

OVERVIEW

This is a time of tremendous challenge for the Commonwealth and for its citizens. The national economic recession is hitting families and businesses across the Commonwealth and the slowdown in projected revenue for their government is a reflection of the challenges they face.

In an economy like this one, citizens and businesses are tightening their belts, looking for savings, and spending only on those things that are most critical. Government should do the same.

The Governor's proposed revisions to the budget for FY 2009 and FY 2010 reflect a government that lives within its means.

Over the course of the past two years, Virginia's government has worked proactively to manage the budget in a difficult time.

As the economy has slowed, Virginia has found savings in every area of state government - streamlining services, consolidating administrative functions, renegotiating contracts, freezing hiring, and merging agencies. Governor Kaine has reduced his own salary, office budget, and the budget for the executive residence.

Agencies have worked to leave no stone unturned and no program unexamined as they have looked for ways to reduce the budget. Together, the Governor and General Assembly have kept the budget balanced without a general tax increase and without compromising the core services that Virginians depend on.



As early as the spring of 2007, when job and income growth began to slow, Governor Kaine directed state agencies to prepare for the slowing economy by curtailing discretionary expenditures and saving money from FY 2008 to carry over into FY 2009.

In October of that year, Virginia implemented \$300.3 million in executive budget savings across state government. Later, in the 2008 legislative session, the General Assembly approved these savings and other strategies recommended by Governor Kaine to make sure that the last biennial budget was balanced.

Last February, the economy showed signs of further slowing, creating a need to reduce by \$1.4 billion the Commonwealth's revenue projections for the remainder of FY 2008 and FY 2009-2010. Working together, the Governor and the General Assembly lowered the projected revenues for that period accordingly and embraced an aggressive strategy of year-end savings and reductions in the expenditures proposed in the introduced budget.

Unfortunately, the national economy continues to slow, necessitating a reforecast and more budget cuts. In October, Governor Kaine directed another round of executive budget savings, reducing state spending by an additional \$348 million.

The introduced budget amendments for FY 2009 and FY 2010 include the most recent round of executive branch cuts, \$2.9 billion revenue shortfall from the budget bill approved last winter.

The introduced budget does propose drawing \$490 million from the Revenue Stabilization Fund to help balance FY 2009. The budget does not rely on the fund to balance FY 2010, so that the fund remains available in 2010 if there is any further slowing in the economy.

While these reductions are not easy, Virginia is in a better position than many states because we have taken an aggressive, proactive approach to the budget shortfall, and have already taken important steps to reduce spending over the past two years.

When Virginia's AAA bond rating was reaffirmed, Standard and Poor's said, "The Commonwealth's strong financial management focus is evident in its early and active response."

Making Government more efficient

The Governor's proposed budget continues to streamline government and make it more efficient and effective.

While this round of budget reductions includes some areas that were previously protected – like K-12 education – this budget follows a set of principles, designed to address the

shortfall, while preserving the essential services state government provides. These principles are what have earned the Commonwealth a national reputation for fiscal responsibility, and recognition as the nation's best managed state.

First, wherever possible, the introduced budget proposes real, long-term savings instead of relying on one-time actions. While this approach means that the choices are sometimes difficult, it also ensures the long-term health and stability of our state finances.

Second, the budget avoids across-the-board cuts in favor of a targeted approach. Governor Kaine has looked closely at each agency, asking hard questions about the performance and efficiency of programs. Taking a targeted approach means that cuts have been focused, as much as possible, in areas that do not affect essential services.

Finally, Governor Kaine and his Cabinet have looked beyond simple efficiencies to a deeper discussion of the policy choices that drive our agencies and programs.

The introduced budget includes more than 1,000 layoffs, split approximately equally over the two years of the biennium. Changes to higher education and shortfalls in nongeneral fund transportation revenue will result in additional staff reductions in those areas of as many as 150 and 1,150 employees respectively.

The Governor continues to merge state agencies when possibilities for greater efficiency exist—the introduced budget

merges the Human Rights Council into the Department of Labor and Industry. It also joins the Department of Human Resource Management and the Department of Employee Dispute Resolution.

The Governor's budget also preserves funding for the Productivity Improvement Fund (PIF), a seed fund to transform the way we deliver services at lower cost. To date, our \$3.4M investment across 28 projects will deliver \$9.8M in savings over three years for a 2.9 to 1 return on investment. For example, our investment in VIDEO-ODU will deliver \$3.3M in savings over 3 years by videostreaming 600 TELETECHNET courses over the Web, enabling Old Dominion University (ODU) to grow videostream enrollment 41 percent from last year while closing six sites. In addition to the savings and convenience, students will save \$1,000 per year in gasoline costs and vehicle wear and tear and reduce CO2 emissions by approximately 400 pounds of CO2 per student per year by not having to drive.

A recent PIF award to Department of Medical Assistance Services (DMAS) helped to launch a public-private partnership with the Commonwealth's health plans and health systems to lower administrative costs with the announcement of a universal eligibility verification portal - a free tool that will allow doctors and hospitals a single point to verify if a patient has presented current and accurate insurance information. DMAS will be working to build on this effort in 2009 by offering a

free claims system for the 38 percent of doctors who still bill us on paper.

In challenging times, the Governor's proposal continues to push for innovative solutions that lower taxpayer costs while improving our services to citizens.

Growing our economy

Balancing the budget while meeting the needs of Virginia's citizens in the long run depends on growing the Virginia economy. Governor Kaine's proposed budget contains several key features designed to stimulate economic growth.

The introduced budget takes lesser reductions in economic development agencies and programs than from other agencies in government. It also calls for a \$5 million increase in the Governor's Development Opportunity Fund, the Commonwealth's primary job-creation incentive fund.

Governor Kaine has also proposed increasing the caps on the Virginia Investment Partnership Act, a fund designed to attract major business headquarters, and extending the Major Business Facility Jobs Tax Credit.

Governor Kaine has also proposed a new income tax credit and a new sales tax exemption designed to attract new green industry jobs to Virginia, which are reflected in the budget bill.

Protecting the classroom

In all the previous rounds of budget reductions, the Governor and General Assembly have been able to avoid making significant reductions to K-12 education. And while it was not

possible to avoid some reduction to the single largest expenditure in our budget in this round, the Governor's proposed budget has as little impact on the classroom as possible.

Because Governor Kaine believes it is prudent to allow our public schools to get through the current academic year without disruptive adjustments to their budgets, the proposed budget reductions are for FY 2010, which will give school divisions time to plan accordingly.

And in order to cause as little disruption to children's education experience as possible, the Governor's proposal protects funding for classroom instruction, by focusing on administrative efficiencies.

Governor Kaine is proposing to place a cap on state spending towards educational support staff. This cap would be based on a ratio of one support position to every 4.03 instructional positions – based on a 3-year linear weighted average ratio of school divisions' prevailing practice.

Despite the detailed formulas that have existed in the state budget for funding classroom expenditures, there has never been a formula to directly control spending for administrative expenses. Taking this forward-looking step now will ensure that more scarce state educational dollars go directly to the classroom.

Along with the cap, the proposal includes a loss reduction clause to ensure that no school is unduly affected under this change.

This focus on administrative efficiency will save over \$340 million.

Keeping Higher Education affordable

Because of the size of the revenue shortfall, it was necessary to make difficult cuts to higher education in Virginia. However, the Governor's budget contains several key components to keeping higher education affordable.

The Governor proposed much smaller cuts to higher education in FY 2009 than other agencies received, and publicly called upon the colleges to acknowledge that by refraining from raising tuition in mid-year. Also, while four-year colleges and universities receive a 15 percent cut in the second year of the proposed budget, the community colleges and Richard Bland take only a 10 percent reduction.

And in one of the few new spending items in the entire budget, Governor Kaine proposes to spend nearly \$26 million in additional money for student financial aid. This money helps to fund the Partnership Model, a formula devised by the State Council of Higher Education for Virginia to determine how much financial aid is needed at each institution. The Governor's additional funding brings every institution up to at least 65 percent of the Partnership Model's goals.

The introduced budget also includes increases in the Community College Transfer Grant program, helping more students begin their higher education at a two-year college and then transfer to a four-year institution to get their degree.

Holding the line on health care

Even though Virginia's Medicaid program is very lean – 47 other states spend more per capita on Medicaid than Virginia – costs are now projected to rise above the previously budgeted forecast by \$268 million GF, even as overall state revenues decline.

Governor Kaine's introduced budget limits the reductions in direct services as much as possible. Some services will now have caps, limiting enrollment growth, though not displacing persons currently being served. Many provider reimbursement rates have been frozen or even reduced. Other planned new services will be delayed. These proposed actions will save a total of \$418 million GF in Medicaid.

In order to keep from removing patients currently covered by Medicaid, the Governor's budget proposes a 30 cents-per-pack increase in the tax on cigarettes. The Centers for Disease Control and Prevention estimate that cigarette smoking causes over \$400 million per year in Medicaid expenses for Virginia. The current cigarette tax raises only about \$166 million for Medicaid. The proposed increase would generate another \$150 million for the Health Care Fund, which supports Medicaid.

Rather than reduce health care services for low-income Virginians, the proposal to increase the cigarette tax will bring tobacco products closer to paying for the costs that they create. A 30-cent increase still will not cover all the costs that Medicaid incurs to treat tobacco-related illness, and still will leave

Virginia's cigarette tax at only half the national average.

Governor Kaine's proposed budget does not reduce the gains made last year in investments in community-based mental health services, and continues to move the Commonwealth's focus from institutional care to community-based care.

Keeping our communities safe

Because our front-line law enforcement officers are so important to keeping our communities safe, the Governor's proposed budget limits the reductions for sheriffs' deputies, Commonwealth's attorneys, and local police through the HB 599 program to approximately seven percent, about half what most agencies across state government are taking.

The budget also includes closures of state Department of Corrections facilities, including many older or smaller facilities that were announced in the October executive budget reductions.

The budget includes a smart, cost-effective adjustment to sentencing policy that will protect public safety while reducing the cost of maintaining the state corrections operations. The budget bill extends the Department Director's flexibility to grant early release, from 30 to 90 days, for nonviolent felons. This small change continues to protect the public, and could result in significant budget savings and less overcrowding in state prisons and local jails.

Transportation

Virginia's transportation budget is supported mostly by nongeneral fund revenue. The Governor's introduced budget reflects changes in the revenue forecast for transportation.

The Department of Transportation (VDOT) will reduce central office staff and streamline operations around the state to respond to the reduced revenue forecast. Over the next three years, VDOT is expected to reduce agency employment by between 900 and 1,150 employees, through retirements, attrition, and other restructuring.

The Commonwealth Transportation Board will announce a revised Six Year Plan to balance proposed construction and maintenance expenditures against proposed revenues.

Fiscal Responsibility

Virginia has faced unprecedented revenue declines during this national recession, yet the Governor and the General Assembly have acted decisively and swiftly to trim spending accordingly, and produce a balanced budget.

As a result, Virginia continues to excel as one of the best managed states in the nation. The Governor's proposed amendments for the remainder of the 2008-2010 biennium are designed to preserve essential services even in the most challenging of economic times.