STATE OF MISSISSIPPI
OFFICE OF THE GOVERNOR

May 6, 2009

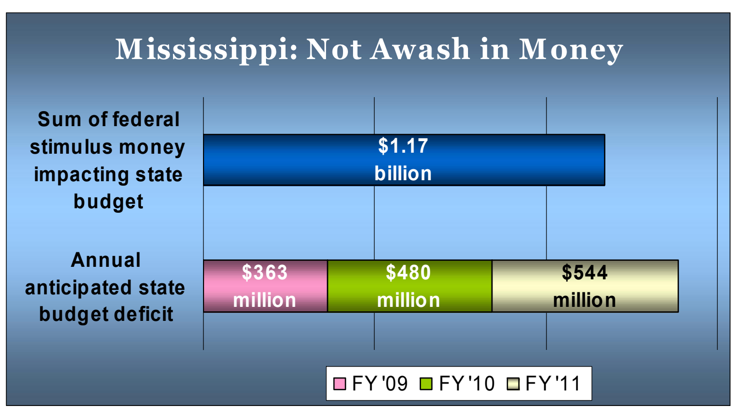
To the Members of the Mississippi Legislature:

As we approached the 2009 legislative session, all of us recognized that the slowing economy would have a depressing effect on the state budget. On November 3, 2008, I noted in my Executive Budget Recommendation for Fiscal Year 2010 that Mississippi is not immune to downturns in the national and international economies.

Since that time, tax collections and other indicators have confirmed many of our deep concerns about the economy. Today we find our state's economy mirroring the national trend- with tax collections decreasing at significant levels while more Mississippians are finding themselves unemployed.

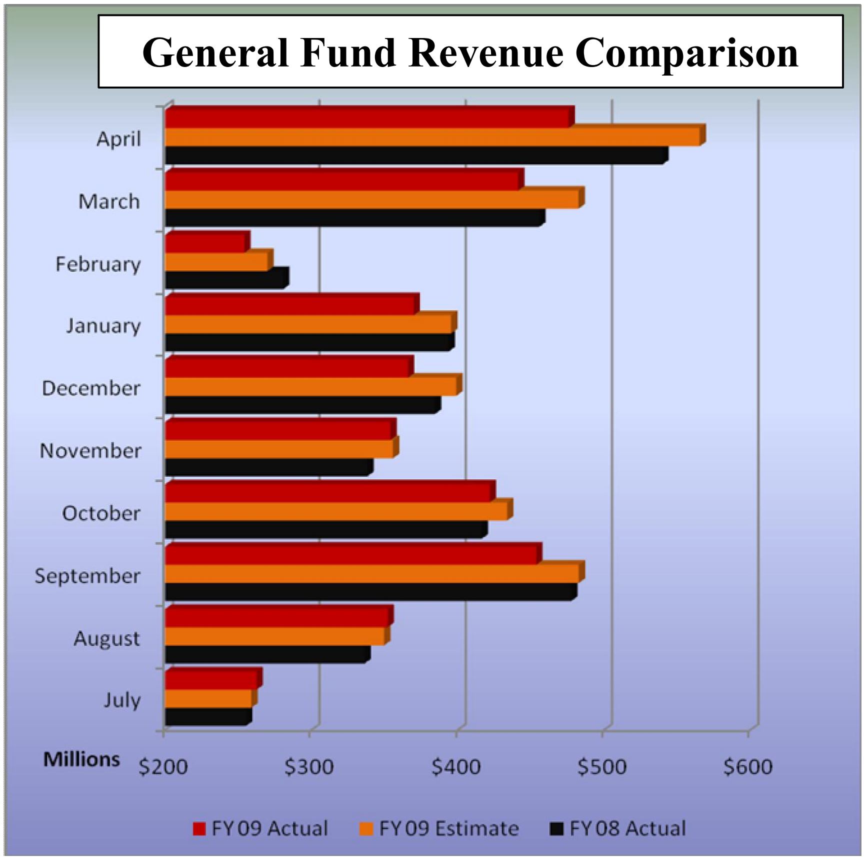
For the current Fiscal Year 2009, we were forced to trim the state budget by $200 million requiring a broad 5 percent spending reduction, excluding court-ordered settlements and Medicaid services, and a smaller 3.49 percent reduction of the Mississippi Adequate Education Program. Mississippi faces a revenue shortfall of over $1.4 billion through Fiscal Year 2011.

It is incumbent upon state agencies, the Legislature and me, as Governor, to take the necessary actions not only to balance the upcoming FY 2010 budget as required by our state's Constitution, but also to be forward-looking by addressing the problems we are certain to face in the FY 2011 budget and beyond. It is necessary to revise my November 2008, Executive Budget Recommendation (EBR) for FY 2010 because revenue estimates have been significantly reduced by the Revenue Estimating Committee. Additionally, the fact that we must budget the American Reinvestment and Recovery Act (ARRA) stimulus monies into FY 2011 mandates this EBR take into account the use of both state and federal funds (ARRA and other federal funds) in FY 2011.



Realistically, we should expect the financial picture to remain dark for Fiscal Years 2010, 2011 and 2012. Economists say this global recession is already a year and a half old and still hasn't hit bottom; and, historically, state revenues recover more slowly than the overall economy. Revenues next year will almost certainly be lower than this year, and the following year isn't likely to rebound much, if at all. That means we must be especially prudent in spending the public's money.

There are no easy answers and no quick fixes, but there are some common sense ways to help weather this financial storm. Giving state agencies lump-sum authority over their budgets and relieving State Personnel Board restraints will give department heads the flexibility necessary for belt-tightening. Some public entities can dip into their own reserve funds rather than relying on the state to fill all of their needs.



Over the next three fiscal years, it is estimated that the State of Mississippi will receive approximately $2.8 billion through the American Recovery and Reinvestment Act (ARRA). Do not mistake this stimulus money as a blank check that will solve all our problems. This money will not make states whole, but simply helps them weather the recession.

Federal rules and regulations dictate how we spend more than half of this money on transportation infrastructure, community development block grants, and other earmarked programs. This leaves $1.17 billion to spend on Medicaid, MAEP base student cost and other state services, which is short of the $1.4 billion projected revenue shortfall through FY 2011. This number does not consider the more than $500 million projected deficit for FY 2012. Clearly, agencies and departments must continue to tighten their belts to ensure we have a balanced, responsible state budget.

The good news is the required cuts do not have to be severe if revenue stays at the most recent revenue estimate. But there remains a serious risk that revenue will fall well below that estimate, which was made in March. April's actual revenue was nearly $40 million below the less-than-one-month-old estimate.

The Fiscal Picture

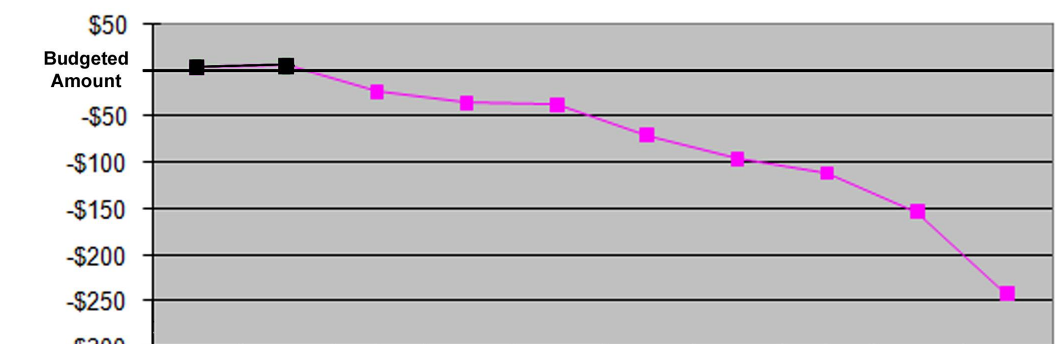
The stimulus package will not be enough to restore all the money trimmed from agency budgets this year, nor will it cover expected revenue shortfalls of more than $400 million each for both FY 2010 and 2011. For the current year, according to the Revenue Estimating Committee's March estimate, revenues will fall $314.4 million short (including beginning cash and Education Enhancement Funds). While $319.2 million of stimulus funds will be used to restore a portion of the budget cuts made during FY2009 and address revenues shortfalls; most agency and program budgets for FY 2010 will still have reductions of four or five percent below the FY 2009 appropriated level.

Our top priority is education at all levels – public schools, community colleges and universities; therefore, most education spending will be restored to about 99 percent of appropriated levels for FY 2009. This is consistent with stimulus regulations set by the U. S. Department of Education.

Cost-saving measures and a conservative use of the state's reserves are key to carrying Mississippi through the next two budget years. In FY 2010, my EBR will use $442.8 million from the stimulus package as the federal government has directed – on Medicaid and education (including public schools, community and junior colleges, and institutions of higher learning). These funds will keep base education programs at about 99 percent of FY 2009 levels; unfortunately other budgets will have to be scaled back if revenue comes in lower than the recent estimate.

A protracted recession means we will need the Rainy Day Fund for years to come. We cannot drain the state savings account in one or two years. I believe we should use one-fourth of the state's Rainy Day Fund in each of FY 2010 and FY 2011, which amounts to about $90 million a year. By conservatively utilizing the Rainy Day Fund, we will be better prepared for the projected shortfall in FY 2012 of more than $500 million.

Aggregate Revenue Shortfall for Fiscal Year '09



Amounts in millions of dollars	July '08	Aug. '08	Sept. '08	Oct. '08	Nov. '08	Dec. '08	Jan. '09	Feb. '09	March '09	April '09
	$3.7	$6.1	$23.1	$35.0	$36.8	$69.8	$95.3	$111.1	$152.3	$242.0

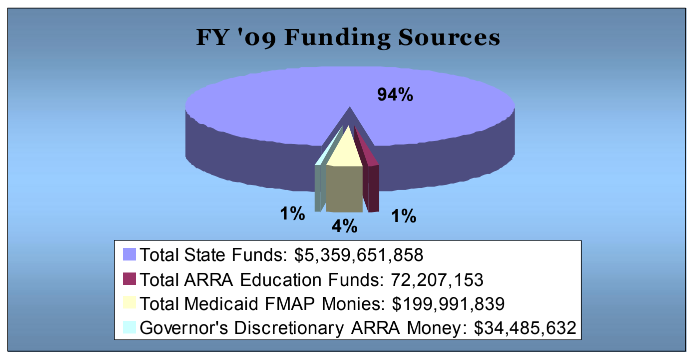
** Does not include beginning cash and Education Enhancement Funds.*

My budget relies on the collection of the hospital assessment, not only as the fair and long-term solution to funding Medicaid, but also to fund Medicaid in FY 2010; and this EBR uses $106.175 million from a 50-cent increase in the tobacco tax. Failure to implement these two measures guarantees deeper cuts for state agencies and services. Similarly, spending in excess of what they'll bring in would require more cuts.

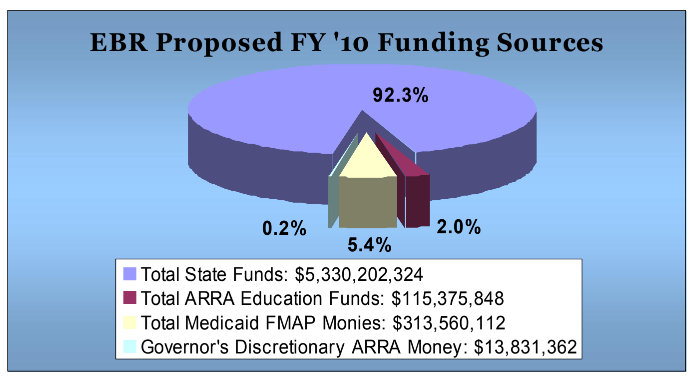
Finally, expenditures do not include $27 million for automobile tags as referenced in HB 364. If the Legislature places a 43 cent per pack tax on nonparticipating manufacturers and taxes smokeless tobacco by unit, the Executive Budget Recommendation will be to use the $25 million to $30 million generated from the taxing of non-settling manufacturers and unit based tobacco for this purpose.

General Budget

As you can see in FY 2010 the non-base education, non-Medicaid budgets receive 6.65 percent cuts below FY 2009 appropriated levels, but the non-base education budget accounts, as opposed to non-education, will be funded at 6.35 percent below FY 2009 appropriated levels.

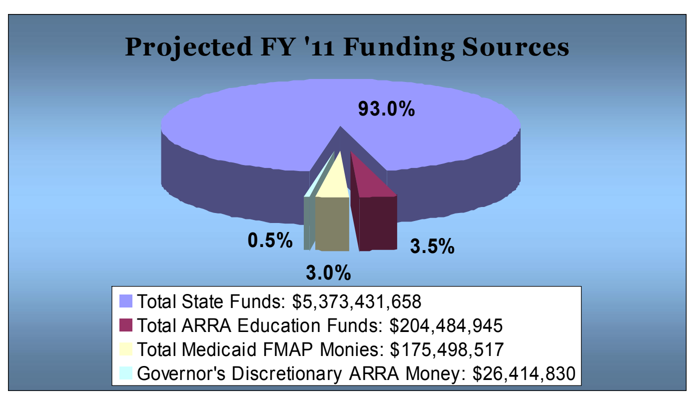


A small number of departments and agencies either got smaller cuts or no cuts. Appropriations based on court orders and debt service are examples of those not cut at all (or increased if required). Corrections is an example of lesser cuts.



Fiscal Year 2011

We won't adopt a budget for FY 2011 in this session, but because the federal ARRA stimulus funding extends into FY 2011, it is critical we consider FY 2011 and the certain effects it must have on the FY 2010 budget.



Except for reinstitution of the hospital tax, the carry forward of Medicaid funds from FY 2009 and FY 2010 to spend in FY 2011 is the biggest issue in dollars and cents.

Even with our avoiding the Medicaid funding crisis in FY 2011, non-base education departments and agencies will likely see small to moderate reductions in state funding in FY 2011.

As you can see the federal stimulus funding keeps our required spending cuts manageable, essentially 5 to 10 percent below FY 2009 appropriated levels. Without the nearly $1.2 billion we are receiving, the cuts would be double or worse.

Again, this EBR assumes restoration of the tax paid by hospitals for 13 years as a provider fee to pay the state's share of Medicaid's DSH program.

Fiscal Year 2012

I am not writing a budget for FY 2012 but you need to know a $500 million or greater shortfall is projected for that year. After the significant infusion of nearly $1.4 billion in one-time money, it is prudent to be mindful about what our state spending would be without those stimulus dollars. A giant hole will be created when these funds completely disappear in FY 2012.

Education

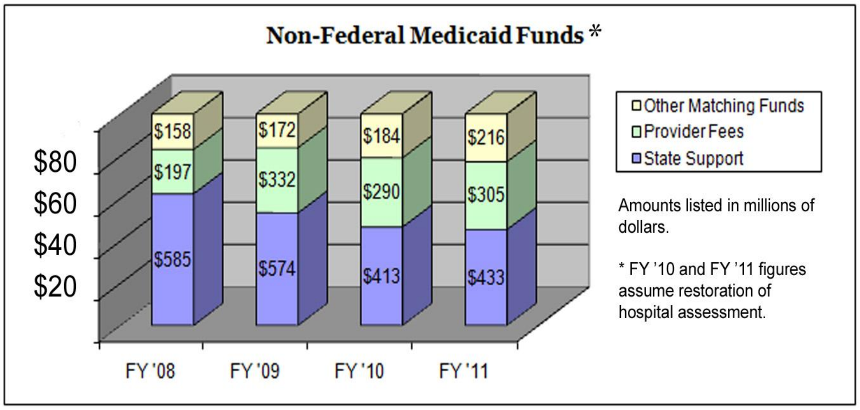
Based on U. S. Department of Education regulations, my budget directs $392 million of ARRA funds to the ARRA-defined education entities, including MAEP Base Student Cost, IHL General Support, instructional activities at the University of Mississippi Medical Center (which is 50 percent of the appropriation), Community and Junior College General Support and the College of Veterinary Medicine. Again, funding by ARRA guidelines restores these education elements to about 99 percent of their FY 2009 appropriated levels and maintains steady funding levels through FY 2010 and 2011. My budget also funds the growth in MAEP Base Student Cost in FY 2010.

Medicaid

Under the federal stimulus act the state's share for Medicaid (FMAP) will be reduced for a period of nine quarters: these quarters in FY 2009 (October 2008 – June 2009); all four quarters of FY 2010 (July 2009 – June 2010); and two quarters of FY 2011 (July 2010 – December 2010). The state share, which is normally 24.16 percent, is being lowered; however, the reduction is in two stages, so the state share for October 2008 through April 2009 is 16.38 percent; from May 2009 through December 2010, it is 15.76 percent. It reverts back to 24.16 percent starting Jan. 1, 2011.

The effect of this very complicated process is that some of our more complex decisions will deal with Medicaid.

During FY 2009, 2010 and 2011 the State will effectively receive $689 million via reduced state match requirements. Most ($561 million) will benefit the Division of Medicaid and the general state match; however, the Department of Mental Health will benefit by $56.5 million, plus $27.7 million that will go to the benefit of the Community Mental Health Centers. UMMC will benefit by $31.8 million because of this effect of the reduced FMAP rate.



Additionally, provider fees paid by Mississippi hospitals will be reduced $65 million in the UPL program; nursing home provider fees are not impacted by the stimulus bill.

This is good news for our providers as it is for Medicaid's general budget. Nevertheless, even with the stimulus bill, the Division of Medicaid will not receive enough funding in FY 2011 to pay all of its bills.

It is, therefore, necessary to capture ARRA Medicaid funds for FY 2009 and FY 2010 and reappropriate them forward to cover the FY 2011 shortfall. Importantly, all of these funds ($3 million in FY 2009 and $90 million in FY 2010) are ARRA stimulus funds intended for Medicaid. The federal formula just makes some of the money available before we will need it for the Medicaid payments.

This is one of the most critical elements of my budget. To help reduce the deficit in FY 2011 we must carry forward and reappropriate $93.1 million from FY 2009 and 2010 to FY 2011. If the Legislature fails to carry these Medicaid funds forward to FY 2011, it means guaranteed cuts in Medicaid of some $466 million in the second half of FY 2011 or, alternatively, nearly $100 million of general fund budget cuts, as the federal government may not allow us to cut Medicaid benefits in a year the state receives federal ARRA funds for Medicaid. This reduction would be on top of the $486 million projected program reduction due to a projected $97 million state match shortfall. And, if the hospital assessment is not realized, another program hole develops of $451 million. In combination, these three issues could result in a total Medicaid hole in FY 2011 of $1.4 billion.

Permanent Funding Source for Medicaid

Among the most critical budgets in the coming years is the Division of Medicaid. Just as the number of Medicaid beneficiaries fell when employment was increasing from 2005 through 2008, as the current recession deepens and unemployment rises, we will see a larger number of Mississippians using this program. The number of eligible beneficiaries increased by 22,000 in March alone, which when annualized, will cause a significant increase in FY 2010.

These increasing costs come at a time when there remains a major hole in funding Medicaid on a permanent, recurring basis. Through FY 2005, hospitals paid $90 million which was used in the Medicaid budget for state matching funds as an Intergovernmental Transfer, which the federal government matched with about $285 million. This practice was disallowed in 2005 leaving a $375 million shortfall from the loss of the assessment and the federal match.

The Legislature has not replaced the $90 million annual payment, so since FY 2006 a variety of one-time federal and state funds have been used to pay the match. Those funds have all run out and will not be available in FY 2010.

In FY 2009, all hospitals received supplemental payments totaling $289 million through the Upper Payment Limit program, which provides an additional payment to help cover hospital costs. Hospitals fund the state match for their UPL payments through a tax called a gross revenue assessment. Because of the federal stimulus, hospitals will pay a reduced UPL match. Hospitals will save $65 million in assessments over three fiscal years (FY 2009, 2010 and 2011) compared to what would have been required to fund normal state share of UPL payments.

Keep in mind that most hospitals are government owned or non-profits and pay no other taxes. Most pay no income tax, no property tax and no sales tax. Health care providers in 44 other states partner with their Medicaid programs by paying assessments or provider fees. Currently, Mississippi Nursing Home Facilities pay the federal maximum allowable assessment of 5.5 percent which is $89 million annually. I am only asking the hospitals to pay for their fair share of the cost of caring for Mississippi's neediest citizens.

Closing Thoughts

My EBR for FY 2010 is really a "least-change," continuity budget. It doesn't call for major restructuring of state government, of combining or eliminating programs. And I don't recommend such a course for FY 2010.

On the other hand, I think it would be wise to create a mechanism to consider every department and agency of state government from the bottom up. I recommend a review that requires every department and agency to justify its existence; its funding; its methods of operation; its stand-alone necessity.

The ARRA stimulus money is masking an enormous revenue shortfall. Even with the federal government's nearly $1.2 billion, Mississippi will likely face a budget shortfall well in excess of $500 million in FY 2012. If the Legislature passes a budget without reinstating the $90 million hospital assessment in 2010, it will be necessary to cut the total Medicaid budget by $571 million or make cuts to other state agencies and programs. In addition if the $93 million is not carried over to 2011, the Medicaid program will have to be cut $387 million. There is a projected Medicaid deficit of $97 million in 2011 which would reduce the total program by $404 million. Couple this with no hospital assessment in 2011 which would further reduce the program by $375 million. The results of the funding shortfalls in FY-10 and FY-11 could create a total Medicaid program reduction of $1.74 billion ($571 million FY-10 and $1.17 billion in FY-11).

These conditions make it an appropriate time to consider major reforms and restructuring. I recommend it to you.

Whether you consider major restructuring or not, maintaining at least $180 million in the Rainy Day Fund (Working Cash Stabilization Fund) into FY 2012 is critical. I will propose using half or $90 million of that in FY 2012 leaving the balance (another $90 million) for use in FY 2013 after my second term as governor ends. Revenue may be back by FY 2013, but it is unlikely it will be back to FY 2009's original estimate by then.

Sincerely,

Haley Barbour