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Deficit Management Plan

A Plan for Managing the State Budget through
June 30, 2003, and Beyond

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Deficit Management Plan

A Plan for Managing the State Budget through June 30, 2003, and Beyond

Directives from the Governor

Since the first signs of economic downturn in Indiana, the O'Bannon-Kernan administration has endeavored to be prepared for any eventuality. That mindset made it possible for the State Budget Agency to respond promptly and expansively when Governor O'Bannon called for a comprehensive Balanced Budget Plan, which he unveiled last November.

That plan reflected the governor's firm belief that sound fiscal policy demands that the state budget be structurally balanced – that is, spending should not exceed revenues. The only exception to that course of action is when the executive and legislative branches agree to deliberately spend down an excessively large surplus and identify one-time expenditures, as occurred in 1997 and 1999.

The Balanced Budget Plan was intended to live up to its name by taking a series of steps that would lead to keeping spending in line with revenue. The governor attempted to make changes – by, among other things, cutting spending and increasing revenue – that would bring the budget into balance with minimal use of one-time devices.

The governor remained optimistic throughout the 2002 legislative session that the General Assembly would value such a fiscally sound approach and adopt his Balanced Budget Plan. But his cautious attitude also dictated that the Budget Agency prepare for any outcome. The groundwork was laid and, when HB 1004 was blocked in conference committee, the Budget Agency was able to respond to the governor's directive to prepare a plan to deal with the situation. This Deficit Management Plan (DMP) has resulted.

Unfortunately, circumstances required the Budget Agency – against its better judgment – to abandon its fiscally responsible, long-term approach to balancing the budget and adopt last-ditch, one-time patchwork. Such fixes will get Indiana through the biennium, but will leave it weaker going into the next biennium, when the General Assembly must adopt a permanent solution or be prepared to preside over fundamental changes in the kind of state services Hoosiers receive and expect.

Resigned to using one-time fixes, Governor O'Bannon nevertheless set out several other parameters for the DMP. First and foremost, K-12 education should be spared as much as possible. Those cuts that would be necessary should not affect the classroom unless all other courses of action have been exhausted. Other spending cuts should harm as few people as possible. Extras should be eliminated if doing so preserves basic services.

The governor rejected political expediency by taking such an approach. He recognized that constituents were less likely to object loudly and demand action by the legislature if the classroom was spared and vulnerable people did not lose services. But he felt strongly that he should take a responsible, defensible approach that would put people first and preserve the policy objectives for which he was elected.

Appropriations minus Revenues Equal Deficit

This is a Deficit Management Plan because the state has an on-going, structural deficit in its General Fund. The Balanced Budget Plan is dead, or at least its goal of restoring the state's budget to balance by the end of FY03 is dead, without new sources of revenue for the General Fund. Financial experts agreed that, if no base cuts were made and if no revenues were raised during the 2002 legislative session, the deficit at the end of June 30, 2003 would be at least \$1.3 billion. Even with all the steps that have been taken to-date, the projected annual operating deficit on June 30, 2002, is \$1.2 billion. When this DMP is fully implemented, the projected operating deficit on June 30, 2003, is \$1 billion. That deficit continues into the next biennium. Assuming zero growth in education and general government, the annual operating deficit remains at \$823 million in FY04 and \$448 million in FY05, assuming the average pre-recession revenue growth of 5.25 percent.

The operating deficit is an on-going problem; it must have a long-term solution, such as that proposed in the Balanced Budget Plan. One-time fixes mitigate the effects of the deficit at a particular time, but they do not solve the problem. One-time fixes just postpone the inevitable: raising revenues on an on-going basis or making even deeper cuts on an on-going basis.

Unfortunately, because there was little legislative action to address the on-going deficit, this DMP has no choice but to rely to a great degree on one-time fixes. As a result, we acknowledge that this plan does not achieve a balanced budget (that is, a budget where revenues equal or exceed ongoing spending) in this biennium. And without legislative action in the future to increase the state's revenues or fundamentally change the level of state government services, a balanced budget will not be achieved in the next biennium.

History of the Balanced Budget Plan and 2002 Legislative Action

The Balanced Budget Plan

The O'Bannon-Kernan Balanced Budget Plan (BBP) was announced November 15, 2001. The BBP was designed to balance the General Fund budget by June 30, 2003, the close of the biennium, and to have the budget in balance for the next biennium as well. The task was daunting because the plan had to wipe out a \$1.3 billion structural deficit. In order to achieve a balanced budget, the BBP required General Fund cuts and reversions, reallocations of existing revenue streams, suspension of certain tax cuts, and increases in cigarette and gaming taxes.

The implementation of the BBP required both administrative action and legislative action. The administrative actions have largely been implemented or are on their way to implementation. However, the short session ended with only a few of the legislative actions having been taken, despite passage of most BBP measures in the House.

Legislative Actions to Support the BBP

The 2002 session ended with three measures being enacted to assist in the implementation of the BBP. They were essential measures that will mitigate the need for further education cuts this biennium and will assist in Medicaid cost containment.

- The tuition support distribution for K-12 from the General Fund was decreased by \$115 million and local school corporations were allowed to “backfill” these cuts from other sources. However, at the same time, the calendar year cap for these distributions was increased by \$24 million, so the anticipated savings of \$115 million were reduced to \$92 million. (HEA 1196)
- The operating appropriation for higher education was reduced by \$29 million, and the Budget Agency was allowed to “backfill” these cuts from BIF appropriations for technology. (HEA 1196)
- Some of the desired Medicaid amendments concerning pharmaceuticals, coverage of children, and asset protection were adopted to help achieve the goal of reducing Medicaid expenditures. (SEA 228)

Provisions of the BBP that will be Implemented

FY 2002

- ⇒ \$524 million in payment delays (\$14 million less than originally planned because of higher than projected tuition support payments)
- ⇒ \$176 million in reversions (more will be achieved as described in the DMP)
- ⇒ Transfers from Rainy Day and gaming reserve funds

FY 2003

- ⇒ \$203 million in one-time reversions (more will be achieved as described in the DMP)
- ⇒ \$109 million in permanent budgetary base cuts
- ⇒ \$115 million reduction in state tuition support, with transfers from other school levies
- ⇒ Transfers from Rainy Day and other reserve funds
- ⇒ \$4 million in fee increases
- ⇒ Additional payment delays

Provisions that Could Not be Implemented

FY 2002

- ⇒ Cigarette tax increase
- ⇒ Transfer of tobacco settlement trust fund reserves

FY 2003

- ⇒ Cigarette tax increase
- ⇒ Gaming admissions tax increase
- ⇒ Use of tobacco settlement trust fund reserve
- ⇒ Suspension of the \$2,500 homeowner property tax deduction, the business property tax deduction (the "add-back"), and the business personal property tax credit

The Medicaid Balanced Budget Plan

The Balanced Budget Plan included a goal of reducing anticipated state Medicaid expenditures by \$250 million for the biennium. Based upon a new Medicaid forecast announced on December 19, a Medicaid Balanced Budget Plan (MedBBP) was prepared by FSSA and released on January 4, 2002. This plan, like the BBP, required both regulatory and legislative actions. A review of the Medicaid forecast subsequently been conducted.

Administrative Actions to Support the MedBBP

The Office of Medicaid Policy and Planning (OMPP) has been prevented in court from implementing Phase One nursing home and pharmacy cost containment rules that were to have been effective in October 2001. The nursing home rules were expected to yield \$13.5 million savings in FY02 and \$18.5 million savings in FY03. Pharmacy rules were expected to yield \$1.5 million in FY02 and \$14 million in FY03. Although permanent rules are underway for each, OMPP will lose \$10.5 million in nursing home savings and \$1.5 million in pharmacy savings in FY02, if the court rulings stand. Both cases are on appeal.

Most policy changes contained in the MedBBP require a rule change. All of the necessary rules are in the permanent rule promulgation process (including the substantive changes that were the subject of the earlier lawsuits); however, this is a lengthy process and will impact OMPP's ability to meet July 1, 2002, start dates assumed in the MedBBP estimated savings.

Legislative Actions to Support the MedBBP

OMPP lost a critical piece of the MedBBP when the General Assembly failed to pass a nursing facility provider bed fee, which had been in HB 1004 as passed by the House. This fee was expected to provide at least \$21million in revenue. The \$21 million loss in revenue will either require additional cuts to long-term care, which will be very difficult for the nursing home industry to absorb, or result in more painful cuts to other program areas. In addition, the legislature passed a provision in SEA 228, which prohibits OMPP from

placing limits on the number of brand name drugs a Medicaid recipient receives each month, and OMPP's plan to impose such a limit was expected to provide \$9 million annual savings as part of the MedBBP.

Anticipated Medicaid Shortfall

The \$250 million goal will not be reached. The latest projected shortfall for Medicaid is \$294 million for the biennium. The increased projection is based on a review of the December actuarial study, which review projected an increase in the number bed-days at nursing homes, an increase in ICF/MR expenditures, and an increase in adult and children enrollment, resulting primarily from the recession. The Phase I and II savings are now projected to be \$173.1 million. The state match for the startup costs for the Pharmacy Benefit Management program and the Disease Management Program (legislation approved in the 2001 Budget Act) is expected to be \$8.4 million. Additionally, the override of the personal needs allowance veto will cost Medicaid \$1.2 million.

The net effect is a Medicaid biennial shortfall of \$130.5 million (\$88.5 million in FY02 and \$42 million in FY03). To offset the shortfall, \$50 million from the Medicaid Indigent Care Trust Fund will be utilized in FY02.

Other Legislative Actions that Affect the Bottom Line

Veto Overrides

The Legislature overrode three vetoes from the 2001 session, resulting in a \$1.6 million impact to the General Fund as of July 1, 2003. Of that amount, \$1.2 million relates to Medicaid (increase in personal needs allowance (see above). The balance affects the Department of Correction (mandatory AIDS/HIV testing and establishment of ombudsman office).

New Legislation

As a result of new legislation, the impact to the General Fund in FY02 will be \$8.2 million, \$ 32.6 million in FY03, and \$33.6 million in FY04. Most of the increase comes from HEA 1195, the Internal Revenue Code update bill, which the Governor signed despite its fiscal impact because he weighed the value of the update to Hoosiers and determined that the update's benefit outweighed the cost to the General Fund. In addition the Rainy Day Fund will be impacted by SEA 17, providing for a maximum loan to Porter County entities of \$28 million.

The Meaning of the Deficit

There is a real consequence to having an annual operating deficit. In layperson's terms, if you spend more than you take in, eventually you go broke. That's true for the General Fund as well. Even after implementing elements of the BBP that can be done without legislation and using all reserves, the State's combined reserve balance would be nearly \$300 million in the hole at the close of the biennium. (Exhibit 1 shows the analysis that leads to this conclusion.)

Risks that are still Faced

The DMP is based upon the best information currently available to the Budget Agency and the Governor's office. However, there are risks that continue to threaten the viability of the DMP, which are summarized below.

Litigation

- 1) The DMP takes into account the Day case, assuming that 75 percent of the forecasted \$323 million will be claimed in FY 2003. If more than 75 percent is claimed, that will result in an even lower reserve balance.
- 2) OMPP is facing additional litigation where the exposure is in the millions of dollars. Some of this litigation may prevent OMPP from achieving savings included in MedBBP.
- 3) The Kraft and Flores litigation over moving people out of institutionalized care (the Indiana version of Olmstead) could also result in additional expenditures.

Revenue Projections

As has been so clearly demonstrated in the last two years, actual revenues can fall short - - far short -- of projections. Recent revenue trends have tracked the November 2001 forecast fairly closely, but are \$38 million or 0.7 percent below projections for the first eight months of FY02 and 1.7 percent below collections for the first eight months of FY01.

Expenditure Projections

Actuaries forecast Medicaid expenditures, but the decline in Indiana's economy has caused an increase in recipient enrollment, as discovered in the recent review of the December forecast. While we do not doubt the actuaries forecast, we know that it is prudent to have other reserves to cover unexpected enrollment

Actuaries also forecast pension expenditures from the Teachers Retirement Fund. But because that fund is on a pay-as-you-go basis, changes in actuarial experience and improvements in benefits go right to the bottom line, causing General Fund expenditures.

Federal Mandates

The State is currently subject to a mandate to implement the Health Insurance Portability and Accountability Act (HIPAA). Because of the current fiscal condition, the State cannot meet the implementation deadlines. The anticipated \$80 million to \$160 million cost of implementation is an expense the state would be required to assume that would impact the General Fund.

The annual Internal Revenue Code update legislation also affects the General Fund. HEA 1195 will cost the General Fund \$71.4 million. If future updates include the recently enacted federal stimulus package, the impact on the State would be approximately \$300 million over the ensuing three years. In fact some taxpayers may remit less estimated taxes in FY02 anticipating the historical practice of updating the Indiana Code based upon the federal tax code.

Contingencies

It is impossible to predict the emergencies that could require additional and unanticipated expenditures. But a natural disaster or terrorist act can require expenditures that cannot be deferred.

Goals of the Deficit Management Plan

The Task before Us

After the 2002 session, an \$800 million “hole” was left in the BBP, because legislation was required for the BBP’s proposed revenue reallocations and enhancements. Therefore, the administration’s effort to balance the budget by June 30, 2003, has been stymied. It is now our task to manage the deficit – but not just for this year, or the next, but also for the long term – although our tools have been limited. And while managing the deficit and being fiscally responsible, the governor must maintain Indiana’s policy priorities – protecting the classroom, adequately funding public safety, protecting our most vulnerable citizens, and maintaining government accountability.

A great deal of painstaking study has gone into the preparation of the DMP. It is based upon the facts, as available to us today. However, as noted above, there are many contingencies that can affect the revenue or the expenditure side of the financial equation, or both. As conditions change, the actions we must take will change.

Critical Decisions

Targeted Cuts

Although no area has been spared, we have not undertaken an across-the-board, one-size-fits-all approach. We have followed the governor’s policy priorities and directives.

Addressing the Structural Deficit

Republican House and Republican Senate leadership have expressed the opinion that the structural deficit should not be addressed until next year. This is an unfortunate approach. If the revenue side of the equation had been addressed this year, the BBP could have been implemented and some of the more painful cuts and transfers required by the DMP would not have been required. Hoosiers will have to endure painful cuts in virtually all areas and then will have to pay increased taxes. If House Bill 1004 had been enacted, cigarette and gaming taxes would have increased this year (rather than next) and tax cuts would have been suspended, but many of these statewide cuts would have been avoided.

The DMP addresses the structural deficit in a fiscally responsible way by the following administrative means:

- 1) Reducing funding for categorical educational programs.
- 2) Reducing higher education operating and capital expenditures.
- 3) Reducing excess appropriations for cost-of-living increases in the Teachers Retirement Fund (TRF COLA).

- 4) Making permanent allotment reductions for separately elected state officials.
- 5) Requesting the judicial and legislative branches make reversions and base cuts to address the fiscal crisis.

One-Time Fixes

Despite the steps being taken to address the structural deficit, without increased revenue or the permanent transfer of revenue, the administration must turn to one-time fixes, including

- 1) Diminishing the Rainy Day Fund, the Build Indiana Fund, and other reserves.
- 2) Making transfers from dedicated funds.
- 3) Requiring above-normal reversions.

The BBP included a balanced approach using some of these one-time cuts and transfers - \$544 million. And on March 20, 2002, the governor specified \$332 million in additional cuts and transfers. But the administration is very clear that one-time fixes do not address the structural deficit and do not further the state's long-term interest in providing good quality education, economic diversity and development, and the welfare of our citizens. But because we can clearly see that the state would have no reserves and its bottom line would be below zero without these one-time fixes, these Band-Aid measures must be taken.

Maintaining Reserves

Experts agree that the state must operate with appropriate reserves. The goal of the BBP was to balance the budget and preserve a 10 percent reserve balance. According to a 2001 report by the National Association of State Budget Officers, a reserve of 10 percent would place Indiana in the top quartile of states. The DMP reduces that goal for FY02 to 6.6 percent or \$627 million and for FY03 to 4 percent or \$393 million. A reserve balance lower than 5 percent would place Indiana in the bottom quartile of states.

But we must examine those reserve balances closely and realize that in each year at least \$300 million, according to the Indiana Fiscal Policy Institute, must be taken out of the equation, because that is what is needed for cash flow. If that amount is removed from consideration (which it should be), we have \$327 million in FY02 and \$93 million in FY03 to address contingencies. These are miniscule amounts when compared to the outstanding risks (enumerated earlier in this plan) – litigation, revenue projection shortfalls (currently -\$38 million), unforeseen Medicaid enrollment, unforeseen pension expenses, federal mandates (the federal stimulus package \$300 million), and natural disasters (tornadoes and floods).

The governor will use the administrative tools at his disposal to protect Indiana's policy priorities, while being fiscally prudent and maintaining appropriate reserves. Cuts will be made in order to maintain this level of reserves.

Exhibits 2 and 3 shows the impact of the DMP on reserves. This chart shows that, without new revenue sources and despite holding education and general government at zero growth, the surplus is gone in FY04. This chart is based on what some say is an optimistic revenue growth projection of 5.25 percent. The state of Indiana is broke!

Reserves and the State's Bond Rating

The rating agencies have made it very clear that they expect the state to take steps to get to a structurally balanced operating budget, without relying on one-time fixes or transfers or fiscal gimmicks that push liabilities out to future years. Standard & Poors' and Moody's have both expressed concern about the temptation to spend down reserves. The Indiana Fiscal Policy Institute identified a 3 percent reserve as the minimum needed to maintain adequate cash flow. However, Standard & Poors' has said that a 5 percent reserve may not be sufficient to avoid a downgrade.

The Cost of a Credit Downgrade

The state is expected to bond for at least \$758 million in long-term bond financings in the next two years – all of which rely on the state's credit for their ratings. In addition, the State Office Building Commission (SOBC) has \$155 million in variable (or "floating rate") debt outstanding that re-prices weekly. This \$915 million in debt will be affected if the state's credit rating were to be downgraded.

If we assume a 'one-notch' downgrade from AA1/AA+ to AA2/AA, the estimated additional cost in terms of higher interest costs would be approximately \$8.85 million, if the state's credit rating were to be reduced 'two notches' to AA3/AA-, the added cost would be upwards of \$21.5 million.

If the General Assembly does nothing, we would expect a two-notch downgrade, and, therefore, increased interest costs of at least \$21.5 million.

The State Budget Agency**Intra-Agency Transfers**

By statute, the State Budget Agency is authorized to:

Transfer, assign and reassign any appropriation or appropriations, or parts of them, excepting those appropriations made to the Indiana state teacher's retirement fund established by IC 21-6.1, made for one specific use or purpose to another use or purpose of the agency of state to which the appropriation is made, but only when the uses and purpose to which the funds transferred, assigned and reassigned are uses and purposes the agency of state is by law required or authorized to perform. IC 4-12-1-12(e).

With the affected state agency's consent, the Budget Agency may transfer appropriations from one specific use or purpose of the agency to another use or purpose that the agency is required or authorized to perform. The State Budget Agency will exercise this power to transfer appropriations within accounts of the same dedicated fund but not to transfer money from dedicated, non-reverting funds to the General Fund. There are, however, a few so-called "dedicated" funds that do not have specific non-reversion language. Those funds could be subject to transfer by Budget Agency.

Allotment System

As long as the Budget Agency has a reasonable basis to support its action, and as long as the reduction is necessary to prevent a deficit financial situation, the Budget Agency has broad authority to control spending through the allotment process. In exercising the allotment power, the state budget director and the Budget Agency have followed and will continue to follow the statutory requirements of IC 4-13-2-18:

In case the state budget director shall discover at any time that:

- (1) the probable receipts from taxes or other sources for any fund will be less than were anticipated; and
- (2) as a consequence the amount available for the remainder of the term of the appropriation or for any allotment period will be less than the amount estimated or allotted therefore;

he shall, with the approval of the governor, and after notice to the state agency or agencies concerned, reduce the amount or amounts allotted or to be allotted so as to prevent a deficit.

The governor, through the Budget Agency, may reduce allotments to avoid a situation in which the state is in violation of Article 10, Section 5, of the Indiana Constitution ("No law

shall authorize any debt to be contracted...”) However, SECTION 35, the specific provision in the 2001 Budget Bill (HEA 1001-2001) authorizes the budget director and governor to “withhold allotments of any or all appropriations contained in this act for the 2001-2003 biennium, if it is considered necessary to do so in order to prevent a deficit financial situation”. This appropriate and legal delegation of legislative authority is a clear and express intention by the legislature to delegate and, when implemented, there must be reasonable, specific and detailed standards by which the Budget Agency makes its allotment decisions.

The state budget director and the State Budget Agency are also mindful of the standards enunciated in Etherton v. Wyatt. In this regard the state budget director has made the following determinations required by statute:

- 1) The probable receipts from taxes or other sources for the General Fund will be less than anticipated at the time of the enactment of the current budget. HEA 1001(2001 Budget Act) was based upon the April 2001 revenue forecast and was anticipated to result in an annual deficit of \$500 million to \$600 million each year. In November 2001, the revenue forecast was revised downward, indicating that the deficit had virtually doubled.
- 2) As a consequence, the amount available for the rest of the biennium will be less than the amount estimated. The November 2001 forecast is proving to be reasonably accurate, but revenues are still falling short by \$38 million for the first eight months of FY02. Therefore, there is no expectation that revenues will match the amount estimated under HEA 1001-2001.

In determining the amount of spending cuts outlined in this plan, the State Budget Agency conferred with every affected agency and has considered its needs for the remainder of the biennium. Historic growth rates and statutory provisions were considered. The State Budget Agency also considered the long-term impact of cuts in allotments on required programs.

The Balanced Budget Plan, the Permanent Cuts Plan (which detailed \$109 million in base appropriation cuts), and the Deficit Management Plan constitute the written guidelines that will control the making and withholding of allotments by the state budget director.

Based upon these findings and considerations, with the approval of the governor and with notice to the affected state agencies, the state budget director has and will reduce the amounts allotted to address the General Fund deficit.

Separation of Powers

Article 3, Section 1 of the Indiana Constitution provides for the separation of powers among the executive, legislative, and judicial branches. While the general allotment authority of the Budget Agency to avoid a deficit, i.e., to “reduce the amount or amounts allotted or to be allotted so as to prevent a deficit” (IC 4-13-2-18(f)) does not apply to the judicial or legislative branches, SECTION 35 of the 2001-2003 Budget Act (HEA 1001) is broad enough to include the legislative and judicial allotments. However, case law from other jurisdictions consistently finds that delegations of legislative authority to the executive branch (such as SECTION 35) do not include the authority for the executive branch to unilaterally reduce the allotments of the legislative and judicial branches. Therefore, the State Budget Agency does not intend to use its allotment power with respect to the judicial

and legislative branches, but will ask them to participate voluntarily in the General Fund cuts.

Rainy Day Fund Transfers

Under the Budget Act (SECTION 49), the State Budget Agency is authorized to use the Rainy Day Fund (notwithstanding IC 4-10-18), with the approval of the governor and after review of the state budget committee “to maintain a positive balance in the state general fund.”

State Board of Finance (SBF)

The governor, the auditor of state, and the treasurer of state constitute the State Board of Finance. The SBF is authorized to:

Transfer money between state funds, and the board may transfer money between appropriations for any board, department, commission, office, or benevolent or penal institution of the state

The authority given the board under this section to make transfers does not apply to trust funds. For purposes of this section, “trust fund” means a fund which by the constitution or by statute has been designated as a trust fund or a fund which has been determined by the board to be a trust fund. IC 4-9.1-1-1.

The SBF may negotiate loans with terms of up to four years for the purpose of meeting “casual deficits” in state revenue. If there are insufficient funds to pay the loans when due, the board is authorized to levy a property tax in order to pay off the loans. IC 4-9.1-1-8. By statute, trust funds are authorized to purchase the notes issued by the SBF. IC 4-9.1.1-9. The governor does not anticipate the need to ask the SBF to borrow from trust funds.

General Fund Cuts to Reduce the Deficit

Categorical Funding for Education Programs

Under the BBP, the tuition support distribution to K-12 schools was decreased by \$115 million and local school corporations were allowed to “backfill” these cuts from their local funds. Similar provisions were incorporated in HEA 1196, allowing schools to be held harmless from painful cuts to tuition support. However, because the budget was not balanced, Governor O’Bannon has been left with no choice but to implement modest funding cuts to schools through their categorical program grants.

Since taking office in 1997, Governor O’Bannon’s top priority has been to protect and reform public education. Over the past several years we have made great progress in our education system and at the critical time of increased accountability, schools need funding support more than ever. Under the governor’s directive, the DMP strives to protect K-12 education funding, and specifically funding to the classroom, to the greatest extent possible.

Categorical funding supports valuable programs such as professional development grants to schools, early intervention programs, alternative education and remediation programs. These programs, and other categorical funds, are important to a student’s success in the classroom. Under the DMP, the governor asked for a plan to cut seven percent from the Department of Education categorical program. This was accomplished by cutting 7 percent from most programs. However, some programs are entitlements, and cuts are not possible. As a result, some of the programs were eliminated. A few programs were cut by 15 percent. The result of this approach is to make a total of \$35.4 million in cuts in categorical programs to help balance the budget, \$30.2 million in FY03. This cut represents 6 percent of categorical funding and less than 1 percent of the total state’s support to schools.

Higher Education

The BBP proposed that university operating appropriations be reduced by \$29 million in FY03 but that \$29 million in frozen technology funds be available for use to backfill the cuts. This provision was incorporated in HEA 1196. The BBP also called for a 50 percent reduction in university rehabilitation and repair (R&R) funds for FY02 in the amount of \$16 million.

On March 20, the governor announced plans to further reduce university repair and rehabilitation (R&R) funds by cutting the FY02 and FY03 appropriation by 75 percent, an additional \$48 million in savings. This cut was part of a total of \$84 million in reductions in state and university R&R funds during the biennium. The governor also announced plans to transfer \$29 million in FY02 gaming funds appropriated for technology to the General Fund.

Recent discussions with university presidents have resulted in a higher education deficit reduction package, which minimizes operating appropriation reductions. Based on these discussions, the governor is urging the public institutions to keep upcoming tuition increases for the 2002-03 school year below 10 percent.

Under the DMP, R&R distributions would be limited to \$4 million for the biennium instead of the \$64 million appropriated. The FY03 university operating appropriations will be reduced by \$34.6 million. To replace this reduction, \$29 million in funds for technology will be distributed and made available to the institutions for use as operating funds, reducing the net operating loss to only \$5.6 million, or 0.5 percent.

In addition, university and other line items will be reduced by 7 percent, and SSACI appropriations reduced by \$3 million in FY03. Finally, \$7.4 million for three authorized university capital projects to be funded with General Fund appropriations will be delayed beyond the current biennium.

As a result of these actions, total university appropriations, including those from gaming funds, will be reduced by \$233 million during the 2001-2003 biennium.

Additional Base Cuts

Reduction in TRF Appropriation for COLA

The BBP included a reduction in the appropriation for the TRF COLA. This is not a withdrawal from the trust fund. The current appropriated amount exceeds the actuarial projection of the necessary funds for the COLA by \$11.7 million. This made long-term sense but this short-term savings is needed to prevent other reductions in services.

Separately Elected Officials

The State Budget Agency will withhold 7 percent from the budgets of the auditor of state, secretary of state, treasurer of state, the administrative accounts of the department of education and the attorney general. These will be considered permanent base cuts. (Note: Other permanent base cuts to the Department of Education are covered in the section entitled "Categorical Cuts for Education.")

Legislative and Judicial Branches

The Administration calls upon these two branches of government to make 7 percent permanent base cuts to their General Fund appropriations.

Dedicated Funds Transfer

The administration will request that the State Board of Finance (SBF) approve transfers from the following funds to the General Fund:

Build Indiana Fund (BIF) – \$247, 503,662

BIF is funded by gaming revenues, after funding is provided for teacher pensions, public safety pensions, and auto excise tax replacement. Under IC 4-30-17-10, the governor must approve expenditures from BIF. On March 20, 2002, the governor officially froze all state and local projects, which had not previously been approved. As a result, \$183.7 million in state projects and \$63.8 million in local projects will not be released. Transferring these BIF monies to the General Fund will help minimize cuts in education.

Tobacco Appropriations – \$60,000,000

Neither the State Budget Agency nor the SBF has the authority to change initial distribution of gaming or tobacco settlement revenue. However, to the extent that the money is distributed to non-reverting funds that are not “trust funds,” the SBF may transfer the money to another state fund. For example, the portion of the tobacco settlement money that was appropriated to the various non-reverting accounts could be transferred by the SBF, while the 40 percent that was retained in the master settlement fund would be considered a non-transferable trust fund.

State Highway Fund – \$30,000,000

HB 1004, as passed by the House, included use of State Highway Funds to replace General Fund appropriations for the State Police. This proposed transfer tracks that approach. The State Highway Fund supports the Indiana Department of Transportation’s (INDOT) highway construction program. A transfer of \$30 million will not negatively impact INDOT’s planned construction program for FY03. This total will be achieved by not reprogramming prior year reversion funds.

Other Dedicated Funds – \$95,000,000

In the negotiations on HB 1004, both House and Senate included proposals to transfer money from dedicated funds to the General Fund. The Senate contemplated \$100 million from eight specific funds, granting the Budget Agency authority to move funds without SBF action and the House suggested that \$75M was a reasonable amount. By reviewing the funds included in the various versions of HB 1004 and also considering other sources of short-term fixes, the following funds were identified for SBF transfer.

Department of Administration

Administrative Services Revolving Fund \$15,000,000

The Data Processing Revolving Fund was established by IC 4-13-1-4. It is a revolving fund used to cover the cost of centralized information technology services. The fund is administered by the Department of Administration's Division of Information Technology. The division is responsible for providing all information services that would benefit from centralization and the resulting economies of scale.

Department of Environmental Management (IDEM)

Waste Tire Fund \$3,500,000

The Waste Tire Fund is made up of money deposited from a \$0.25 fee assessed for each new tire sold, and fees assessed for those who store, transport, and process waste tires. The anticipated unobligated balance of the fund after the transfer would be about \$1.2 million, which will be needed to fund the FY04 expenses.

Environmental Management Special Fund \$3,500,000

The annual appropriations from this fund exceed \$3.3 million. The current balance of the fund is \$23.8 million. The current balance includes \$4.5 million in projects that are legally obligated as court ordered reserves. The remaining balance includes about \$11.5 million in fees from air and water programs that are internally earmarked for use in the appropriations of the air and water programs. This fund is also used to fund some emergency cleanups so any transferring of these funds may hamper IDEM's ability to perform emergency cleanups like the White River incident.

Department of Commerce

Recycling Promotion and Assistance Fund \$8,000,000

Provides loans and grants to Indiana businesses and government entities to promote and assist recycling efforts via the *Recycling Promotion and Assistance Program* appropriation. The fund's primary revenue source is 50 percent of a \$0.50 fee levied on solid waste at disposal facilities; other revenue sources include loan repayments and interest.

Department of Correction

Industries and Farm (PEN Products) \$2,000,000

This fund is a result of the residual profits from products sold by Prison Industries. The estimated unobligated fund balance on June 30, 2003, will be \$3 million. This estimate includes the \$2 million transfer, expenditures of \$40 million, and revenue of \$30 million for FY03.

Department of Education

Veteran's Memorial School Construction Fund \$37,000,000

The General Assembly created this revolving account in 1955. The initial appropriation of \$5 million was from funds transferred from the World War II Bonus Fund. The Indiana State Board of Education administers the account. Disaster and non-disaster loans from the fund are given to school corporations solely for the purposes of construction, remodeling, and repairing of school buildings. The current balance in the account is \$38,666,008, which includes outstanding loans totaling \$764,081.

Bureau of Motor Vehicles (BMV)

Financial Responsibility Compliance Verification Fund \$11,250,000

The Financial Responsibility Fund is made up of fees paid for the reinstatement of driver's licenses. BMV uses the money to administer the Financial Responsibility law, as well as to improve the agency's technology infrastructure. The unobligated balance for FY03 after the transfer will be about \$1.6 million.

License Branch Fund \$7,000,000

The State License Branch Fund is made up of service charges imposed on transactions performed by the Bureau of Motor Vehicles Commission (BMVC). The BMVC uses this money to pay the expenses of the license branches across the state. The unobligated balance for FY03 after the transfer is estimated to be \$3.9 million.

Odometer Fund \$5,000,000

The Odometer Fund is made up of annual fees paid by motor vehicle dealers. The BMV, the State Police, and the Attorney General all use the money in the fund to enforce odometer laws. A portion of the revenue also gets transferred to the Motor Vehicle Highway Fund, which will not be affected by any fund balance transfers. The unobligated balance for FY03 after the transfer will be about \$1 million.

Miscellaneous

State Drug Free Communities Fund \$750,000

This fund is established under IC 5-2-10-1 to promote comprehensive alcohol and drug abuse prevention initiatives for the coordination and provision of treatment, education, prevention, and criminal justice efforts. It is funded via IC 33-19-9-4 (state user fee fund). The estimated fund balance on June 30, 2003, including the recommended transfer, will be \$635,000.

Alcohol & Drug Countermeasures Fund \$500,000

This fund is established under IC 9-27-2-11 to assist in developing and conducting a program of effective alcohol and drug countermeasures to protect and conserve life and property on Indiana streets and highways. It is funded via IC 33-19 (court fees). A transfer of \$500,000 will necessitate the suspension of spending from this fund for FY 03. The estimated fund balance on June 30, 2003, excluding any spending and including the recommended transfer, will be \$250,000.

Bail Bond Enforcement Fund \$600,000

The Bail Bond Fund was instituted for the purposes of employing an investigation staff and for covering the costs of bail bondsmen examinations and licensing. Fee revenue generated by bail bondsmen license applications and renewals is the primary funding source. The treasurer does invest money in the fund, which generates some interest income. If \$600,000 is transferred to the General Fund, the estimated balance by the close of FY03 will be \$200,000.

Board of Animal Health Fund \$900,000

The Meat and Poultry Inspection Fund was created to operate the meat and poultry inspection program. The program is funded by a grant from the federal government and matching state funds. The fund also accrues a small amount of revenue from fines for failure to comply with dairy drug residue rules. The fund will have an unobligated balance of about \$80,000 after the transfer of \$900,000. This will cover all necessary appropriations for FY03.

Increased Reversions

The original reversion target for FY03, as set forth in the BBP, was \$203 million. Under this DMP, the new reversion amount is \$314 million

Under the BBP, it was anticipated that FY03 reversions would rely to a great extent on the freezing and reverting of capital project dollars. Those reversions amounts have been substantially increased as reported on March 20 and as modified for higher education in this DMP. These capital reversion amounts have been pulled out of the \$203 million. This means that greater operating cuts must be achieved. In the following sections, we delineate examples of the ways that these cuts will be achieved.

Eliminating or Reducing Dependence on the General Fund

Alcohol and Tobacco Commission (ATC)

The ATC FY03 budget is \$5,630,953. The budget is currently funded from state General Fund (32.5 percent) and dedicated/transferred funds (67.5 percent) The dedicated funding (Alcohol and Tobacco Enforcement Fund) is from the payment of permits, fines and penalties, employee permits, and temporary permits. Through the allotment process, funding for the ATC will be removed from the state General Fund in FY03. This move will provide \$1,830,705 in General Fund savings. The fund balance for the ATC can the continuation of 100 percent dedicated funding through FY05. Legislation may be required to increase dedicated funding sources if this approach is to continue.

Department of Environmental Management (IDEM)

The IDEM FY03 budget is \$140.6 million. The budget is currently funded from the General Fund (27 percent) and dedicated/transferred funds (73 percent). Through the allotment process, \$11.9 million of IDEM funding will be removed from the General Fund in FY03. This move will provide \$4.9 million in General Fund savings. The fund balance for IDEM can support this level of dedicated funding through FY05, if legislation is obtained to increase those fees that are set by statute. (See HB 1004,

as introduced.) IDEM will continue to be partially funded by the General Fund to preserve its mission to protect health and welfare.

Law Enforcement Training Academy (LETA)

The LETA FY03 budget is \$4,675,846 of which \$1,984,585 (42.4 percent) is from the General Fund and \$2,691,261 (57.6 percent) from dedicated funds. The dedicated funding comes from local court fees, advanced training fees, and vending commission fees. It is proposed that for FY03, 50 percent of the General Fund funding be replaced with LETA's dedicated fund. This will allow \$881,310 to be reverted to the General Fund. The fund balance for LETA will support the additional \$881,310 required of the dedicated fund for FY03 only.

Department of Natural Resources (DNR)

The DNR has several divisions that have blended funding, a combination of the General Fund and dedicated funding. In FY03 two divisions, the Division of Reclamation and the Division of Forestry will replace existing General Fund appropriations with dedicated funding.

The Division of Reclamation has an annual appropriation of \$5,050,023 of which 2.36 percent (\$119,500) is from the General Fund and 97.64 percent (\$4,930,523) is from dedicated funds. The primary source of funding to the Reclamation Fund is reclamation fees. In FY03 \$95,153 in general funding be replaced with dedicated funds. This approach can continue in FY04 and FY05.

The Division of Forestry has \$10,137,815 of which 22 percent (\$2,230,230) is from the General Fund and 78 percent (\$7,907,495) is from dedicated funds. The dedicated fund is supported from county tax levy, forestry licenses, annual permits, gate receipts, campground receipts, and the sale of products. In FY03 \$1,171,307 of general funding will be replaced with dedicated funds. Without an increase in fees, the replacement of general funding with dedicated funding can occur only in FY03.

Institutional Closings and Downsizing

FSSA's Division of Mental Health and Addictions (DMHA)

Evansville Psychiatric Children's Center (EPCC) -- Closure

EPCC is a small facility (capacity of 28, and a recent census of 18) that serves children ages 4 - 12, primarily from southern Indiana. The average length of stay at EPCC is 10 -12 months, which tends to coincide with the school year. EPCC's total operating allotment for FY02 is \$3.3 million. That is over \$150,000 per child, assuming that approximately 22 different children are served during the course of a year.

Based on the following factors DMHA recommends closure of the EPCC:

- ⇒ In the final report of the Governor's Council on State-Operated Care Facilities, the section on services for seriously emotionally disturbed children stated "... a number of private providers located around the state provide services to this same population". County government or local school systems pay for the services provided by these private providers.

- ⇒ The location of EPCC creates a problem with long distances to most parts of the state. Maintaining family involvement is difficult in a facility like EPCC because location is so remote from most of the state.
- ⇒ The state should be doing everything possible to maintain children in the community. The Surgeon General's report on Mental Health indicates that the gains made in residential care, such as is provided at EPCC, are often not transferred by the child to other settings. Instead, the emphasis should be on the family and/or the community working with professionals to cope with the child's behaviors.
- ⇒ Wrap-around services have met with initial success and are being implemented across the state. It is the advent of these services that is largely responsible for the low census and lack of any waiting list for EPCC beds.
- ⇒ Most of the children currently at EPCC would normally leave following the end of the school year, so finding a "place" for most of the children will not be necessary. If EPCC is to close, no new children will be admitted, so the downsizing will occur naturally. DMHA will continue to work with the mental health centers to provide the intensive services children will need.

Evansville State Hospital (ESH) -- Reduction to 168 Beds

DMHA has been moving continuously toward decreasing the census of its state-operated facilities by growing community services. ESH census has dropped, and the waiting lists for adult psychiatric beds in all hospitals have decreased from over 65 in early August 2001 to 39 in March 2002. DMHA originally requested a 168-bed facility at Evansville. This would have brought the facility in line with the recommendations from the Council on State Operated Care Facilities, and with the new facility being developed in South East Indiana (150 beds). Local concern about the facility downsizing instigated an increase in size from 168 to 228 beds.

The current census at ESH is 185, well below the 228 that will be built unless this reduction is instituted. Going forward with the renovation would entail a \$1 million renovation that includes 40 beds not needed by the current census. In addition to the capital savings, there would be approximately \$5.5 million saved annually (\$2.8 million in FY03) in operating expenses. These savings will be the result of a 120 FTE reduction in state/contracted positions.

Indiana State Police (ISP)

Three state police posts -- as yet unspecified -- will be closed, there would be an annual average savings of \$720,000, of which \$345,000 would be from the General Fund. The ISP reports that the average annual operating cost savings per state police post is \$240,000. This includes eliminating all civilian personnel through attrition or layoffs, depreciation and replacement of vehicles, and gasoline and vehicle maintenance

All Agencies

State Employee Raises

The BBP called for the suspension of state employee raises for the balance of FY02 (first six months of 2002), with the hope that, upon passage of BBP revenue provisions, raises

could be provided in FY03. However, at this time, it is clear that state employee raises must be withheld for the balance of this calendar year, saving \$15 million in FY03. This situation will be reevaluated as the fiscal year progresses.

Capital Reductions

A total of \$92 million in appropriations for capital projects will be cut during the biennium.

Diminution of Reserves

Medicaid Reserve Balance

The Medicaid Reserve Balance was established by administrative practice to address the difference between incurred claims and paid claims. Under the DMP, this reserve is being completely depleted.

Tuition Reserve

The DMP maintains the tuition support reserve at \$265 million for each year of the biennium. This reserve is required to protect the distributions to K-12 and is not available for contingencies.

Rainy Day Fund

State Budget Agency will follow statutory procedures to seek review and approval for Rainy Day Fund transfers to keep the General Fund “in the black.” At this time, it is anticipated that \$200 million would be transferred to FY02 and \$240 million in FY03 to maintain a General Fund positive balance.

Looking Ahead to the Next Biennium

\$1 Billion Deficit

Exhibit 2 clearly shows that, despite the cuts and transfers that are made in the DMP, a \$1 billion deficit remains at the end of this biennium. This DMP has only put off the inevitable. The politicians who have said that it is acceptable to wait until 2003 or some later date to address the structural deficit have tried to mislead the public.

Budget Directions for 2003-5

In April, state agencies will begin the process of preparing their budget requests for the biennium that ends June 30, 2005. The State Budget Agency prepares "Budget Directions" to be used in the preparation of the agency budgets and to be used in Budget Committee discussions. Following are the key messages that will be included in the Budget Directions:

- 1) There will be zero percent increase in the amount appropriated for the tuition support formula for K-12.
- 2) There will be zero percent increase in other K-12 appropriations. Base cuts made in this biennium will not be restored.
- 3) There will be zero percent increase in higher education appropriations. Base cuts made in this biennium will not be restored.
- 4) There will be zero percent increase in general government appropriations, where entitlements are not involved. Base cuts made in this biennium will not be restored. Exceptions will be made in cases of emergency or when matching funds would result in greater benefits from the federal government.
- 5) Appropriations for Correction, Medicaid, Property Tax Replacement, and Teachers Retirement Fund will grow to the extent required by law.

Continued Use of BIF Monies

The BBP anticipated that \$100 million per year would be reallocated from BIF to the General Fund. That measure was not enacted in the 2002 session. Looking to the future, it would be our intention to ask the State Board of Finance to transfer the BIF balance each year, which is anticipated to be \$150 million per year.

The Cost of Waiting

Exhibit 3 and accompanying graphs summarize the financial results of the DMP and incorporate two scenarios for the upcoming FY 2003-05 biennium in order to provide a longer-range view of the fiscal challenges the state is facing.

In putting together the scenarios, the following assumptions were made:

- ⇒ For both scenarios, forecast revenues were increased by 5.25 percent for both FY04 and FY05. This represents the average growth rate during the last economic cycle and is realistic only if an economic recovery in Indiana is realized.
- ⇒ For both scenarios expenditure increases were anticipated in unavoidable areas including Medicaid, FSSA, Correction, Teachers' Retirement Fund payments, and property tax replacement credits.
- ⇒ For one scenario, no funding increases for K-12 or higher education are included. Under this scenario, state spending would grow by about 2 percent in FY 2004 and about 1 percent in FY 2005.
- ⇒ For the second scenario, 3.5 percent funding increases for K-12 and higher education were included. Under this scenario, state spending would grow by about 3.7 percent in FY04 and about 3.0 percent in FY05.

The no-growth scenario is unrealistic in terms of meeting reasonable funding demands for essential state services, especially education. Nevertheless, it illustrates the grave fiscal situation the state faces. In fact, the bottom-line results are sobering. The operating deficit in FY04 would be \$823.4 million and \$447.6 million in FY05. The state would go broke during FY04, exhausting all of its reserves. In reality, a no-growth assumption would mean that the bottom line is negative, which is not constitutionally permissible. Either the State Board of Finance would have to borrow to address the problem or another \$800 million would have to be cut in order to get back to restore the budget to balance.

There is a heavy price to pay for inaction on HB 1004 in addressing the budget crisis during the 2002 legislative session. Governor O'Bannon's Balanced Budget Plan relied on two permanent tax increases, cigarette and gaming, to generate about \$450 million a year in additional revenue. A much larger tax increase will now be needed to bring the budget back into balance and to fund essential state services. The Governor specifically avoided proposing any increase in sales or income taxes to resolve the budget crisis. However, if no action is taken to raise revenues prior to the 2003 legislative session, at that point the level of permanent revenue increases will have to be doubled, at a minimum. Relying on only cigarette and gaming tax increases is no longer workable.

It is also important to point out that with a projected reduction of combined state reserves to \$393 million at the close of FY03, the state is left unprotected against the next economic downturn. Prudent fiscal policy would dictate that the state generate enough additional revenue as soon as possible to restore its combined reserves to the desired level of 10 to 12 percent of operating expenditures. Finally, the ability of the state to pay back the payment delays to schools, higher education institutions, and local units of government appears to be impossible for the foreseeable future.

Failure to act on a HB 1004 in 2002 also means that tax restructuring becomes a virtual impossibility in 2003, when \$1 billion in taxes must be raised just to provide minimal increases in education funding.

Exhibits

Exhibit 1 – Analysis of the State’s Financial Condition – Current Biennium

Exhibit 2 – Governor’s Deficit Management Plan

Exhibit 3 – Fiscal Years 2004-2005 Budget Scenarios

Exhibit 4 – Deficit and Combined Balances for FY04-05

EXHIBIT 1

ANALYSIS OF STATE'S FINANCIAL CONDITION

(Before Applying the Deficit Management Plan)

(In Millions)

Projected Resources:

Combined Reserves @ 6/30/01	910	Beginning balances at start of biennium
Ongoing Revenues and Gaming Reserve Transfers	18,773	Forecast revenues plus DSH plus new fees plus transfers from gaming reserves included in biennial budget
Subtotal	19,683	

Projected Expenditures:

Biennial Appropriations	20,726	HEA 1001-2001 appropriations plus \$8M per year for judgments
Plus: Medicaid Expenditures Above Appropriations	251	Based on December Forecast
Plus: Day Medicaid Case Retro Payments	242	Assumes 75% of claims will be incurred during FY2003
HIPAA	0	Assumes State will not comply with federal Mandate
Less: Administrative Cuts	-703	\$782M in planned cuts set out in the Balanced Budget Plan less \$79.3M in Medicaid cuts no longer achievable
Payment Delays	-549	K-12, universities, and property tax replacement credits
Subtotal	19,967	
Projected Combined Reserves @ 6/30/03	-\$285	

EXHIBIT 2
GOVERNOR'S DEFICIT MANAGEMENT PLAN
(In Millions)

Fiscal Situation Before Applying the Deficit Management Plan

	<u>FY2002</u>	<u>FY2003</u>
On-Going Revenue		
Forecast	\$9,005.5	\$9,249.5
DSH	\$70.0	\$65.0
Fee Increases	\$0.0	\$4.0
Sub-Total	<u>\$9,075.5</u>	<u>\$9,318.5</u>
Expenditures		
HEA 1001 Appropriations	\$10,211.9	\$10,497.7
Base Reversions	-\$50.0	-\$50.0
Medicaid Shortfall (12/01 Forecast)	\$82.9	\$168.3
Veto Overrides of 2001 Legislation	\$0.0	\$1.6
2002 Legislation	\$36.2	\$32.6
Sub-Total	<u>\$10,281.0</u>	<u>\$10,650.2</u>
Operating Deficit	-\$1,205.5	-\$1,331.7
Non-Base Adjustments		
Transfer from Lottery & Gaming	\$200.0	\$175.0
Payment Delays for K-12, Higher Ed, and PTRC	-\$523.6	-\$25.3
Judgments and Adjustments	\$8.0	\$8.0
Day Case Retroactive Payments	\$0.0	\$242.3

Administrative Actions Taken Under the Deficit Management Plan

<u>General Fund Base Cuts</u>		
State Agency & Elected Officials Appropriations		\$110.2
Medicaid	\$44.4	\$127.6
K-12 Categoricals		\$30.2
Higher Education		\$41.7
TRF Cost of Living Appropriations		\$11.7
Sub-Total	<u>\$44.4</u>	<u>\$321.4</u>
Operating Deficit Under the Deficit Management Plan	-\$1,161.1	-\$1,010.3
<u>One-Time Transfers, and Reallocations of Resources</u>		
Transfer of Medicaid Reserve	\$100.0	\$0.0
Transfer of Tobacco Fund appropriation		\$60.0
Transfer of State Highway Fund		\$30.0
Transfer of Other Dedicated Funds		\$95.0
Transfer of Rainy Day Fund	\$200.0	\$240.0
Replace 10% of Tuition Support with Local School Funds		\$115.4
Transfer from BIF	\$0.0	\$247.5
Sub-Total	<u>\$300.0</u>	<u>\$787.9</u>
<u>One-Time Reversions</u>		
Cuts in Operating Across all Categories	\$63.0	\$153.0
No pay raise for state employees in CY 2002	\$15.0	\$15.0
State Capital Projects Cutbacks	\$32.0	\$59.7
Higher Education R&R Cutbacks	\$32.4	\$36.3
Sub-Total	<u>\$142.4</u>	<u>\$264.0</u>
Grand Total of Actions Taken Under Deficit Management Plan	\$486.8	\$1,373.3
<u>Reserves as of June 30, 2002</u>		
General Fund Balance	\$15.5	\$7.2
Medicaid Reserve Balance	\$0.0	\$0.0
Tuition Reserve Balance	\$265.0	\$265.0
Rainy Day Fund Balance	\$347.0	\$120.9
Total Reserves	<u>\$627.5</u>	<u>\$393.1</u>
Less Payment delay liability	\$523.6	\$548.9
Net combined balances	<u>\$103.9</u>	<u>-\$155.8</u>
Combined balances as percent of operating	1.09%	-1.54%

EXHIBIT 3
FISCAL YEARS 2004 - 2005 BUDGET SCENARIOS
(Millions of Dollars)

	NO GROWTH IN EDUCATION AND GENERAL GOVERNMENT ASSUMPTION		MINIMAL GROWTH IN EDUCATION AND NO GROWTH IN GENERAL GOVERNMENT ASSUMPTION ⁽³⁾	
	<u>Estimated FY 2004</u>	<u>Estimated FY 2005</u>	<u>Estimated FY 2004</u>	<u>Estimated FY 2005</u>
General Fund Balance at July 1	7.1	(364.3)	7.1	(544.3)
Total Current Resources (1)	9,673.1	10,182.1	9,673.1	10,182.1
Net Total Current Uses (2)	10,496.5	10,629.7	10,676.5	10,995.9
Operating Surplus/(Deficit)	<u>(823.4)</u>	<u>(447.6)</u>	<u>(1,003.4)</u>	<u>(813.8)</u>
Total One-Time Resources	540.8	150.0	540.8	150.0
Total One-Time Uses	88.8	8.0	88.8	8.0
General Fund Balance at June 30	<u>(364.3)</u>	<u>(669.9)</u>	<u>(544.3)</u>	<u>(1,216.1)</u>
Total Combined Balances	<u>(364.3)</u>	<u>(669.9)</u>	<u>(544.3)</u>	<u>(1,216.1)</u>
Payment Delay Liability	-	-	-	-
Total Net Combined Balances	<u>(364.3)</u>	<u>(669.9)</u>	<u>(544.3)</u>	<u>(1,216.1)</u>

Totals may not add due to rounding

Notes:

- (1) Includes ongoing revenues; revenue growth of 5.25% in FY 04 and 5.25% in FY 05
- (2) Expenditures after base cuts
- (3) Minimal growth in education is assumed to be 3.5%

**EXHIBIT 4
DEFICIT AND COMBINED BALANCES for FY 04 & 05**

