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House Appropriations Committee Retreat
The Honorable Lacey E. Putney

November 18, 2008

Good afternoon. I would like to welcome the Committee members, invited guests and the general public to the sixth annual Appropriations Committee retreat.

In addition to the members of the Committee, I am pleased that Speaker Howell and Majority Leader Griffith have joined us, along with the Chairman of the House Finance Committee Bob Purkey and members of the Finance Committee. Welcome to all of you.

Over the next two days we will engage in several panel discussions in which the Committee staff, along with outside experts, will discuss a variety of issues including the current conditions of the housing and mortgage industry, the economic outlook of the Commonwealth, college affordability, and the funding relationship between local and regional jails and the state. We will finish off the retreat with a discussion of the recent JLARC recommendations on State employee compensation and benefits.

Before we get underway, I would like to digress a moment to last Session. You may recall that last winter I and other members of the General Assembly expressed concern that the revenue estimates proposed by the Governor for the 2008-10 biennial budget appeared to be overly optimistic.

As a result of those concerns, I and Speaker Howell wrote to the Governor urging him to convene his board of economist and the business leaders. While that did not occur, the Governor did ultimately reduce the revenue estimates.

In total, last Session, we dealt with a cumulative revenue shortfall for the fiscal years 2008, 2009, and 2010 of approximately $2.6 billion.

Since approving the budget, the U.S. economy has continued to contract, as the housing problems turned into a credit crisis and escalating gas prices stymied the consumer. All told, consumer confidence is at a historically low point as more companies shed jobs, with the expectation of more job loss over the next 9 to 12 months.

Although Virginia typically out-performs the U.S. economy, it is not immune from the nation's problems.

Last month, the Governor presented to the General Assembly revisions to the general fund revenue forecast for the current biennial budget. All told, the Governor recommended a revenue reduction of slightly over $2.5 billion over the next two years.

Certainly, there are many that question weather the revenue decline will get worse.

Although the Governor revised the revenue estimates in October, he already has begun a new review that will culminate with an updated revenue outlook accompanying his budget amendments on December 17th.

As you will learn from today's presentations, Virginia's economy is slowing down and, like the nation, Virginia consumers are retrenching. However, payroll withholding, which represents 60 percent of the state's general fund revenues, is currently growing at 5.5 percent, above the revised estimate of 3.3 percent.

What makes this more perplexing is the fact that the last four months of fiscal year 2008, payroll withholding grew about 2 percent.

Why the turn around? It appears based on recent jobs data, Northern Virginia and Hampton Roads have seen an up-tick in job growth since July. Of course, both of these regions are greatly influenced by the Federal government – primarily defense and uniform military. In fact, 35 percent of Northern Virginia's economy is driven by federal spending.

So, if the current recession is looking a lot like 1991, why isn't Virginia seeing greater job loss?

One answer could be that back in 1991, Virginia led the nation going into the recession, primarily as a result of dramatic reductions in federal defense spending, which began in 1989-90. You may recall that the "Cold War" was over and the need for a 600-ship Navy no longer existed. Virginia saw two years of negative job growth as a result of the dramatic reduction in defense spending, along with the collapse of the Northern Virginia commercial real estate market and S&L banking crisis.

The situation today is much different. By way of example, in the 1990's, federal payroll represented approximately 60 percent of federal spending and procurement about 35 percent. Today, the percentages are reversed, with most of the backroom and IT operation of the federal government, defense and intelligence community outsourced.

Also, since 2001, annual federal procurement spending has more than doubled in the region, from just under $30 billion to approximately $60 billion last year. This of course, is what has driven Virginia's job growth, with over 60 percent of total job growth occurring in Northern Virginia.

So, it would appear that Virginia economy has become more dependent on the federal government. In some respect our destiny can be greatly altered by the change in federal spending policies.

Another possible reason why we have yet to see significant job loss may very well be that Virginia simply is lagging and the effects of the recession may be more of timing issue, with our decline still to come.

We still must balance the $2.5 billion shortfall and position ourselves for the potential of a further decline in 2010.

While the Governor has used his executive authority to reduce spending in fiscal year 2009, the reality is that most of these reductions were onetime actions; leaving the heavy lifting in fiscal year 2010, which will has a $1.5 billion shortfall based on the October projections.

Because so few of the fiscal year 2009 reductions were on going, it falls on the General Assembly to make significant reductions that are ongoing and structural.

This is especially critical because the failure to structurally balance the budget in fiscal year 2010 will only push the problem into fiscal year 2011.

For example, for every $150 million in savings actions that are not ongoing, it will require 1 percent new revenue growth in fiscal year 2011 in order to balance the budget.

As painful as it might be, we are better off addressing this issue once, not leaving it to the next General Assembly to fix.

While the Governor exempted public education and most of health and human resources from reductions in fiscal year 2009, he has indicated that these areas will be subject to targeted reductions in fiscal year 2010.

The fact is we can ill afford to exempt over 50 percent of the budget from any form of reduction.

Since 2001, the overall general fund budget has grown 49 percent. By comparison, spending for public education has increased 65 percent, Medicaid 115 percent, and CSA 207 percent. In combination, these three programs represent 54 percent of the general fund budget, up from 45 percent in 2001.

In a meeting with the Governor and the Senate leadership, I and other House leaders have pledged to work as a team to balance this budget. As we approach the 2009 Session, it is my hope that the collective "we" in this room will work together in a fiscally responsible manner with minimum rancor so that we can do the people's business.

I would implore all the members of the House to provide me their input as to how we balance this budget and what specific programs should either be reduced or eliminated. What I don't want is generalized statements of cutting waste and eliminating inefficiency. Neither of those are line Items in the budget.

It is my hope that Members that submit amendments for spending or program restoration will also submit a corresponding amendment to reduce spending.

In closing, I would like to remind you that in 2004, then Governor Warner stated that the tax increase approved by the General Assembly would align our longer term revenue and spending requirements. Clearly this did not work. The fact that state spending continues to grow faster than revenue growth is not indicative of the need for more revenue, rather the need for spending reform. Creating new programs without a corresponding reduction elsewhere is a recipe for fiscal disaster. I look forward to working with Governor Kaine and all of the Members of the General Assembly in developing long-term structural reforms in state spending without a tax increase, which would just further burden the consumers during this economic downturn.

Now, before we get underway, I would like to thank the entire staff for their hard work in putting together the various panel discussions as well as their own presentations.

Likewise, I would like to thank the entire group of distinguished panelists for agreeing to participate in the House Appropriations Committee retreat.

Now sit back and enjoy the retreat and learn a little.

First up, we have Denis McLaughlin, Senior Vice President and Chief Credit Officer for Sun Trust Mortgage.

Following Denis, will be John McClain, Senior Fellow and Deputy Director for the Center for Regional Analysis at George Mason University.