OPENING REMARKS

The Honorable Charles J. Colgan
Senate Finance Committee Retreat
Staunton, Virginia
November 18, 2010

I'd like to welcome my Senate colleagues and those in the audience to our annual meeting here in beautiful Staunton. The budget discussions that occur around this table will help to shape our thoughts and inform our actions in the upcoming General Assembly session. So, please ask questions, raise issues – we want to hear from everyone.

Every Senate Retreat starts with a discussion of the economic outlook and budget pressures that we will face in the upcoming session. Going back to at least the 2006 Retreat, the message has been consistent – an economic reversal was occurring.

What we did not know initially was that the magnitude of that reversal would be of historic proportion.

We now have moved through the greatest economic upheaval since the 1930's depression, and are on a recovery path that looks <u>different</u> from those we have come to know.

That fact is worrisome because we realize the signals the economy is sending may not be transmitting exactly the same message they transmitted in years gone by. Our instincts tell us the "great recession" has left some structural damage in its wake, and it may be years before we know for certain what the new structure will look like.

Yet, we have to move forward with the best information available and, at the same time, continue to carry our friend "caution" in the passenger seat.

This year's economic discussion will not deviate significantly from last year's discussion because the economic outlook is essentially the same. **Last year, our closing observation was that this economic recovery will be slow and uneven**. That still is a fact, and the question simply is one of timing. Where are we on the economic highway?

At the national level, the picture is clear. We moved from second gear at the end of last year back down to first gear during the summer because the initial strength was based on temporary factors, such as inventory rebuilding and government stimulus. As those started to wane, sufficient confidence had not returned to allow consumers and businesses to pick up the baton and sustain growth.

The data we've seen over the past few weeks look better and offer the hope that we are on the verge of shifting the gear back up again.

In Virginia, we are performing better than the nation as a whole. That's not surprising because our economic base is more heavily weighted toward those industries that fared best in the "great recession." On the other hand, as we look to the future, we have to be mindful of the fact that one of our "high flyers" – Business and Professional Services – has been targeted by the defense department and will be less of a growth industry than has been the case in our recent past.

That said, our current task is to focus on whether slight shifts in the national economic outlook will impact Virginia's current biennial revenue forecast.

Based on staff analysis, we can expect an upward adjustment to our revenues of about $300 million, on a biennial base of about $30 billion. This is not a huge adjustment, nor does it signal an end to this period of fiscal uncertainty. But at least it's going in the right direction!

These revenues will be consumed by the additional spending that will be required this biennium, primarily in the areas of Medicaid, public safety, and VITA. Accordingly, we can expect a relatively modest budget shortfall of less than $200 million, requiring some additional budget cuts.

Although the budget shortfall will be significantly smaller than those we've addressed in recent years, we will be making these cuts against a meaningfully reduced budget.

Let's face it -- we made a number of tough choices last session. Faced with a $4.5 billion budget shortfall, we could not afford to take large portions of the general fund budget off the table. Proposals for new resources were offered, but few gained any traction.

So we were forced to make deep budget cuts to close the gap. Unfortunately, there is no easy or popular solution when you consider that <u>half</u> of the state's general tax dollars are returned to localities – primarily for public education. The <u>other half</u> of the state's general tax dollars is used largely for higher education, Medicaid, and corrections.

We also turned to one-time savings from reducing the contribution rate to our retirement program and other employee benefits. While this choice allowed us to avoid making deeper cuts to our safety net programs and education, we acknowledged that it was a <u>one-time strategy</u> that would need to be repaid in the 2012-14 biennial budget.

So, while we may get a little breather on the current budget, we need to start turning our attention to the 2012 session when we will craft the 2012-14 budget. Frankly, that budget is of greater concern than the one before us this January. Growth in Medicaid, education, and debt service can be expected, plus we will need to replace some of the one-time revenues and savings that are "propping-up" our budget.

The desire will be strong to undo cuts, add funding to high priority programs, and fund new initiatives. None of those is likely unless we see revenue growth that rebounds quickly and sharply over the next two years or so. That outlook is unpredictable at best.

We would be well-served, then, to proceed cautiously this next session. We must avoid incurring any obligations that will make the 2012-14 budget even more difficult -- we already have several "bills in the drawer" that need to be paid.

Clearly, the Commonwealth has been through an unprecedented period of economic upheaval, one that has required some gut-wrenching decisions. We don't fully know the impact of the choices we've had to make, and we don't know if we've seen the last of these tough choices. But I believe we have tried our very best to make sound decisions, in an effort to protect Virginia's reputation as a well-managed state, and to promote the quality of life that our citizens expect and deserve.

Now let me turn to our program. Over the next two days you will hear updates on several of our key budget drivers -- health and human resources, public and higher education, and public safety. In addition, we will discuss the state's use of debt and the implications for transportation. Finally, you will hear a presentation on the effectiveness of our economic development incentives. I believe you will find each of these presentations useful and enlightening.

We will open today's discussion by seeking clarity on the economic picture. This afternoon, we're privileged to have Dr. Chris Chmura with us to reflect on the national recovery and how Virginia is faring in it.

Chris is a familiar face to many of you. She has long been a member of the Governor's Economic Advisory Board of Economists and has provided assistance to this Committee on several occasions.

After serving as an Associate Economist at the Federal Reserve Bank of Richmond and Chief Economist at Crestar Financial Corporation, Chris established her own research, economic development and workforce consulting firm about 10 years ago.

Her views are widely respected and frequently quoted, and she is known for her in-depth knowledge of the state. And that is exactly what we need at this point in time – an economist who understands what makes Virginia tick and can help us sift through the often mixed messages that we get from the national data.

Chris – we welcome your thoughts on where Virginia's economy is headed.