Mr. Speaker, Chairman Callahan, Chairman Chichester, Chairman Parrish, and Members of the General Assembly:

Good morning.

I have come before you this morning to report on the state of our economy and to share with you the substance of the amended budget which will be introduced as Senate Bill 700 and House Bill 1400. These bills meet our responsibility to balance our budget fairly and honestly - in a manner that protects public education, public safety, and Virginia's most vulnerable citizens.

In a real sense, we begin today a conversation that will continue throughout 2003 and beyond -- over the nature of what we expect from state government.

Particularly over the coming weeks and throughout the next session, I hope that we will continue the cooperative relations that have characterized this past year.

By putting partisanship aside, we have been able to achieve important successes together this year.

When I took office eleven months ago, our economic conditions dictated that Virginia would have to do business differently. The boom of the late nineties was over, and it was time for state government to acknowledge that reality.
Working together with you, we have taken dramatic steps to restore fiscal stability and begin building a foundation for long-term reform.

We started with a focus on accountability across state government. You see, I believe in a simple, but powerful rule -- that which gets measured, gets improved. We have brought that principle to state government.

For the first time, the Commonwealth now has clear, written agreements with which to assess the performance of each Cabinet member and agency head.

At the agencies that historically had been the most troubled, we have made the most progress. We installed a new management team at the Transportation Department, and we have begun the long-term reforms necessary to restore public confidence in this once-proud agency.

To capture the renewed spirit of civic duty that emerged since the September 11 attacks, we created Virginia Corps, to help individuals find a way to serve their communities in protecting the homeland.

We have worked hard to recruit new employers to Virginia and to help existing businesses expand. So far - in a very tough year - we have announced almost 25,000 new jobs statewide - including 4,000 new jobs in Southside. We recently learned that statewide unemployment is at its lowest level in 14 months. Virginia is clearly well-positioned for economic recovery.

Student achievement on the Standards of Learning exams continues to rise. Nearly two-thirds of our schools now meet the standard for full accreditation - well ahead of schedule. That's clearly welcome news, and our PASS initiative is making great strides at helping close the achievement gap so that all children can succeed.

We've made FAMIS more family friendly, by removing red tape and administrative barriers, and we have increased enrollment 30 percent since January -- bringing health care coverage to thousands of Virginia's children.

And in higher education and in our state parks, we won a great victory last month when voters approved bonds to upgrade and expand these facilities. These bonds will be Virginia's first major new investment in infrastructure in more than a decade.

These important steps represent a significant beginning in our collective effort to make state government work - to make it more responsive, accountable, and effective.

Taking these steps will position Virginia to emerge stronger, better able to compete for jobs and economic prosperity.

**Budget History: Setting the Stage**

The central topic of this meeting is the Commonwealth's budget, which is the clearest statement we have of our core priorities and basic commitments.
As you know, the Commonwealth finished fiscal year 2002 with the weakest revenue performance in the last 40 years.

Rather than wait for the traditional fall forecasting cycle, as many other states have done, we took direct and aggressive action to conduct a comprehensive re-forecast of general fund revenues, even before the books for fiscal year 2002 were closed.

In August, I reported to you that our state's leading economists and business leaders saw Virginia's economic performance continuing to be weak for the remainder of fiscal year 2003 - with a measurable rebound not likely until fiscal year 2004.

Based on their advice, I reduced the official revenue forecast for FY 2003 and FY 2004 by a total of one billion two hundred and eighty-four million dollars ($1,284 million). With the carryover effect of the FY 2002 revenue shortfall, the revenue shortfall for this biennium totaled about $1.5 billion.

Added to that were $601 million in additional spending requirements which we could not ignore - car tax reimbursements - Medicaid - the Comprehensive Services Act - foster care and adoption - aftercare pharmacy - more students in our public schools - the loss of revenue from out-of-state inmates - state employee health insurance - and indigent criminal defense, to name a few spending drivers.

The revenue shortfall and additional spending requirements therefore combined to make our budget problem for this upcoming session more than $2.1 billion.

In August, I announced a number of concrete steps to control spending - further limits on hiring and the use of consultants, monthly spending limits for state agencies, and the deferral of some unexpended general and nongeneral fund balances.

I also directed state colleges and agencies to prepare reduction plans for my review. I asked my staff to provide detailed briefings on the reduction plans to any legislator who asked for one, and I solicited input from legislators from both houses and both parties.

On October 15, I announced the results of that deliberative process - $858 million in budget reductions over the next two years, and state agencies began implementing those cuts immediately. Excluding our colleges and universities, 63 of the 91 state agencies had their budgets reduced by the maximum 15 percent in at least one year.

More than 140 programs saw their funding reduced significantly. In the Governor's office, we cut spending by 17 percent - more than any other agency.

I recognize that the cuts I announced were difficult and painful. I knew that the reductions would affect important services that Virginians count on. However, I was convinced - and I remain convinced - that a budget shortfall of the magnitude we were facing could not be addressed by waiting to act until December, or by simply reducing budgets at the margins.
By acting aggressively in the summer and early fall, we saved ourselves the much more draconian actions that many states are just now beginning to face. Our proactive approach to re-forecasting and making significant budget cuts early was validated when our AAA bond rating was re-affirmed by all three rating agencies.

I have heard - as you have heard - about the impacts of the October 15th reductions - on funding for community mental health services - libraries - state colleges and universities - cooperative extension - constitutional officers - private colleges - DMV offices - state meat inspection - tourism promotion - and a host of other programs.

I expected that, and I know you did too.

We should acknowledge up front that everything in the state's budget is important to someone. Our task, however, has been to focus our limited resources on those core functions and programs which are most central. That principle has guided me in constructing this budget.

At the same time, we should not lose sight of the fact that the substantial budget shortfall we face presents an opportunity to re-think how state government operates. It would be a serious mistake if we simply tried to restore the funding which has been cut - because we've heard complaints - without trying to find a way to do things more effectively, and at lower cost.

The recommendations of my government efficiency commission - which Governor Wilder chaired and on which some of you served - offer us a useful road map in that regard.

Equally important is the need for all of us to begin to plan carefully about where we want Virginia to be 10 years from now. Like many of you, I attended the recent meeting of the Coalition for Virginia's Future. I think the ideas presented there warrant our attention, effort, and follow-through.

**Looking to This Budget**

The cuts announced in October addressed the largest part of the budget shortfall for FY 2003, and allowed us to consider in a careful and deliberative way the other actions that are necessary to balance this budget. As a result, we have crafted a responsible budget that establishes clear priorities - and makes difficult choices.

**Consolidations.** This budget proposes the merger or elimination of 12 state agencies and entities. It consolidates our unwieldy, unnecessarily costly, and decentralized management of information technology.

It proposes collapsing some human resource and payroll functions into more efficient centralized units. It proposes new efforts to collect receivables, including a tax amnesty program in fiscal year 2004, and participation in a federal debt set-off program. These actions not only save money - they are also sound business decisions.
This budget also eliminates some activities which can be performed better elsewhere. For example, we will sell the Department of Housing and Community Development's housing loan portfolio to VHDA, and take state government out of the business of making mortgage loans.

Encouraging home ownership is an important objective - particularly for first-time borrowers - many of whom fall outside the typical qualifications set by private lenders. It is therefore appropriate for the Commonwealth to provide incentives to make loans available to these Virginians.

As a condition of the portfolio sale, we have asked VHDA to move beyond its existing programs to serve these new customers. The senior managers at VHDA have agreed to this plan, and have agreed to provide new funding from VHDA to enhance the partnership funds.

Our action will leave to VHDA the actual business of mortgage loans, which is after all its basic mission and specialty.

For years, the Department of Corrections has been the landlord for wardens and other staff who resided in agency-owned housing, and were charged rent by their employer. Rents had to be adjusted to match market value or else be considered imputed income to the employees. Operating rental housing is not a natural function for the Department of Corrections. We will therefore take the Department of Corrections out of the housing rental business and sell its 35 houses.

Cuts. But let there be no mistake. This budget also contains outright cuts. It adds several hundred million in budget cuts to the $858 million in reductions that were announced in October. These additional cuts affect state aid for local governments, some funding for Medicaid providers, aid for businesses, and numerous other programs.

One-time Actions. At the same time, this budget also makes use of some one-time savings and revenues. We have used these tools when it made business sense to do so, in order to avoid deep cuts in education, human services, and other core areas.

This budget utilizes the Revenue Stabilization Fund in both years of the biennium. It makes use of nongeneral fund balances. It supplants some revenue appropriated for capital outlay in favor of the limited use of bonds.

This means that absent a stronger economic recovery than any experts are now projecting, we will again experience a difficult budget next year.

Nevertheless, when the choice is whether to make use of one-time savings and revenues or to substantially damage our most basic services, we have elected to preserve basic services.

I could not and would not construct a budget that reduces funding for public education - or one that lays off state troopers and deputy sheriffs - or one that cuts funding for highway construction and maintenance - or one that creates gaping holes in the social safety net - or one that stops investing in the key activities which will strengthen Virginia's long-term future.
This budget does not rely on tax increases. It does not divert or securitize ongoing Tobacco Settlement revenues in order to plug our budget hole. It does not accelerate revenue collections into this biennium or defer spending obligations into the next biennium.

And it does not take funds from any of the programs administered by the Virginia Retirement System. With almost three years of investment losses that have yet to be factored into rates, now is not the time to compound that problem.

**Key Features of this Budget**

Let me get, then, to the heart of the matter. Public Education. I consider no priority to be higher than state support to our public schools. Public education is the backbone of our democratic society, and the key to Virginia's long-term economic prosperity. Early on, I directed my budget staff to prepare options which did not reduce funding for public schools, knowing when I did that it would be a difficult objective to achieve.

Nevertheless, the budget we are proposing does meet that goal. Even with the substantial budget shortfall we face, we have provided in this budget about $65 million in additional state funding for public education - largely from additional Lottery and Literary Fund revenue.

Let me make it clear, though, that this is not simply a status quo budget for public education. I have said on many occasions that I am interested in funding programs that improve student achievement. If it works, let's fund it. If it doesn't, let's shift funds to education programs that do work.

This budget takes a step in that direction by combining funding for Dropout Prevention, School Health Incentives, and Technology Assistants into Student Achievement Grants, which school divisions may use to support programs which have a demonstrable effect on achievement - such as smaller class size in primary grades, at-risk four year old programs, early reading, and SOL remediation.

Any school division which can demonstrate effective programs in dropout prevention, school health, or technology may apply for a waiver to continue its existing programs.

My proposal does not alter basic funding distributions, and no school division will have its funding reduced by the change we propose.

Public Safety. Preserving public safety is another of government's most basic functions. That means adequate funding for state and local police and sheriffs, and providing the resources to keep criminals off our streets.

Budget reductions for the State Police and Sheriffs will be held to five percent each year. For the State Police, the Superintendent has assured me that these reductions will not hurt our efforts to fully staff the ranks of sworn officers.
In fact, as of January 2003, State Trooper vacancies are projected to be about half of what they were when I took office last January - with another basic trooper school about ready to start. That means more troopers on the road, and a safer Commonwealth.

For sheriffs, we have been assured that the five percent reduction, which will be taken principally against jail per diems, will likewise mean no layoffs among state-funded deputies.

For aid to localities with Police Departments - commonly called 599 funding - there will be no additional reduction beyond what was announced on October 15th.

And for Commonwealth's Attorneys, budget reductions will be lowered to five percent per year, contingent upon adoption of a one-dollar increase in fees charged for court convictions.

This budget also proposes and funds a program for the secure confinement and treatment of sexually violent predators who are civilly committed.

Health and Human Resources. In health and human resources, we face the continuing challenge of meeting the basic needs of vulnerable citizens, at a cost we can sustain within existing revenues. About half of all additional spending contained in the amended budget is in health and human resource programs. Without some action, required additional funding for Medicaid alone would have totaled about $200 million.

This budget preserves basic services, but it does freeze provider reimbursements for hospitals, nursing homes, and HMOs. It also includes steps to control the burgeoning cost of prescription drugs.

To soften the impact of these actions, the budget includes about $60 million - half of which is federal - to preserve access to health care. This funding would support special reimbursements to providers who are the sole source of medical services in their communities, or who serve disproportionate numbers of low-income Virginians.

In mental health, we have taken positive steps to make our mental health system more responsive. No institutions will be closed, but resources will begin to be funneled away from institutional care toward community care, which we have all known for years is often more effective and appropriate.

At the end of the day, this budget proposes a net increase of about $190 million in spending for health and human resources - clear evidence of the priority we have placed on preserving the safety net.

Transportation. In transportation, we face daunting challenges. We have initiated reforms to ensure greater accountability and stronger financial management of our transportation dollars. At times, that has meant delivering bad news about projects we cannot afford, given available resources. At other times, that has meant rooting out questionable financial practices.
Against that backdrop, it is unacceptable to further reduce the resources that are devoted to highway construction, maintenance, and mass transit. For that reason, this budget has retained within transportation all of the $146 million in new general fund revenue which was appropriated last session.

On top of this general fund revenue, an additional $189 million in additional transportation revenue which has resulted from strong car sales and increased fuel consumption will be available this biennium to support highway construction, maintenance, and mass transit.

I also want to also say a few words about DMV.

If we are serious about reducing waiting times for DMV customers, we must change our present business practices. This budget takes some steps toward that end.

This budget proposes additional license agents, and the use of mobile driver licensing teams to augment existing service centers. This budget also proposes that local Commissioners of the Revenue, Treasurers, and town officials be enlisted to expand service capacity.

And, this budget expands the number of automated kiosks where most transactions can be completed - in the same way that our citizens routinely use ATMs to conduct most of their banking transactions. Many of these measures are already being implemented. This area is a primary example where technology and innovation can serve our citizens well, at lower cost.

Aid to Local Governments. Let me take a moment to concentrate on our relationship with our local governments -- an issue that cuts across all secretarial areas. Excluding the car tax, over $10 billion in general fund revenue flows as aid to localities each biennium. It has not been possible to close our $2.1 billion budget hole without affecting state aid.

Nevertheless, it has been my view that we would accomplish very little if we solved the state's budget problem simply by creating a local one. For that reason, we have done what we could to limit the impact of the budget reductions on local governments.

In the end, the October and December cuts reduce state aid to localities by a total of about $175 million over the biennium. Cuts to state aid comprise about 8 percent of the actions necessary to balance our budget - only a fraction of the 43 percent that state aid comprises of the entire general fund budget. I hope that local officials will see this result as responsive to their own financial situations.

State Employees. Having said that, let me take another moment to focus on a group of people who are very important to all of us - our state employees. Our employees are the face of state services to all Virginians.

As I visit agencies, I am consistently impressed with the knowledge, dedication, and commitment that our state employees demonstrate. Virginia's state government functions as well as it does because our employees routinely go the extra mile.
As I talk with employees, the concern I hear expressed most often is health insurance. Employees understand the substantial budget problem facing us, and they also understand the rising cost of health care. The fact is that without some action, employee health insurance premiums would increase by 16 percent. That is unacceptable.

Your staffs have been working with us throughout the fall to help develop a plan that mitigates these cost increases. We will propose a restructured health benefit plan that will be simpler and which actually enhances the current level of benefits. This budget includes the funds necessary to implement this plan.

**Tax Policy.** Finally, let me address a key aspect of tax policy.

Last year, we included language in the Appropriation Act to decouple Virginia's tax laws from federal tax provisions. That action was necessary to avoid the loss of about $310 million that would have resulted from federal tax changes that Congress enacted on March 7 - two days before our legislative session ended.

It is my view that returning to full conformity is desirable, as soon as it is fiscally prudent to do so. Until then, we will propose legislation to advance fixed date conformity by one year to December 31, 2002, with the exception of the bonus depreciation and net operating loss provisions. It is my hope that this legislation can be advanced and enacted very early in the coming session.

**Conclusion**

Ladies and gentlemen, when you convene in January, we will have much work to do together.

Over this past year, we have all worked hard to repair our budget and return to Virginia's tradition of fiscal responsibility.

Throughout the fall, this administration took the initial steps to modernize state government. The next steps come in the budget that I present to you today, which is a central part of our broader reform agenda. Taken together, this package presents significant and far-reaching ideas for changing the way state government operates.

Our plans will reform and modernize VDOT - information technology - water policy - services to veterans - workforce training - mental health - and the budget process itself.

Now - I ask you to join me in this reform, and I hope that we can continue working as partners. I know that some will oppose our plans. That is part of the process, and a vigorous debate is a sign that our democracy remains strong.

Going forward, let us not lose sight of the unique moment we have to reform state government for the twenty-first century. As we look for ways to serve Virginians better, I hope we will always keep in mind two basic questions:
• When our children look back at our work, will they see reform and progress - or gridlock and partisanship?
• And more importantly - will the actions we take this session preserve the status quo, or will they move our Commonwealth forward - toward a brighter future of prosperity and security for all Virginians?

I ask you to join me on the path of progress and prosperity. That is the only way we can build a future worthy of Virginia's past.

Thank you for inviting me to join you this morning, and I wish you and your families the very best holiday season.

---

By The Educational Policy Institute of Virginia Tech
sjanosik@vt.edu

---

Posted: December 20, 2002