

**STATE OF THE STATE ADDRESS**

Mr. President, Mr. Speaker, Members of the Legislature and my fellow Nebraskans:

Our State Constitution requires that the Governor address the Legislature and present a budget recommendation early in the legislative session. This morning, I come before you to fulfill that obligation and, in doing so, accept the responsibility of framing the reality of the day.

The past two years have witnessed national and international events that have dramatically altered our individual priorities and how we view the world around us. Since the Legislature last debated and adopted a biennial budget, our nation has been attacked, we've commenced a war on terrorism, our national economy has slipped into a stubborn recession that refuses to loosen its grip, and our state has been stricken by a drought of historic proportions. Any one of these issues would have been a challenge. All together, as one of my colleagues said, they have created the perfect economic storm.

Nebraskans answered the challenge of the terrorist attacks by giving of themselves through volunteering, donating blood, and contributing financially to those in need. We promised to never forget the sacrifices of those who died that day in New York, at the Pentagon, and in Pennsylvania.

Our commitment to freedom, and the strength we find in it, has never been stronger. We answered the call to a new war on terrorism by supporting our men and women in the military, but also by reinforcing our commitment to first responders at home. Under the leadership of our own Homeland Security Director, Lieutenant Governor Dave Heineman, we developed a national model for bioterrorism preparedness and a comprehensive plan to address agroterrorism. We are as prepared as we can be for that which we pray never happens.

For more than eighteen months we have struggled to come to grips with the recession and its impacts. In conjunction with the federal government, my administration approved extended unemployment benefits for workers who have lost their jobs while keeping our commitment to encourage the creation of new, quality jobs all across our state. The struggle continues, but so does our commitment to working families.

Then there is the drought - a natural disaster impacting Nebraska and many other states. I will never forget seeing the South Platte River flowing at a trickle near Ogallala this past summer. Our farmers and ranchers, who are some of the hardiest of all Nebraskans, and the communities in which they live and do business, have suffered the most from this drought.

For state government, the greatest consequence of these four challenges has been a free-fall in tax receipts that is worse than the farm crisis of the

1980's. The worst year then, fiscal year 1985, witnessed revenue growth of less than one percent, but there was still revenue growth. This compares to fiscal year 2002 when tax collections were \$91 million dollars or nearly four percent less than in 2001. In fact, 2002 tax collections were even less than 2000 tax collections by \$38 million dollars, or nearly two percent.

Ladies and gentlemen, 2002 tax receipts were truly historic - on the down side.

It is a credit to your efforts that we acted in a timely and responsible manner and, in doing so, avoided the crisis other states have faced and continue to face. We may have disagreed on some parts of the solution to our fiscal problems, but we have never disagreed on the need to reach our common goal of fiscal stability for Nebraska.

Our collective hope has been that the national and state's economy would improve by now. That has not been the case.

A Nebraska business owner described it to me as a saw-toothed economic recovery - plenty of ups and downs with very sharp edges. It is in this economic climate that we continue our work with the fiscal stability of our state as our overriding goal.

I have agonized more in developing this budget than any other in my eighteen years of public service. I have every reason to believe that you will do the same.

One way to put our fiscal problem in context is to consider that even if state spending were frozen at current year levels for the next two years, a \$115 million dollar shortfall would exist between available revenue and expenditures. That's not factoring in the deficit requests or the Boyd County litigation.

From another perspective, the Legislative Fiscal Office defines our dilemma as a \$673 million dollar difference in projected spending needs and projected revenue over the next two years. That number is conservative. Deficit requests and a potential liability arising out of the Boyd County Low-Level Radioactive Waste Site litigation balloons this number to a staggering \$850 million dollars.

I expect these very large numbers will cause you to reach the same conclusion I did: very difficult choices cannot be avoided. To help understand some of those choices, let's divide the current year budget - fiscal year 2003- into four categories: first, operations; second, aid to individuals; third, aid to local governments; and finally, higher education.

Operations would include everything from the Governor's Office and the Legislature to the State Patrol and Corrections. Altogether, operations include state agencies at a price tag of \$539 million dollars this year or 20

percent of the total general fund budget. Half of those costs, or about \$267 million dollars, can be found in just two agencies: the Health and Human Services agency within the Health and Human Services System and the Department of Corrections. The complete and total elimination of all funding for operations for one year, at best a foolish concept, would not even provide enough savings to balance the budget.

Aid to individuals includes Medicaid, childcare subsidy, and other individual assistance programs. The total price tag this year is \$535 million dollars or 20 percent of the total budget. Medicaid, the state and federal health care program for low-income seniors, the disabled, and children, is the largest component of this category at three-quarters of the total. The complete elimination of aid to individuals for one year - of course, not a possibility - would not balance the budget.

Aid to local governments is \$905 million dollars or 35 percent of the budget and includes state aid to schools, special education funding, and aid to counties, cities, and NRDs. State aid to schools is \$647 million dollars or 71 percent of this category. Entirely eliminating state aid for one year would nearly cover the shortfall, but obviously we will not head in that direction.

The final category is higher education, including the University, state colleges, community colleges, and student financial aid, which received \$521 million dollars or 20 percent of the budget this year. The complete elimination of funding for higher education for one year, another impossibility, would not balance the budget.

Now consider the revenue side of the picture as well as our Constitutional obligation to finance general fund spending without incurring debt.

Over my objection last year, the Legislature approved a mostly temporary general tax increase. During debate on this issue, a number of senators made it clear they would not support an extension of these tax increases. And some senators who supported the tax increases have left the Unicameral. It is a different Legislature that considers these issues.

But if this Legislature made those temporary tax increases permanent, an estimated \$247 million dollars would be generated in the next two years. That's only about one-third of our current budget gap. Even if the Legislature took this step, more than \$425 million dollars in spending reductions would still be required to balance the budget. Again, if we consider deficit requests and the possible judgement from the Low Level Radioactive Waste Site lawsuit, that number climbs back to about \$600 million dollars.

Furthermore, recognize that deficit spending - the often-used solution at the federal level - is not an option for Nebraskans. Our founders made sure that every generation would live within its means. Article XIII of the Nebraska Constitution very specifically limits the power of the state to incur debt for

the purpose of financing more spending or to balance the budget. We cannot and will not borrow our way through this challenge.

All of these numbers remind us that however the shortfall is addressed, the choices will be difficult and sacrifice will be required. With these facts in mind, I prepared this biennial budget recommendation guided by five principles.

First, the budget plan had to be realistic and honest. It had to be tied to the reality of the economy and current projections of tax revenue.

State tax revenues are simply not there and we cannot afford a spending plan based on wishful thinking about tax receipts. Our projections of future revenue must be very conservative. And this budget recommendation had to be void of gimmicks and false hope. I am confident we will agree that my recommendation is straightforward and unvarnished.

The second principle on which I built my budget recommendation was that there not be a general sales or income tax increase.

The challenge we face is so large that significant spending cuts have to be the major part of any solution. Relying primarily on general tax increases to solve the problem will only serve to delay economic recovery and take resources from Nebraskans trying to balance their own family and business budgets.

The third principle was that spending in each year of the biennial budget absolutely could not exceed projected revenues.

The tremendous investment in education, human services, and corrections that began more than four years ago was based on revenue projections that dramatically missed the mark. When the phenomenal revenue growth of the mid- to late 1990's ended, it was as if we had spent our way to the edge of a cliff. We have an obligation to bring ongoing spending and revenue in line with one another on an annual basis. Very simply, we must restructure the base of spending and do it now. If we fail to act, spending will forever outpace our citizens' ability to pay for their government.

A fourth principle was that we had to protect a set of priorities representing state government's core responsibilities to the fullest extent possible.

My budget recommendations require reductions across nearly all programs, services, and aid provided by State government. However, my recommendation reflects a continued priority for funding services that ensure safe communities, protect the most vulnerable Nebraskans, and promote the health and safety of our children. The State Patrol, Military, and Fire Marshal are spared from deep cuts. I have also spared from deep cuts public and private nursing homes, the state's 24-hour care facilities including our veteran's homes, and our home for the developmentally

disabled. And finally, children's health care, the family childcare subsidy, and early childhood education aid are spared deep cuts under this budget recommendation.

The fifth and final principle was that the cash reserve fund had to be protected and increased, both because of continued economic uncertainty and to prepare for contingencies that might arise from the Low Level Radioactive Waste litigation.

With regard to the litigation, we have strong arguments for our appeal, but considering the tone of the ruling and the size of the judgement, we must be prepared for any outcome. If our state is not required to pay the judgement, a strong cash reserve position will better enable us to maintain a basic level of state services should tax receipts fail to rebound in the short term. Be mindful that members of the Nebraska Economic Forecasting Advisory Board have lowered state revenue projections each of the last five times they have convened.

The budget I submit to you today reflects these principles. Again, they are: one, the budget is tied to the reality of the economy and current projections of tax revenue. Two, there is no increase in the general sales and income taxes upon our citizens. Three, spending in each year does not exceed projected revenues in each year of the biennial budget. Four, the core responsibilities of State government are protected to the fullest extent possible. And finally, the cash reserve is protected and increased.

As you will discover in reviewing the details of my recommendation, there was no easy path to this result. I am personally encouraged by the memory that the farm crisis of the 1980's was followed by the economic growth of the 90's. However, this memory is tempered by the reality of today and the need to be ever so cautious and conservative until we see a national recovery that is sustained over time.

Admittedly, this budget recommendation is stout fiscal medicine, but I believe it is necessary. Only by making tough decisions can we see the light at the end of the tunnel.

As you start your debate, I expect you will hear from many interests proclaiming that their favored program cannot operate with the budget I have proposed. The truth is that all of us must accept the challenge of doing more with less.

The economy is not generating the tax revenues necessary to support the current level of state spending. All of us must sacrifice for the foreseeable future.

In the more than 135 years of our state's history, we have met many challenges including recessions, the depression, drought and farm crisis.

There is no question we are being tested. But I remain confident that we will pass this test and be better for it.

In 1938, in the midst of the Great Depression, FDR said, "We have all learned the lesson that government cannot afford to wait until it has lost the power to act."

We must hold to that same sentiment today. The time to act is now so that we can preserve a bright future for our state and our children.

There isn't a person in this chamber or across the state who doesn't wish for a rapid national and state economic recovery. That day will come. When it does, I will lead the charge to allocate funds to worthy programs impacted by this budget.

As always, I pledge to have an open door to work with you in this Legislative Session.

Good luck, Godspeed in your work, and God bless Nebraska.

The committee escorted Governor Mike Johanns from the Chamber.

### **BILLS ON FIRST READING**

The following bills were read for the first time by title:

**LEGISLATIVE BILL 401.** Introduced by Jones, 43; Burling, 33; Cudaback, 36; Dw. Pedersen, 39; Price, 26; Schrock, 38; Stuthman, 22.

A BILL FOR AN ACT relating to speed limits; to amend section 60-6,186, Reissue Revised Statutes of Nebraska; to reduce the interstate speed limit as prescribed; to provide an operative date; and to repeal the original section.

**LEGISLATIVE BILL 402.** Introduced by Speaker Bromm, 23; at the request of the Governor.

A BILL FOR AN ACT relating to appropriations; to amend Laws 2001, LB 543, section 133; Laws 2002, LB 1309, section 164; and Laws 2002, Second Special Session, LB 2, sections 11, 32, 34, 35, 42, 56, 57, 76, 81, 87, 118, 121, 126, 128, and 133; to define terms; to change certain appropriations as prescribed; to provide for transfers; to repeal the original sections; and to declare an emergency.

**LEGISLATIVE BILL 403.** Introduced by Speaker Bromm, 23; at the request of the Governor.

A BILL FOR AN ACT relating to the Nebraska Environmental Trust Fund; to amend section 81-15,174, Revised Statutes Supplement, 2002;