

THE THOMAS JEFFERSON
INSTITUTE FOR PUBLIC POLICY

Th Jefferson

Virginia Spending and Budget Reform

By: Geoffrey Segal
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Thomas Jefferson Institute for Public Policy

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The work of the Thomas Jefferson Institute for Public Policy is geared toward educating our political, business and community leadership about the issues facing our society here in Virginia. The Institute offers creative solutions to these problems in a non-partisan manner.

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This study, “*Virginia Spending and Budget Reform*,” is published by the Thomas Jefferson Institute for Public Policy. This paper does not necessarily reflect the views of the Thomas Jefferson Institute or its Board of Directors. Nothing in this study should be construed as an attempt to hinder or aid any legislation.

Introduction

The Thomas Jefferson Institute for Public Policy has, since its first study was released in 1997, focused much of its attention on making state government more efficient, more accountable, more transparent and more business-like in the way it manages programs and activities.

These past studies have brought important concepts and specific suggestions to the table for public debate and discussion. Over that period of time, the Jefferson Institute has become a well-respected addition to the public policy debate here in Virginia without a partisan ax to grind.

This new study, “Virginia Spending and Budget Reform,” is written by Geoffrey Segal, Senior Fellow on Government Reform for the Thomas Jefferson Institute. Mr. Segal is a well-respected and nationally recognized leader in the field of government reform.

Mr. Segal’s most recent study clearly shows how quickly Virginia’s state budget has grown over the past ten years and outlines several ideas for legislative and executive action that can be taken to better manage this spending. Without the management tools and actions outlined by Mr. Segal in this study, Virginia will face the need for another tax increase in only a few short years.

This study is an important addition to the management tools necessary for those who want to truly “get a handle” on state spending and do it in a way that is logical and reasonable. Mr. Segal outlines important pieces for a road map to be followed by our elected leaders and supported by business leaders who want to help craft a better running state government.

This study is presented in an effort to bring good, solid and reasonable ideas to the table of public discussion. The views presented here are those of the author and do not necessarily reflect the opinions of the Thomas Jefferson Institute or its Board of Directors. Nothing in this report is meant to influence pending legislation.

Michael W. Thompson
Chairman and President
Thomas Jefferson Institute for Public Policy
February 2005

Virginia Spending and Budget Reform

By: Geoffrey F. Segal

While transportation and budget surplus issues dominate this legislative session, how to pay for infrastructure improvements, specific budget amendments and education issues are also being hotly debated. The landscape is much different this year from last year. The talk of deficits is gone, rather we've had a surplus for two consecutive years (one before the new taxes took effect and one after) supporting some legislators' beliefs that we would grow out of the deficit. The surplus at the end of the last budget this past June 30th and the projected surplus at the end of the current budget is at least \$1.2 billion.

The real problem facing our state is the average annual growth in spending of 8.12 percent between 1997 and 2006. If this continues we will face another tax battle in a few years and it will make last year's "mud fight" look tame in comparison.

Since the 1996-98 biennium budget cycle (former Gov. George Allen's first budget) the Commonwealth's budget has seen a dramatic increase. In just 10 years, the two-year budget has grown from \$34,751,813,652 to \$62,724,671,691 – an 80.5 percent increase (see Table 1). The budget has grown an average of 16 percent each biennium over this time. At this rate the biennium budget will reach more than \$110 billion in 2012-1014.

| Table 1 | | | | |
|-----------|----------------|---------------------|----------------|--------------|
| Biennium | | Percentage Increase | Average Growth | Total Growth |
| 1996-98 | 34,751,813,652 | | | |
| 1998-2000 | 41,331,050,188 | 18.93207 | | |
| 2000-02 | 46,805,961,842 | 13.24649 | | |
| 2002-04 | 51,362,282,966 | 9.734489 | | |
| 2004-06 | 62,724,671,691 | 22.12205 | | |
| | | | 16.00877 | 80.49323 |

Growth has been most dramatic in the non-general fund with increases of more than 112 percent between 1997 and 2006 (see Table 2). However, general fund spending has increased at an alarming rate as well, topping off at just over 85 percent. When the budget is looked at from an annual perspective, the growth is more dramatic -- nearly doubling!

| Table 2 | | | | |
|---------|----------------|------------------|----------------|---------------------|
| | General Fund | Non General Fund | Total | Percentage Increase |
| 1997 | 8,134,360,672 | 8,996,749,839 | 17,131,110,511 | |
| 1998 | 8,715,476,981 | 8,905,226,160 | 17,620,703,141 | 2.85 |
| 1999 | 9,967,431,115 | 9,994,651,817 | 19,962,082,932 | 13.29 |
| 2000 | 11,093,396,991 | 10,275,570,265 | 21,368,967,256 | 7.05 |
| 2001 | 12,283,610,813 | 11,039,138,204 | 23,322,749,017 | 9.14 |
| 2002 | 12,013,820,347 | 11,469,392,478 | 23,483,212,825 | 0.69 |
| 2003 | 12,105,186,620 | 12,877,724,256 | 24,982,910,876 | 6.39 |
| 2004 | 12,370,158,175 | 14,009,213,915 | 26,379,372,090 | 5.59 |
| 2005 | 13,379,200,378 | 15,138,603,338 | 28,517,803,716 | 8.11 |
| 2006 | 15,105,092,583 | 19,101,775,392 | 34,206,867,975 | 19.95 |

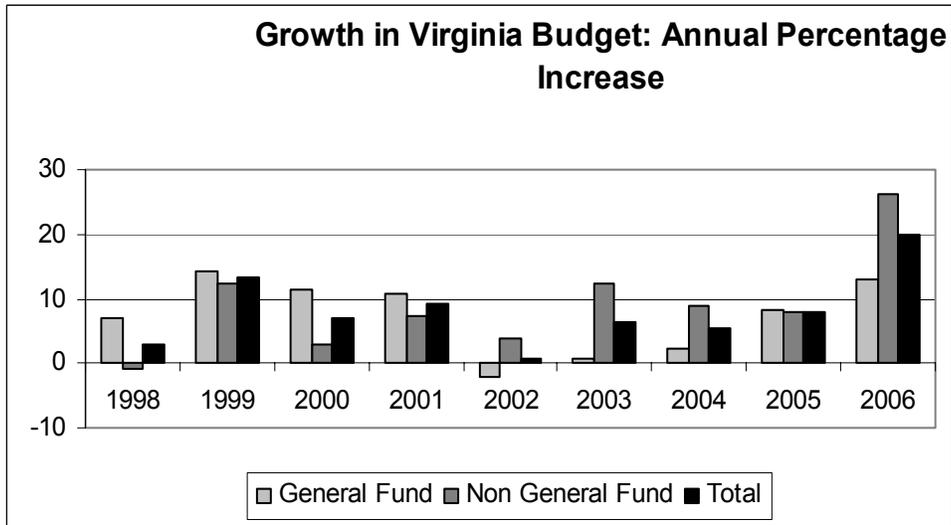
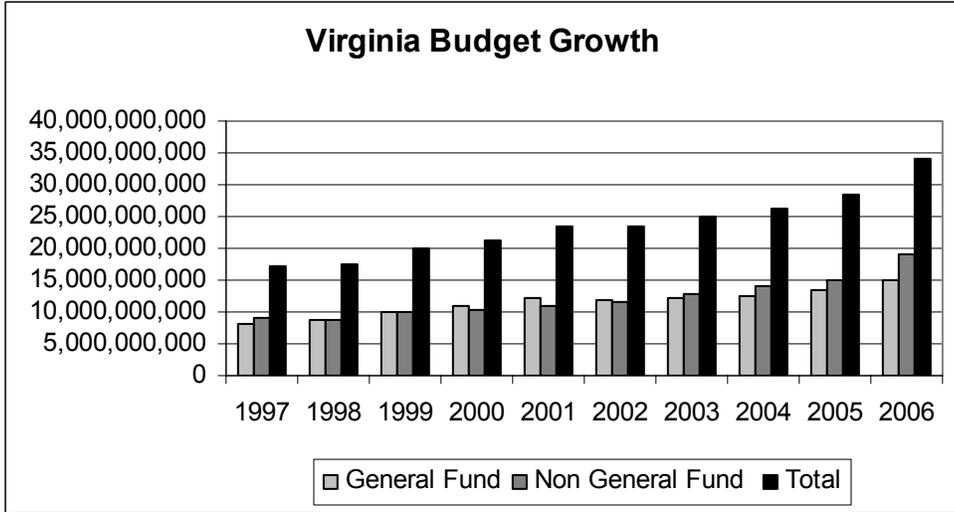
When the budget is reviewed on an annual basis rather than bi-annually, our state budget has actually doubled in ten years—from \$17.1 billion in 1997 to \$34.2 billion in 2006.¹

The Commonwealth enjoyed a surplus at the end of the last fiscal year – June 30, 2004 -- of \$324 million.² While a portion of the surplus was, by law, channeled into the Rainy Day Fund, most of it was quickly gobbled up by additional state spending. Once again, the Commonwealth is faced with a surplus—\$918 million and growing—and additional spending will likely swallow the projected surplus whole.

To put it simply, this kind of spending is not sustainable. Spending must be more carefully analyzed and controlled. If not, more and larger tax increases will be needed to continue to “feed the beast” of state government.

¹ As proposed by Gov. Warner

² The real surplus remains to be debated as discussed by Steve Haner, Vice President, Virginia Chamber of Commerce, in “Reality Check” *Bacon’s Rebellion*, September 7, 2004. Available at: <http://www.baconsrebellion.com/Issues04/09-07/Haner.htm>. Haner points out that there was an “unreserved balance” of \$677 million at the end of the fiscal year and that’s after an unscheduled transfer of \$87 million to the rainy day fund—without that the surplus would have been \$764 million.



One bright note has been the relatively slow growth of the number of government employees at the state level. While the bi-annual budget increased by nearly 81 percent (see Table 1), the number of state government employees grew by only 6.9 percent.

| Position Levels | |
|-----------------|------------|
| 1997 | 104,925.13 |
| 1998 | 107,106.48 |
| 1999 | 110,199.50 |
| 2000 | 111,215.63 |
| 2001 | 112,685.03 |
| 2002 | 109,513.89 |
| 2003 | 109,670.10 |
| 2004 | 109,495.92 |
| 2005 | 111,819.61 |
| 2006 | 112,151.46 |

Government should not and cannot, over an extended period of time, increase faster than the economic growth of families and the communities that support it. Savings need to be found in some areas and spending must be restrained in others. The Commonwealth's government has grown into a Leviathan and has become a vastly different government from Jefferson's and Madison's vision.

When it comes to how government operates and what government actually does there are two major issues. We all should agree on the first:

If a government decides to provide a service or spend taxpayer dollars it should be done in the most effective and efficient manner possible. The process (i.e., who, how, where) should not matter as long as results are demonstrated and performance is achieved.

The second major issue will be more contentious and political in nature:

Determining the proper role and function of government.

The following three sections of this report are tested and proven techniques for making government work smarter, better, more effectively and more efficiently. Each section includes a brief description, rationale, and examples of where it has worked. In addition, Virginia's experience and opportunities are listed. The reform options are targets and meant only as a guide and certainly do not represent the entire universe of what can, and perhaps should, be done in each of these categories.

The final section represents an attempt to paint a picture of what the Commonwealth might consider in order for the state government to move toward Jefferson's vision. Again, as in the other sections, what is suggested here does not entail a complete list of options and each needs to be carefully considered with an eye on the proper role of government and how to ensure that the taxpayers' dollars are used most efficiently.

Make Virginia Government Compete

WHAT: The Commonwealth spends billions of dollars in each bi-annual budget carrying out work that is produced in the private sector. Competition in services involves the examination of an activity of an agency to determine whether it should continue to be carried out within the agency or should be purchased from an outside entity. Put simply, “should the agency ‘make’ or should it ‘purchase’ this activity?”

Government reform experts David Osborne and Peter Hutchinson said in their recent book, *The Price of Government*, “the fastest way to save money and increase value is to force public institutions to compete.”

The Commonwealth should aggressively identify activities and functions currently provided by state employees that could be provided under contractual arrangement with private enterprises and hold a competition to determine who should provide the service or activity.

See: The Jefferson Journal: *Making Government Compete*
(http://www.thomasjeffersoninst.org/main/news.php?subcategory_id=22)

WHY: Governments seek competition for various reasons including (but not limited to) cost savings, enhanced quality, timeliness of delivery, and gaining access to innovation. Generally speaking, cost savings dominate the debate, and the focus of this paper will remain there. Typical savings range between 15 and 30 percent.³

WHERE:

- Since 1999 the state of Florida has initiated over 138 competition initiatives for various state services including human resources, highway maintenance, computer help desk, administering Medicaid billing, and food service at state prisons. The state has saved hundreds of millions of dollars with these and other initiatives and has helped the state avoid deficits and return over \$8 billion of taxes to citizens in the same time frame.
- The Federal government has initiated one of the largest efforts to bring competition to government in recent years. Just last year over \$1.2 billion was

³ Over 100 studies of cost savings from privatization are reviewed in John Hilke, *Cost Savings from Privatization: A Compilation of Study Findings*, Reason Foundation How-to Guide No.6, (Los Angeles: Reason Foundation, 1993), <http://www.rppi.org/htg06.pdf>. For an overview of research on cost savings in federal privatization, see General Accounting Office, *DOD Competitive Sourcing: Savings Are Occurring, but Actions Are Needed to Improve Accuracy of Savings Estimates*, Washington, D.C.: GAO/NSIAD-00-107, Aug. 8, 2000; General Accounting Office *DOD Competitive Sourcing: Some Progress but Continuing Challenges Remain in Meeting Program Goals*, Washington, D.C.: GAO/NSIAD-00-106, Aug. 8, 2000; and Center for Naval Analysis, “Long-run Costs and Performance Effects of Competitive Sourcing,” Washington, D.C., 2001 <http://www.cna.org/research/studies/comsourc.html>

saved — a savings of over \$12,000 per position studied—regardless of who won the competition (i.e. whether the service remained in-house or was contracted out). While there are some costs associated with managing and implementing public-private competitions, the federal government saved \$12 for every \$1 it spent—a 10 to 1 return on investment.

- Some of the most robust uses of competition exist in local governments. Water and wastewater services are one of the more common competed and contracted out in the country. A 1999 report examined systems in 29 cities serving over 3 million customers throughout the US. The study found that contracting out (via a competition) improved compliance with environmental standards.⁴ Prior to entering into a public-private partnership, 41 percent (12) of the facilities were not in full compliance with the federal Safe Drinking Water Act. One year after, all were in compliance with federal water standards. In addition, cost savings between 10 and 40 percent were achieved.

FOUNDATION FOR IMPROVEMENT: Virginia government has a long history with competition. There was a time when the Commonwealth was considered ahead of the curve. However, the Commonwealth has slipped from the perch as other states have not only caught up but have surpassed us in many ways.

With that said, there is a good foundation and some promising initiatives already in the pipeline. In 1995, Virginia created the Commonwealth Competition Council (CCC) to “examine and promote methods of providing a portion or all of select government-provided or government-produced programs and services through the private sector by a competitive contracting program.” In 1999, the CCC conducted a survey of state activities. Modeled after the federal government’s FAIR ACT, the survey wanted to separate “inherently governmental” jobs from “commercial activities” or jobs only government can do versus jobs that can be purchased from the private sector. The survey identified over 37,555 positions that were commercial in nature. A new survey will be completed no later than January 1, 2006.

If all of these jobs were competed with the private sector, if each job cost the state \$50,000 in salary and benefits, and if the state realized a savings of 15 to 30 percent, then the state would save between \$281 and \$563 million each year or \$562 million to \$1.1 billion in each two-year budget.

To further encourage competitive government and public-private partnerships, the General Assembly passed the Public-Private Transportation Act of 1995 (PPTA) and in 2002, the Public-Private Education Facilities and Infrastructure Act (PPEA).

In the last session of the General Assembly, there were several competition-focused bills that were successfully passed and signed into law. Perhaps the most notable was HB 1043, the Competitive Government Act, introduced by Del. Christopher B. Saxman

⁴ National Association of Water Companies (NAWC), *A Survey of the Use of Public-Private Partnerships in the Drinking Water Utility Sector* (Washington, D.C.: NAWC, 1999).

(Staunton) that requires every state agency to analyze its workforce and identify competition opportunities. It was designed as a follow-up/update to the original inventory that the Commonwealth Compensation Council took in order to re-evaluate and find new opportunities for competition. The process should be similar to the rules and guidelines of the federal competitive sourcing plan and procedure.

ACTION NEEDED:

- The Commonwealth currently contracts for maintenance on a 251-mile stretch of highway. There have been significant cost savings in addition to quality improvements. Additional contracting/competition opportunities should be identified within the Commonwealth's vast highway network.
- There is one privately operated prison in the Commonwealth. Additional contracting opportunities for both adult and juvenile facilities should be identified; including facility operations, food service, and medical services.
- Commercial and auxiliary services at state colleges and universities including food service, residential/student housing, parking, transportation, and bookstores.
- Enterprise-wide (statewide) competitions for commercial services such as facilities, the vehicle fleet, and ground maintenance should be sought out.
- Maintenance and reservations at state parks could be contracted out.
- Identify and execute additional competition opportunities from the commercial activity inventory.

Make Virginia Government More Responsive

WHAT: Consolidate and reorganize agencies to flatten the state bureaucratic organization across mission and purpose. Remove duplicative and overlapping programs.

Over time a myriad of boards and commissions have been created to address specific needs, but they rarely, if ever, have been evaluated to ensure that a need for them still exists or that similar services are not provided by other agencies. “Advisory” boards and commissions can, and perhaps should, be eliminated and “policy-making” boards can be folded into existing agencies or departments.

WHY:

- Cost savings from removing duplication, overlapping programs, and redundancy. Savings can be tremendous, and could generate at least 10-12 percent savings with the reduction of overhead.
- Achieve greater agency focus on outcomes within mission areas.
- Simpler more responsive mission and goal centered organization.

WHERE:

- The California Performance Review (ordered by Gov. Arnold Schwarzenegger) recently announced a reorganization plan that would consolidate the state's existing 11 agencies and 79 departments into 11 new "super departments" with aligned functions and consolidated administrative support services. More than 100 independent boards and commissions are also proposed for elimination. It is projected that the implementation of the recommendations would result in savings of as much as \$32 billion over five years.

FOUNDATION FOR IMPROVEMENT: Governor Mark Warner commissioned the “Governor’s Commission on Efficiency and Effectiveness” to develop recommendations that would enable the Commonwealth to serve its citizens more effectively and to manage its resources more efficiently. Former Governor and current Richmond Mayor Douglas Wilder chaired the Commission. Among the many recommendations were proposals to streamline and/or consolidate approximately 15 percent of existing state agencies and departments. The commission estimated that savings could be upwards of \$500 million.⁵ In addition, savings would continue over time as these costs continue to be avoided year after year.

⁵ Note: this figure includes the privatization of ABC which is discussed at a later point in this paper.

ACTION NEEDED:

- Consolidate Secretary of the Commonwealth and Secretary of Administration
- Merge Dept of Fire Programs into the Dept of Emergency Management
- Consolidate Dept for the Blind and Vision Impaired, Board for People with Disabilities, and the Dept for Deaf and Hard of Hearing
- Merge Dept of Charitable Gaming into the Dept of Lottery
- Merge Dept of Minority Business Enterprise into the Dept of Business Assistance
- Merge Human Rights Council into the Attorney General's Office
- Merge Marine Resources Commission into the Dept of Game and Inland Fisheries
- Consolidate regulatory functions of Virginia State Bar and Board of Bar Examiners

Make Virginia Government Results Oriented

WHAT: The Commonwealth budgets and appropriates money based on an incremental system in which budget requests are made as adjustments to the previous year's level of spending. Oftentimes, there is little justification provided for increases. Performance and success (or non-performance and failures) certainly are not communicated to the taxpayers in the budget document. In short, appropriations are not directly tied to results, making progress toward goals, or performance in general.

The Commonwealth should shift towards full performance budgeting to focus less on the intentions of programs and more on the results of programs. Instead of automatically granting programs increases on their base budgets, performance budgeting would examine a program using relevance, performance, and management efficiency.

Last year, the Thomas Jefferson Institute published a guide to developing a more citizen friendly budget that is transparent, and performance based.

http://www.thomasjeffersoninst.org/pdf/articles/Citizen_Friendly_Budget.pdf

See: The Jefferson Journal: *Why Results Matter*

(http://www.thomasjeffersoninst.org/pdf/articles/Segal_Why_Results_Matter.doc)

See: The Jefferson Journal: *Government Reform Starts By Taking PART*

(http://www.thomasjeffersoninst.org/pdf/articles/Segal_Taking_PART.doc)

WHY:

- Agencies should show how each activity is directly related to achieving its core mission, goals, and the Commonwealth's priorities.
- Focus less on the intentions of programs and more on the results.
- Protect and fully fund performing and effective programs while reducing or eliminating funding to ineffective or poor performing programs.

WHERE:

- The state of Texas has utilized a performance review system for years, results include: abolishing 44 agencies, consolidating another 11, and saving over \$2.4 billion initially.
- The Bush administration instituted the Performance Assessment Reform Tool to measure programs effectiveness and determine appropriate funding changes—in effect it is true budget and performance integration. In the FY05 budget, “effective” programs enjoyed an average increase of 7.18 percent to their budgets, while “ineffective” programs were cut by a dramatic average of 37.68 percent. In addition, 13 federal programs were eliminated, saving over \$1 billion.

FOUNDATION FOR IMPROVEMENT:

- Last year Senator Jay O'Brien introduced an important bill that became law – SB304 implemented performance-based budgeting for drug and alcohol treatment as well as job training programs — essentially requiring agencies to fund only those programs that can demonstrate results and stop funding those that don't or can't.
- The Roadmap for Virginia's Future, an effort by the state government and key business leaders to get a better grasp of how state functions really work and how it can be made better, holds promise. However, its effectiveness for change has yet to be determined.
- Executive Order 67,⁶ which mirrored unsuccessful legislation (HB973) to bring real budget reform to Virginia offered by Del. Gary Reese (Fairfax County) in the 2004 General Assembly session. This holds much promise to bring real budget and spending reform to the Commonwealth. However, this executive order has yet to be "activated" and it was signed last spring.

ACTION NEEDED:

- Implement Executive Order 67 or pass new legislation that creates a performance and outcome based budgeting process and document.
- True budget and performance integration is needed so that the Commonwealth would only fund programs that can demonstrate positive results and benefits to the taxpayer. Programs that cannot do so should be eliminated.
- Initiate a performance review for all state programs that evaluates performance, relevance, and efficiency. The review should include, but not be limited to, making recommendations for elimination or alternative delivery systems.

⁶ See: http://www.governor.virginia.gov/Press_Policy/Executive_Orders/html/EO_67.html

Getting Virginia Back to Jefferson's Vision

WHAT: It is often noted that it is easier to add programs and layers to government than it is to remove them. Over the years, government has expanded significantly and moved into areas of service that are not core or central to government's purpose—at least as designed by one of Virginia's founding fathers, and the namesake of this Institute. Thomas Jefferson's vision is well documented, these three statements best spell out his thoughts on the role and growth of government.

"I am for a government rigorously frugal and simple."

"Government big enough to supply everything you need is big enough to take everything you have The course of history shows that as a government grows, liberty decreases."

"I think we have more machinery of government than is necessary, too many parasites living on the labor of the industrious."

WHY:

- Government grows and if left unchecked will (and has) extended its reach into areas and programs where it should not be.
- The Commonwealth should strive for low taxes and fewer regulations to spur economic growth, vitality, and a pursuit of happiness that our founding fathers envisioned.

ACTION NEEDED:

- Surplus land and assets – Virginia has often overlooked public-use infrastructure assets that—when sold or leased through a public-private partnership—could yield hundreds of millions in revenue. This can all be achieved in a manner that preserves or improves services and ensures the assets continue to serve the the community.⁷

States such as Florida, Massachusetts, Maryland, Texas, and even California have used, or are using, asset divestiture and enhanced-use leasing to gain or save money. For instance, in 2001 California sold surplus state real estate in Silicon Valley for \$149 million.

Benefits include getting assets off the states books, receiving one-time cash payouts, and additional revenue kicks in after assets are sold and they enter the property tax rolls.

⁷ Henry Gibbon, *A Guide for Divesting Government-owned Enterprises*, Reason Foundation How-to Guide No. 15, (Los Angeles: Reason Foundation, 1996), <http://www.rppi.org/htg15.pdf>.

For example, the Commonwealth could consolidate existing mental hospitals and divest the land. In recent years patient populations have declined markedly. Yet, all 10 state hospitals remain open. Lawmakers reflexively resist seeing any facility in their districts closed, but there appears to be no reason some of the hospitals could not consolidate and pool resources.

Money raised from asset divestiture can be used to supplement any service—or act as an influx of cash to reduce maintenance backlogs or introduce new capital for transportation projects.⁸

- Alcohol Beverage Control (ABC) Stores - Virginia is one of only 18 states that have the exclusive rights to sell liquor within their borders where the state owns and operates ABC retail stores. Additionally, Virginia is one of only five states that operates the wholesale market as well. Mississippi, Michigan, Iowa, and West Virginia have recently converted to private and semi-private retail stores. Several states have always had private retail stores. The Alabama Court of Civil Appeals ruled that the state's public retail outlets violated the Alabama Constitution by competing against private retail outlets.⁹

Opponents of privatization note that ABC makes a profit, so why sell it? Beyond the philosophical grounds that government simply should not be in a retail business, much of ABC's profit comes from licensing and fines which will not go away—ABC will continue to fine violators and issue licenses. If anything, revenue may be enhanced through additional licensing. Additionally, other revenue streams could be offset by lower costs of operation and increased activity and tax revenues collected from the privatized businesses.

If the ABC stores can become more like the old savings and loan industry, citizens might be served better and the state might find additional income. The current controls can remain in place; the ABC commission would remain the regulatory body and current enforcement would remain in place.

- Eliminate the Commonwealth's function as a power plant operator.
- Eliminate the Commission on the Arts – this is not a core function of government, and the private sector can support this activity.
- Eliminate financial assistance for cultural and artistic affairs – this is not a core function of government.
- Eliminate all marketing, research, and product promotion programs that benefit one industry (e.g. Virginia Tourist Authority; Agriculture and Seafood Product Promotion; Virginia Racing Commission; Industrial Development Services; Innovative Technology Authority). At best these are not core functions of government. In many ways they represent corporate welfare. These industries should fund their own promotional activities.

⁸ Steve A. Steckler, John E. Joyner, And Brian F. Wolf, *Tapping Public Assets: Frequently Asked Questions About Selling Or Leasing Infrastructure Assets*, Reason Foundation Policy Study No. 303, (Los Angeles: Reason Foundation, 2003), <http://www.rppi.org/ps303.pdf>.

⁹ Birmingham Post Herald, June 28, 1994, pages A1, 6. Patrick Rupinski.

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Geoffrey F. Segal is a Senior Fellow for Government Reform at the Thomas Jefferson Institute. In addition, he is the director of privatization and government reform at Reason Foundation. His advice and counsel has been sought by Gov. Mark Sanford and Gov. Jeb Bush of Florida where he served as an advisor to the Governor's Center for Efficient Government. In addition, Segal has worked closely with legislators and staff in California, Virginia, New York, Indiana, Oregon, Maine, South Carolina, and Texas in efforts to improve the efficiency and effectiveness of government spending. He is a sought after speaker and has written dozens of articles for leading publications including *Investor's Business Daily*, *Atlanta Journal-Constitution*, *Indianapolis Star*, and *New York Sun*. Segal is also a contributing editor to *Budget & Tax News*.

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“... a wise and frugal government, which shall restrain men from injuring one another, shall leave them otherwise free to regulate their own pursuits of industry and improvement, and shall not take from the mouth of labor the bread it has earned. This is the sum of good government, and this is necessary to close the circle of our felicities.”

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