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Governor Kaine's Prepared Remarks to Joint Meeting of the Senate Finance, House Finance & House Appropriations Committees

RICHMOND - Governor Timothy M. Kaine today addressed the joint meeting of the Senate Finance, House Finance and House Appropriations Committees. The prepared text of his remarks follows:

"Chairman Putney, Chairman Colgan, Chairman Purkey, and Members of the General Assembly: Good Morning.

Each year, I come before you to present an end-of-year report on the Commonwealth's economic and fiscal performance. My message today is far more challenging than my previous reports. And yet, despite our challenges, I am confident that we have the fiscal tools and innovative spirit to succeed even in difficult economic times.

As you all know, our nation is struggling with a significant economic downturn. Virginia is not immune from the effects of this economic decline. Across the country, other states find themselves in similar situations, as we all struggle with the fallout of a national economy that is continuing to slow.

When I appeared before you last year, we were beginning to see slower rates of growth in jobs and income and moderate growth in the overall economy. I told you then that we were likely to face a revenue shortfall in the second year of the biennial budget and proposed averting the shortfall through expense cuts, using debt rather than cash to fund some capital expenses and targeted use of some of the state's Revenue Stabilization Fund. Six weeks after that speech last August, we implemented $300 million in executive budget savings across state government. Later, in the 2008 legislative session, you approved these savings and the other strategies I suggested to make sure that the last biennial budget was balanced.

In February, we announced that our reforecast indicated further economic slowing, creating a need to reduce by $1.4 billion our revenue projections for the remainder of fiscal year 2008 and fiscal years 2009-10. Working together, we 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.

Now, six months later, the national economy is continuing to slow, which will necessitate a reforecast this fall and the likely need for more budget cuts. To prepare for the impact of the continued downturn, I have already asked our state agencies to curtail hiring and discretionary spending. But the indicators I will discuss with you today mean that we will likely have to go further in the coming months to address slowing revenues.

The task that lies before us will not be easy. The cuts we have made over the last year –cuts based on solid data and careful prioritization—have been tough. The next round will be more difficult. However, we have met these challenges in the past, and I know that we will work together again to do the right thing. That's what the "best managed" state does. That's what a Triple A state does. It's the Virginia way.

I would like to start by reviewing the underlying conditions in our national economic picture and the Commonwealth's financial performance in the just completed fiscal year.

The National Economic Picture

As anyone reading newspaper headlines knows, the effects of the ongoing housing downturn and turmoil in financial markets continue to be a drag on economic growth. House prices nationwide were down 14% in the first quarter of this year, and existing home sales for June 2008 were down 16% from June of last year.

American families and businesses are struggling with increased energy costs. While the price of gasoline has fallen recently in response to reduced demand, it is still high enough to squeeze budgets. Adding to the anxiety as we approach the fall and colder months are predictions of increased costs for natural gas. The effect of energy and food price increases pushed the June national inflation number to its highest level in 27 years.

Partly due to these energy and credit issues, employers clamped down on hiring in July. Jobless claims reached their highest level in 6 years last week, as the nation's unemployment rate jumped to a five-year high of 5.7%. Employers have cut jobs every month so far this year, driving up losses to 463,000 over the last seven months. Economists expect another half million jobs to be eliminated nationally this year alone, and the jobless rate could hit 6.5% by the middle of next year.

Finally, growth prospects are slim in the near term. Global Insight's July U.S. economic outlook projects a two-quarter decline in real GDP (fourth quarter 2008 and first quarter 2009). And, the White House has recently revised its national deficit estimate, suggesting that the federal deficit this year is likely to be the largest ever recorded.

The Commonwealth's Fiscal Performance in FY 2008

In Virginia, the revenue forecast for fiscal year 2008 was the second most accurate estimate in the last twenty-five years. The Commonwealth ended the fiscal year on June 30 with a $6.5 million surplus in its $17 billion general fund budget. Total general fund revenue collections for fiscal year 2008 increased 1.3 percent for the year, just 0.1 percent ahead of the annual forecast.

However, the national economic factors continue to affect revenue collections at the state level. The housing market in Virginia continues to drift downward, with notable declines in sales prices statewide.

The unemployment rate averaged 3.1 percent during the first half of the year and grew to an average of 3.8 percent during the second half of the year. Employment growth statewide also slowed considerably during the last quarter of fiscal year 2008. Growth averaged only 0.9 percent over the fiscal year; the first time employment growth has been below 1.0 percent since fiscal year 2003. These job figures are significantly better than national averages, but are not at the level we have been used to seeing in Virginia in recent years.

Virginia isn't alone in facing these fiscal challenges. While Virginia met its revenue projection for FY 2008, 20 states reported that they did not meet their official estimates. Only 8 states fell short of their revenue estimates in 2007. This is a sharp departure from FY 2006 and FY 2005, when every state met or exceeded its revenue estimate. The growing number of states that are not meeting their official revenue estimates is additional indication that the revenue problem is national in scope.

The Need to Reforecast

As we look ahead into the likely revenues for the current biennial budget, there are some troubling trends. The two general fund revenue sources most closely tied to current economic activity are payroll withholding and retail sales taxes, and both experienced a meaningful slowdown in the rate of growth during the second half of fiscal year 2008.

Sales tax collections, which would now have to grow at 4.9 percent to make the fiscal year 2009 forecast, grew at an average rate of only 0.8 percent in the last four months of the fiscal year. Likewise, income tax withholding, which would now have to grow at 6.4 percent to make the 2009 forecast grew at an average rate of only 1.6 percent in the same four month period.

The weaker than normal performance in income and sales tax collections at the end of the 2008 fiscal year suggest the need for a reforecasting process to begin sooner than the traditional November and December timeframe. The sooner we conduct a reforecast, the sooner we can take the steps necessary to work through our challenges in a fiscally prudent way.

In the past, the primary focus of any revenue re-forecast has been on general fund revenue sources. But, due to changes in the transportation sector, we must also take a close look at those revenue sources. The Commonwealth Transportation Board recently reduced proposed six-year plan expenditures by $1.1 billion—reducing planned primary, secondary and urban road construction by over 40%. Recent developments with both state and federal revenue sources will require additional downward adjustments.

In the midst of a difficult time, Virginians are purchasing fewer vehicles and shifting toward less expensive models. These changes are reducing transportation revenues associated with the motor vehicle sales tax. And, with rising gas prices, Americans drove 12.2 billion fewer vehicle miles in June 2008 than they did in the previous June. The largest decline in miles traveled was in the Southeastern states, including Virginia. Gas tax collections at both the state and federal levels reflect this decline.

The federal transportation revenues relied on by Virginia and other states are very much in doubt at this point. The federal Highway Trust Fund is currently slated to be in deficit to the tune of $3 billion by calendar year 2009. Absent significant Congressional action, the lack of federal revenues will be felt directly by all states.

Because of these real concerns about general and non-general fund revenue sources, I believe it would not be wise to wait until November to conduct the normal reforecasting of state revenues. Instead, I am directing my Secretary of Finance and key state agencies to begin work now on an immediate revision of the general fund and transportation revenue projections.

Secretary Brown will confer with industry leaders in key sectors over the coming weeks to discuss their assessment of future prospects in their respective areas. We will convene meetings of the Governor's Advisory Board of Economists and the Governor's Advisory Committee for Revenue Estimates before the end of September to examine economic data and recommend a revision to the biennial revenue forecast. As is always the case, those revisions will be based on the consensus position of my office, the legislative leadership and the business leaders who serve on the GACRE. This prompt schedule should enable us to produce a revised revenue forecast in the first part of October.

Despite news reports speculating about the magnitude of the revenue slowdown, it would not be wise to engage in guesswork at this point. We have a set process for making such estimates that involves getting the best expertise from academic economists, private sector leaders, House and Senate staff and legislative leaders. That consensus model is one reason why Virginia receives top marks for fiscal management. We will initiate that process immediately and develop the necessary information on which to make sound revisions within the next 7 to 8 weeks.

Next Steps After the Re-forecast

The obvious question given the need for a reforecast is what steps will be taken after we have new numbers in place. While the steps we take will obviously depend upon the magnitude of any downward revenue adjustment, our recent history gives us the basic template for future action.

In the last 12 months, we have dealt with revenue reductions that total nearly $2 billion over the three fiscal year period of 2008, 2009, and 2010. In making these reductions, we have followed a few basic principles.

First, we have made our cuts on the basis of performance. The Virginia Performs data platform and the DPB performance-budgeting system give us the ability to scrutinize how each program affects our citizens. We can then make decisions that reflect the best prioritization of state services.

Second, we have made our decisions in an open and transparent way. As we make cuts, we deliver to the General Assembly full information about where the reductions will be made, as well as information about reduction ideas that we have considered but chosen not to pursue.

Third, as we have lowered revenue estimates, we have tried to adjust base budget expenses downward, using sustainable long-term strategies to find savings. To be sure, some of the revenue adjustments in FY 2008 were covered by our joint actions to withdraw money from the Revenue Stabilization Fund and use debt rather than cash to fund certain capital expenses. And, we have also been able to use certain one-time savings strategies to reduce programmatic costs. But, the lion's share of our reductions have been actual adjustments in the base budget that will allow us to rely upon savings in future years. While these cuts are harder, they also position us for more rapid success when the national economy starts to improve.

Finally, we have made no recommendations for increases to general fund revenue sources. During my tenure as Governor we have eliminated state income taxes for the working poor, joined the majority of states that have eliminated the estate tax and created sales tax holidays for purchase of school and emergency supplies and energy-efficient appliances. We will continue to manage through the national economic decline without increasing the general fund tax burden on Virginia residents.

As we go into a next round of cuts, it is clear that the choices will be more difficult. The 2008 Governing Magazine survey of state performance that ranked Virginia, yet again, as the top performing state government in America pointed out a positive but challenging fact. While Virginia was listed as having the 5th highest per capita income in America, our spending per capita is 36th in the nation. The relatively low per capita spending for government services in Virginia is a measure of efficiency, but also points out that sizable cuts will be harder to find. There will be no way to complete the task without a comprehensive review of all options.

For example, in the past rounds of reduction, nearly two-thirds of the general fund programs were not subjected to significant levels of budget reductions. We have held public education harmless from the effects of the slowing economy, and as a result, school divisions are about to begin a new school year with significant increases in state funding over the prior year. We have managed state transfer payments to localities so that reductions to those programs have been less than reductions to state agencies. And there are other programs that have not yet been significantly affected.

The need to engage in a third major round of budget reductions will mean, by necessity, that all programs—including those previously held harmless—and all available strategies will be on the table for review. We will need to engage in a thorough review of all areas where our costs outstrip national norms and take a close look at current state policies that might lead to higher costs. We will continue to do all we can to protect core services, but the need for tough decisions will require examination of all areas of state spending. My administrative team recognizes the opportunity to use this challenging time as a way to ask fundamental questions that just don't get asked when times are good. As always, your own ideas and input are very welcome.

In closing, I look forward to working with you and legislative staff on these hard choices in the months ahead. We should remember that the only reason state revenues are slowing is that our citizens and businesses are negatively affected by a slowing national economy. People are hurting and having to make painful choices in their own lives every day. I pledge that our deliberations and decisions will be made with those citizens in mind. I also pledge to you that we will continue to act in the steady and fiscally responsible way for which Virginia is known. Tough times test resolve and leadership—I am confident our actions will meet our citizens' high expectations."

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