Governor Mark Warner's
Speech to the Joint Money Committees
August 25, 2003

Opening Remarks

Chairman Callahan, Chairman Chichester, Chairman Parrish, and Members of the General Assembly: Good morning.

I am pleased to be here this morning to report to you on the financial condition of the Commonwealth for the fiscal year that ended this past June 30. Last year at this time, I came here to tell you:

- that the Commonwealth finished the fiscal year 2002 with the weakest revenue growth in 40 years;
- that the revenue forecast which had seemed conservative a few months earlier needed to be reduced by well over a billion dollars; and
- that significant budget reductions were on the horizon.

I also told you that we would institute a series of steps to control and reduce spending, including monthly spending limits and a continued freeze on non-essential hiring.

We have spent much of the past year successfully confronting the challenge of that budget shortfall, which through last session had exceeded $6.0 billion.

Given news like last year's, it's nothing short of a miracle that you invited me back this year. This year, I am pleased to report to you that despite the worst economic conditions in well over a decade, and for the first time in three years, Virginia finished the fiscal year with a modest revenue surplus.

We therefore begin fiscal year 2004 with a balanced budget and in a much stronger financial position than many of our sister states. I just returned from meeting last week with the nation's other Governors. I am pleased to report that other states continue to look to Virginia as a model of how to navigate the uncertain fiscal waters that state governments continue to face across the country.

Much of the Commonwealth's success flows from our collective commitment to conservative financial management, and from our determination to face our budget challenge directly and forthrightly.

I have said many times that despite the magnitude of our fiscal problems, we should not be content to simply balance the budget. And we have not been. Instead, we've embarked on a series of sweeping reforms to state government that will improve the efficiency of vital services and give taxpayers a better return on their investment.
At the same time:

- We not only protected public education from cuts, but actually increased education investments by more than $80 million;
- We reached the 80-percent enrollment mark in FAMIS -- our state health insurance program for children;
- We won passage of a $1.0 billion bond package to support new capital colleges, museums and parks;
- And we leveraged state resources to create 45,000 new jobs, and over $5.0 billion in new investment to the Commonwealth. I take particular pride in the fact that 20 percent of those jobs and over a quarter of that investment will take place in Southside and Southwest Virginia.

Reform has been at the heart of our agenda. This past July 1st, new laws took effect to streamline many areas of state government, from water policy and mental health delivery to veterans' services and the budget process itself.

The most visible such reform has been in the area of information technology, a $900 million annual enterprise in state government that up until now has been administered separately across each of the 91 agencies in state government. Our reform will consolidate information technology into one agency, saving -- over time -- millions of dollars that can be reinvested in other vital areas.

Through our procurement reforms, we are leveraging the purchasing power of the Commonwealth to achieve significant savings on goods ranging from light bulbs to computer systems. Virginia's electronic commerce program, known as eVA, has been recognized nationally as one of the most successful and innovative practices in digital government anywhere in the nation. Shortly, eVA will surpass the $1 billion mark in the value of goods and services purchased through this internet portal.

We have achieved these things with a state workforce that has 4,900 fewer full-time positions than when I took office, and against the continuing backdrop of the $6 billion budget shortfall. This past June, all three of the national rating agencies recognized our efforts by re-affirming Virginia's AAA bond rating.

Beyond reforming state government, we have moved forward to create new educational and economic opportunities for our children. The nationally-recognized Partnership for Achieving Successful Schools (PASS) represents a new approach to matching the demands of accountability with the resources necessary to actually improve student achievement.

We have moved proactively to help students who are at risk of failing to pass the SOL tests needed for graduation from high school this coming school year -- a move that we hope will help the state avert the kind of problems faced by other states, which have retreated from the consequences of accountability. We are determined to make standards based education work in Virginia.
Project Graduation focuses on remediation efforts through summer academies, online tutorials, and distance learning to get students the help they need to graduate on time. This summer, in a pilot program in Southside Virginia, more than 80% of students who previously failed their Algebra or English SOLs passed the test after participating in a Project Graduation program.

Some of you joined me in Brunswick County last month as we celebrated with several dozen students their success in that program. The renewed sense of hope and pride on the faces of those young people was a vivid reminder of the importance of our work here. For behind all of the budget numbers and trends we'll talk about today are real people who are depending on us to do the right thing. They reminded me of how much more needs to be done for our schools.

And there is no question that much more remains to be done. Like many of you, education is my top priority. As the Chairman of the Education Commission for the States, we have been working hard to build on our PASS Program and Project Graduation by developing innovative reforms in education. Doing so is important in light of the federal mandates contained in the No Child Left Behind Act and the pressing need to improve student achievement.

Over the next few weeks, I will be announcing in more detail several specific steps I think are crucial in strengthening our educational system. Like our reforms in every other area of state government, the measures we'll identify in our educational program are designed to make better use of existing resources, to promote accountability, and to position Virginia to compete successfully for economic growth in the 21st Century.

And now, let me turn to the budget.

**Fiscal Year 2003 Results**

The economic outlook on which the revenue forecast for fiscal year 2003 was based anticipated continuing weakness throughout this past fiscal year. Employment losses were expected to continue but lessen, and income growth was expected to rebound from fiscal year 2002's anemic levels. That is essentially what happened. In addition, income growth rebounded, although not quite to the level which was forecast.

At the end of the day, actual general fund revenue collections grew at 1.8 percent above actual general fund revenues for fiscal year 2002 -- about six-tenths of a percent above the 1.2 percent on which the enacted budget was based. When Lottery proceeds, ABC profits, and all other transfers are included, the bottom line surplus totals $55.2 million. Within that overall total, the revenue surplus came primarily from greater than expected collections in corporate income taxes; strong collections in recordation taxes, driven primarily by mortgage refinancings; collections from insurance premiums, and from individual income tax nonwithholding.

Offsetting surpluses in these sources were shortfalls in income tax withholding and sales and use taxes. In addition, substantially more refunds were paid than forecast partly as a result of the continuing weakness in the job market, and partly as the result of ongoing efforts by Tax Department staff to expedite refund processing.
I am pleased to report that this past filing season, about 93 percent of all income tax refunds were processed and refunded within 12 days, and over 98 percent were processed within 30 days. The expedited processing of income tax refunds is a great success story for our tax department, and it marks a striking reversal from where we were just a few short years ago. Most importantly, this reversal is a victory for the taxpayers of Virginia.

As welcome as this $55 million revenue surplus is, remember that the last revenue surplus occurred three years ago in Fiscal Year 2000; it adds very little to our cushion for the current fiscal year. $46 million of the surplus is already spoken for:

- $23.6 million of the surplus comes from that portion of the accelerated sales tax which would normally go to the Transportation Trust Fund. Under provisions of the Appropriation Act, I have elected to return that money to the Transportation Trust Fund, where it can be used, as it was intended, to fund highway construction, mass transit, ports, and aviation projects. This represents a needed infusion of additional resources for transportation, and one that I am pleased to announce.
- $11.4 million comes from surplus Lottery proceeds, which are constitutionally dedicated for public education;
- $6.0 million is designated by statute for the Water Quality Improvement Fund; and
- $5.0 million has been set aside for floods and natural disasters for which disaster declarations have already been issued.

**Fiscal Year 2004**

With the small revenue surplus for fiscal year 2003, revenues must now grow by 4.6 percent to meet the forecast for 2004 on which the enacted budget was based.

Last year's economic outlook assumed that the nation and Virginia would see a modest and gradual economic recovery this year. And thus far, the economic indicators are pointing in that direction.

You know the indicators as well as I do. The performance of second quarter gross domestic product was better than the experts expected. Retail sales activity jumped in July. Initial unemployment claims seem to be stabilizing. Nationally, manufacturing activity seems to be improving slightly. And, the financial markets have clearly priced in their expectations of an improving economic picture. All of these signs point to the kind of gradual recovery that has been projected for some time.

Despite some encouraging initial signs of job growth, many of Virginia's rural areas continue to struggle, most notably the communities of Southside and Southwest Virginia. I know we all stand united in our determination to help the people of Fieldale, where almost 1000 Virginians lost their jobs at the Pillowtex plant on July 30th.
The state has moved quickly to help. And while we are grateful for the federal government's recent approval of a National Emergency Grant for these workers, we remain hopeful that the Department of Labor will grant expeditious approval of our application for Trade Act Adjustment Assistance.

In other areas, the news is better. Job growth in Virginia has now been positive for three months. Job growth in July (0.9%) showed the best monthly increase in over two years. In Northern Virginia, job growth has now been positive for seven consecutive months. And, payroll withholding collections \* the best current indicator we have of the Virginia economy \* are showing some momentum.

The tentative signs of recovery elsewhere must continue and improve further if we are to sustain revenue growth of 4.6 percent for fiscal year 2004. Nevertheless, all of these signs have led me to conclude that it is not necessary at this time to order an early re-forecast of revenues for this fiscal year. Beginning this fall, our economists and business leaders will fully examine all the projections and assumptions on which our revenue forecast is based \* both for fiscal year 2004 and for the next biennium.

Nevertheless, it would be a serious error to think that state government has reverted to business as usual. We still face significant fiscal challenges. As a result, controls on hiring therefore remain in place, and I have renewed directions to all state agencies to continue to scrutinize and control all spending which is not clearly essential.

**Looking Ahead to the Next Biennium**

As we look ahead to the 2004-06 biennium, it should come as no surprise that we face another very difficult budget. Even with an economic recovery, there will be a substantial gap between available revenues and the spending requirements which we would all judge as non-discretionary.

The list of spending requirements is well known. Let me cite just a few:

- The Board of Education has submitted its preliminary estimate that $525 million in additional state funding will be necessary to fund the state share of the current Standards of Quality. This figure does not include the $324 million that the Board of Education's has said is needed to fund its recent revisions to the Standards of Quality;
- Federally-required Medicaid costs continue to grow faster than revenue, and virtually every provider group that participates in Medicaid now regards state support as seriously inadequate. Indeed, all comparative data that is available places Virginia's Medicaid program among the very leanest in the nation;
- We can expect increased spending requirements in other human resources programs \* such as the Comprehensive Services Act, Foster Care, Special Needs Adoptions, and indigent health care at our teaching hospitals;
We will need to plan for the civil commitment of an increased number of sexually violent predators, and there is a growing backlog of state prisoners in local jails that must be addressed;

Debt service will increase for the bonds that have been and will be issued to fund capital projects in our colleges and universities, parks, mental health, corrections, and other facilities;

Spending to reimburse local governments for the car tax will increase above what is budgeted for FY 2004;

Enrollment demand at our colleges and universities will continue to grow;

Homeland security costs continue to rise, and the federal government's commitment to covering the cost is uncertain at best;

After three years of investment losses at VRS, state contribution rates for employee retirement systems will increase, as well as state contributions for employee health insurance; and

The upcoming salary increase for employee groups, which is funded in this budget for 7 months, must be funded in the next biennium for all 24 months.

Some of these programs and areas will require additional funding in our current fiscal year as well. I could go on, but I think the point is clear. This next budget will again test our ability to come together to make tough choices that will not just balance the budget, but balance our budget in a way that makes the strategic investments that will strengthen Virginia's future. The easy solutions, and even the not-so-easy solutions are gone.

As I look across the landscape of other states, I know that Virginia is not alone in having continuing budget problems. At the National Governor's conference this past week, we were told that states face a cumulative budget shortfall exceeding $100 billion in this fiscal year alone. While we are ahead of most other states in the responsible way we have addressed our problem, we are not immune to the fundamental imbalance between spending drivers -- corrections, Medicaid, enrollment growth, and others -- and moderate revenue growth. This is a basic situation that shows no signs of changing.

This past spring, the federal government took action in a limited way to recognize that fundamental imbalance by appropriating $20 billion in one-time fiscal relief for the states. The latest estimates we have set Virginia's share at $400 million. The largest portion of these funds comes as flexible spending grants. The remainder comes as a temporary increase in federal reimbursement for Medicaid.

I have received numerous requests and suggestions about how these funds might be allocated. I'm sure you have also. While I appreciate the federal government's limited assistance, and while it would be tempting to use these funds to ease budget reductions already enacted, it would also be a mistake, given our fiscal outlook. The fact is that with Washington having turned a $232 billion federal budget surplus into a $450 billion deficit, we cannot consider this revenue to be anything other than a one-time assistance.

As the fiscal year proceeds, it may become necessary to use a portion of these funds to address pressing situations in accordance with the provisions of the Appropriations Act. My plan is
therefore to reserve these funds at the present time. In the end, we will use these funds to deal with only our core responsibilities.

As we move forward on these and other issues, we must be mindful of uncertainty on many fronts. The direction of the national economy is not at all clear. And decisions made in other arenas can affect greatly what we do.

When Congress reconvenes after Labor Day, for example, legislators may take significant action to address the financing of homeland security, prescription drugs, Medicaid, Temporary Assistance for Needy Families, and transportation.

Or, as we have seen so many times with Congress, they may not.

All of these issues will have an effect on the budget that I will present in December. Over the weeks to come, we will continue to wrestle with these issues, and I welcome your input.

**Conclusion**

Ladies and gentlemen, when I took this job almost 20 months ago, I began with a call for renewed civility and bipartisanship as we set out to address Virginia's fiscal challenges. And I appreciate the willingness of so many of you to join me in that effort. Working together, we have truly put Virginia first. We have restored fiscal integrity, streamlined government, protected our core responsibilities and actually increased funding for education. This is exactly the kind of approach that the people of Virginia want and deserve. When I travel around the Commonwealth, people don't care about the ebbs and flows of politics in Capitol Square. They don't care about who's up or who's down. They have had enough of political posturing.

Instead, I find that they want assurances that their kids will get a good education, that we're doing all we can to promote economic opportunity, and that we're careful stewards of their tax dollars. We're working to do that and much more. As we go forward, we should recognize that Virginia has an exceedingly bright future -- but there are plenty of challenges we must face. We've got to make sure our schools and colleges can meet the challenges of a modern economy. We need to bring the promise of economic prosperity to every region of the Commonwealth. We must ensure that our communities are secure from internal and external threat. We need to work together to modernize Virginia's tax structure. We need to continue our drive to reform government. And, we need to work always to make sure that every tax dollar is well spent.

As we proceed, we must do so mindful that the citizens of the Commonwealth will be well-served only if we all work together.

So today, I renew the call I made in my Inaugural address for bipartisanship, and for a commitment to put the Commonwealth and her people first. If we stay focused on that simple goal, I am confident that we will build the Commonwealth of Opportunity that our people want and deserve.