BUDGET ADDRESS OF GOVERNOR DENNIS DAUGAARD

THE STATE CAPITOL – PIERRE, SOUTH DAKOTA – DECEMBER 6, 2011

Welcome back to Pierre. It's good to have you back. It gets kind of lonesome around here for Linda and me when you're not here and we kind of miss you. The worst part of it is when you're not here Linda is stuck talking to me, so I know she is glad to have you back. I want to say a special welcome to Senator Kent Juhnke and Representative David Scott. Would you stand and they will be taking on new roles next year in the legislature. Welcome to both of you!

I also want to say a special thanks to Jason Dilges, Liza Clark, Jim Terwilliger, and everyone from the Bureau of Finance and Management for their help in putting together last year's budget; and then, putting together the budget I am about to present to you. They worked very hard. We are very lucky to have their able and determined assistance, so thanks to all of you.

I want to thank all of you for joining me today as I offer my proposals for our FY13 state budget. When we met to create the FY12 budget last year, we faced a significant deficit. We recognized we were spending more than we were taking in and we targeted ongoing cuts totaling $127 million and everyone participated. Everyone: education, Medicaid providers, all the state agencies. Everyone participated, even though it was difficult. Now to sustain these cuts is a necessity. I want to urge that upon you. We now enjoy because of those cuts the opportunity to consider investments in key areas.

This graph shows how far the deficit developed. Revenue fell in FY09, then fell again in FY10. And even as those revenues fell, our spending edged up, but the FY12 adopted budget fixed the structural deficit that was created by the recession. It adopted a conservative revenue estimate and it brought expenses into line with that estimate. We should all be proud of the work that we've done. This sets the stage for future growth opportunities.

Let's take a look at the national economy that we face today. The gray bars on these four charts describe the national economy in terms of its history. The gray bars show history. The blue bars show the forecast that Global Insights, our econometrics firm that advises us – one of the biggest in the world; the blue bars show their forecast with 50 percent confidence. Normally when Global Insights gives us their revenue projections and their economic forecast, they give them with 60 percent confidence – 60 – and then they say there is maybe a 20 percent chance that it will be worse, a 20 percent chance it will be better. This year they have stated that they have 50 percent confidence in these projections and they believe there is a 10 percent chance it will be better, and a 40 percent chance it will be worse. So, that tells us that those in the business of projecting the national economy - they believe the future looks better, but they are very uncertain about the dependability of that projection.

Let's look at the charts. On the upper left, the US employment declined by 8.7 million jobs during the recession and only a fraction have been added back. In the upper right-hand side, US housing starts declined from nearly 1.5 million, and now are only at about 0.5 million. About a third of what they were pre-recession. The United States real GDP, here on the lower left, is the only indicator that has surpassed pre-recession levels, but much of that support is due to stimulus spending. On the lower right, the US unemployment rate remains high, at 8.6 percent presently, as the labor market continues to struggle. The bottom line is the economy is recovering, but it has not yet recovered and we have to be cautious going forward.

Let's look at how South Dakota compares to the national economy. The South Dakota economy is performing better than the US economy by many measures. These four charts show four key factors. We focus on nonfarm employment, because that's a pretty good predictor of what our tax revenue will do. The first graph on the left shows nonfarm employment levels of the United States economy on the left axis and South Dakota on the right axis in a ratio scale. You can see US employment declined much more sharply in the US and the recovery has been slower. US employment declined by 6.3 percent peak to trough, from the top to the bottom. South Dakota only declined about half as much, or 3.1 percent peak to trough, and our employment growth has been higher than the US recently. The next chart, you can see right here, South Dakota's unemployment rate remains about half of the United States unemployment rate. The two graphs on the bottom simply highlight that South Dakota's nonfarm income on a quarterly basis, as well as South Dakota's per capita income growth on an annual basis, has grown at a faster rate than the United States over the past four to five years. We are fortunate that South Dakota's economy was not as impacted by the recession as the United States economy, and that our economy here in the state is recovering more quickly.

With that background, let's take a look at revenues. You will remember this chart earlier this calendar year, when we got together about the budget, and we talked about how in the years 2003 – 2006 we did a pretty good job of predicting revenues in a conservative way. At the end of the year, we actually under-estimated our revenues. Of course, you want to do that because if you over-estimate your revenues and spend it all – well, you spend money you never got and that's what gets you into trouble. In the years 2007 and 2008, we did just that. We over-estimated our revenue and it came in less than what we thought. Not too bad, not too far off, but on the negative side. And, we want to be on the positive side. Then along came the recession and really exacerbated that problem. In fact, not only did we over-estimate what our revenue was, but we also saw our revenue fall from 2008 to 2009, it went down. In 2009 to 2010, it went down still further. When we got together last year, one of the things we agreed we needed to do was be conservative about our budget estimates. I challenged us to be conservative with our revenue estimates, and I know that legislative leaders of both parties understand how important it is to rely upon conservative estimates. You did adopt conservative estimates and between that and an improved economy we realized actual revenues in FY11, which were better than we projected. This is something we can be proud of. It is something we should strive for every year. Some will say "Oh, we should have spent that money." Well, that's all fine and dandy when you can look back and know exactly what the numbers are. When you can't know what they are, you must conservatively project your revenues and not over-spend. We need to continue this cautious, conservative pattern going forward.

Now, let's look at the year we're in right now – FY12. When we left, when you adjourned in March, this was the budget revenue estimate you adopted. Since then, we've had some history. We've had July, August, September, and October revenue and we built that based on those four months. We're starting to now get in November revenue, but these revenue numbers are revised from what you adopted when you left; because we've got a little more history now behind us, and we can see trends better. You can see we're predicting improvements. Several sources have been revised higher. Sales tax is up 9.6 million, contractor's excise tax is up 10.9 million. The bank franchise tax is up considerably. Why is that? We did not budget to collect any bank card tax in FY12 because we had so grossly over-estimated what bank franchise tax would be that we had a debt when the legislator adjourned. Remember they had over-paid their taxes and we owed the banks money, not they owe us. But thankfully, we are again starting to receive bank card tax this year, which is the primary reason for the increase.

The largest revision down is in the Property Tax Reduction Fund where we are still experiencing the hangover from the smoking ban and the effects of the Iowa casino on nearby video lottery sales. Overall our ongoing, and I want to focus on that, our ongoing revenue is up by $38.8 million. Contrast that to our one-time receipts which are up $24 million. One-time is up $24 million because of two things: One, we paid off the bank franchise tax liability early because our FY11 ending was so strong. Remember, we had those very strong May and June months; and so, we paid off the bank franchise tax liability entirely. We did not have this offset that we had to eat up before we could start recognizing revenue. Secondly, we had a reallocation of income from prior years by some of the bank franchise taxpayers and they pushed more of their income into this fiscal year. It hurt them with respect to us because they owed us more tax, but it helped them with respect to the federal government because they owed them less tax, and on balance, it was better for them to make that reallocation and they did so.

Now let's look at FY13 forecast revenue and compare it to what the changed revenue for FY12 is. You can see the change shows growth in Sales and Use Tax, the Property Tax Reduction Fund, and Insurance Tax. The declines in some of the other areas overall net ongoing is up $22 million, and remember we were up ongoing for this year $38 million. We are still trending up, not as much of an ongoing increase. You will see we project a one-time receipt of $28.8 million. Well, how can we predict a one-time receipt in FY13? Well, it's because I am going to propose that some of the money that we have in this fiscal year - now that we realize our ongoing and one-time revenues are coming in better for FY12 - now that we see that money coming in, I am proposing we move some of that money and obligate it to be spent in FY13 to the tune of about

$29 million. That is where that money is coming from – that one-time money. You will see that developed. The total change to ongoing and one-time is $39.5 million.

We've looked at revenues a little bit, let's look at expenses. Again, we need to move forward cautiously with expenses using the reset of state expenditures to realize long-term efficiencies by sustaining the cuts. We talked about the difference between ongoing revenues. We want to invest new ongoing revenues cautiously in targeted areas that can be sustained. One-time dollars should be spent on one-time expenses, and that's why I'm suggesting we take some of our FY12 money, move it into FY13, and spend it one-time in FY13. You'll see that later in the presentation. All through this we want to ensure we don't create a new structural deficit - that we contain our ongoing spending to only be what our ongoing revenue can sustain.

Why is it important to sustain the FY2012 cuts? Let's get some perspective on it. Remember the hard work that we did last year to cut nearly $127 million out of our expenditures. Consider that in FY12 we're seeing, remember, about $38 million in increase and $20 some million in FY13. If you start with our actual FY11 revenues, and go to what we project will be our FY13 ongoing revenues, the difference in revenue growth from the end of FY12 to the end of FY13, two years, is only about $63 million. Those two years of revenue growth still are only about half of what we had to cut. So, we need to be very cautious as we go forward. It has taken two years of ongoing revenue growth to pay for just one year of expenditure growth in our budget. Without the cuts, we would still be in a significant deficit situation.

Let's move on and look at what we did in FY11, because that will help me explain what I propose for FY13. During FY11, we adopted the FY12 budget and that FY12 budget proposed a 10 percent cut in funding for K-12, a 10 percent cut to providers, a 10 percent cut to the Board of Regents, and a 10 percent cut to the state agencies. When we adjourned, that had been amended to some degree. Senate Bill 152 changed the property tax ratio to maintain about 1.4 percent of what would otherwise be a 10 percent cut. Then one-time dollars were appropriated to add into to both the K-12, providers, and the Board of Regents to ameliorate the effects to some degree of this 10 percent cut. You can see the depth of each cut in its respective group. The state agencies shouldered the entire 10 percent cut.

Now, let's look at the increases I am proposing for this year. Remember the 1.4 percent property tax change will be a sustaining change. The property taxes were not cut, have not been cut, will not be cut down to create the 10 percent. They are starting with that in FY12. Then again we are going to show the one-time monies that were added. That's where we are in FY12, as you left the legislature. Instead of a 10 percent cut, we gave them back about 3.5 - K-12. We gave back about 4 percent to the providers and about 0.9 percent to the Board of Regents.

Just recently the state received $388,000 in one-time money. You might remember that last year the Ed Jobs bill provided South Dakota money to be spent in education or in jobs. Other states did not spend their entire allocation and those funds are redistributed to states that did. We did, and so, we get a little share that other states did not spend. I am proposing that we distribute our share, the $388,000, directly to the K-12 schools, directly on a per pupil basis. With this little revision, this in essence is what the schools were receiving in cut reductions, if you will last year, or the fiscal year we're in right now.

Now let's look at FY13. We'll start again with the 1.4 percent, that is the Senate Bill 152, and then on top of that I am proposing 2.3 percent. Let me say it this way. I am committed to the notion that in years where we have dollars available, new dollars available, education should receive the first dollars. That is we should fund the formula and the last dollars. If we have money left over, we should send them to education. This year I am proposing those first dollars fund the formula to the tune of 2.3 percent. That's what the statute calls for, 2.3 percent. It's based on the retrospective inflation rate – 2.3 percent – so that's what this is. In policy, not in statute, but in policy we have been traditionally providing also an inflationary adjustment to Medicaid providers. Looking at inflation prospectively and that prospective look forward indicates that a 1.8 percent inflationary ongoing increase would be provided.

In the Board of Regents, I am proposing an ongoing increase to the Board of Regents by 0.9 percent, simply based on specific spending requests that they have made. They asked for a fair amount more than this. I am proposing that we give them this and you will see more of that in the Appropriations Bill.

As I previously stated, this shows the ongoing funding that I am proposing in the FY13 budget. In addition, I am proposing some one-time spending. I want to use one-time funds to get each increase up to 3 percent for FY13. If you start with the 2.3 percent, we add 0.7 percent to get these two to add up to 3 percent. The 2.3 percent is ongoing, the 0.7 percent is one-time. You also have one-time 1.2 percent, one-time 2.1 percent for Board of Regents to get each of the three up to 3 percent. These are one-time dollars that I'm proposing we use FY12 money obligated at the end of FY12 to be spent in FY13 to meet these one-time expenditures. As you can see, this gets K-12 above the funding level where they are right now. It gets them a little bit more than the funding they have right now. They never do fall down to the 10 percent cut level. I would like to do the same for these two providers.

I am going to propose even more one-time funds, another 1.5 percent for Medicaid providers, on average they'll get this total amount, and another 1.5 percent to the Board of Regents, and for the Technical Institutes as well. They will be treated the same as K-12. That puts each group in a slightly better position than they are in FY12.

I didn't put a 1.5 percent increase into K-12 but I am going to propose that as well. I am going to propose we spend an additional 1.5 percent for K-12 to fund what I am going to call an Investing in Teaching initiative. This will be a massive training program this summer and next summer in four areas. I've heard many leaders in education worry about the new common core curriculum standards, and they say our teachers are going to be held to these standards teaching our kids these standards. We have to train them on those standards and they are going to have to develop curriculum for those standards. We need time and effort and money to do that. This will fund an intensive training in the summer for every teacher. These dollars will go right to the teachers. They won't go through the school districts. They will go right to the teachers. We are also training administrators on the common core standards and on new teacher evaluation methods. We're including intensive training for science and math teachers, because this is an important area of emphasis for our students. I propose also we train guidance counselors to help our students make wise choices as they move through the high school years. So, that when they get to the end of high school they are planfully choosing their workforce career, or their technical school, or their college career with some guidance help during their high school years. This is a major investment. This 1.5 percent is over $8 million and most of this money, as I said, will go directly into the pockets of teachers, both in stipends for attending the training, and to the instructors who conduct the training.

Let's talk about the ongoing general fund increases that these ongoing percentages I just talked about – what they represent. In state aid, it's almost $10 million, for Technical Institutes $434,000, and these increases do not include additional amounts they'll get for additional student population growth. That will be shown later. For Medicaid provider inflation, this $6 million sum does not include any expansions for utilization or additional enrollment. This is simply for inflation to serve the same number they are serving today. For the Board of Regents, this does not include anything for employee compensation. These are simply for program growths.

That was ongoing, now here are the one-time general funds. As I said, these are dollars that would be spent in FY13 in this chart. It will move state aid to 3 percent and then another 1.5 percent on top of that. I talked about being over $8 million. For a total of $12 million in one-time money. Provider inflation will total $9 million between these two percentage increases and the Technical Institutes with Tech Schools $413,000. All tolled about $27.8 million in one-time monies in FY13 coming from FY12. Dollars that will be in our pocket already. Down here you can see that supplement award that will come in FY12.

Now I want to talk about state employees. Our state employees have gone three years without a raise and they have continued to work hard and serve the state well. I disagree with the caricature that shows government employees leaning on the shovel. That's not South Dakota. Our South Dakota employees work hard and we've had year, after year, after year of cuts to their programs. So, fewer and fewer people are serving more and more South Dakotans in more and more years using less money and they're working hard. I've heard from many of you, many legislators, who would like to do something for state employees this year. I am pleased that we are finally in a position to end the freeze on state employee salaries.

I am proposing two things. First, I'm proposing a $12 million one-time general fund payment to state employees. These would be permanent, non-probationary, state employees paid in this year in FY12 before the end of FY12. That is before June 30th, equaling 5 percent of their pro-rated annual salary payable in April of 2012. Neither I, nor any elected official, would participate. We would also be able to utilize federal and other fund dollars to magnify the general funds and leverage the general funds that we would be allocating. As you can see, this $12 million would be joined by $5.6 million in federal funds and $13.2 million in other funds to make those payments. This payment would not go into their base. It would not go into their base. Just as we are giving one-time dollars to school districts and Medicaid providers, this would be one-time payment to help state employees recover some of their purchasing power that they lost over the three years when they got no increase. To give you some perspective, if a state employee would have gotten, say a 3 percent increase in each of those three years, compounded that would have been a 9.3 percent increase on their base and we would be adding prospectively to that base. I'm not proposing that. I'm proposing a one-time 5 percent payment to be made in April and elected officials would not participate.

Beyond that, I am proposing a 3 percent across the board salary policy for employees going forward starting from their old base, from FY09, and adding 3 percent to that for FY13.

In addition to the across the board cut, there would be what we call the pay system that would move entry level employees up to job worth over a period of up to seven years so that they are fully at job worth when they have worked in their job for a long period of time. Also there are four careers right now in state government that we're having trouble recruiting and holding employees in these career bands - accountants, engineers, nurses, and environmental scientists. We can't recruit them and we can't keep them, because we are so far out of the market with our salaries. Part of this money is to get us back into the market so we can hire and keep employees in those areas.

Finally, the employee salary package would also include a 3.3 percent increase in state paid health insurance costs. What we pay for our state employees to have health insurance, and this takes into account plan changes recommended by the Bureau of Personnel and keeps the program in good financial shape.

This next chart kind of gives you an overview of both the ongoing and one-time funding recommendations in broad summary categories. As you know in FY12, we're still using some stimulus money that we got pushed from the Ed Jobs fund from FY11 into FY12 – about $36 million, almost $37 million, in state aid and Board of Regents payments is made up of stimulus money. So, we have to replace that or they will fall from current funding levels. This is the last time we will have a hangover from the stimulus that we have to deal with in our budget. Second thing, 19.9 million is an increase of 2.73 in our FMAP. For every dollar in Medicaid that we spend, we are going to have to pick up 2.73 percent more and the federal government will pay 2.73 percent less of each dollar in FY13. It's because in those earlier charts you saw our personal income growth is growing faster than the nation, so we're picking up more burden because we're stronger. $13.3 million is the State Aid and Tech Institutes at the 2.3 percent inflation. It also includes the enrollment growth, technology in the schools, sparsity, and South Dakota My Life. $12 million is that employee compensation package, the 3 percent across the board. Again, these are all ongoing increases, this group here, all ongoing. This is the 3 percent across the board inflation, the careers, accountants, environmental scientists, the health insurance, that's in that number. Then inflation, again, the 1.8 percent policy driven inflation for Medicaid providers. We also have to give inflation to our critical access hospitals. We have to reimburse them for their actual costs, qualified health centers, child care. There is a mandated inflation to get the federal match for child care. All those things are essentially inflationary increases that are mandated.

I am going to propose out of the $127 million in cuts that we restore a small number of them – three of them. $1.2 million for graduate medical education, $250,000 for LRC memberships, and $84,000 for Northern State University E-Learning, which helps our K-12 schools. No other FY12 cuts are being proposed for restoration. The other state agency cuts will remain. None of the state agency cuts are going to be restored in my proposal.

We see about $800,000 in eligibles and utilization growth. For those of you who watched our Medicaid rolls and Chips rolls grow at an alarming rate, last year the increase, not the total amount, but the increase that asked for was $12 million. The fact that I am only asking for about $788,000 shows you how the Medicaid growth has abated, and slowed, and stabilized. We still have a little bit of Medicaid enrollment growth but it's considerably less in terms of the rate than it has been, and that's good news. Another $195,000 in various other increases and decreases combined. Those are the $92 million, almost $93 million, in total ongoing increases that I'm proposing. One-time general funds I've described before that total about $27 million. These are all FY13 expenditures. Some funded by FY12 money on a one-time basis, others funded there.

To execute some of these plans we will propose an amendment to the FY12 general bill and these are my proposed amendments. A $12.5 million one-time payment to state employees. I already told you about that. A $5.3 million for immediate workforce needs. I've been spending a lot of time talking to employers and businesses around South Dakota. I've been hearing a lot of concern. Some of you were in Mitchell earlier this year talking about workforce needs, and I have been hearing and you've probably been hearing a lot of concern about workforce. This budget item is for some initiatives that I will be proposing in detail in my State of the State Address. You will hear more about it before you need to make decisions about it during the session. I am going to be proposing $4 million in money to the Railroad Trust Fund to replenish the Railroad Trust Fund in order to match potential federal grants. You know you've gotten some Tiger Grants in the past that has allowed us to upgrade some of our railroads and move farm products to market better, and we've applied for still another federal grant and I'm hopeful we might get that and this would provide matching money for it - a $1.6 million for maintenance and repair.

$349,000 in this item. We have available funding in correctional healthcare based on our current projections and I would like to cut those funds and spend them instead under the Department of Health on a one-time basis to pay for flu vaccines in FY13 for 6 to 18 year-olds who aren't eligible for Medicaid. $39,000 for three new correctional officers that were added to the state pen following the murder of R.J. Johnson. One small amount for a veteran's home accountant to help us bill for Medicaid and track Medicaid. Then a small cut for DOC teachers. These were previously contracted positions. If we bring them in as state employees, we can do it a little bit cheaper and save some money. These are the proposed general bill amendments that I will offer to you for your consideration.

We also want to talk about emergency specials and we have some emergency and disaster issues to deal with as you know. It's been a difficult year for disasters. Many parts of our state have faced historic flooding this year. The northeast, up and down the Missouri River, and people from all across South Dakota rose up to prevent disastrous flooding in their areas, or to fight the flood, and to help those who suffered damage. I can't tell you how proud I was to be Governor of a state like South Dakota, when I saw the volunteerism of so many South Dakotans who were helping their friends and neighbors and strangers that they didn't even know; coming out to help those who needed help. I've always said that we need to save the state reserve fund for emergencies, and I am proposing that we pay for $20 million of flood and Mountain Pine Beetle costs out of our emergency reserve fund. As I mentioned, the flooding is about $14 million and about $6 million is addressing a disaster in the Black Hills. The Mountain Pine Beetle infestation has become an epidemic, and the Black Hills is facing a real danger of massive and catastrophic fire. We have already begun aggressive address to stop the spread of Mountain Pine Beetles, and we need to do more. This is really a case where a "stitch in time saves nine." If we act now, in Custer State Park especially, and through the Black Hills, we can protect this treasure as best we can.

Here are the emergency specials that I am asking for. The $20 million would come out of the budget reserve. $14 million for essentially flood relief issues and $6 million for fire suppression of pine beetles. Of that $6 million, $4 million would be to cost share with private landowners who are adjacent to Black Hills National Forest to encourage them to deal with the problem on their land so it doesn't get onto our land. Also, as I mentioned, in Custer State Park we felt pretty good about our control efficacy in the park, but in a more recent fly over and on the ground checks, we realized that the pine beetles have gotten through our thinned areas and are into the northwest quadrant of Custer State Park in many areas and we need to attack those vigorously before they spread further. I know during the session the Custer State Park folks will have maps for you and presentations to show you where we're finding the infestations and the extent to which we are finding them. I'm also asking for $1.3 million for fire suppression from the special pay fund to fight fires in South Dakota. The extra ordinary litigation fund – this pays lawsuit costs we have been ordered to pay.

A veteran's bonus program - I'm asking for $1 million there that would cover us for four years at $250,000. We had an original appropriation to give special bonuses to veterans returning from the Middle East engagements and that was during the 2004 session. At that time, we believed by FY11 or FY12 the wars in Afghanistan and Iraq would be over, and everyone would be home, and we will have paid our bonuses, and would be done. Well, as you know, the wars have extended further and so this million dollars would give us four more years of capacity to pay those veterans bonuses. You've seen the tax refund for the elderly and disabled appropriation before.

The SDDA, South Dakota Department of Agriculture Construction, this special appropriation would take $400,000 in savings from our Conservation Reserve Enhancement Program and use it to renovate old Game, Fish, and Parks property. Game, Fish, and Parks moved into the new outdoor campus and vacated their property. Wildfire Suppression people are being kicked out of the airport property where we are occupying, some federal regulation apparently disallowed that kind of function in airport adjacent property. This money would help us remodel and reconstruct the old Game, Fish, and Parks property for the uses the Wildland Fire people need.

Physician tuition reimbursement – that's for one doctor and one dentist who have met the requirements by locating in a rural area and staying a certain number of years. Now we are going to repay their tuition.

You've seen the Water Omnibus bill before for the water development, solid waste, and water quality improvement projects throughout the state.

Those are all the details of emergency specials that I am proposing as part of the budget proposal. I've been diving into the details, but now I want to step back a little bit and ask you to look once again at the big picture. We still have in the midst of our improving revenue picture much uncertainty, much uncertainty. I mentioned earlier how Global Insights has departed from their normal practice of saying "here's what we think with 60 percent confidence, 20 percent confidence it will be better, 20 percent worse.' They're only saying, "we think it's going to be this way with 50 percent confidence, 40 percent confidence it will be worse." That tells you even the best economists, the best projection experts in the world, don't know what the future holds and we don't either.

Here are some things that make us uncertain. The failure of the Super Committee of Congress to deal with the federal budget deficit. Now those automatic cuts remember don't take place until federal FY13. Between now and federal FY13, we don't know what Congress will do and yet we have to adopt a budget for our state FY13 without knowing. South Dakota's budget allocations from the federal government are in jeopardy. Also the sluggish global economy is dragging down and has the potential to drag down not only the South Dakota economy but the national economy. I'm sure you've been reading in the paper there's some questions about whether in the next two weeks we will even have a euro anymore in Europe, or whether all those European nations that have confederated into the euro as one common currency will break apart and go back to national currencies. Some economists think that will cause a sharp recession in Europe, and that will impact the United States, and that will impact South Dakota. That's an uncertainty we face. Also, we've got the healthcare reform that the federal government passed, the Patient Protection and Care Act. As you know, some of the provisions of it have come into play already but many of the most significant provisions come into play in 2014. The decisions we make in FY13, in terms of ongoing spending, we need to sustain them in 2014, even as we shoulder some uncertainties as a result of the Healthcare Act. I don't whether the Supreme Court will strike down parts of that Act, all of that Act, none of that Act. I don't know and you don't know and yet we have to make a budget. The point I'm making is that all these uncertainties cause us to need to be very conservative on how we commit to future ongoing expenses.

Here is the bottom line. In FY12, our recommended receipt projection now is that we'll bring in $1.236 billion. The expenditures I am proposing will on an ongoing basis expend $1.198 billion. I am saying on a one-time basis some more of those and then $27.8 million. I'm saying lets obligate them on a one-time basis to be receipted and spent in FY2013. There are $10 million that I'm not proposing to spend in anyway at all. I am leaving $10 million on the bottom line. Because we live in a time of uncertainty, I am not spending every dime we expect to get. $10 million is less than 1 percent of our revenues. I'm proposing to spend over 99 percent of the revenue we receive and leave $10 million as a contingency. If our revenues come in as we hope they will, and if our expenditures are as controllable as we hope they will be that $10 million on the bottom line will be swept by state law into our budget reserves. Remember, I am proposing to spend $20 million of those reserves. This would in part replenish that if it's not needed for other things.

The same is true in FY13. I'm proposing to spend $12 million less than we take in, including the one-time money that we take in and leave $12 million on the bottom line as a contingency against some of these uncertainties. If revenue comes in as we think it will, and we are able to control our expenses to the degree we think we can, then that $12 million will also get swept in reserves. But if we have problems, if revenue drops, if we double dip recession because of Europe or the federal government, or if we have expenses that are unforeseen because of the federal budget problems, then we've got a little bit of room. Less than 1 percent room, but we've got some room. I hope that you will leave that money on the bottom line for that kind of contingency. If you do, and if it remains on the bottom line at the end of each fiscal year, this is what a chart of our emergency reserve history will look like. Going back to FY03, we had a little less than $110 million in reserves. We got some federal dollars that we bank rolled and our reserves went up by quite a bit. We spent some of those reserves to fund Homestake Mine. We spent some other reserves along the way and then the reserves have been held at about $107 million, talking about the budget reserve and the Property Tax Reduction fund together, they total $107 million. I'm proposing we spend $20 million. And then, if it remains on the bottom line at the ends of FY12, $10 million of it would bring us back, and then $12 million at the end of FY13 again. If it's there, would bring us back to about $110 million, so a little bit above where we stand today.

Now, let's return to a historical perspective. This chart is familiar to you. It shows ongoing revenue against ongoing expenses. Our goal is to have these lines track as closely as possible. They diverged widely after the 2008 recession. Because of your hard work last year, these lines once again track each other. Because of a strengthening economy and improving revenues, we are projecting surpluses in both FY12 and FY13. Some people still don't believe that we made the right decision last year. They believe we should have spent the reserves, avoided the tough decisions, and kicked the can down the road. They claimed to support making cuts, but they opposed every specific cut that was proposed and offered. Let's look at what would have happened if we had adopted their plan.

This would be our situation today. Even with improving revenue projections and even with only mandatory spending increases, FMAP increases, inflationary increases mandated, we would be running an $88.7 million deficit for this year, FY12, and we would be looking at $116.7 deficit for FY13. Our reserve funds would be completely gone, and we would be $100 million in the hole. We would be confronting massive deficits, like many other states are still confronting.

Instead, our budget is healthier. Our unemployment is lower. Our growth in personal income is higher. Standard & Poor's has upgraded our credit rating in South Dakota, even as they downgraded the federal government's credit rating. There is one area where we can improve, however. We have a long tradition in South Dakota of requiring a balanced budget. Many of us, myself included, are proud to tout that our constitution requires a balanced budget. In fact, even the National Council of State Legislatures lists South Dakota among the states that have this requirement.

We discovered this year though, as we worked with Standard & Poor's to upgrade our bond rating, that this requirement is pretty difficult to find in the constitution. You can imply it from a couple of provisions read together, but there is not a clear, explicit requirement in the constitution of a balanced budget. In fact, Standard and Poor's refused to credit us with having a balanced budget requirement in our constitution because of this ambiguity. We already hold ourselves to the balanced budget requirement, and we should make that very clear in our constitution. I am asking the legislature this next session to pass a joint resolution to provide a constitutional amendment that requires the Governor to propose and the Legislature to adopt a balanced budget every year. I hope this will help South Dakota improve and upgrade its bonds from AA+ to AAA. But even if it doesn't, it reiterates an important principle to our elected officials and to our friends in Washington about the importance of a balanced budget.

I said it last year and I will say it again - South Dakota has the opportunity to show other states that there is a better way. We balance our budget every year. We create stability in state government at a time of instability in our federal government. We avoid raising taxes and we maintain reasonable regulation. And, we earn a higher credit rating to demonstrate our strength. Right now, right now in Washington D.C., and in Sacramento, and in Albany, and in St. Paul they are contending with massive budget deficits. They are still spending money they don't have. Meanwhile, here in South Dakota, we're taking care of business. We balanced our budget last year, and we will keep our budget balanced by being cautious and conservative. As a result, this session does not need to be about more cuts. We can focus on making government better through investments. We are in this position because of your hard work and I am proud of what we accomplished. I know that as long as we stay true to our principles, we will build an even stronger South Dakota.

Thank you.