THE UNITED STATES VIRGIN ISLANDS
OFFICE OF THE GOVERNOR
GOVERNMENT HOUSE
Charlotte Amalie, V.I. 00802
340-774-0001

June 29, 2012

Honorable Ronald E. Russell
President
29th Legislature of the Virgin Islands
Capitol Building
St. Thomas, U.S. Virgin Islands 00802

Dear President Russell:

Enclosed is the proposed Executive Budget for Fiscal Year 2013 for the Government of the U.S. Virgin Islands ("Government"). I would like to express my sincere appreciation to you for your leadership of the 29th Legislature, and for your patience as we have worked together to make many difficult decisions in the best interests of our Territory.

Over the last year, and especially since the onset of the Great Recession in 2007, our community has been subject to economic and financial challenges not witnessed in recent decades. Our resources have been severely strained and the near term options for alleviating these pressures are few. As I stated in last year's transmittal, there are no simple solutions to the profound problems that we face, but the duty to lead falls upon each of us as public servants and stewards of the greater good. We must make the hard choices that will right our course, no matter how difficult those choices may be. I look forward to our continued collaboration in the weeks and months ahead as we embrace our responsibility to lead our community.

The economic environment that we confront is not solely of our making, but we, like all others in this global economy, must adjust to the prevailing winds. In early 2012 it was the sudden announcement of the closure of the HOVENSA oil refinery that had the most dramatic impact on the social, economic and financial fabric of our community. This decision not only ended a sixty-year relationship with the closure of the third-largest refinery in the western hemisphere, but also silenced the economic engine that powered so much of St. Croix's business community, philanthropic giving and job creation. The operating shut-down of the oil refinery is estimated to represent a $580.0 million reduction in direct gross economic output, or approximately 13% of our total gross territorial product, and a loss of over $92.0 million in tax receipts. The closure resulted in the direct termination of approximately 2,500 employees and subcontractors, representing 12% of total employment and 27% of the average gross pay of the private sector on St. Croix. This past May, the current unemployment rate the Territory stood as a dismal 12.2% but for St. Croix, the unemployment rate increase to a shocking 14.6% from 10.8% for the prior month. It is only now, as we monitor the economic fallout that we will begin to get a more accurate understanding of the multiplier impact on St. Croix and the Territory.

Needless to say, this one corporate decision has been devastating and it requires us to further refine our expectations, especially as we navigate our way forward. This decision came upon us as the economy was beginning to stabilize and signs of sustained local economic activity were appearing. We had replaced the lost revenues by accessing the capital markets to provide the financial resources needed to sustain Government operations and to initiate capital projects to maintain a vibrant private sector. We had implemented targeted tax increases, assured judicious spending of the stimulus funds across many social and community programs to support our economy, and imposed a policy of limited hiring to reduce our employment numbers. The passage and approval of the Virgin Islands Economic Stability Act of 2011 had a tremendous impact, as it reduced our annual General Fund payroll costs by approximately $26.3 million with the implementation of the 8% salary reduction measure and resulted in the early retirement of 324 General Fund employees, which further accounts for an additional annual savings of approximately $16 million. Unfortunately, in spite of the aforementioned well intended initiatives, the reduction in overall revenues still required the elimination of 571 General Fund positions during the second and third quarters of FY 2012, which realized a net savings of $28.8 million. Not since the Cyril King administration has the government had to resort to balancing its financial affairs by impacting its hardworking and committed workforce. However as entrusted leaders, placed into the position by the power of the ballot, that tough decision had to be made to preserve the critical services we offer to our citizens.

The challenges of our current environment are not only to manage for the near term—the next twelve months—but more importantly to begin to restructure public sector operations, so that costs are in line with our reduced financial resources, critical services continue to be provided, and we begin to transform our economic platform to achieve and drive growth. We must manage these interwoven events within a complex global economy. The U.S. faces a jobless recovery as unemployment hovers around 8.2%, the European community is struggling with austerity policies and with uncertainty surrounding the strength of its currency union, and even certain emerging economies (Brazil, Russia, India and China) that have signaled strong growth now are showing evidence of slowing. There is simply no denying that the economic ramifications of events in the larger world are and will continue to be felt in the U.S. Virgin Islands and will drive our tourism traffic, manufacturing activity, submission of new economic development applications, and prospects to obtain financing for private sector projects or support for construction activity. Our charge is to execute on the needed changes that will put us on the right path for long-term growth as we manage through the next twelve months of activity.

The General Fund operating budget for FY2013 is based on a net revenue projection of $695.8 million. This revenue projection reflects the anticipated reduction and leveling in our core revenue streams due primarily to the changes to corporate income and gross receipts tax income. The impact of the national recession on our core revenue streams remains severe, as projected total net revenues are still $100.0 million below pre-crisis levels. On a positive note, revenues attributable to real property taxes continue to rise, as do individual income taxes as a result of our specific focus on the collection of past due obligations. The projected total resources available in the FY 2013 budget is $849.6 million, down for the third year in a row, and down $25 million from FY 2012.

This budget reflects revenues available for appropriations of $695.8 million, 2.4% below FY2012 levels, representing $17.0 million in operating funds that are not available to the departments and agencies for the provision of services in FY2013. During this challenging budgeting process we havecontinued our policy of not filling General Fund supported positions unless deemed absolutely critical, eliminated programs and services that could no longer be justified in this economic environment, and streamlined processes whenever possible and shifted costs to achieve more equity and efficiency.

The revenue pressures that we confront are not unexpected given the economic factors and the external forces that impact our local economy. As such, we will continue to be vigilant in the spending of public funds, to seek operational efficiencies in our departments and agencies, and to make structural adjustments that will result in long-term savings. Within the mix, we must also ensure that capital project activity be initiated either directly by the public sector or by facilitating rather than hindering private sector investment.

Some of the key elements in the foundation of the FY2013 Budget include:

- We plan to streamline the eligibility process of the Women, Infants and Children unit within the Department of Health through the eligibility platform in the Department of Human Services to avoid duplication of resources and to better serve the customer;

- The transfer of the Medical Assistance Program from the Department of Health to the Department of Human Services to achieve synergy with their collective missions as we implement the MMIS. This will enable us to improve service delivery to the client who are frequently beneficiaries of more than one of our social service programs and take advantage of over $300 million in federal funding available to the U.S. Virgin Islands.

- Increased funding to the East End Health and Frederiksted Health Center to expand their clinic services since the Department of Health closed its dental, dermatology and eye clinics;

- Legislation to *(i)* revise provisions of the career incentive program to be a one-time bonus instead of a recurring payment and to *(ii)* eliminate the payment of a 'night differential';

- Funding for additional staff and operating costs to open the Charles Wesley Turnbull Regional Library;

- Increased funding to cover the higher health insurance premiums for the increasing number of retirees;

- Transfer of the Bureau of Economic Research to the Virgin Islands Economic Development Authority;

- Shifting the funding of the Office of Collective Bargaining to the Union Arbitration Fund, similar to that of the Public Employees Relations Board and the Labor Management Committee;

- Commenced discussions with the U.S. Department of Homeland Security, Customs and Border Patrol, on the cost elements in the collections of customs duty and the need to revise the process for cost savings;

- Increase in the Workmen Compensation premiums to effectuate certain program reforms and additional funding to cover the Government's share of increased employer contributions;

- Re-instate the 8% salary reduction, which was enabled by the Virgin Islands Economic Stability Act of 2011, effective in July 2013;

- Re-allocate the cost-share health insurance premiums of active employees and retirees to a 60/40 split instead of the current 65/35 split;

- Institute the operating policy that the cost of the employer share of health insurance is capped;

- Increased funding to the Special Revenue Collection Task Force to concentrate on businesses and individuals that are under-reporting and not reporting tax obligations;

- Progress made on a memorandum of agreement between Fire Service and the Department of Health to streamline our first responder requirements, while funding EMT trainees to reduce the overtime costs in both agencies;

- Funds to cover the *(i)* Excessive Force Consent Decree correction plan of the Police Department, *(ii)* the Golden Grove Correctional Institution (USDOJ) and the Criminal Justice Complex (ACLU) consent decrees of the Bureau of Correction and *(iii)* the required Third Party Fiduciary pursuant to the 2002 Compliance Agreement and the 2011 USED Special Conditions;

- Continued investment in early childhood education with implementation of the Quality Rating and Improvement System (QRIS) that will lead to higher standards and performance in our daycare and development centers; and

- Funding the 20% local match requirement in order to obtain $5 million U.S. Department of Commerce/USEDA federal grant to establish a revolving loan fund to assist small business.

In addition to the above, we have allocated funding to expand the MAP program to serve more of the population in need of medical services and consistent with Healthcare Reform, to school maintenance and repair, to road repairs and striping, to mental health operations, and to provide additional legal services to handle increased caseloads.

Faced with the reality of diminished core revenues for the third budget year, we took extreme care to craft the leanest possible budget for FY 2013. As noted earlier, we have developed the budget by not filling General Fund supported positions, unless absolutely critical, eliminating programs and services that could no longer be justified in this economic environment, streamlining processes and shifting costs. Yet the need for working capital persists, and this need is a direct consequence of the loss of HOVENSA generated revenues, a circumstance that we could not foresee. Accordingly we have no recourse but to utilize $60.0 million of the $120 million we intend to borrow in FY 2012 for working capital to close the gap in the FY 2013 budget. It is my sincere belief that in subsequent years this gap will be reduced with the implementation of our growth strategies and continued focus on the collection of past due taxes. If the HOVENSA revenues were still available to the Government, even at the lower levels collected in the current years, we would not have had to borrow the full $120 million authorized by the Legislature to augment FY 2013 revenues even with the re-instatement of the salary levels. To avoid borrowing the full $120 million we would have to dismiss more employees, and this is a policy I do not endorse.

I ask that you and each of the members of the 29th Legislature give due consideration to this budget. I am committed to working with you to ensure that we have a functional and realistic FY2013 operating budget. I am hopeful that our future is extremely bright and that together we will set a dynamic foundation during this very challenging period in our history by "Building Sustainability: A Foundation to Progress."

Thank you for your continued support and guidance on behalf of our community.

Sincerely,

John P. de Jongh, Jr.
Governor