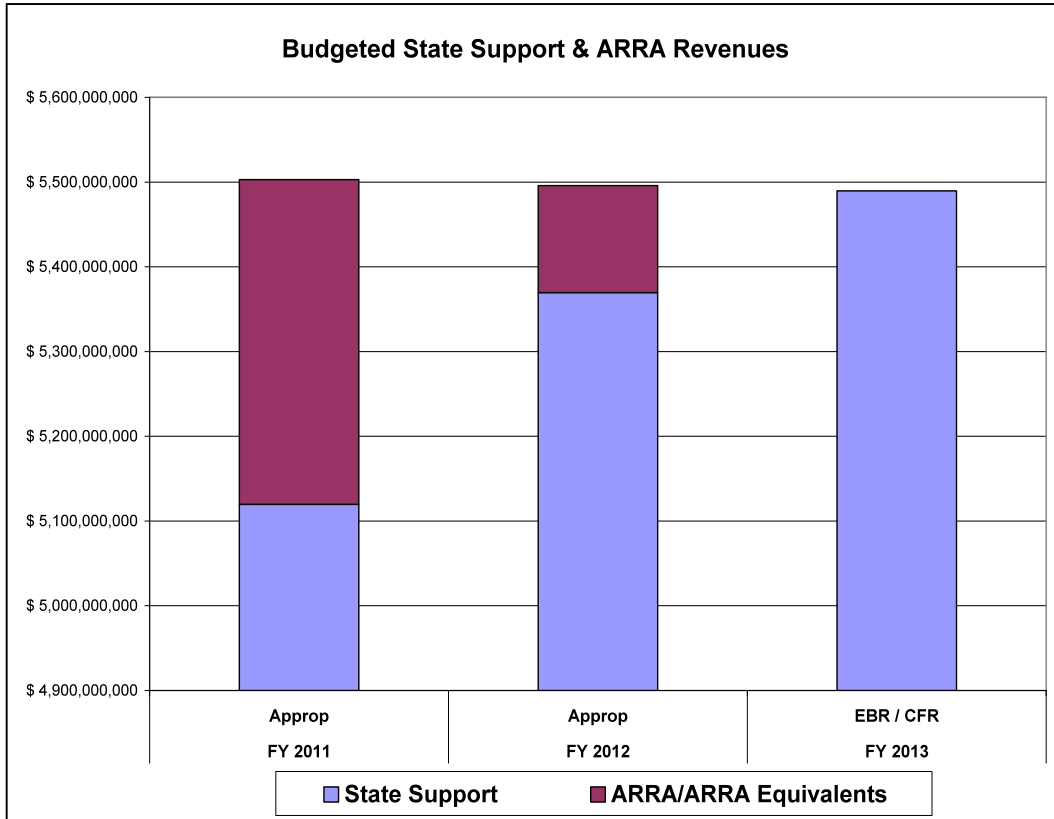
Now that I am leaving office, I am proud of the results the Legislature and I have achieved. Together, we were able to balance the state's budget, and leave more than \$241 million for my successor for FY 2013 and thereafter. Agency budgets are smaller, yet state government continues to provide its citizens with quality services. Importantly, we have been able to prioritize spending and adopt conservative, honest budgets. The state must continue these prudent budget practices if Mississippi is to continue its path to economic prosperity and be first out of the chute in recovering from the lingering effects of the economic downturn.

The next administration and Legislature should build on these successes and resist falling back into old bad habits. Keep taxes on our families and businesses low to encourage investment in our economy. Do not arbitrarily underfund mandatory spending or the budgets of agencies that generate revenue and jobs for our state. The Auditor's Office, Mississippi Development Authority and Department of Revenue play important roles in growing our economy and/or generating revenue or controlling spending.

Do not expect significant increases in revenue or spending in the coming years. Mississippi, like other states, continues to feel the crunch from the weak national economy.

In fact, the National Governor's Association recently found states squeezed by demands from local and federal governments. Funds from the American Recovery and Investment Act are no longer available to prop up state budgets as demonstrated in the following

chart. Mississippi will lose \$126 million attributable to stimulus funds in the current fiscal year. The new health care law is expected to greatly expand Medicaid rolls by more than 400,000 – if the law is not struck down by the courts. Mississippi taxpayers would pay an average annual \$225 million to \$250 million more for Medicaid beginning in 2014, more than \$400 million a year by 2020.



State revenues are slowly increasing but collections still are not to pre-recession levels. The state economist recently said that Mississippi should not expect revenues to return to pre-recession levels before FY 2015 or FY 2016. We have to take a hard look at our priorities. And agencies with reserves – K-12 schools, community colleges and universities – need to use their reserves if they cannot generate enough savings. The state has drawn down \$591.1 million from its reserves over the past four years to avoid deep spending cuts. Now, it is time for the state reserves to build back up and other reserves, which are very large, to be drawn against.

My budget proposes an average 2.9 percent reduction in state agency funding. This budget funds public schools at \$2.178 billion, 1.43 percent below the current year. It includes \$1.975 billion for the Mississippi Adequate Education Program, only 2.04 percent less than the current year. Universities are cut 3.07 percent and community colleges are cut 2.27 percent. The Department of Public Safety and Highway Patrol will each have a 7.62 percent reduction. Attorney General is reduced by 5.58 percent. This budget funds the Mississippi Development Authority – the agency responsible for job creation – at \$21.2 million, essentially flat.

These reductions are manageable for agency directors, particularly if they are granted more flexibility in running their agencies. Also, savings can be found by streamlining agency functions and requiring cost efficiencies through the implementation of shared services, the creation of an Office of Small Agencies that consolidates services from the regulation of water and wastewater infrastructure improvement programs to integrated health and agriculture inspection functions.

I warn the Legislature against knowingly underfunding accounts, as is demonstrated in its legislative budget recommendations, including the FY 2013 recommendation.

Perpetually underfunding Medicaid or debt service – obligations the state must pay – doesn't make sense. The LBR does not include funding for the FEMA-required building insurance and also underfunds the Crime Lab and legal requirements like Olivia Y and Chickasaw Interest. These are critical needs that simply must be paid.

The LBR contains large cuts for priority agencies, including an 11.6 percent cut for our agency which focuses on job creation, MDA; a 17.7 percent cut for the Department of Finance and Administration, which provides management and financial accountability of state funds; huge cuts to our disaster budgets (a 17 percent cut to MEMA support and a 37 percent cut to MEMA disaster relief); huge cuts of more than 9.4 percent to law enforcement agencies like the Department of Public Safety; and further cuts to the Department of Corrections which has made significant cost-savings in previous years.

The LBR uses \$22.1 million of special funds in its FY 2013 recommendation and includes \$26.2 million of special fund balances in its reserves for future fiscal years. The Legislature should discontinue its practice of raiding agency special funds to help shore up the state budget. Targets for this practice often include so-called "idle" special funds from the Department of Insurance, Public Service Commission, and even the Treasurer's Office (Surplus Property). In the past, I have compromised on this issue in order to get more important budget items passed. However, I believe it is time the Legislature adopt prudent, honest, and transparent budgeting practices.

Another budget trick utilized in the legislative budget recommendation (and is once again used for their FY 2013 document) is the deletion of all unfilled positions in state government. While this may save money on paper, deleting all of these positions is bad budgeting policy and simply unrealistic. The Legislature has no intention of deleting all vacant positions, so it shouldn't include this as a cost-savings in its budget recommendation. A more prudent approach is to identify a portion of long-term vacant positions that may be reasonably eliminated without tying the hands of agency directors. Toward this end, my budget recommends eliminating 25 percent of these types of positions to achieve cost-savings in both FY 2012 and FY 2013.

My \$5.48 billion budget recommendation is built on the general fund revenue estimate of \$4.63 billion adopted by the Joint Legislative Budget Committee, which represents a slight decrease of 0.6 percent below the revised FY 2012 revenue estimate. The legislative budget recommends delaying the accelerated tax amendment and repealing the

repayment to the Department of Transportation, and I support both of these proposals that generate an additional \$62 million for use in FY 2013, resulting in a total general fund revenue estimate of \$4.69 billion.

The \$5.48 billion recommended in my budget represents a 0.5 percent decrease in total state spending. While this is not a monumental decrease in available revenue, we must consider that the FY 2012 budget included one-time monies that aren't available for expenditure in FY 2013.

In addition to the \$4.69 billion in general funds, my budget recommends using much of the remainder of the state's reserve funds, which include:

- \$97.4 million from the Health Care Trust Fund. Since I've been Governor, it has become clear to me this trust fund is not and never will be held in trust in the true sense of the word. I said previously that if it was the will of the Legislature, I would agree to spend down the balance of the existing funds;
- \$99.6 million from the Working Cash Stabilization Fund, also known as the "Rainy Day Fund;"
- \$28.3 million from the Hurricane Disaster Reserve Fund; and
- \$12.1 million from the Capital Expense Fund.

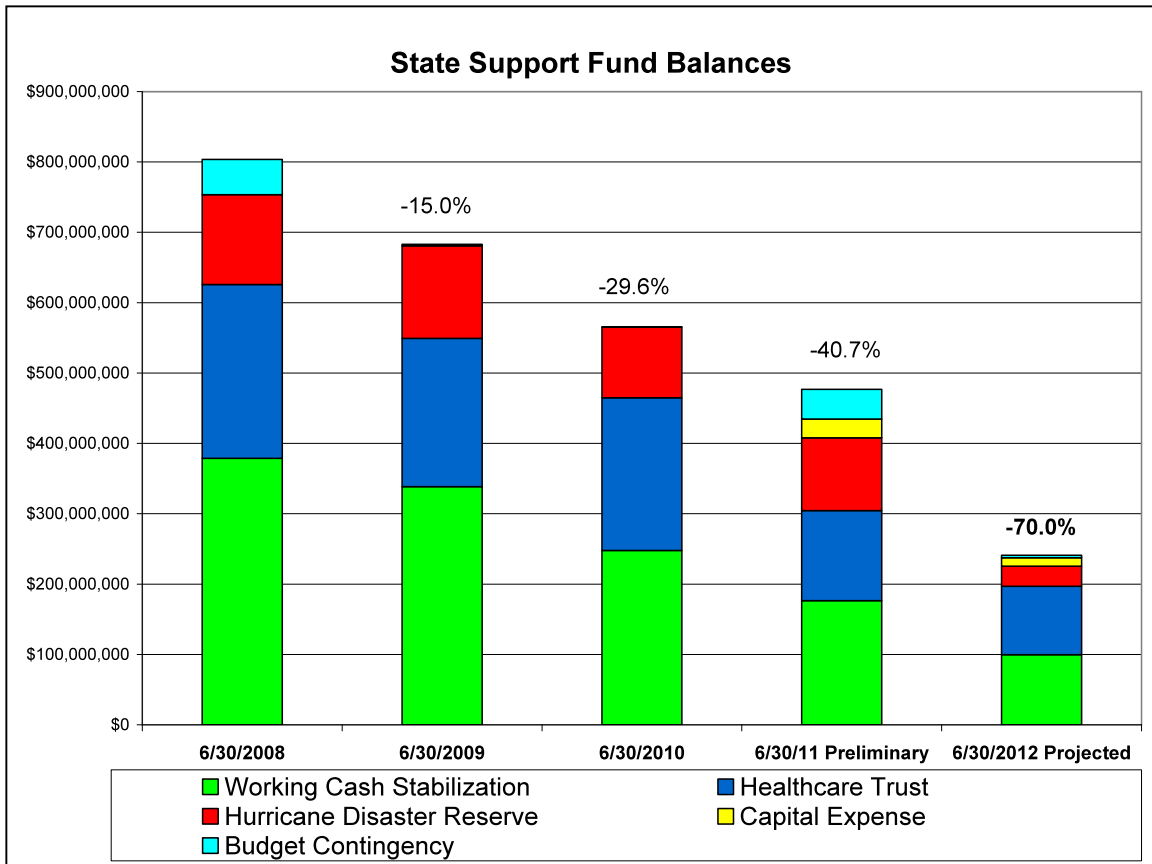
Other revenue entries are related to money not used during the previous fiscal year and cost-savings achieved through reforms or spending cuts recommended in my budget.

Saving for a Rainy Day

From the moment I took office, establishing a "rainy day fund" was a priority. In 2004, Mississippi had just \$3 million in unallocated reserves. I set a goal for \$375 million to be set aside in a "rainy day fund" as anticipated by statute so Mississippi would be prepared for an economic downturn. This fiscal preparedness helped Mississippi survive the most devastating natural disaster in American history, Hurricane Katrina, plus the Great Recession that spread across the world.

We have insisted upon prudent use of cash reserves to ride through the recession instead of spending all the federal stimulus funds immediately and counting on additional "manna from heaven." The result? More than \$241 million is available to my successor to help cushion the FY 2013 budget.

However, now is the time to begin rebuilding our reserves. As noted earlier, the state has spent a substantial amount of its reserves, but we have spent it prudently and in nearly equal amounts over each of the past four fiscal years.



For FY 2013, I am recommending the Legislature follow the law and set aside 2 percent of total general fund revenue as a starting point to rebuild the “rainy day fund.” This course of action will leave a budgetary cushion of reserve funds for my successor for years to come.

I will point out that funds held in reserves must not be funds obligated to some other expense. A good example of this is the recent Attorney General settlement by which the state received some \$25.7 million. More than \$20 million of this is not a windfall to the state budget, but rather money that must be paid to the federal government. Counting this \$20 million (or any other obligated funds) as part of the state’s “reserves” is misleading.

Maximum Flexibility for Department Heads to “Right-Size” Agencies

State government must deliver services in the most efficient and effective manner, especially in these unprecedented tight budget times. Our managers in state government must be afforded more flexibility to manage the provision of services to the people – consistent with the money available.

From a historical perspective, we know this type of flexibility works. In recent years, the Legislature granted maximum flexibility and exemption from Personnel Board rules to the Departments of Corrections and Agriculture, which saved taxpayers \$60 million and

\$49 million, respectively, because of the flexibility. This restructuring was done without any decline in the quality of services provided. To weather these continued budget constraints, every agency should be allowed out from under legislative meddling and the restrictions of the State Personnel Board for at least two years. This will allow directors to “right-size” their organizations with maximum effectiveness.

Budget flexibility by awarding “lump sum” appropriations should be the standard to allow needed flexibility to move funds as circumstances dictate, and I appreciate the Legislature for granting lump sum budgeting to agencies during the previous appropriations process. Legislative micromanaging reduces efficiency. Looking forward, state leaders should continue to support maximum budgetary and right-sizing flexibility.

Preparing Young Mississippians for School, College, and Careers

Ensuring all of state government is successful and can serve our citizens means we must make tough decisions – even including our highest priority programs. We make savings in education, our top priority program; however, my budget does not reduce National Board Certification. Although the Legislative Budget Recommendation level funds Chickasaw Interest, my budget recommends a \$3.75 million increase in accordance with the federal court order which established a funding formula for this budget.

Next year, FY 2013, the Mississippi Adequate Education Program funding will be reduced slightly, by \$41.2 million, which represents a cut of 2.04 percent. Overall, K-12 education in Mississippi will receive \$2.178 billion. Including federal, state and local funds, K-12 schools in Mississippi are receiving about \$4.4 billion in total funding for FY 2012, including federal Ed Jobs funds.

To achieve these savings, I recommend we fund administrative expenses at a level that matches the national average for administrative costs. We must ensure that more dollars make their way into the classroom, not administrative offices. Mississippi school districts spend approximately 8.8 percent on administration; the national average is 7.6 percent, so this will cut administration expenses by \$24.1 million, or 1.2 percent of state funding levels. Administrative expenses within districts would be reduced 13.6 percent.

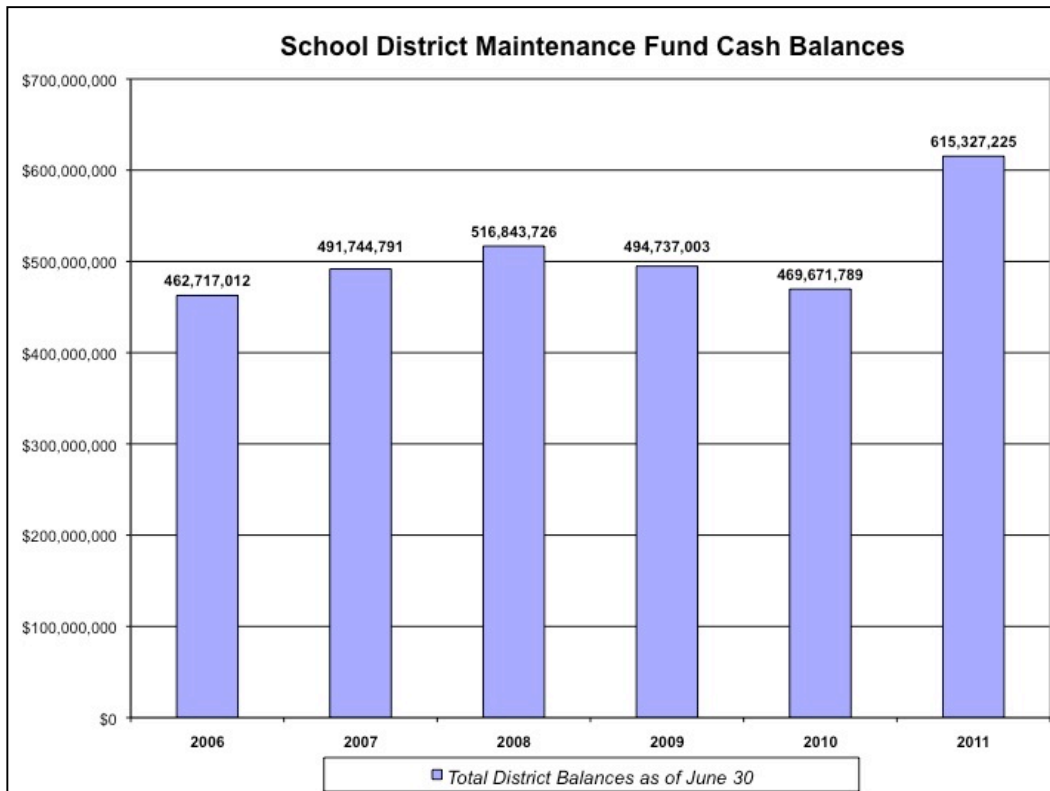
Although the Legislature has taken no action to consolidate school districts, I remain convinced this is an important piece of our approach to reducing costs while improving education for our schoolchildren. Instinctively, we know that Mississippi’s having 152 school districts across 82 counties is inefficient. Consolidating school districts will reduce administration costs in the short term, ultimately match effective teachers with “right-sized” classes, and push more money into the classroom, improving educational achievement by our K-12 students. I urge the Governor and Legislature to consider whether reducing the current number of K-12 districts would be beneficial to providing our children and parents with the educational outcomes they – and the state – deserve.

Last year, the Legislature created a study commission to look at ways to increase school efficiencies. While I have not seen the results of this report, I hope the Governor and Legislature will review their recommendations with an eye toward increasing efficiencies, reducing administrative costs, and improving the quality of education for our children.

Over the past few years, state funds used to subsidize local ad valorem taxes have declined, from \$46 million in Fiscal Year 2004 to \$2 million in Fiscal Year 2012. I am recommending that we fully discontinue this subsidy in Fiscal Year 2013.

While I support inter-school K-12 athletics, I believe there is a better way to fund these programs, and that community and athletic associations can play an important part of the funding structure. K-12 athletics and student activity expenditures cost nearly \$37 million more than these programs generate in revenue (\$16.6 million of this amount is the estimated relative share in state funds). My budget suggests that school districts absorb reductions in state spending by reducing athletics by this amount, which would require the inter-school athletics to run no deficit.

My budget includes some \$72 million of local funds freed up by federal education jobs funds that will be available to school districts in FY 2013. This is the result of school districts receiving more than \$97 million from the federal government last year for the specific purpose of offsetting budget cuts. It is not fair to trim other state agency budgets without requiring K-12 schools to spend their increased cash balances arising from funds they received from the federal government and which are available for FY 2013.



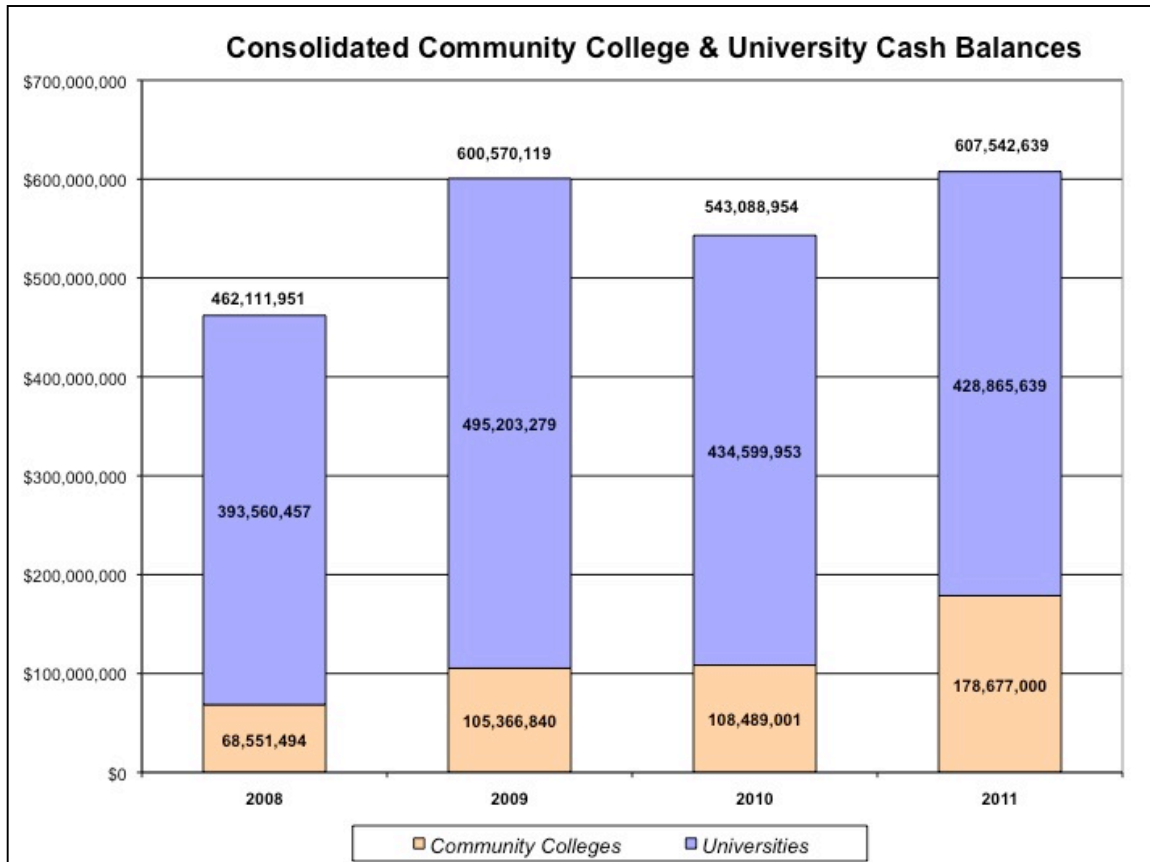
Similarly, I am recommending that school districts tap into their own reserves which topped \$615 million as of June 30, 2011, an increase in unallocated reserve of more than \$145.6 million from year end FY 2010 to FY 2011. (This figure does not include 16th Section interest funds, which are available to school districts for use in their general budget. According to the Department of Education (MDE), school districts have more than \$164.8 million in these funds for use in the upcoming fiscal year.) My budget suggests that school districts use up to one-half of the estimated state relative share of cash balances of \$46.8 million – or less than ten percent of total reserves (excluding 16th Section funds) – to offset reductions in state support, if the school districts are unable to make the savings recommended.

Most school districts have significant reserve fund balances that can be utilized to make up for state-funding shortfalls; for those few districts without the reserves to offset reductions in state funding, my budget includes \$10 million for the Emergency Bridge Loan Program that helps struggling school districts to avoid insolvency by lending them needed funds.

In recent years, our public schools, community colleges and universities have worked on creating a system that guides our young people from kindergarten to the workforce with a goal of graduating productive citizens who are ready for college or to embark on their career paths while reducing the number of dropouts.

My budget includes a 2.6 percent reduction for the Institutions of Higher Learning General Support and a 2.53 percent cut in spending for Community and Junior Colleges Support; however, I increase Student Financial Aid by \$2.6 million. In addition, my budget adjusts Ayers funding for the \$6.7 million step-down. Including CJC workforce and excluding IHL ag units, total higher education funding will be cut less than 3 percent.

Like school districts, community colleges and universities have significant cash balances on which they can draw to offset spending cuts. I recommend that community colleges use up to one-half of the estimated state relative share of their cash balances, or up to \$7.3 million (approximately 4 percent) of their cumulative \$178.6 million unrestricted cash balances to shore up state spending if savings cannot be achieved. For universities, I am recommending they consider using up to one-half of the estimated state relative share of their cash balances, up to \$65 million (1.5 percent) of their total cash balance of \$428.8 million.



At a time when the focus must be on efficiencies and excellence, we must recognize the inefficiency of dividing our limited IHL funding among eight public universities. I urge the Legislature to reconsider merging Mississippi Valley State and Alcorn State with Jackson State. No campus would close, but administration would be unified and significant savings achieved. Our historically black universities would be united into a premier university with the land grant agriculture and technical advantages of Alcorn, MVSU's Delta campus, and JSU as an emerging great urban university.

Similarly, MUW should be merged with Mississippi State. Its campus, like those of Alcorn and Valley, would continue to function. There would be a rationalization of class offerings at the various campuses, including the three not affected by the mergers (Delta State, Ole Miss, and USM). Every university would be expected to reduce costs by consolidating or eliminating programs and reducing administration costs through shared services.

The mergers would not achieve significant savings during the first year as they take time to plan and implement. However, the mergers should save about \$9.5 million upon full implementation.

Currently, the agriculture units at Mississippi State and Alcorn State are funded in appropriations separate from the universities' main funding. In fact, I applaud Mississippi State's decision to merge its College of Agriculture with the College of Forestry. This is a step in the right direction. I recommend separate appropriations for the agriculture units cease, and the funding becomes part of the two universities' appropriations. This administration consolidation will give the leadership of the two universities greater flexibility in spending authority and should result in better setting of priorities. My budget reduces the FY 2012 agriculture unit appropriation by 15 percent (not inclusive of funding for the PERS increase). The universities can make these savings from ag unit expenditures, through other efficiencies in the greater university budget, or from reserves.

To achieve the savings contemplated for community colleges, I again recommend eliminating \$3 million in state funds spent on community college athletics. Mississippi community colleges spend more than \$23 million in state, local and student fees combined to fund athletics. Private funds and campus boosters can support these activities if an institution desires. Local governments may choose to support community college athletics, and student fees to support athletics should be at the students' option. There are more than 1,100 community and junior colleges in America, but there are only 70 football members of the National Junior College Athletic Association. Of those, 15 are in Mississippi. In a time when resources are scarce, it is difficult to justify spending millions in tax dollars on the field of play.

Likewise, universities should rely less on state funds to pay for athletic costs. While some universities use virtually no state funds to support their athletic programs, other universities aren't as prudent. I believe universities should save at least ten percent on athletic costs, with a goal of eliminating within five years their reliance on tax dollars to pay for these athletic programs. Student fees that are used to support athletics should be at the students' option, too.

To improve the effectiveness of Mississippi's career training programs, I recommend a more focused career-technical mission for community colleges. We need far greater numbers of students enrolled in the valuable programs that train a workforce and that have a solid reputation worldwide. Currently, we allocate about \$27 million to the Department of Education (MDE), which then transfers the money to the community colleges. MDE does not use these funds but simply acts as an intermediary. At best this lacks transparency, and both our budget process and community colleges would be better served with a direct appropriation.

Last year, I proposed that the state develop a new funding mechanism for community colleges and universities based upon productivity goals and accomplishments rather than enrollment. The Legislature agreed to study how this funding mechanism would work through its Education Achievement Council, whose study of improving educational results should continue. I urge the 2012 Legislature to seriously consider basing higher education funding levels on achievement, not just enrollment. Our current system pays based on the number of students enrolled at an institution, but that institution is not held

accountable for the results accomplished by those in the system. We should track community college and university graduation rates and follow students after they leave the school at which they begin their post-secondary education and follow their results at another university and in the workplace. The State Longitudinal Data System is a tremendous resource that tracks such results.

Government should always examine what it does and ask whether certain expenditures are appropriate uses of public money. During this continuing revenue reduction, I am proposing sharp cuts in funding for agencies whose missions are outside the core function of government. The Mississippi Library Commission's budget, which subsidizes local libraries through grants, would be reduced by 15 percent. I also propose a one-year reduction in funding for the Mississippi Arts Commission of 15 percent. Both provide important support to local institutions, but local institutions must make savings, too.

Mississippi taxpayers should not continue subsidizing a television and radio network, so I also again recommend a sharp reduction of 15 percent in the appropriation for Mississippi Public Broadcasting. MPB must rely more on private sponsorship than tax dollars to operate, and the Board of Directors has committed to more aggressively raise funds to go toward budgeting purposes. This decrease should begin a reduction in funding for MPB that will ultimately result in its operating on private donations or advertising revenues, except for educational programming used by MDE.

Improving healthcare services

It is imperative the Division of Medicaid (DOM) and the Departments of Health, Human Services, Rehabilitation Services and Mental Health identify overlapping expenses and find ways to share costs. As a matter of good policy, we must increase home- and community-based services for Mississippians with disabilities, especially served by the Department of Mental Health. Enabling individuals to live in their communities near families and friends fosters independence and costs less than institutionalizing patients.

The Division of Medicaid protects Mississippi's most vulnerable citizens by providing healthcare for low-income and disabled individuals. The state will continue to provide these vital services, but we must implement cost savings in order to keep the program viable.

In FY 2014, Medicaid will face an unparalleled expansion due to healthcare reform. Obamacare will add more than 400,000 more individuals to the Medicaid rolls, meaning one-in-three Mississippians will participate in the state's Medicaid program. This dramatic increase in enrollment will cost Mississippi's taxpayers an average annual \$225 million to \$250 million beginning in 2014. By 2020, the annual cost will have risen to \$443 million and will continue to rise in subsequent years.

The Medicaid program must remain financially solvent. To accomplish this goal, we must reform Medicaid. We can start by implementing known cost containment measures that will allow Medicaid to generate \$52 million in savings for FY 2013. The measures

include: freezing rates of long-term care and hospitals to last year's levels; instituting a State-specific Maximum Allowable Cost Pharmacy reimbursement program; and implementing federally-allowed, lower-of-logic savings for all Medicare Part B crossover claims. Mississippi hospitals are reimbursed by Medicaid at some of the highest rates of any hospitals in the country. Nationally in 2010, Mississippi hospitals ranked eighth in profitability; and, over the last two years, hospitals received a 19 percent increase in rates. This was an increase of \$100 million in Medicaid funding for hospitals, including some \$25 million of state funding increases.

We should expand coordinated care services through the Mississippi Coordinated Access Network (MississippiCAN), a voluntary Coordinated Care Program for Mississippi Medicaid beneficiaries, as a path to cost savings in health care. MississippiCAN improves access to needed medical services by connecting beneficiaries to providers for preventative and primary care. The program will improve the quality of care by providing support services for managing illnesses, and it will empower beneficiaries. MississippiCAN will save tax dollars through a more compliant healthcare approach.

Currently, State law does not allow inpatient costs to be included in the MississippiCAN program. The carve out of hospital inpatient services from the capitation rates, which led to a large increase of hospital Medicaid receipts, prevents DOM from achieving its desired level of cost savings from MississippiCAN. Limiting the care coordination companies' ability to manage the most costly service (inpatient) conflicts with their ability to manage the overall treatment of the patient. MississippiCAN will never generate the maximum savings intended by DOM, unless the Legislature allows inpatient costs to be included. Such changes will foster better coordination of care and improve health outcomes.

Over the years, the State has relied heavily on institutional care for mentally ill individuals. Going forward, the state needs to commit fewer fiscal resources to institutional care and more fiscal resources to home- and community-based care. The Department of Mental Health can achieve savings by closing four Department of Mental Health facilities and six crisis centers. These include:

- Central Mississippi Residential Center (includes one crisis center)
- Mississippi Adolescent Center
- North Mississippi State Hospital (includes two crisis centers)
- South Mississippi State Hospital (includes one crisis center)
- Brookhaven Crisis Center
- Cleveland Crisis Center

These are appropriate first steps to save \$23 million over the coming four fiscal years. Closing the facilities will put a greater reliance on home- and community-based services like those offered at the community mental health centers. My budget includes an additional \$7 million for the Department of Mental Health to assist in transitioning those individuals in institutional settings to home and community based services.

As the state draws down its reserves, state agencies with cash reserves should use a portion of these funds for FY 2013. I recommend a reduction of the Department of Health's state appropriation and recommending it draw down its own Health Department cash balance to help offset the budget cut. I am recommending the Department use \$4.4 million of its cash balance for this purpose.

In closing, I will remind you that should our efforts to defeat the Patient Protection and Affordable Care Act (PPACA) in the courts fails, we expect more people to enroll in Medicaid rather than face federal fines for lacking private health insurance coverage. In 2014, the ACA will significantly expand Medicaid eligibility thresholds to individuals with incomes of 138 percent of the Federal Poverty Level (FPL). This increase will add more than 400,000 new individuals to the Medicaid rolls, meaning one-in-three Mississippians will participate in the state's Medicaid program. This dramatic increase in enrollment will cost Mississippi's taxpayers an average annual \$225 million to \$250 million beginning in 2014 through 2020. By 2020, the cost for that year alone will have risen to \$443 million and will continue to rise in subsequent years.

Optimizing State Services

In these stark budget times, significant savings cannot be achieved solely by purchasing fewer office supplies or traveling less. Mississippi has more than 100 agencies, many of which offer similar services. All have directors and hiring departments that manage a small staff. We have a responsibility to taxpayers to avoid redundancy and wasteful spending. The consolidation of many boards and smaller departments into existing state agencies will reduce administrative costs and prevent unnecessary duplication of certain tasks. Agency consolidations will save money while providing more efficient services to taxpayers.

Even agencies that are wholly special fund agencies can be combined to achieve savings. For example, consideration should be given to what savings could be achieved by merging our three state public defense agencies.

To ensure we are spending taxpayer money in the most efficient way possible, Mississippi will develop and implement a comprehensive program to achieve significant cost-savings through administrative initiatives, such as bulk purchasing, joint procurement, and consolidating back-room operations, preferably into a single office for all universities and community and junior colleges. The Department of Finance and Administration, in conjunction with the Institutions of Higher Learning and the Community College system, would carry out these consolidations.

Agencies such as the Department of Revenue and Medicaid already have worked successfully to renegotiate state contracts. Their good example should be followed by every state agency that has contracts with an outside vendor.

Modernizing the State's Technology Capabilities

When I was first elected Governor, my top priority was to clean up the then-existing \$720 million budget shortfall. The Legislature enacted large parts of “Operation Streamline” to reduce costs. With your help, we were able to get Mississippi back into the black in only two and a half years, without raising anybody’s taxes.

This time part of our strategy is to achieve increased collections of the revenue owed the state. To do so, I recommend additional funding to the Department of Revenue via sharing of increased collections from new auditors.

The Department of Revenue should receive increased funds to hire 20 new auditors and revenue agents to help reclaim a large portion of the estimated more than \$260 million in known liabilities owed to the state. Collecting taxes already owed the state is critical in today’s budget environment. I’m against increasing taxes, but I want to collect all the taxes we are owed.

Mississippi should employ the improved new technologies being utilized both in the private and public sectors to achieve cost-savings while also improving service. For example, as the Department of Information Technology Services (ITS) rightly points out, significant cost-savings as well as improved performance could be achieved by consolidating duplicative IT hardware, software and personnel across all state agencies. Streamlined technology purchasing would improve state government operations and reduce administrative costs. Additionally, we should arm the ITS Board with the authority to approve technology expenditures and only when the request is consistent with the state’s IT plan.

Privatizing Wine Sales to Increase Revenue, Improve Service

During my January 2009 State of the State address, I committed to improving performance and saving money by contracting out parts of services performed by the Bureau of Alcohol Beverage Control. After analysis, I believe Mississippi can generate \$2.5 million in new revenue by privatizing the wine functions of ABC. The Department of Revenue should arrange competitive bidding to ascertain that privatization will in fact increase net revenue to the state as well as improve service.

Effective Management of Natural Resources and Agriculture

Five years ago, I suggested combining the Mississippi Forestry Commission and the Department of Agriculture and Commerce as a way to streamline services and share expertise. I reiterate that proposal for consideration in future fiscal years, as Mississippi is one of only seven states managing its forestry program as a stand-alone state agency. Other states oversee forest management through agricultural, university, environmental or natural resources departments. Folding several other smaller, independently budgeted agencies – the Soil and Water Conservation Commission, the Board of Animal Health, the Fair Commission, the Board of Registered Foresters, the Egg Marketing Board, and the Board of Veterinary Medicine – into one department should result in administrative

savings for all aggregate functions. Creating a new Mississippi Department of Agriculture and Forestry could save the state more than \$4 million annually in future years. The newly formed department must be free from the restrictions of the State Personnel Board, as should all other departments and agencies during the next two years.

Keeping the Public Safe

The first function of government is to ensure the public's safety, and we can do this while achieving smaller savings at public safety agencies.

For example, I have previously proposed shifting the Department of Transportation Enforcement Division to the Department of Public Safety (DPS). Officers in both agencies perform similar functions, and there is no reason for such duplication. This would improve the public's safety on the state's highways and roads. We have as many troopers at the highway patrol as when I took office in 2004. As much as I would like to increase the number of new troopers, I do not believe the state can afford a trooper school in the coming year, but this realignment would result in nearly 40 more troopers on the road.

Ensuring the continued safety and justice for our citizens means the state has a responsibility to maintain adequate funding for the judiciary. My budget exempts Trial Judges from any cuts, and I have recommended lesser cuts of approximately 2.7 percent for Supreme Court Services and the Court of Appeals. While all areas must find efficiencies, we cannot shortchange the state judicial system and its mission to help law enforcement entities put criminals behind bars.

Ensuring the Integrity of the State Retirement System

Mississippi, like most other states across the country, is facing significant fiscal challenges related to the state pension program, the Public Employees' Retirement System (PERS). PERS is funded through contributions from employees and taxpayer-funded employers (state agencies, universities, school districts, cities, and counties), as well as investment returns. The PERS Board has the authority to set the contribution rates.

Taxpayer costs to fund PERS have risen sharply in recent years while employee contributions remained static for nearly twenty years. For 15 years, the employer (taxpayer) contribution rate of 9.75 percent remained steady; however, the PERS Board increased the state's contribution to the system each year from 2006 to 2010 to its current rate of 12 percent, which will increase to 12.93 percent next month. A sixth rate hike to 14.26% will take effect July 2012 if projections hold true. That means the taxpayers' share will have increased by almost half – 46.2 percent– over eight years. On the other hand, employee contributions were unchanged at 7.25 percent from 1991 through 2010. At my request, the Legislature increased the employee's rate to 9 percent in 2011.

Despite significant increases in taxpayer and employee costs, PERS continues to experience persistent growth in unfunded liabilities. One decade ago, the plan was funded at 88 percent; today, that level has dropped to 62.4 percent – and the dollar amount of our unfunded liabilities has more than quadrupled at \$12.3 billion. That’s about as much money the entire general fund takes in over about 2.25 years!

To better inform the public as well as state employees and retirees, I appointed a special commission to study PERS and recommend ways to strengthen the plan. I appreciate the hard work of the study commission, which has provided a baseline from which to start for making reasonable changes to the plan.

Strong consideration should be given to the following recommendations of the study commission:

- Revising the makeup of the PERS Board to include more financial subject matter experts and non-participant taxpayer members;
- Lowering the plan’s investment return assumption from 8 percent to 7.5 percent as recommended by PERS’ own actuary, Cavanaugh MacDonald. (Over the last ten years, PERS has actually achieved a 5.41 percent investment return. Many states are lowering their investment return assumptions to more accurately reflect market conditions.);
- Delaying the cost-of-living adjustment (COLA) for three years and thereafter actually tying the COLA to the Consumer Price Index instead of an automatic three percent annual increase, which is estimated to save \$122.2 million in first year employer contributions and increase the plan’s funding ratio to 67 percent; and
- Setting the normal retirement age at 62, with the following tiers for retirement:
 - Eligible to draw full retirement at age 62 if vested;
 - Eligible to draw full retirement at age 55 with 30 years or more of service, but with no cost-of-living adjustment until age 62; or
 - Eligible to draw an actuarially reduced benefit before age 55, after completing 30 years of service.
- Implementing these changes for current members’ future service and all new hires would reduce first year employer contributions by \$92.8 million and increase the plan’s funding ratio to 64 percent.
- The full recommendations of the study commission are located at www.governorbarbour.com.

While I believe it is necessary to make fundamental changes to PERS in order to ensure the long-term solvency of the system, my FY 2013 budget is not predicated on the cost-savings associated with these reforms. I recommend that the employer and the employee should evenly pay the contribution rate increase of about \$26.3 million. The Legislative Budget Recommendation, however, does not even account for any increase associated with PERS. In practice, this cuts agencies even further than what is reflected in the Legislative Budget Recommendation. While some legislators may choose to ignore the fiscal giant of PERS, now is the time to bring reforms before more difficult measures are required. Honest, transparent budgeting is needed to get PERS back on the right track.

Providing Health Insurance Options for Mississippians

Since 2007, I have supported a conservative, market based health insurance exchange that does not include subsidies. On March 24, 2011, I wrote Senator Buck Clarke indicating my support for a Mississippi state-based exchange which would focus on small businesses and individuals, be voluntary and would allow individuals to choose the insurance plan that best suits their needs by taking advantage of pooled purchasing power. Purchasing insurance through a defined contribution health-insurance market ensures portability and fosters choice, competition and value.

Let me be clear, an exchange which imposes new regulations, administers new subsidies, standardizes coverage and restricts consumer choice and insurer competition must be opposed. Unfortunately, these are all consequences of federal healthcare reform. In the Patient Protection and Affordable Care Act (PPACA), Congress destroyed the core concepts of an exchange and perverted the exchange concept into a bureaucratic tool for federal subsidization and micromanagement by the federal government. Despite the uncertainty surrounding PPACA, preserving state authority and creating a Mississippi, state-based exchange which empowers consumers and reduces risk to employers has been a priority.

A Mississippi exchange must demonstrate good, conservative, innovative policy that deviates from Obamacare's government takeover methodology. Insurance Commissioner Mike Chaney has moved forward with this charge, and I have supported his efforts.

Announced in October of 2011 and funded by a federal grant, our state is set to begin the Mississippi Health Insurance Exchange program, which is designed to give many Mississippians a way to buy, own and keep health insurance. This portable and affordable option will help Mississippi families and small businesses achieve health insurance equity.

The plan creates a state-authorized health insurance exchange for health insurance options, and participation is voluntary and not subsidized. Housed within the non-profit Mississippi Comprehensive Health Insurance Risk Pool Association and overseen by the Insurance Department's authority, the exchange will assume many of the administrative functions for small businesses that result in tax deductibility for the business and the employees as well as lower rates via purchasing power from increased numbers of insured.

Health Insurance for State Employees

Our state employee health insurance plan needs to be reformed. As shown in the graphic below, the employer, i.e. the state, contribution to the current state health insurance system is projected to be more than \$509 million, comprising 67 percent of the total cost of the program. On the other hand, the employee contribution in total is nearly half the employer's amount and is only 33 percent of the program's total cost. This disparity is

unacceptable. To help mitigate these cost challenges for the state, I propose a couple of policy changes.

Figure 1

Analysis of FY12 Total Health Plan Costs

	Premium Paid For By:			Gain to the Plan from Active EE Rates	Subsidy Cost Paid by Active EE Gain
	Employee	State	Total		
Active Employee Premiums					
Employer Contributions		\$509,329,508	\$509,329,508		
Employee Contributions	\$33,873,391		\$33,873,391		
COBRA Premiums	\$3,596,209		\$3,596,209		
Active Employee Subtotal	\$37,469,600	\$509,329,508	\$546,799,108	\$62,822,003	
Dependents Of Active Employees	\$109,072,161		\$109,072,161		\$31,512,823
Disabled Retirees (Regular)	\$1,167,353		\$1,167,353		\$8,846,703
Retirees & Dependents (Regular)	\$64,599,787		\$64,599,787		\$23,926,721
Retirees & Dependents (Medicare)	\$34,671,355		\$34,671,355		-\$351,785
Total	\$246,980,256	\$509,329,508	\$756,309,764	\$62,822,003	\$63,934,462

In our current system, taxpayers significantly subsidize health insurance for non-Medicare eligible retirees. During FY 2012, benefits for early retirees are projected to cause the state an incurred loss ratio of 141 percent (see Figure 2, below). Therefore, I propose that an early retiree’s premium cost should be based on the actual cost of providing insurance, as they are with the costs for all other beneficiaries. Through this proposed system, early retirees’ premium would increase by 15 percent each year for four years when their projected rates are closer to fully paying for their projected claims. With this policy implementation, the savings during Calendar Year (CY) 2013 would be about \$10.2 million, compared to having no rate increase in CY 2013.

Based on Medicaid experience, implementing programs to encourage usage of generic drugs and applying a surcharge for tobacco users can achieve true cost savings. However, it is important for us to study additional cost-savings best practices from other states. Currently, the Base Coverage of the state employees’ plan qualifies as a “high deductible health plan” under IRS rules. While the state plan does not offer a Health Savings Account (HSA), a participant wishing to open an HSA does have the option of enrolling in Base Coverage and then opening an HSA through many of the financial institutions or other approved sources. It is crucial that we offer better, more affordable options to encourage young people to work for Mississippi state government.

Figure 2

State & School Employees' Life & Health Insurance Plan Projected FY 2012 Incurred Loss Ratios Includes Incurred Claims, Expenses, and Rebates			
	FY12 Incurred Loss Ratio	% of Costs Paid for by:	
		Employee	State
Active (& COBRA) Employees	89%	See Note 1	See Note 1
Active (& COBRA) Dependents			
Spouse Only	162%	62%	38%
Full Family	126%	79%	21%
Child Only *	105%	96%	4%
Children Only *	111%	90%	10%
Early Retiree (Disabled)	858%	12%	88%
Early Retiree (Non-Disabled)	141%	71%	29%
Spouse Only	126%	79%	21%
Medicare Retirees & Spouse Only (Medicare)**	99%	100%	0%
<p>* The children and child only premium classes are available to all employees. ** Includes disabled retirees eligible for Medicare.</p>			
<p>Note 1: Approximately 11% of the active employee premium is used to offset subsidies for dependent and retiree classes. Of the active employee premium, about 6% is paid for by the employee, on average, and about 94% by the State.</p>			
<p>Note 2: The above analysis disregards any amounts that might be received under the Early Retiree Reinsurance Program under the Affordable Care Act.</p>			

Savings through self-sufficiency and procurement reform

The Department of Wildlife, Fisheries, and Parks should make its park operations entirely self-sufficient. In other words, the Department should match user fees to its actual expenses, so that Mississippi parks would not be a drain on the state budget. If this is not feasible, the Department should identify which parks are the least profitable and develop a plan to close these facilities and recreation areas.

Further reforms should be implemented to maximize efficiency in state government. An example of such a reform is reorganizing the way procurement is handled. This will produce meaningful savings to the state that will only increase over time.

For example, over a three-year period of time, the Department of Finance Administration's (DFA) Office of Purchasing should become self-funding and, thus, provide procurements saving of \$166,136 annually. While my budget offers this specific recommendation, it is evident that implementing a comprehensive procurement reform plan would provide additional cost-savings for the state.

The Office of Purchasing, Travel and Fleet Management (OPTFM) within DFA is understaffed, even to accomplish its current mission. Mississippi only has three buyers—or contract analysts—for the entire state. Taking on a series of strategic sourcing projects will be labor intensive and will require a workforce with a different set

of skills and experience than the contract analysts currently possess. Therefore, a strategic sourcing unit housed within OPTFM should be created. The unit, which would consist of five to seven highly skilled strategic sourcing specialists, would give state procurement the necessary resources to be able to implement an aggressive strategic sourcing program. The intent of this program is to increase the state’s buying power by maximizing the leverage it has with suppliers for the purposes of reducing cost and enhancing quality. Through strategic sourcing, the procurement demands of all agencies are aggregated so that the number of suppliers used is consolidated based on “bundled” needs. This approach is data-driven and requires up-front planning, analysis, and strategy.

Statutorily, the legislature should amend Title 31, Chapter 7 of the Mississippi Code to allow OPTFM to contract for services. A policy should be adopted through which OPTFM is allowed to keep rebates and administration fees to replace budgeted funds and pay for education, training and staffing expenses. Lastly, to ensure optimal information sharing, the Public Procurement Review Board (PPRB) and the Personal Service Contract Review Board (PSCRB) should be consolidated under DFA.

Through the identification of key metrics and benchmarks relevant to OPTFM’s needs, a system for following the progress of procurement would be created. OPTFM must also clearly define workload allocation to ensure that the work given to agency and contract employees is distributed fairly. Formal business reviews and compliance tracking devices also should be established as an accountability measure for the new system.

Commodity	PA Annual Spend	GA Annual Spend	PA Savings		GA Savings \$	GA Savings %	Combined Annual Spend (GA/PA)	Average Annual Spend	Combined Annual Savings (GA/PA)	Combined Annual Avg. Savings % (GA/PA)	Estimated MS Category Spend \$	Estimated MS Savings %	Estimated MS Savings \$
Software	\$ 43.7	\$ 50.0	\$ 4.0	9%	\$4.3	9%	\$ 93.70	\$ 46.85	\$ 8.30	9%	\$ 9.84	4%	\$ 0.44
MRO/Supplies	\$ 17.4	\$ 23.2	\$ 3.5	20%	\$4.9	21%	\$ 40.60	\$ 20.30	\$ 8.40	21%	\$ 4.26	10%	\$ 0.44
Office Supplies	\$ 22.5	\$ 24.9	\$ 9.6	43%	\$7.6	31%	\$ 47.40	\$ 23.70	\$ 17.20	36%	\$ 4.98	18%	\$ 0.90
Auto Parts	\$ 7.9	\$ 10.1	\$ 1.1	14%	\$5.5	54%	\$ 18.00	\$ 9.00	\$ 6.60	37%	\$ 1.89	18%	\$ 0.35
Computers	\$ 56.6	\$ 79.1	\$ 19.1	34%	\$17.1	22%	\$ 135.70	\$ 67.85	\$ 36.20	27%	\$ 14.25	13%	\$ 1.90
Peripherals	\$ 29.5	\$ 20.1	\$ 8.5	36%	\$5.1	25%	\$ 43.60	\$ 21.80	\$ 13.60	31%	\$ 4.58	16%	\$ 0.71
Servers	\$ 40.0	\$ 44.2	\$ 13.4	34%	\$16.2	37%	\$ 84.20	\$ 42.10	\$ 29.60	35%	\$ 8.84	18%	\$ 1.55
Office Furniture	\$ 18.1	\$ 70.0	\$ 7.0	39%	\$17.5	25%	\$ 88.10	\$ 44.05	\$ 24.50	28%	\$ 9.25	14%	\$ 1.29
Cleaning Supplies	\$ 11.1	\$ 27.9	\$ 3.5	32%	\$7.3	26%	\$ 39.00	\$ 19.50	\$ 10.80	28%	\$ 4.10	14%	\$ 0.57
Fleet	\$ 16.0	\$ 15.0	\$ 2.4	15%	\$1.5	10%	\$ 31.00	\$ 15.50	\$ 3.90	13%	\$ 3.26	6%	\$ 0.20
MFD's (Copiers Segment 2-4 and 5+)	\$ 18.9	\$ 21.3	\$ 7.9	42%	\$6.7	31%	\$ 40.20	\$ 20.10	\$ 14.60	36%	\$ 4.22	18%	\$ 0.77
IT Staff Augmentation	\$ 65.0	\$ 53.3	\$ 19.8	30%	\$6.7	13%	\$ 118.30	\$ 59.15	\$ 26.50	22%	\$ 12.42	11%	\$ 1.39
Prof. Svcs. Temp Labor	\$ 5.9	\$ 8.7	\$ 1.8	31%	\$2.1	24%	\$ 14.60	\$ 7.30	\$ 3.90	27%	\$ 1.53	13%	\$ 0.20
Totals	\$ 346.6	\$ 447.8	\$ 101.6	29%	\$102.5	23%	\$ 794.40	\$ 397.20	\$ 204.10	26%	\$ 83.41	13%	\$ 10.72

Assuming the conditions above are met, real savings can be achieved— which we estimate at upwards of nearly \$11 million.

A number of the categories listed in the chart involve information technology (software, hardware, services). Since IT procurements fall under ITS, the strategic sourcing project will have to be broad enough to include OPTFM as well as ITS. In addition, for non-IT services categories, PSCRB will need to be involved as well.

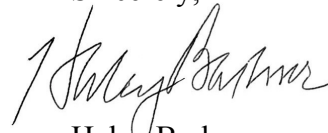
Before the state begins to realize these savings, OPTFM is going to have to recruit,

interview, hire, and bring on-board the five to seven sourcing specialists. After they have been trained on public procurement and Mississippi's procurement practices (assuming they are external hires), it will take roughly eight to twelve months to establish each contract through strategic sourcing. Therefore, the savings will not be realized for some period of time. However, the eight- to twelve-month procurement period could be reduced to one or two months by identifying contracts that could be piggybacked upon; similar to the way that OPTFM decided to use the cooperative contracts.

Closing

States, more than ever, must lead and chart the course for growing their economies and providing necessary government services, while recognizing the limited role government ought to play. The Obama Administration continues to usurp the authority of states and hand down rules and regulations which include unfunded mandates, making balancing state budgets even harder. As you prepare our state's FY 2013 Budget, I am confident that Mississippi will continue to live within its means and you will make the tough decisions without raising taxes.

Sincerely,



Haley Barbour