

**Statement of  
The Honorable Mark R. Warner  
Governor of Virginia  
Before the House Appropriations,  
House Finance, and Senate Finance Committees  
December 17, 2004**

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

Good morning. I have come before you today to outline the details of the amendments I am proposing to the Biennial Budget we enacted last year, which will be introduced as House Bill 1500 and Senate Bill 700.

The budget I will describe to you in a few minutes is consistent with the priorities that we have adhered to jointly over these past 35 months:

- It is fiscally responsible;
- It promotes greater fairness in our tax code;
- It will help build a stronger, more competitive economy; and,
- It meets our basic commitment to education, health care, transportation, and other core services of government.

But before I describe the budget, I want to spend a few minutes talking about the state of Virginia's economy ... the extraordinary achievements of the past year ... and our prospects for new growth going forward.

I am pleased to report to you that at no time in my three years as Governor has Virginia's future looked brighter.

Plainly, challenges remain. But it's increasingly clear that the course we charted three years ago was the right one for this Commonwealth.

Together, we put partisanship aside and tackled problems that had been ignored for too long. I thank you for your support and cooperation.

Consider for a moment where we are today:

- Job growth now stands at 2.0 percent for November. At this rate, we are significantly outpacing the nation.
- Not only are we creating new jobs, but our unemployment rate remains low. In fact, our 3.3 percent jobless rate is the second lowest in the nation.

- During a single day a few weeks ago, we announced more than 11,000 high-paying new jobs for the state. Firms relocating or expanding to Virginia cite our commitment to good schools and smart fiscal decisions we have made as reasons for bringing new investment to the Commonwealth.

But numbers only tell part of the story. Across Virginia, we're restoring confidence in state government, strengthening public education, and giving more of our people the opportunity to succeed.

Today's success didn't happen by accident. It's the result of tough choices we made, and smart reforms that we insisted on together. Let me cite four of these choices.

**Our first choice** was to confront Virginia's budget crisis head on. I don't need to recite for you how severe the shortfalls were through most of this administration. They were the most severe in more than two decades.

Together, we closed those shortfalls and balanced the budget. We did it with deep cuts in spending – averaging 20 percent in almost all agencies of state government. We eliminated personnel. And we closed or consolidated 78 agencies, boards or commissions of state government.

We tackled these challenges not as Democrats or Republicans -- but as Virginians committed to our tradition of fiscal discipline. And I thank you for it.

**We made a second choice as well**, and that was to use tough economic times to fundamentally reform how state government does business.

To that end, we enacted landmark legislation to consolidate all of state government's IT functions into a single state agency – a move that makes good business sense and that will avoid costs of \$172 million by fiscal year 2010.

We have fundamentally changed the way government buys goods and services, saving tens of millions of dollars.

And this year, we will ask for your support once again when we propose reforms in how state government holds and manages its real estate portfolio.

We have also achieved lasting reforms at VDOT, and made the Six-year Transportation Plan a commitment that we can all rely on. Although we still have a ways to go, we have made great progress at VDOT. In FY 01, 51 percent of construction projects were on budget. This fiscal year, 80% will be on budget. In FY 01, only 20% of construction projects were on time. This year, 60% will be on time.

And, we changed the budget process itself.

With the support of Senator Chichester and Chairman Callahan, we won passage in 2002 of legislation requiring every Governor to produce a six-year financial plan as the basis for sound management and balanced budgets. That single action requires us to look beyond our traditional two-year budget cycle.

Together we also enacted a requirement that we make an extraordinary deposit to the Revenue Stabilization Fund in any year when there is extra-ordinary revenue growth.

This session will present the first test of our resolve to actually stick to our commitment to this common sense reform.

**Our third choice** was perhaps the most important. We said that even in the midst of the deepest budget crisis in Virginia history, we would not retreat from public education.

We understood that together with fiscal discipline, education was the key to a rebounding economy and new jobs. During the first three years of this administration, we not only refused to cut funding for our public schools, but we substantially increased our investment.

We did more than just add additional funding, however. We launched smart new initiatives to strengthen public education across the board. These reforms range from helping schools identify cost savings to training turn-around specialists for Virginia's most academically troubled schools.

We established the **PASS Program** – to bring the resources of the private sector, and the expertise of Virginia's best schools to schools at the greatest risk of failure.

And now three years into PASS, over 90 percent of PASS schools showed improvement on their SOLs.

We implemented reforms we call **Education for a Lifetime**, to increase the academic rigor of the senior year of high school, and to better prepare our graduates either for college or a good job. By helping seniors earn up to a semester's worth of credit that can be applied towards a college degree, our **Senior Year Plus** program can help families save up to \$5,000 in college tuition costs. The program is drawing national attention and is opening up new doors for our young people across the Commonwealth.

More of Virginia's high school students are taking the SAT and Advanced Placement (AP) courses, which is a good indication that more are pursuing post-secondary education.

And at all grade levels, our students continue to improve their performance on the Standards of Learning (SOL) tests. As a result, over 85 percent of the Commonwealth's public schools have met or exceeded the standards for full accreditation.

As you know, the Class of 2004 was the first in Virginia history to be required to pass basic SOL proficiency tests in order to graduate. Some thought that we would see unacceptably high failure rates. Others thought we should retreat from high standards, as other states have done.

Well, the Class of 2004 defied all of the predictions. Thanks in large part to the active intervention of *Project Graduation*, we identified students at risk of failure, gave them the remedial help they needed, and prepared them for the SOL and graduation.

At the end of the day, 94.3 percent of our students graduated -- almost exactly the same percentage as before the tests. As important an achievement as this is, we will not be satisfied until all of our students graduate.

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**We made our last tough choice** just a few months ago.

Like our emphasis on educational excellence, government reform, and fiscal discipline, the tax and budget reform package we enacted last May is helping to fuel economic growth.

It affirmed a basic Virginia value: we pay our bills and we meet our commitments.

It made possible record new investments of \$1.5 billion in our public schools ... \$267 million for higher education ... increased resources for public safety ... \$35 million in new investments in water quality and open spaces ... long-overdue salary increases for our public employees ... and \$1 billion more in state funds for Medicaid and other health and human services programs.

In addition to helping the Commonwealth meet its core responsibilities in these and other essential areas, tax reform also made the tax code fairer for the people of this Commonwealth. We eliminated the marriage penalty; provided tax relief for military families; raised the personal exemption and filing thresholds; lowered income taxes for low-income working Virginians; and reduced the sales tax on food.

Even with the revenues we raised, the tax burden in Virginia remains low in comparison to other states.

The fact that Virginia's Aaa bond rating was reaffirmed by Wall Street less than three weeks after you adopted a compromise on tax and budget reform shows that we did the right thing. Our action . . .

- **Did** make the tax system fairer.
- **Did** allow us to meet Virginia's commitment to education and other core services.

- **Did** restore the Commonwealth's fiscal integrity, and preserve our AAA bond rating.

Having restored Virginia's financial stability, we now face the challenge of maintaining it over the long term.

The choices we make now – when times are better – will say as much about us as how we handle the tough times.

We need to remain steadfast in the fiscally conservative, careful approach that we have followed over these past 35 months.

It is an approach that we have embraced together, and it has contributed mightily to the rebounding economy we now enjoy.

One more positive step we took together this past session was to create a Secretary for Agriculture and Forestry. Please recognize my appointee to be Virginia's first Secretary of Agriculture and Forestry, former delegate Bob Bloxom.

### **Budget Overview**

The formal revenue forecasting process that Virginia has relied on for two decades depends on the active and informed participation of the state's leading professional and academic economists, and of senior business leaders from across the Commonwealth.

Their collective advice is that we should expect continued employment and income growth through the rest of this biennium. Our experts endorsed the view that Virginia's economy would out-perform the nation, with employment growth in the mid-two percent range and personal income growth in the range of six percent. Many of the experts – have said that we should be cautious in assuming that the housing market and federal procurement would remain as strong as they have been in recent months.

We have based the revised revenue forecast on the economic outlook that the economists and business leaders suggested. That outlook, combined with our most recent information on collections, produces a revised revenue forecast which adds

\$450.8 million to projected revenues for fiscal year 2005; and

\$467.9 million to fiscal year 2006 –

a total of \$918.7 million for the biennium.

We will budget the additional projected revenue just like any prudent business would.

We will use it for one-time expenses that are urgently needed or that represent smart investments in economic growth, new jobs, or a better quality of life for Virginians.

We will replenish our cash reserves.

We will use current revenues rather than issuing new debt for capital expenses.

And we will avoid the mistakes of the recent past.

We will not make spending or tax policy commitments whose cost will show up or escalate in the out years. We will not start major new programs. And, we will not assume that Virginia's economy will grow at peak performance for years to come. I want to personally thank Delegate Callahan and Senator Chichester for comments they have made in recent weeks that convey this same message.

If we adhere to these basic business principles, we can approach the future with confidence.

The budget I am proposing meets this challenge.

### **Making the Tax Code Fairer**

We began building this budget at the same place we ended last session— acting to make the tax code fairer. Today, I propose that we take another step toward that goal.

Specifically, I propose that we reduce the sales tax on food by 1.5 percent next July — completing the planned reduction in one step -- rather than phasing in the reduction over the next three years.

We can do this because it meets our criteria as a one-time expense. And it meets the goal of tax fairness that I set out last year.

This will reduce revenue by \$99.1 million in fiscal year 2006 and \$57.7 million in fiscal year 2007, but it has no additional impact in FY 2008 beyond what was already projected.

I know that both Senator Chichester and Delegate Callahan have also advocated moving this reduction forward. I have asked Delegate Parrish, Delegate Callahan, Delegate Chris Jones, Delegate Sickles and Delegate Melvin, as well as Senator Potts and Senator Lucas to introduce this legislation, and they have graciously agreed. Those bills will be pre-filed in the new few days.

I am also proposing that we advance by one year the date we use to conform to the federal tax code. This change will simplify tax filings for businesses, and pass on to Virginia residents and businesses the benefits of the recent tax changes passed by

Congress. Advancing the date by one year will also allow us to carefully analyze yet-to-be-specified tax policy changes considered by President Bush and Congress – while leaving to Virginia the decisions about which changes to enact.

This proposal to advance the conformity date will reduce general fund revenues by about \$6.7 million for the biennium.

### **Maintaining Fiscal Responsibility For the Long-term**

Maintaining fiscal stability over the long-term is another fundamental objective that shaped our budget decisions. I ask that you also consider it a top priority in yours.

In practice, that means identifying pressing issues that could be addressed with one-time funding. The budget I am proposing commits more than 80% of the additional resources which are available – including balances brought forward from fiscal year 2004 – for one-time uses or mandated programs. Central among these is replenishing the Revenue Stabilization Fund.

All three of the national bond rating agencies look carefully at the level of our cash reserves when they assess our financial standing. They also watch carefully to see how quickly those reserves are replenished. The amended budget proposes substantial additions to our cash reserves.

Specifically, the budget adds \$229 million to the amount appropriated last session for the Rainy Day Fund. This total includes both the deposit required by the Constitution, as well as the first required super-deposit to the Fund.

The super-deposit is required by a statute the General Assembly enacted at my request two years ago, providing that whenever Virginia experiences extra-ordinary revenue growth, as we did in fiscal year 2004, that we make an extra-ordinary deposit to the Revenue Stabilization Fund. The budget includes \$135 million for this deposit. Your appropriation of this super-deposit will clearly demonstrate to the rating agencies and all who are watching that we share a common commitment to fiscal discipline. Let me remind you that as recently as this week, another state that once had a Aaa bond rating got downgraded.

The budget also doubles state funding for building maintenance, which we call Maintenance Reserve. Virginia maintains a physical plant conservatively valued at more than \$12 billion. And yet, we appropriate less than \$25 million a year for roof replacement, HVAC upgrades, and other costs of maintaining these capital assets. The result is a growing backlog of deferred maintenance.

The amended budget adds \$45 million to the amount appropriated last year. In addition, I have taken the administrative action of moving the existing second year appropriation for Maintenance Reserve to the current year, to expedite as much as possible the completion

of pressing maintenance projects. Replacing failing roofs and leaking windows does not generate headlines, but it's a good business practice.

The amended budget includes other capital appropriations from current revenues. About \$32 million is provided to equip buildings which will be completed and occupied this biennium. And, over \$82 million is provided to address unanticipated cost increases in building materials like steel and lumber for capital projects previously approved.

Finally, to fairly implement the car tax cap, the budget provides \$24 million as a one-time, transitional payment. Without this payment, up to 150,000 vehicles would not receive reimbursement for car tax bills for tax year 2005 and earlier.

## **Transportation**

Let me now turn to transportation.

Any long-term solution to Virginia's transportation issues will require multiple ideas and approaches. While additional revenue alone is not the sole solution, additional resources are required.

Last week I announced a series of innovative steps to begin achieving that solution, as well as proposed new funding totaling \$824 million. The plan continues our program of transportation reforms, and repays the Transportation Trust Fund for funds that were used to balance the General Fund budget during the last three years.

We will use \$354 million for two initiatives that will complete our financial house-cleaning at VDOT. Of that total, \$256 million will be used to end deficit financing of highway projects.

Another \$97 million will be used to fund maintenance and safety operations within the department.

We will invest \$470 million for five new initiatives that will yield long-term dividends in the areas of transit, rail, public-private partnerships, and local government road construction:

- \$140 million will be used to create a Private Partnership Fund, to encourage and promote the success of highway and transit projects proposed under the Public Private Transportation Act.
- \$23 million will be dedicated to a Rail Partnership Fund, using the three percent tax on rental vehicles, to encourage and promote passenger and freight rail improvements, including a minimum 30% match requirement from the private sector.

- \$80 million will be used to create a Local Partnership Fund, to encourage and promote -- purely through incentives and options -- greater local government roles in local roadway construction.
- \$80 million will support a Transit Partnership Fund, to ensure that the Commonwealth remains a stable and reliable investment partner in the acquisition of major capital items like railcars and buses.
- \$147 million will be used for additional port, airport, transit and highway improvements across the Commonwealth, in accordance with existing formulas.

Of the \$824 million that is proposed, \$350 million is a one-time re-payment from the general fund. Another \$24 million ends the practice of using transportation revenues for general fund programs. And \$23 million returns to transportation and dedicates to rail the three percent tax on rental vehicles now budgeted in the general fund.

The specific actions we have proposed are not business-as-usual. We are changing the way we do business, and acknowledging that more change is needed before we can fully address the remaining, and very real, long-term transportation needs in Virginia.

### **Virginia Works**

In economic development, the last three years have seen more than 103,000 jobs created or saved across Virginia. More than 21,000 of those jobs were located in Southside and Southwest Virginia. Despite this progress and the Commonwealth's general prosperity, many parts of Virginia and many Virginians continue to suffer economic distress and dislocation. Clearly, additional efforts are required.

Two weeks ago, I announced a new approach to stimulating economic development in rural and distressed areas. We call it Virginia Works. Virginia Works has three elements:

First, Virginia Works offers support for existing businesses, which are often over looked in traditional economic development.

Second, to support new businesses, we will build on our existing assets in tourism, advanced manufacturing and specialty agriculture through smart, targeted investments.

Third, to strengthen our rural and distressed communities, Virginia Works provides new financing tools available to build our infrastructure and attract new investment.

I have consulted with many of you on this legislative package and I appreciate your genuine interest and support for these critical tools. Through these carefully targeted investments, we intend to create new jobs and build the foundation for a stronger future in rural and distressed communities.

## **Public Education**

In public education, our fundamental obligation has been and remains meeting the state's funding commitment to the Standards of Quality and ensuring that student achievement continues to improve. At the same time, we must make sure that the reforms we have begun take hold, and that we help our public schools become as efficient as possible.

The existing Appropriation Act provides over \$1.5 billion in additional state funding for our public schools – the largest biennial increase in Virginia history. The amended budget continues to meet our commitment to public education. It distributes to school divisions the additional projected lottery and sales tax revenues. In total, the amendments provide a net increase of \$48.8 million for the biennium.

I have proposed an additional \$20 million in Interest Rate Subsidy funding in 2006 -- to put the Literary Fund back on track. If market conditions hold, that could provide up to \$200 million in project funding for public school buildings currently on the Waiting List – virtually wiping out the existing List of more than 40 projects. This is good news for our local school divisions.

Finally, the amended budget proposes two targeted investments. Research shows that children who eat breakfast perform better academically, are less disruptive in class, and are generally healthier. To expand participation in the school breakfast program, I propose that the state contribute one nickel for every breakfast sold – a total cost of about \$1.6 million. This will leverage up to twenty times that much in federal funds.

I am confident that this small contribution will yield substantial benefits in student achievement down the road.

I have also recommended additional resources for the GED program. We are making progress in our efforts to reduce the more than 700,000 working-age Virginians who don't have a GED or high school diploma. To meet the documented demand, additional classes and testing opportunities are needed. A Virginia worker with a GED or high school degree makes more than double the income of a worker without a GED or degree. The economic benefit of this program is clear.

## **Higher Education**

In higher education, we have recently held six town hall meetings across the Commonwealth. These meetings focused on the need to expand educational opportunities, keep higher education affordable, promote quality and accountability, and help our colleges stimulate economic development. The amendments I have proposed address many of these concerns.

In sum, the proposed budget provides an additional \$50.8 million in state operating support for higher education on top of last year's significant increase.

The proposed amendments provide funding to recognize the enrollment growth that some colleges and universities have absorbed, while rewarding for the first time institutions that are increasing the number of degrees awarded each year.

We have acted to keep higher education affordable by increasing student financial aid, and we have boosted by \$100 Tuition Assistance Grants provided to students attending private colleges in Virginia. We have continued funding to provide one year of in-state tuition for children and spouses of military personnel stationed in Virginia. And, for the first time in nearly ten years, we have provided additional funding for financial aid for graduate students. This funding will help keep the best and brightest graduate students in the Commonwealth, and contribute to Virginia's success in research and economic development. Support is also provided to support cutting-edge research.

Finally, the budget provides \$1.5 million to support continued efforts to develop a coordinated plan to strengthen the options for higher education in Southside Virginia. I have asked the Secretary of Education to work with SCHEV, the Harvest Foundation, and other interested parties to move an appropriate proposal forward.

### **Health and Human Resources**

In health and human resources, the amended budget focuses on meeting the core services that our most vulnerable citizens depend on. An additional \$259 million in state funding is proposed for increasing caseloads, rising costs, and high priority needs. A higher Medicaid forecast accounts for most of this increase. Fully nine percent more children, elderly, and disabled people will be enrolled in Medicaid than forecast last year.

We are not alone in facing this challenge. Just this week a National Governors Association study showed that even with an improving economy, all states are facing severe, long-term financial challenges due to growing Medicaid costs.

Virginia's Medicaid program is one of the leanest in the nation, and as a result, some services are especially difficult to access – notably obstetrical and dental care. Based on recommendations of my special OB task force, I propose increased Medicaid rates for obstetricians and dentists and a limited expansion of prenatal care for women.

A number of amendments are aimed at improving mental health care and other services for especially vulnerable Virginians -- at-risk children, and elderly and disabled persons. The amended budget addresses shortfalls in funding for early intervention services with young children, coupled with added funding for mental health treatment of older children. It funds improvements in foster care and the child welfare system. Proposed amendments would also enable rising numbers of low-income families to receive child day care and other support services.

For the elderly and disabled, I recommend a number of actions -- enhanced state oversight and reimbursement to improve care in assisted living facilities, additional funding for medications and crisis stabilization services for mentally ill persons, and funding to initiate community-based care for mentally retarded persons.

In my continuing commitment to implement the U.S. Supreme Court's Olmstead decision, I recommend additional funding for housing, community transition, case management, independent living skills, and guardianship, to enable individuals with disabilities to live as independently as possible in their communities.

### **Public Safety**

Preserving public safety is another of government's most basic functions. The amended budget proposes about \$15.5 million to strengthen investigation, enforcement, prosecution, and incarceration of criminal offenders.

In law enforcement, 28 additional deputy sheriffs are authorized to cover Virginia's growing population, and 27 additional state troopers are added to fight gangs and patrol our highways. Funding and positions are also provided to enhance Virginia's intelligence capability in preventing terrorism. And, to successfully prosecute crimes, an additional 36 positions are provided for Commonwealth's Attorneys' offices, with additional support also provided to train prosecutors to combat gang-related crimes.

The amended budget also includes funding for 20 additional forensic scientists. This includes funding for three new scientist positions and start-up costs to establish a cutting-edge mitochondrial DNA testing unit.

The amended budget also adds funding for home electronic monitoring, day reporting centers, and return to custody programs. Funding for expanded alternative sanctions preserves expensive jail and prison beds for those offenders who pose the greatest threat to society, but also improves offenders' chances of becoming productive citizens.

### **Natural Resources**

Our efforts in Natural Resources build on the progress we made last session. The amended budget provides about \$32 million for the Water Quality Improvement Fund, to address both point and non-point source pollution. Additional support is provided to state parks, to help staff and equip park facilities, improve public access to natural areas, enhance wildlife management of natural area preserves, and repair dams.

Additional funding will also support more marine patrol officers, as well as costs associated with the opening of the new facility at the Virginia Museum of Natural History.

## **Compensation**

As I approach the end of my comments, let me pause a moment to recognize our state employees, who are – after all – the face of state government to all Virginians. Virginia's state government functions as well as it does because our employees routinely go the extra mile. The same can be said about faculty in our colleges and universities, teachers in our public schools, sheriff's deputies, and other state-supported local employees.

For that reason, the amended budget I have proposed provides \$107.8 million to support a three percent salary increase for state employees, faculty, teachers, and state-supported local employees, effective November 25, 2005.

In addition, the amended budget also provides \$32.6 million to help cover health insurance premium increases for state employees. Although employee premiums will increase, no changes in the basic benefit plan are proposed.

## **Conclusion**

As I said at the outset, the budget amendments I outlined today are fiscally responsible. They make Virginia's tax code fairer. They make smart investments in transportation, economic development and better schools. They will help sustain Virginia's rebounding economy and create new economic opportunities for our people.

One afternoon last spring, I had the chance to visit James Monroe High School in Fredericksburg, to lend support to a couple of dozen high school seniors from the Fredericksburg area who were participating in Project Graduation.

With a small state investment, we have been able to help so many students like the ones I met at James Monroe get the extra help they needed to graduate. Some received help online. Others went to our summer academies. Others were helped with tutors and mentors.

And if you have ever seen the expression on a student's face when they learn that, yes, they too will graduate with their class, you know that our work here does have meaningful rewards.

I mention them because behind all of the statistics and numbers we talk about at meetings like this are real people who are depending on us to do the right thing.

Together, we have worked for three years to reshape Virginia government, balance our books fairly, and create new opportunities for our people. And because we have stood together in making tough choices, Virginia is once again moving forward. I thank each

of you for helping to make this progress possible and I look forward to working with you in the months ahead.

Let me take this opportunity to wish you the happiest of holiday seasons.