

**Transcript**  
**Governor Joseph E. Kernan**  
**Keynote Address**  
**Indiana Fiscal Policy Institute Annual Meeting**  
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*Introduction by Steve Johnson, Indiana Fiscal Policy Institute President:* Once again, I want to thank all of you for coming today. I realize that with the Legislature in session, there will be a lot of people who will have to move in and out and we understand that, but I think we have a wonderful opportunity here. You know, when it comes to introducing someone that you've known and worked with, it's the kind of thing that I could've asked the Governor's office to give me the usual text of things about his past and how he has essentially risen up through the political ranks and become Governor, but quite frankly, I think from my standpoint, there's a story that I'd like to tell you from my viewpoint, indicates who this gentleman is as a person.

When he and the late Governor Frank O'Bannon were first elected, Joe Kernan as Lieutenant Governor at that time, comes into the office with the Constitutional authority to preside over the Senate. Now here's a man that, quite frankly, very few of us knew anything about. What impressed me the first time was, we came in on Organization Day, he took over his duties at the podium as if he'd been there for years. Now I would assume that he rehearsed it quite well. That's fine. Fast forward a couple more months. Now things are at a point where we're moving through legislation fairly quickly at third reading. Nothing terribly controversial had come up, but a lot of things are always procedural and so forth. We're at one particular bill, and as the president of the Senate often does, he gets ready to get on with the final vote on the bill and asks if all the Senators on the floor have voted. He looked down at the TV screen that tells him who has and who has not voted. One particular Senator of the Minority Caucus was off the floor. I knew that this particular Minority Senator had a very strong interest in this bill and was going to want to vote on it, but looking around the room, he saw the Senator was not on the floor. So he called the second time, the normal process, and finally the gavel drops and he closes the machine. Just at that moment, the Senator comes through the side door. Now for those of us who would be sitting in the minority or the majority, here's sort of the first test of what the presiding officer is going to do because the rules are very clear. "The Senator wants to vote." Lieutenant Governor Joe Kernan, as the presiding officer, looked the gentleman right in the eye and said "Sir, you were not on the floor, the machine is closed." Every single one of us in that room, minority and majority Senators understood the evenhandedness that this man was going to use as he presided over the Senate. It set a tone. A tone then that he carried virtually every single year after that. That, I think, is the best introduction I can give to our governor, Joe Kernan.

*Governor Kernan:* Thank you and good afternoon. Steve, thank you very much for the invitation to be here. Andrea, thank you for all the work that you did I know to help get everybody here. I would just add a sidebar to Senator Johnson's story. He made it sound as if it was on a Tuesday afternoon and we had all the time in the world. And the fact is that it occurred

at about 20 minutes to twelve on the last night of the session when there was great interest on everyone's part to be able to one, go home, but two, be able to handle as many bills as we possibly could. Everything I learned in the Senate I owe to Luke Kenley. *[laughter]* That's not quite true. But I will say that from the time that I did arrive in the Senate as a rookie, and having had no state experience, that members of the Senate, from Bob Garton, Morrie Mills, Larry Borst, and other members of the Majority Caucus, and Richard Young, Earline Rogers, and members of the Minority Caucus, it was a fabulous experience for me to be able to work with a group of very, very good people on some difficult issues over time.

I appreciate the opportunity to be with you today. How about those Pacers? *[laughter]* The Colts had a fabulous year, but the calendar has turned and now we're focused on the Pacers and pitchers and catchers report for spring training on February 20 and I just want to say that I think Mayor Peterson has done a fabulous job of snow removal this year. *[laughter]* I had no trouble getting across the street today and I want to thank the Mayor.

I'm here to just share a couple of thoughts with you and try to put them into a context of the kinds of challenges we face along with some of the opportunities that we face as well. Our revenue forecast, you may know, came out about 10 days ago and it was not particularly good news, but it was not news that was unexpected. And in fact, as we have been tracking the progress of revenues this year on a month-by-month basis, we knew that we were in excess of \$150 million behind where the original revenue forecast had projected we would be. And in our projections going forward, we took that into account. As well, we did not assume that we would have that as part of our base going into the next fiscal year. So the hit that we took, instead of being in excess of \$400 million, although that's really what it was, but in terms of our planning and what we were anticipating, we were just about \$80 million off of where the final revenue forecast came in. For us, \$80 million is a lot of money. \$420 million is an awful lot of money over that two year period, but we had been projecting in our discussions, internally, that that, in fact, was going to be the case; that there would be a shortfall in revenue and we were all hoping that the new revenue forecast that has come out, that we would not just make those expectations, but hopefully, as we traditionally have in Indiana with the bipartisan revenue forecast, that we would actually have been conservative and we would see some additional revenue that does come in as a result.

We will be in the black at the end of fiscal '04 and fiscal '05 and we will do so because we will continue to take the actions and make the decisions that are necessary in order for us to be there. Secondly, you may be aware that yesterday afternoon we received official notification that Standard and Poor's had downgraded the state's bond rating. Not something that we are happy about, but again, it is not a shock for us. We have been on negative outlook for about a year. We understood that this possibility existed. States all across the country have been downgraded as a result of the same kinds of challenges that we're facing in Indiana, some with problems worse than ours, some with problems not as grave, but nonetheless, going on across the country. And while today, we still, with the downgrading, have a rating that only 11 other states exceed. We no longer are on a negative outlook. We believe, again, that certainly the credit rating is something that is very, very important to the state; it is something that we take very, very seriously.

But I would like to make something very clear and that is the proposal for a full day kindergarten and the mechanisms that we are using to pay for full day kindergarten and early learning were, in the words of Standard and Poor's, not a driver in this current credit rating decision. And I think that that's very, very important to understand. I think that there has been a little bit of back and forth on that, but that is the official report from Standard and Poor's.

And in working on our credit rating, it has been the history of the state of Indiana that this is a bipartisan effort; that we recognize the importance of the state's credit rating and certainly that will continue to be the approach that I take as we deal with this and other issues of the same kind of importance. There is no room for politics. There is no room for casting different tints on exactly what has happened and why it's important. And we have to do, collectively, as Republicans and Democrats, everything that we possibly can in order to maintain the state's very strong credit rating.

Reassessment. We are continuing to go through this process. It has, like most reassessments, it's had its challenges and there have been delays at the local level in implementation, but it is a process that still goes on. And the delays are even more dramatic than we normally see and that is for the obvious reason that not just that this a reassessment year in the normal sense, but we changed all of the rules. And so it has been a real period of adjustment for local elected officials to be able to get up to speed. Our Department of Local Government and Finance works every day with communities across the state. But we are still waiting on bills to go out in roughly 20 of our counties and now are faced with, at the local level, the challenges that local governments are going to have that haven't gotten out their '03 bills, but to get out their '04 bills. And that process is under way and is in parallel or somewhere in the process. And it has been, because of that, very difficult to gather the kind of information that we believe is very important in order to make informed decisions about what kinds of actions we might be able to take in the General Assembly in order to mitigate some of the taxes for those who have been particularly hard hit. We know, anecdotally, that in some communities there are some groups of taxpayers, particularly those that own homes in older neighborhoods, farmers across the state and seniors, who have been hard hit because of reassessment. Not to be confused with restructuring, but because of reassessment.

It is important to understand that the bills that people are receiving today and have received for the '03 property taxes, would have been 40% higher but for the bipartisan actions of the Indiana General Assembly back in 2002. So as we look at how we might be able to provide some relief, I think that it's important that it targeted, that it focus on those who have been hardest hit. And again, we believe, at this point, that we will find that it is in those categories that I mentioned earlier where that, in fact, has happened.

There will be a great deal of discussion about this in the General Assembly. And there are a number of things that are out there. And I think that one of the mechanisms that is worth taking a hard look at is giving local communities the opportunity to be able to enact additional revenue in order to be able to deal with the increases in property taxes. That does a couple of things. One, it leaves that decision to the local community where, as I said, everything is different depending on exactly where you are, and they are in a much stronger position to understand intimately the kinds of challenges that are faced there and what action might be appropriate in

terms of additional property tax relief. And secondly, to not have us, at the state level, enacting policies that would be statewide absent our being able to arrive at some conclusions in the interim, not putting in place things that might fix the problem in one part of one community, but it will exacerbate the problems in another part of another community. So the discussions that will go on I think here over the course of the next two months will be very, very important as we go forward. And as we look ahead, recognize that there are going to be continuing challenges that not only property tax payers are having, but also that some local governments are having really as a result of the reassessment process.

So, with all of that good news, where do we go from here? I think the answer is, we continue to make the kinds of decisions that are necessary for us to be able to provide the services that we do in our business, the business of the state of Indiana, which has 76 different companies within that broader holding company, to our 6.2 million customers. How do we make sure that they're getting the services that they deserve and understand that we are providing them as effectively and as efficiently as we can? And so we look at it as any business would, we have to be thinking in the near term and we have to be looking down the road, looking into the future and making decisions that will affect us in the long term. Not easy stuff, but I think we have lessons that we have learned from tax restructuring in 2002. A very complex issue, but Republicans and Democrats came together and did some things on the business side that we've been talking about doing forever; the elimination of the inventory tax and the gross receipts tax, an increase in research and development tax credit in order to make Indiana a more attractive place for business and therefore, give our company the opportunity to be able to keep jobs here and bring new jobs to the state.

In 2003, earlier last year, Energize Indiana, again, during these very, very difficult financial times, the General Assembly made the decision in a bipartisan fashion that we were going to invest more money in K-12 and higher education and we were going to make unprecedented investments in economic development activities, activities that will help us to create more jobs. No other state in America did either one of those things. Difficult decisions fought through by all of the different partners, and in the end, we made those decisions that were going to continue to keep the state of Indiana moving forward, that we were not going to hunker down and create a bunker mentality, but instead that we were going to go on offense.

So, as we make decisions, near and long term, there are a couple of things that will happen. One, we will continue to make cuts in state government operations. Departments, over the course of the last three years, have been asked to do with less and less in the way of resources and unfortunately, that will continue. But at the same time that we are looking for places just to cut, I have asked the Lieutenant Governor, who brings very strong credentials from both the private and public sectors, to take a look at how we can make Indiana government more effective and more efficient, how we might redesign Indiana government. Recognizing that things have changed over the course of the years and that while we have continued to do business in much the same way as we always have, there's an opportunity for us to look for ways to provide better service and to provide it more efficiently, thereby providing us with additional resources to be able to perform our core mission of service to the people of Indiana.

Tax fairness is an issue that I think we have to look at. I'm not talking about instituting new taxes, but instead, as we look at those taxes that are on the books and the intent of those taxes, as we are struggling to make sure that the system is fair and that everyone is participating to a fair degree. And I would just make mention of one thing, Senator Kenley, good to see you. Luke told me that he had to leave early, so I take no offense.

But one issue that you might not be aware of is that in 1963, when Indiana adopted the sales tax, a part of that sales tax legislation called for citizens to pay taxes on those things that they ordered out of catalogs or purchased from out of state. Now today on line 17 of your IT 40, there is a line that says "here is how much I purchased outside of the state." That would include things that you bought over the internet; it would include things you bought in a catalog; it would include things that you may have bought and didn't pay taxes on in the community where you were. And you're supposed to fill that in and pay a corresponding amount of tax. Now I'm not going to ask everyone in this room who paid that tax or didn't pay that tax last year to raise your hands, but I will tell you that of the three million tax returns that were filed in the state, 25,000 people filled out that line on their tax returns and we've been working with the Federal government for a number of years on that. Senator Borst on the Senate side has taken a real leadership role. But this is, at the end of the day, really an issue of fairness. And certainly, it's a law that's been on the books now for 40 years that you should pay a tax on those things that you've gotten where you didn't pay a tax on them, but it also is important to our merchants and businesses here in the state of Indiana that in not paying that tax and providing that additional advantage to those that would sell products into the state from outside. We put Indiana businesses and therefore Indiana jobs, at risk when we provide by our inaction that disadvantage to Indiana companies. So, I would just ask you to take a look at it. It's line 17. I would appreciate your full participation in filling out that form. *[laughter]*

I believe that the governor of the state of Indiana should have a line item veto. I know that there are some members of the General Assembly that don't think that that's a good idea, but 43 governors across America have that authority. I think that it's important that the Executive branch, that the Chief Executive, have the ability to be able to make decisions about different line items in the budget at a time when you're looking at the entire budget and to be able to make those decisions about spending that might be unaffordable, that might be unwarranted. I think it's an important tool for governors to have.

We believe that we ought to take a look, and Mark Moore, the Director of Public Finance, is on his way across the street to testify, but we believe we ought to take a serious look at the securitization of the proceeds that we receive from the tobacco settlement. This is not a new discussion. It is one that we've had before, but I think recognizing that the General Assembly will only be here for, hopefully, another two months or so, that market conditions continue to change. And we would ask the General Assembly to give the state the authority to be able to move forward on securitization. Then if warranted, work hand in hand with members of both parties in both houses to not do anything that they would not want us to do. But at the same time, give us the authority to be able to move forward and get ultimately, if conditions are warranted, the ability to be able to securitize tobacco funds. I don't think that that money should be touched or looked at in terms of an appropriation, until next year's session, until the 2005 session. It will take us, even if we were to start tomorrow, a long time for that to be able to be

accomplished. And we're not planning on starting tomorrow. I don't know what the market conditions might be, but I believe that it's important for us to look at, not just in terms of providing additional revenue for the state for some of the challenges that we face, but also to continue our commitment to health care and the sorts of programs that are in place as a result of additional revenue that we have.

I think that for free, we ought to do something that would be good for job creation in the state of Indiana. And that is support daylight savings time. It is not something that requires anybody to throw a lot of money in the hat. It's not going to cost us anything. And the problem is not that we get confused. The problem is that people that we deal with in other states and all over the world get confused about what time it is in Indiana. I have one of those clocks at home. It's an Atomic clock, and it is something. It tells me what time it is. It tells me what date it is, what year it is. I know what the temperature is in my room. I know what the temperature is outside. I have a forecast of what the day is going to look like. But there are two times a year when my clock is stupid. And I have to change the Atomic clock that is controlled in Colorado. I have to change it to put it on the right time because it doesn't know. It does everything but the dishes, but it can't tell me what time it is in Indiana twice a year. It's a problem. *[applause]*

We will continue to work with Indiana companies to maximize the opportunities that they have to do business with state government through the Opportunity Indiana program. We announced just a week ago an Indiana at Work initiative to invest in such a way that it is for the benefit of Indiana workers as well as Indiana companies. Using work keys so that employers and employees are speaking in a common language so that they can understand from the employee's side what kinds of skills are required for the jobs that are available, and from the employer's side understand what types of skills a prospective employee brings to the table so they are all talking in the same language. And actually, it is very complimentary to the program that President Bush announced last night, Jobs for the 21<sup>st</sup> Century, where we are talking about exactly the same kinds of things: engaging our community colleges, those that provide training and making sure our workers have the kinds of skills that they need in order to be able to be successful.

We will maintain those decisions that we made through Tax Restructuring as well as through Energize Indiana. And very, very importantly, I think that it is incumbent upon us to continue to invest in our assets and particularly our most important asset, and that is our people. Indiana at Work does that by investing on the back end, if you will, in employees and their training as they are going through the workforce, and as they are preparing to enter the workforce.

But today, the most important investment that we can make is in our children and in their early learning. Now there are a couple of reasons why this is important and why it has to be a priority for our state. Number one, we know from all of the research that 90% of a child's brain is developed by the time they arrive at Kindergarten. What that means is that much of their potential has already been determined. Their capacity has already been determined. So it's important for us to try to intervene in those earlier years and to provide full day Kindergarten as another early learning initiative in order to maximize their opportunities to have their full potential by the time that they arrive at school. We know nationally, that 50% of our children across the country that go to Kindergarten are not prepared for Kindergarten. They're not ready to be entering Kindergarten. We know that if we have, as an example, 84,000 children that are

born in the state of Indiana, which is about the number in that birth cohort over the course of a year, that roughly 53% of those children, their families, will be eligible for WIC programs (Women, Infant, Children programs). And what that means is that 53% of our kids are born into families, for example, a family of three that is making \$28,231 a year or less; 53% of our kids. And what that tells us is that those are kids that are going to have a more difficult time being prepared, for a thousand different reasons, for Kindergarten. And it's important for us to intercede, work with parents, to work with their teachers, to work with their communities in order to better prepare them. We know that if you grow up and your family income is in the lower quartile of earnings in the state of Indiana, and that if you compare that to the opportunities for a child that's born into a family whose family income is in the upper quartile, you have 10% of the chance that that youngster who is born into the upper quartile family has of getting a college degree. Ten percent, the odds are stacked against you ten to one.

So, what does that mean? It means that when we have these kids that are entering the pipeline, we understand what their risks are. We've been able to quantify them. And we understand how to deal with them, that we have to do something about it. And I would just give you one more number that, for those that would say, "well God, you're talking about young kids, you're talking about full day Kindergarten," it's going to take a long time for that program to be able to have impact across Indiana. It will take a long time and that's why we should start today instead of tomorrow. But what is another sobering number is that in year 2010, there will be as little as 5, a little less than five workers for every retiree in America. In 2040, there will be less than three workers for every retiree in America. So, if we want to have our workforce in 2010, 2030, 2040, that is going to be capable of supporting themselves and their families and the kinds of community obligations that they're going to have, if we're going to have people over the course of that period of time that are going to be able to compete in an economy that is becoming more and more competitive every day, that requires more and more education every day. We've got to get engaged now and not wait until tomorrow. We have a way to be able to pay for this program. It provides us the ability to be able to put 20,000 more children in full day Kindergarten this fall and do so for each of the next three years, to begin pilot programs for early learning, pre-Kindergarten; curriculum based programs next year and the year after. And by 2007, to make full day Kindergarten available for all of the roughly 80,000 children that will be in the pipeline at that time. This will mean that we will be able to intercede and have a very positive effect on ½ million Indiana children over the course of the next ten years. If we don't, we squander their potential and we make a terrible mistake for these children and for our future. We have a way to pay for it that is responsible. It takes lottery and gaming revenue. Yes, some lottery and gaming revenue that for the first three years otherwise would be dedicated to the Pension Stabilization Fund for our teachers. But, when you talk about making an investment like this and the fact that the Pension Stabilization Fund, has actually got assets in it now that meet the obligations that we originally intended when the legislation was passed, that we cannot afford not to make this investment.

The fact that we're going to go in and tap the Common School Fund. You may not know what that is. It was invented in 1851 and served a great purpose so that school corporations across Indiana, particularly in small towns, could build buildings. They had no other way to do that. Today, it has a ½ billion dollars in assets. Our school corporations no longer need access to that capital. The conventional market place provides them with the opportunity to be able to get low

cost capital. Our schools, our state, is highly rated, so they have the ability to be able to do this in other ways. And we can take that ½ billion and provide full day Kindergarten, provide early learning, pre-Kindergarten opportunities for our children. And if we don't, I believe that we pass up an extraordinary opportunity, because concern has been "Well, gee, it's a tough time." There will be another reason next year why we can't do this. And if we don't take the first step this year, one, we're abandoning 20,000 kids that would otherwise be in full day Kindergarten this fall, and two, if we don't begin the Constitutional process, which is required to get into the Common School Fund, a fund that has outlived its purpose, then we are delaying the ability to be able to get into that fund at least until 2009 as opposed to 2007. So what we do here in the next two months will have to do with when we can begin full day Kindergarten as well as early learning opportunities for our children.

There is no more important investment that we can make in our future, in our children, in our ability to be able to create jobs today and tomorrow here in the state of Indiana. I thank you very much for the opportunity to be with you today. I want to say particularly a thank you to the members of the Indiana Fiscal Policy Institute for all of your good work, for your support of the mission of the Institute. It has been extraordinarily important in the state of Indiana as we have looked at issues not unlike those that we are talking about today and provide that independent, objective perspective that we get from the good work that has been done over the years. With that, I'd be glad to answer any questions that anyone might have.