COMMONWEALTH OF VIRGINIA

HOUSE OF DELEGATES

RICHMOND

APPROPRIATIONS COMMITTEE
9TH FLOOR, GENERAL ASSEMBLY BUILDING
CAPITOL SQUARE
POST OFFICE BOX 406
RICHMOND, VIRGINIA 23218
804-698-1590

LACEY E. PUTNEY., CHAIRMAN
ROBERT P. VAUGHN, STAFF DIRECTOR

The Honorable Lacey E. Putney

Comments to the House Appropriations Committee

House Bill 30

February 21, 2010

It has been just over 8 weeks since I introduced House Bills 29 and 30. During that time, we have conducted 5 public hearings across the state in order to receive input from citizens on the priorities they would like to see the Commonwealth address.

When Governor Kaine presented his budget in December, there were many who claimed that it was not a balanced budget because it assumed a statewide income tax increase that would not pass. Technically, the Kaine budget was balanced. But, it was balanced only because it did <u>not</u> provide $1.9 billion to reimburse our localities for Car Tax relief. In other words, if the $1.9 billion is not restored by the General Assembly, then local governments will saddle taxpayers with paying 100% of the cost of the personal property tax. Imposing such a steep financial burden on working families and anxious taxpayers already grappling with job losses and economic uncertainties makes absolutely no sense.

In many respects, crafting this year's budget represented the "perfect storm." Think about it, we had Governor Kaine leaving office and Governor McDonnell transitioning into office, and we had what amounted to a $1.9 billion inherited deficit to address. As I reflected on all of this, I came to the conclusion that at the end of the day, the job of crafting a budget was the sole responsibility of the General Assembly. The Virginia Constitution is quite clear, that only the General Assembly can appropriate funding. The role of a Governor to develop and present a budget rests in the Code of Virginia. There is no provision or requirement in the Code for a Governor to submit amendments to the budget once it has been introduced. Under the Constitution, the Governor's role in the budget is two-fold. First, once the budget is adopted by the General Assembly and sent to the Governor, he may send down for our consideration amendments to the budget, including line-item vetoes. The second role is to ensure that the budget remains balanced after it is enacted.

In my 49 years as a member of the House, I have not seen a budget situation this bad. The nation's economy is in the worst shape it has been since the early 1980's recession. While Virginia is faring much better than just about any other state, the stark new economic reality is that the Commonwealth's projected general fund revenues for the next two years will be at the level of 2006.

While Governor Kaine and the General Assembly worked hard to balance the budget over the last two years, the fact is that almost two-thirds of the $6.3 billion already wrung from the current budget were one-time actions, meaning that the budget was structurally out of balance. I am not being critical of our previous actions to balance the budget; however, I would merely state that the inevitable is now before us. We no longer can rely on just the easy one-time fixes for the challenges facing Virginia. Though we certainly did not seek these circumstances, we must seize this opportunity to enact sensible, long-term structural reforms in state spending that can make the best state in America even better.

As I look back at how we balanced the 2008-10 biennial budget, what stands out the most is that approximately one-third of the budget, which would include public safety and higher education, has seen cumulative reductions of nearly 20%, with higher education alone taking reduction nearing 30%.

On the other hand, the other two-thirds of the budget – health and human services and public education – has largely been "held harmless" and spared deep reductions. I would also note that these two areas of the budget have also seen the greatest spending increases since 2004. Clearly, in developing the 2010-2012 biennial budget, economic reality dictated our looking closely at this portion of the budget.

Given the magnitude of the task at hand, I decided very early that the best approach in crafting a budget would be to work closely with the subcommittee chairman and the staff. In December, I directed the staff to begin preparing for my review budget reduction proposals.

In the first week of the Session, I began meeting with the subcommittee chairs – collectively and individually – to discuss budget reductions and cost-saving strategies generated by the staff. Over the next several weeks, the conferees and I engaged in many conversations with Governor McDonnell and with the Senate conferees to see if there were any broad areas of agreement. I also urged the Governor to go through an internal process of how he would balance the budget and to share with both sides any recommendation he might have.

All of these meeting, in my opinion, have been very time consuming but highly productive.

Against this backdrop, as Committee chairman and patron of the legislation, I felt that it was my responsibility to offer Committee amendments to the budget in these unprecedented times. In other words, *"The Buck Stops Here!"*

Accordingly, before you is a package of House budget amendments that achieve the following objectives:

1) Restore the Car Tax and reject higher taxes in a recession;

2) Eliminate Fee Increases embedded in Kaine's introduced budget;

3) Modify Kaine's "dealer discount" proposal on taxes collected by businesses;

4) Mitigate cuts to law enforcement and public safety since these activities are among the primary responsibilities of government;

5) Invest in job-creating economic development;

6) Minimize the impact of cuts on the health safety net;

7) Provide school divisions maximum flexibility in implementing education budget reductions; and

8) Establish a substantial reserve to replenish the Rainy Day Fund and help ensure a more structurally balanced budget going forward.

Of course, the fundamentally important decision to restore Car Tax relief was made early in the Session when the House of Delegates *unanimously* rejected Governor Kaine's 17% increase in the statewide income tax (House Bill 1155) on January 21. This key vote made clear our shared commitment to approving a state budget that will hasten economic recovery without exacerbating the burden on Virginia's taxpayers, working families and job-producing small businesses.

With regard to the fees in the budget, Governor Kaine proposed about $145 million annually in new and expanded fees, ranging from a tax on property and casualty insurance to an increase in the E-911 fee and additional $10 fee to record deeds. All of these fees have been removed in the House budget.

Concerning the so-called "dealer discount," I propose that retailers that file electronically will not receive compensation. This will affect about 1,800 retailers. However, for the remaining 94,000 retailers they will continue to receive compensation at half the level.

Before I go into area-specific recommendations, I would like to highlight two vital issues. First is Governor McDonnell's revenue revisions and second, my long-term structural reform proposal towards funding the Virginia Retirement System.

Focusing in on the revised revenue forecast, as you recall this past Wednesday, Secretary Brown briefed this Committee on the current state of our economy. As you have heard on numerous occasions, Virginia's economy continues to out perform that of other states. While it appears that we are tracking the forecast in our major revenue categories – such as withholding, nonwithholding and sales tax – we are performing better in corporate tax collections, recordation taxes and the amount of refunds issued. All told, Governor McDonnell has recommended upward revisions of $200.5 million over a three-year period. I believe that's a responsible and conservative estimate as well as some very encouraging news for a change.

While the easy thing would be to use these dollars to mitigate government spending cuts, I believe the far more prudent course of action would be to set aside a sizable portion of these revenues into a reserve fund that – if not needed to offset any further downward revenue adjustments over the next two years – would go towards replenishing our rainy day fund. You will recall that it will have about $300 million left in it after the Fiscal Year 2010 withdraw of $293.0 million which is needed to balance the FY 2010 budget. In the 2012-2014 biennium, the General Assembly will be required to deposit $232.4 million into the Fund, based on current calculations by the Auditor of Public Accounts. Therefore, I am recommending that we set aside at least $165.0 million for this purpose. I believe this action not only is fiscally responsible, but demonstrates to the national bond-rating agencies Virginia's resolve to balance our budget in the most prudent manner possible and explicitly recognize our out-year obligation to pay back into the Rainy Day Fund.

Now, with regard to funding for the Virginia Retirement System, in working with Subcommittee Chairman Jones, we crafted HB 1189, which has already passed the House. This bill fully recognizes and addresses the need to bend the cost curve of our pension liabilities which will help bring the state budget into more structural long-term balance going forward. However, as I stated to the entire House during floor debate last week, HB 1189 only applies to *new* hires. Nevertheless, the cost of providing benefits to new hires will be about 15% lower than the cost of benefits currently provided.

In addition to the long-term fiscal benefits that HB 1189 will provide the VRS, it is important for everyone to understand what really drives the funding status of the system. When rates are set by the actuary, they consist of two components. The first component is called the "normal" rate, which is the rate needed to pay for the benefits for each employee. The second component of the rate is the unfunded liability, which is primarily driven by market conditions or in other words, the value of the VRS assets. We all know that the current market is down some 30% from its high in March 2007. However, we also know that the markets are rebounding, having recovered half of their loss. When the rates for the 2010-12 budget were set by the actuary in June 2009, the VRS asset value was approximately $42 billion. Over the succeeding six-month period, the VRS assets increased in value by 20% to about $50 billion. By its very nature, the unfunded liability of the VRS is less today than when the rates where set in June. As such, when given the choice on what rates should be funded, I recommend that we fully fund the normal rate only, since the rate attributable to the unfunded liability is somewhat self correcting with the current and improving markets. Likewise, HB 1189 over the long-term will lower the unfunded liabilities of the system as well.

In short, this proposal will result in budgetary savings of approximately $803.0 million over the two-year period. In addition, our local school divisions will benefit and see a corresponding savings in their share of lower VRS rates for teachers. We estimate that this will result in about $200 million in annual savings for local school divisions over the next two years, which will mitigate the additional budget reductions that will be included in our Committee amendments.

Now, I would like to return to specific areas of the budget.

In law enforcement and public safety, I am proposing that we restore approximately $41.2 million each year to Sheriffs' Departments, which will lower the cuts from nearly 15% in the introduced budget to less than 5% in ours. Included in this restoration is full funding for the 1 to 1500 ratio for Sheriffs' offices that have law enforcement responsibilities.

Other public safety funding restorations include $7.5 million each year for Commonwealth Attorneys and about $7.5 million over the biennium to reestablish the 116th and 117th state police academies.

Turning to economic development and the need to help expand job opportunities throughout Virginia, I believe in the old adage in business that says "you have to spend money to make money." We are currently emerging from the worst economic times I have seen in my 49 years in the General Assembly. We all know people who have lost their jobs, families who are struggling to avoid foreclosures, and friends barely able to keep their businesses afloat. Yes, we face a difficult budget cycle, but especially in these tough times we must have the foresight to invest in our future prosperity. Growing the tax base through job-creating business development is the key to Virginia's long-term economic recovery and why my amendments today include substantial investments in economic development. The package before you includes a total of $53.8 million over the biennium to expand our economy through economic development program support and business incentives for creating new jobs and opportunities in the private sector.

Included among these amendments is an appropriation of $12.1 million to double the amount of money in the Governor's Opportunity Fund in Fiscal Year 2011. My amendments also include $5 million for an industrial mega-site fund to direct businesses in currently less developed areas. When a major business is considering a move to Virginia, we will be able to present a site ready for their project and show them that the only thing missing is *them*.

As has long been the position of this committee, the amendments provide support for tourism promotion – increasing by $3.6 million each year the amounts available to market Virginia's natural and historic treasures. Thousands of tourism-related businesses can be found in virtually every part of the state. This industry employs more than 200,000 Virginians, and contributes more than $1.2 billion in state and local tax revenue each year.

While we work to attract new businesses to Virginia, we must also make this the best state in which to grow a small business while not losing sight of our existing industries. That is why my amendments include funds to recapitalize the Department of Business Assistance's Loan

Guarantee Fund as well as appropriations for the Center for Innovative Technology's GAP Funds. In these times of tight lending standards, often all a company needs is a little bit of support to grow their business and expand much-needed jobs.

In the area of health and human resources, I recognized early on that it would have to share in additional cuts in order to balance the budget. This is one of the most difficult areas of government to address. Behind many of Governor Kaine's proposed reductions is the face of an individual with critical needs, such as the elderly and disabled, children with serious mental health needs, and children and adults with intellectual and developmental disabilities. Therefore, in making reductions to this area, I tried to mitigate negative impacts in the introduced budget to the safety net by providing funding to lift the freeze on Medicaid home and community based waiver slots, including MR waivers which remain a priority for this Committee. I also am proposing to continue to operate the Commonwealth Center for Children and Adolescents in Staunton so seriously mentally ill children continue to get acute inpatient services they so desperately need.

Nevertheless, difficult decisions had to be made. I am proposing that we reduce the eligibility limit for the children's health insurance program from 200 percent to 175 percent of the federal poverty level. This seemed to be a better alternative to freezing enrollment in the program, which would mean that no additional low-income children would be eligible. This decision was not made lightly and without some grave concern. I am hoping that if Virginia receives additional federal enhanced Medicaid dollars proposed in either federal legislation or the President's budget, then we can restore eligibility to current levels with those funds. I am offering language in the amendments before you, which would allow the Governor to do so.

Many of you recognize the Medicaid program has been a driving force behind increased spending in our budget over the past 20 years. And, while it has played a critical role in serving low-income children, elderly and disabled individuals, its rapid and steep growth is eclipsing our long-term ability to fund other critical governmental services. Reducing Medicaid growth is a particularly difficult challenge. It requires either cutting payments to health care providers, cutting services or cutting eligibility requirements. The amendments I am proposing in this area will reduce provider payments, reduce eligibility and curtail some services. In reducing payments to nursing homes and hospitals, the amendments reflect efforts to mitigate reductions to those providers who serve a large proportion of Medicaid patients, including those critical providers in rural areas. In reducing eligibility, I am proposing an additional reduction in the eligibility threshold for an optional category group of Medicaid recipients that was reduced in Governor Kaine's proposal. While this was an extremely difficult decision, the change would not occur until Fiscal Year 2012, hopefully giving us additional time to analyze the effect of this eligibility change over the next year.

In the area of public education, over the last several months, we have heard from a number of school division superintendents, board members, teachers and parents. They have acknowledged the economic situation, and local education leaders are preparing their school budgets for decreases in state and local revenues. In order to help manage necessary reductions, they have all consistently asked legislators for additional flexibilities to make difficult decisions in balancing their budget plans. We all believe that additional flexibility and fewer mandates will greatly benefit our school divisions. To that end, I am proposing the following recommendations for K-12.

First, allow school divisions to increase class sizes by one student in kindergarten through grade seven and waive the staffing ratios for prescriptive enrichment and supplemental areas such as elementary resources, technology, gifted, vocational and remediation. For example, a school can now add an extra student into a classroom rather than be mandated, as required under existing law, to hire an additional teacher and then subsequently split a single class into two classes. And, let me point out, that this action will not impact the state's allocations to schools – only free up local resources. Second, I propose suspending the state mandate on secondary planning period that was approved in 2004. This action will save about $185 million each year for the state and localities will also realize a significant savings, in the neighborhood of $150 million each year, to their local required match.

Another strategy that I am proposing gives more flexibility to localities by establishing a Lottery Block Grant for participation options in different programs. This new initiative allows school divisions to decide in which of the eligible programs they want to participate and at what levels. The block grant will provide $260 million over the biennium to schools and will be allocated on a per-pupil amount basis.

Along with these initiatives, I am recommending lower rates paid for VRS retirement and retiree health care, which will again save both the Commonwealth and localities considerable funds. Current estimates show that the state will be able to save $180 million each year and localities will save even more, well over $270 million each year. The local share of savings from the lower VRS rates will help offset some of the state reductions that are included in my recommendations for public education.

Finally, Governor Kaine's unprecedented, and I believe ill-advised, decision to freeze the LCI in the first year was unfair to our good friends in northern Virginia. Having listened to many in and beyond Capitol Square, I decided that we must address this inequity and unfreeze the LCI. However, my dilemma and concern about unfreezing the index was the unintended consequence to those localities that would loss state funding in doing so. Therefore, I am proposing to provide $91.0 million to fund a "hold-harmless" payment to them, which will restore about 80 percent of what they will otherwise lose.

As we move forward in developing this very difficult and austere budget, I hope that you will agree with me that with the realization of the current revenue situation, and all of the demands placed on the Commonwealth, this proposal outlines a balanced partnership between localities and the state in our collective support to public education.

In the area of higher education, my recommendations do not call for any further cuts. As you know, the funding status of higher education now stands at the 2006 level. Because the federal stimulus dollars will help mitigate cuts in FY 2011, the reality is that beginning in FY 2012, higher education will be facing an additional reduction of approximately $150.0 million. Of course, these cuts will translate into higher tuition increases for our students and their parents. It is my hope that if Congress provides the state an additional enhanced Medicaid match rate for the last two-quarters of FY 2011, this will allow us to reduce the FY 2012 budget cuts by $75.0 million or 50%.

Finally, throughout this budget-balancing process, I am always mindful of the men and women who serve the Commonwealth – whether as highway workers who build and maintain our roads; as correctional officers and state troopers who protect us; and the individuals who provide care and services to those most in need. These are the faces of government who, unlike the policy makers, actually have to implement programs and do them in a cost-effective and efficient manner.

To these employees I am recommending several actions. First, as I had previously stated, the Commonwealth will keep its promise that it made since 1983 and we will continue to pay for your VRS contributions. Second, my amendments will restore funding for the cash match program. This program has empowered our employees to invest towards their retirement by taking greater personal responsibility for their savings. The state's $40 per month match is a small but important investment in helping employees to save. This program also has taken the pressure off of increasing costly benefits through the Virginia Retirement System. I also want to restate what has already been reported in the media: the Committee budget recommendations do *not* include any furlough days, including the one recommended by Governor Kaine for the current budget year.

Finally, with adoption of this budget, it will be four years since state employees have been given a pay raise. Throughout this financial crisis, our state employees have done more with less. They have seen layoffs of co-workers and increases in their cost of health care. However, they have continued to work hard and have been partners in helping to find ways to reduce costs and deliver services more efficiently for the people of Virginia whom we are honored to represent and serve. For this I want to commend you, and if Congress provides the state an additional enhanced Medicaid match rate, then language will direct that effective December 2011, employees will be provided a 3% bonus.

In closing, our committee budget recommendations will clearly and strategically focus state resources on keeping our promises to fund the core services of government in a structurally more balanced manner so as the economy recovers we can begin to make new investments and enjoy growing levels of opportunities and prosperity.

Equally as important, I want to emphasize once again that the budget recommendations before you restores the $1.9 billion to localities so they can continue providing tax relief to hard-working and tax-paying citizens throughout our Commonwealth.

Now I would like for our able committee staff director and his colleagues to review with the committee in greater detail the amendments I have put before you. I also would welcome the Subcommittee Chairs to offer any additional comments as we move through each area of the budget. And, as always, members are invited to ask any questions you might have.

Robert . . .