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## Analysis of Governor's FY 2014 Budget Proposal Declining Revenue Hurting State

*Sean O'Leary and Ted Boettner*

On February 13, 2014, Governor Tomblin released his FY 2014 budget, setting the state's priorities for the coming year. While West Virginia avoided the major budget problems that plagued many other states during the recession and its aftermath, recent events have finally caught up to the state's budget, and many programs and agencies will see large cuts in FY 2014. After avoiding budget cuts for several years, Governor Tomblin called on state agencies to cut spending by more than \$75 million in the FY 2014 base budget.

Governor Tomblin's state budget proposal totals \$11.28 billion, a \$202.2 million decrease from last year's enrolled budget. Appropriations from state resources total \$7.2 billion, down \$150.2 million from last year, while appropriations from federal resources total \$4.1 billion, a \$51.8 million decrease.

This brief provides an overview of base budget changes, as well as important budget trends and future budget challenges. It also highlights opportunities for creating a stronger and healthier budget that can provide the investments that will create prosperity.

### Key Findings

- The FY 2014 proposed base budget (general revenue and lottery) is approximately \$34.9 million or 0.8 percent less than the enrolled FY 2013 budget.
- Nearly half of the \$75 million in proposed budget cuts are derived from higher education, which could result in steeper increases in college tuition.
- West Virginia ranks high in education spending because it is a low-income state with large unfunded liabilities, expensive transportation needs, and aging schools.
- While base budget Medicaid spending increased by \$142 million in FY 2014, total state-source appropriations to Medicaid is \$57 million less than in FY 2013.
- The FY 2014 Six-Year Financial Plan shows smaller future budget gaps mostly because of spending reductions put into place in FY 2014.
- The only source of substantial revenue growth projected over the next five years is from personal income tax collections. Revenue from severance, B&O, tobacco, corporate net income/business franchise, and the lottery are projected to decline.
- West Virginia has the third-largest rainy day fund in the country at \$916 million.
- To ensure the budget's long-term health, lawmakers will need to raise revenue and control costs in Medicaid and the state's correction system.

## Overview of Base Budget Expenditures

The state's base budget refers to appropriations from the General Revenue, Lottery, and Excess Lottery Funds (**Table 1**). The base budget comprises about 40 percent of total appropriations. The proposed base budget for FY 2014 totals \$4.46 billion, a 0.8 percent decrease from FY 2013's enrolled budget.

Table 1  
**Base Budget Shrinks in FY 2014**

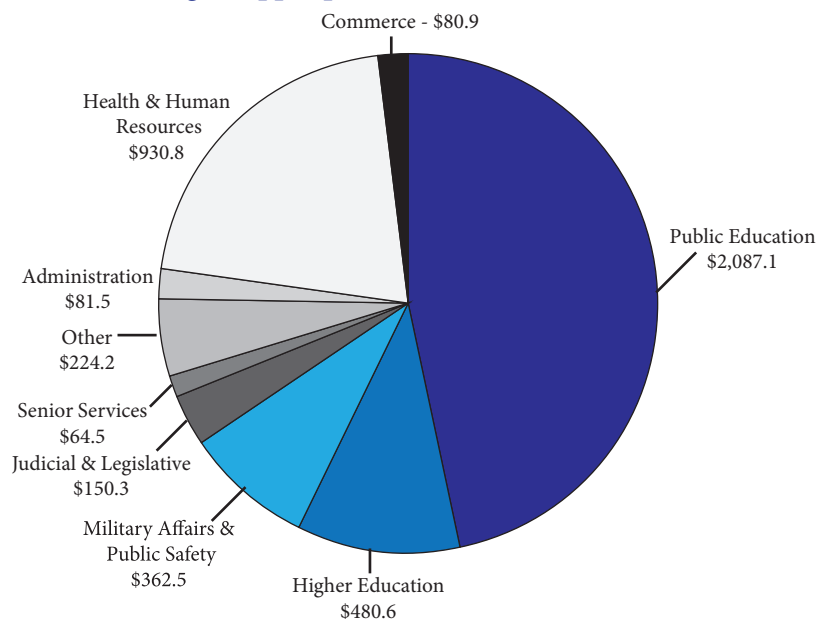
|                 | FY 2013 Enrolled | FY 2014 Proposed | Difference    | % Change |
|-----------------|------------------|------------------|---------------|----------|
| General Revenue | \$4,148,200,999  | \$4,140,751,000  | -\$7,449,999  | -0.2%    |
| Lottery         | \$145,025,203    | \$151,573,583    | \$6,548,380   | 4.5%     |
| Excess Lottery  | \$197,964,890    | \$163,922,000    | -\$34,042,890 | -17.2%   |
| Total           | \$4,491,191,092  | \$4,456,246,583  | -\$34,944,509 | -0.8%    |

Source: WVCBP analysis of West Virginia State Budget Office data. (Note: Totals do not double count Excess Lottery Transfer to General Revenue).

While appropriations from the Lottery Fund are up slightly, appropriations from the General Revenue Fund are down by a greater amount, and appropriations from the Excess Lottery Fund are down more than 17 percent.

As in past budgets, about half of base budget appropriations are dedicated to public education, with another one-fifth dedicated to Health and Human Services. Higher education is also a major part of the base budget, comprising over 10 percent of appropriations (**Figure 1**).

Figure 1  
**Base Budget Appropriations, FY 2014**



Source: WVCBP analysis of West Virginia State Budget Office data.

### *\$75 Million in Budget Cuts*

While some areas of the budget saw growth, overall the governor's proposed budget for FY 2014 was nearly \$35 million less than FY 2013's enrolled budget, due to the governor's call for state agencies to cut more than \$75 million in spending. The need for these cuts was driven by a combination of falling tax revenue and exhaustion of Medicaid funding sources outside of the base budget.

Multiple state agencies were asked to cut spending by 7.5 percent to keep the budget balanced. While some areas of the budget, like Medicaid and public education, were exempt from the cuts due to statutory and constitutional requirements, other areas saw millions in cuts. **Table 2** shows how the \$75.5 million in cuts was spread between 13 departments.

Table 2  
**Governor’s \$75 Million in Budget Cuts**

| Department                         | 7.5% Budget Cut (Thousands of \$) | Share of Budget Cut |
|------------------------------------|-----------------------------------|---------------------|
| Executive                          | \$2,775                           | 3.7%                |
| Administrative                     | \$1,719                           | 2.3%                |
| Commerce                           | \$4,955                           | 6.6%                |
| Public Education                   | \$7,123                           | 9.4%                |
| Education and the Arts             | \$2,981                           | 3.9%                |
| Environmental Protection           | \$626                             | 0.8%                |
| Health and Human Services          | \$10,921                          | 14.5%               |
| Military Affairs and Public Safety | \$4,683                           | 6.2%                |
| Revenue                            | \$2,247                           | 3.0%                |
| Transportation                     | \$536                             | 0.7%                |
| Veterans’ Assistance               | \$332                             | 0.4%                |
| Senior Services                    | \$1,792                           | 2.4%                |
| Higher Education                   | \$34,796                          | 46.1%               |
| <b>Total</b>                       | <b>\$75,486</b>                   | <b>100.0%</b>       |

Source: Governor’s FY 2014 Budget Presentation, WV Budget Office.

Nearly half of the \$75 million in cuts came from higher education. Many of the state’s universities and colleges saw cuts exceeding 7.5 percent, including a \$10.4 million cut from West Virginia University’s appropriation, and a \$4.9 million cut from Marshall University’s appropriation. The state’s technical and community colleges will also share millions in cuts.

Other programs affected by budget cuts this year include: Foreign Student Education, Regional Education Service Agencies, Vocational Programs, Domestic Violence Programs, Sexual Assault and Prevention, the Human Rights Commission, and Senior Citizen Centers and Programs (**See Appendix for full list of budget cuts**).

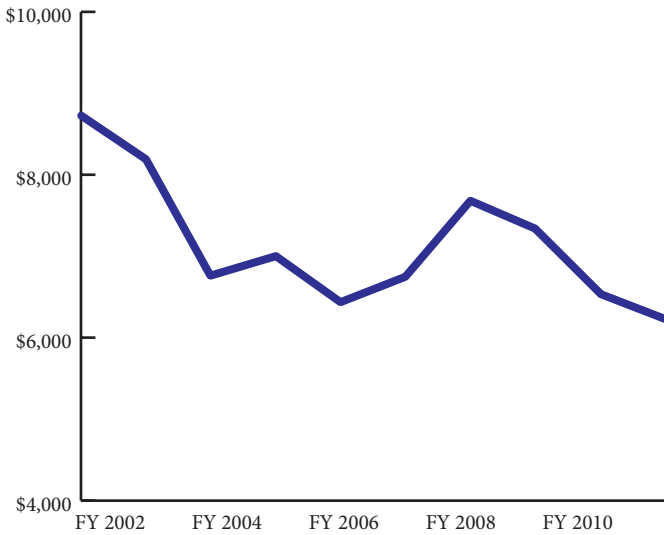
While most budget areas saw some cuts in the FY 2014 proposal, there were exceptions. Proposed spending on corrections topped \$180 million, a small increase over FY 2013, while the state police saw a \$10 million or 10 percent increase.

Another notable increase is an additional \$10.4 million in the Division of Human Services appropriation for Child Care Development. This appropriation offsets the loss of federal funding for subsidized child care for working families, and brings the state’s contribution up to \$11.2 million. This additional money will help keep child care affordable, keeping low-income working parents from having to choose between child care and their jobs. <sup>1</sup>

*Higher Education Support Dwindling*

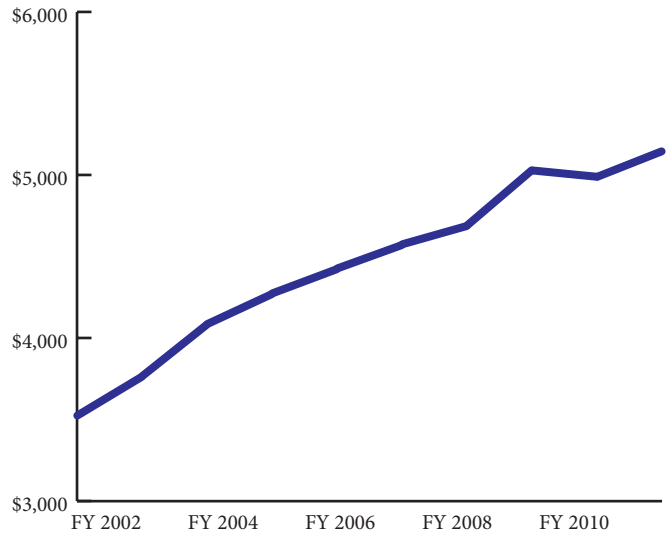
As highlighted in last year’s budget brief, state support of higher education was already on the decline before these budget cuts. With enrollment continuing to increase, the state support per student will continue to drop. And as the past has shown, dropping state support has corresponded with rising tuition (**Figures 2 and 3**). If this trend continues, college will become even less affordable in West Virginia, a state that is already struggling with a lack of education in its workforce.

Figure 2  
Higher Education Appropriations Per Student (2011 \$)



Source: West Virginia Higher Education Policy Commission and WV Executive Budget

Figure 3  
Average In-State Tuition



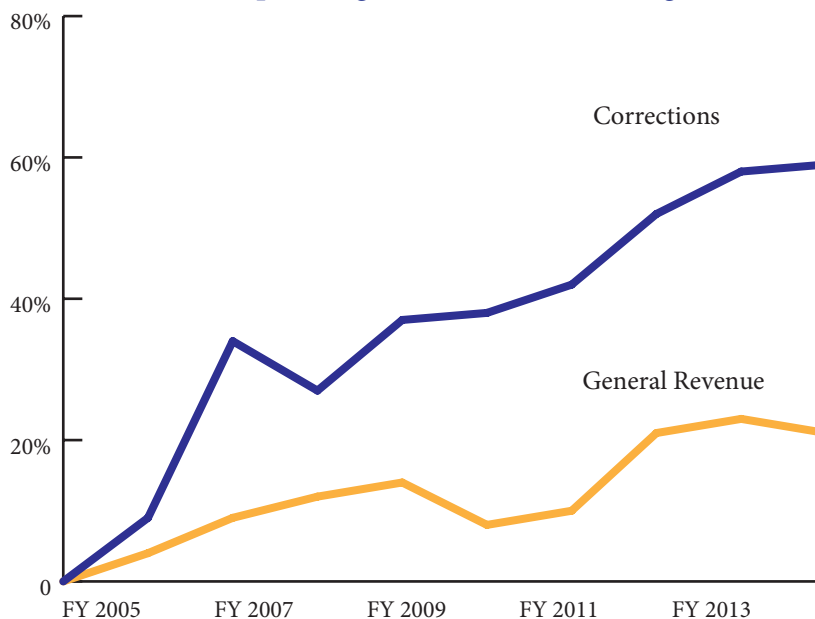
Source: West Virginia Higher Education Policy Commission and WV Executive Budget.

*Corrections Ripe for Reform*

One area that did not see any cuts in the Governor’s FY 2014 budget proposal was corrections, where more than \$180 million is budgeted, accounting for 4.4 percent of proposed spending from the general revenue fund.

The growth in corrections spending has far outpaced the rest of general revenue expenditures. From FY 2005 to FY 2014, corrections spending grew by 58 percent, compared to 21 percent for all of general revenue expenditures (Figure 4). The rise in corrections spending is fueled by a growing prisoner population, which has created massive overcrowding in state prisons.<sup>2</sup> This has led lawmakers to put prison reform as a major topic in this year’s legislative session. Without reform, more and more state resources will have to be diverted to corrections, making it harder to invest in the state’s other priorities.

Figure 4  
Corrections Spending on the Rise (% Change Since 2005)



Source: WVCBP analysis of West Virginia State Budget Office data.

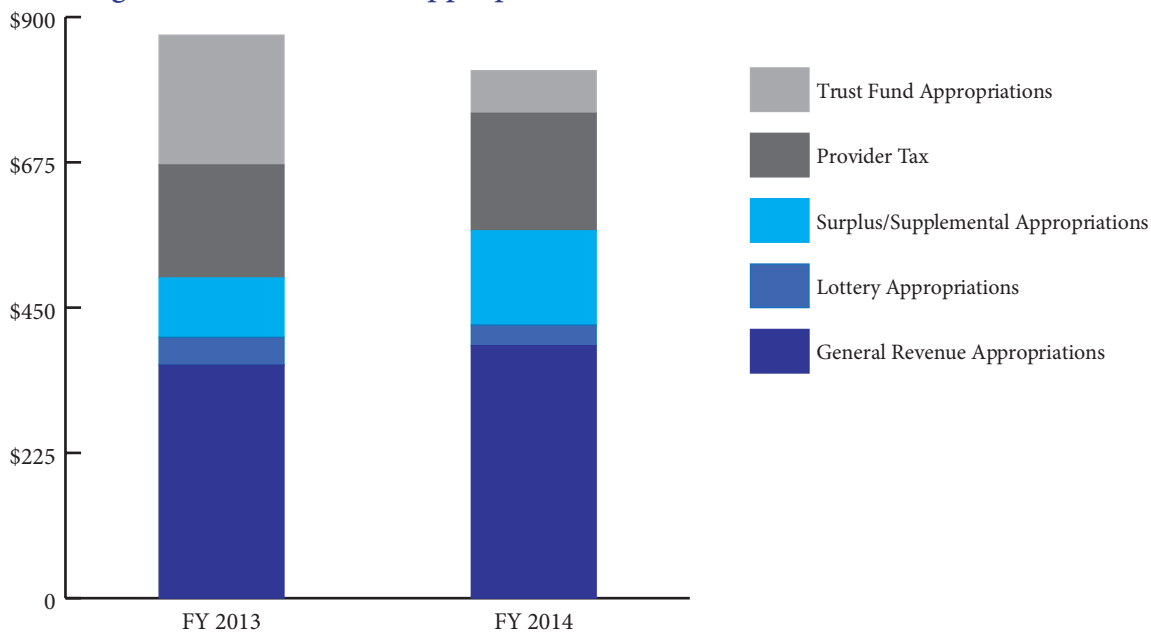
### Structural Problems in Funding Medicaid

A combination of state and federal funds, Medicaid, at \$3.1 billion, is the state budget's largest program. As West Virginia's per capita income grew in recent years, the federal government's share of Medicaid costs fell, from 74.04 percent in FY 2010 to an expected 71.09 percent for FY 2014, resulting in more state dollars spent on Medicaid.

West Virginia funds its share of the Medicaid program from four main sources, including General Revenue Fund, Lottery Funds, Health Care Provider Tax, and the Medical Services Trust fund. Other sources of funding include the "certified match" and, in recent years, supplemental and surplus funding from previous budgets, as well as over \$550 million federal stimulus dollars from 2009 to 2011.

Base funding for Medicaid, which is from General and Lottery Revenue Funds, totals \$568 million, while appropriations for Medicaid from the Special Fund, which includes the Medical Services Trust Fund and the Health Care Provider Tax, total \$247.8 million (Figure 5). Altogether, the FY 2014 budget proposes state spending of \$815.8 million on Medicaid.

Figure 5  
Budgeted Medicaid State Appropriations, FY 2013 and FY 2014 (in Millions)



Source: Governor's Proposed FY 2014 Budget Bill, Governor's Budget Presentation FY 2014, FY 2013 Enrolled Budget, and email conversation with Mike McKown, Director, West Virginia State Budget Office.

The proposed \$568 million in base funding for Medicaid is an increase of \$142 million from FY 2013, but, as Figure 5 also shows, this increase is not entirely due to the rising cost of Medicaid, but rather diminishing sources of funding from other parts of the budget. Most of the base budget increase is offset by a decrease in funding from the Medical Services Trust Fund. In FY 2013's budget, \$201.4 million was appropriated from the Trust Fund, while in FY 2014, only \$65.8 million is available to be appropriated, a decrease of \$135.7 million. The Trust Fund is expected to be exhausted after FY 2014. So while the amount of Medicaid funding coming from the base budget has increased, the total \$815.8 million in proposed state appropriations for Medicaid is \$57 million less than was appropriated for FY 2013 (\$873 million) in FY 2013's budget.

The growing reliance on base budget appropriations underlies a significant problem for West Virginia's Medicaid program. Current funding sources are inadequate. Of the \$568 million in base budget appropriations, \$145.6 million, or about 26 percent, are supplemental and surplus appropriations from FY 2013. Overall, nearly one-fourth of the state's FY 2014

proposed appropriations for Medicaid are from previous year’s surpluses and supplemental appropriations, or the now-exhausted Medical Services Trust Fund. The governor’s FY 2014 Medicaid base budget appropriations and revenue from the provider tax amount to less than 75 percent of total state spending on Medicaid.

The lack of base building for the Medicaid budget will continue to lead to situations that are seen in the FY 2014 budget – even as overall costs remain flat, more general revenue resources are being diverted to Medicaid at the expense of other programs. While it is misleading to state that Medicaid’s “exploding costs” are straining the budget, our current structure for funding Medicaid is quickly becoming a problem.

*Education Spending – Where Does It Go?*

Education reform is a major topic in this year’s legislative session, which was kicked off by the governor’s educational efficiency audit. The audit was produced in part to help the state receive the highest return on its investments in education. But, to achieve that goal, it is necessary to understand what is driving the state’s education spending.

The education audit is premised on the fact that West Virginia ranks 8th nationally for education expenditures relative to income, and identifies \$115.7 million in savings over 5 years.<sup>3</sup> Spending relative to income is misleading, however, because, as a poorer state with relatively low income, West Virginia typically skews high when making comparisons relative to income. The audit notes that West Virginia ranks ahead of rich states like Massachusetts on education spending as a share of personal income, but when measuring spending per pupil, Massachusetts outspends West Virginia by more than \$2,000.<sup>4</sup>

On a per pupil basis, West Virginia ranked 17th in 2010, spending \$11,527 per pupil; compared to the national average of \$10,600, a difference of \$927 per pupil. **Table 3** breaks down the per pupil spending by function, and compares West Virginia to the national average, as well as West Virginia’s rank in each category.

Table 3  
**Education Spending Per Pupil By Function (2010)**

| Function                             | WV       | U.S.     | Difference | WV Rank |
|--------------------------------------|----------|----------|------------|---------|
| Total                                | \$11,527 | \$10,600 | \$927      | 17      |
| Instruction Salaries                 | \$3,821  | \$4,277  | -\$455     | 32      |
| Instruction Benefits                 | \$2,490  | \$1,468  | \$1,023    | 3       |
| Instruction Other                    | \$646    | \$682    | -\$36      | 22      |
| Pupil Support Services               | \$499    | \$578    | -\$78      | 31      |
| Instructional Staff Support Services | \$404    | \$501    | -\$98      | 36      |
| General Administration               | \$222    | \$194    | \$27       | 25      |
| School Administration                | \$595    | \$562    | \$33       | 17      |
| Operation & Maintenance              | \$1,131  | \$986    | \$145      | 13      |
| Pupil Transportation                 | \$815    | \$448    | \$366      | 3       |
| Other Support Services               | \$185    | \$354    | -\$169     | 43      |
| All Other Functions                  | \$719    | \$550    | \$169      | 7       |

Source: U.S. Census Bureau, Public Elementary–Secondary Education Finance Data, 2010

As **Table 3** shows, West Virginia’s per pupil education spending is in the middle of the pack for most categories. West Virginia ranks 32nd in the biggest spending area, instruction salaries; spending \$455 less per pupil than the national average. And while the audit finds major administrative savings, West Virginia ranks right in the middle at 25th, spending only \$27 more per pupil

on general administration than the national average.

There are two notable exceptions, the most obvious being instruction benefits. In this category, West Virginia ranks 3rd, spending over \$1,000 more per pupil than the national average. But, as the audit acknowledges, this is a current anomaly due to the pay-down of the unfunded liability of the Teachers' Retirement System. According to the audit, this amounts to an average of \$333.6 million per year.<sup>5</sup> If you exclude that anomaly, West Virginia's rank falls to 8th, with the difference between West Virginia and the national average falling to \$689 per pupil. While spending in this category is still high, it is mostly offset by lower spending on salaries and wages. It is also important to remember that the state ended the retiree health benefit for teachers and school service personnel hired after January 1, 2010 and that the state capped the retiree subsidy for those currently in the system.

The audit does address the other function where West Virginia ranks highly, transportation. The audit found \$10 million in savings over five years for transportation, and West Virginia ranks 3rd highest in per pupil transportation spending, with \$366 more per pupil than the national average. The \$2 million per year in savings recommended by the audit, however, would account for less than one percent of the \$231 million spent on pupil transportation, which suggests that rather than inefficiencies, there are hard-to-avoid structural challenges that are driving costs.<sup>6</sup>

The same is true for another area in which West Virginia ranks highly. West Virginia's operations and maintenance spending, which includes spending on heating, electricity, air conditioning, property insurance, and care and upkeep of grounds and equipment, ranks 13th, with \$145 more per pupil spent than the national average. The audit identifies \$34.8 million in facilities savings, or about \$7 million per year, but that only accounts for about two percent of the \$321 million spent on operations and maintenance in 2010.<sup>7</sup>

What does this all suggest? That the savings found in the audit are not necessarily in areas that are driving education spending in the state. Instead it is factors like the past under-funding of pensions, transportation costs, utility costs, and the upkeep of the state's aging schools that are inflating education costs. And there is little the state can do to control many of these factors, as the meager savings found by the audit in these areas proves. Absent these areas, West Virginia's education spending is not all that high compared to other states, and, in fact, is closer to the bottom than to the top in many aspects.

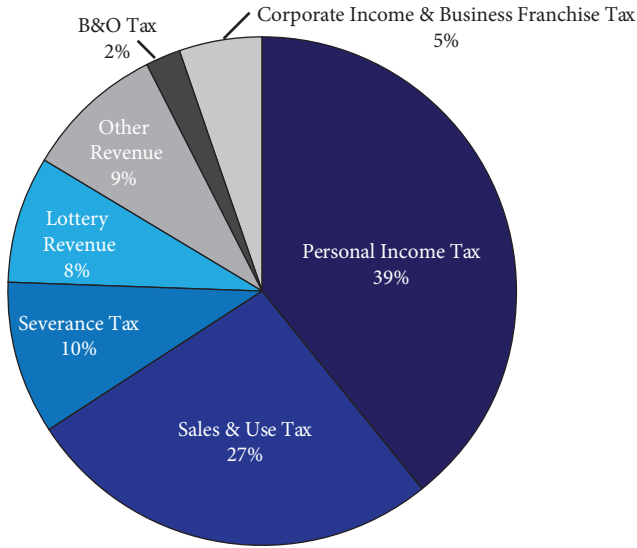
## Base Budget Revenues

Revenues for the governor's proposed FY 2014 base budget total \$4.51 billion, including \$4.1 billion in general revenue funds and \$365.5 million in lottery funds. The bulk of this revenue is from the personal income tax and the sales and use tax. The FY 2014 revenue estimates also include anticipated revenue from several legislative proposals from the governor, including \$10 million from the sales and use tax from passage of a physical presence nexus bill or "Amazon law" (HB 2754) and \$10 million in personal income taxes from scaling back the Alternative Fuel Tax Credit (HB 2506). The governor also proposed legislation to cap the amount of the Film Industry Investment Tax Credit to \$5 million (SB 182).

According to the FY 2014 Six Year Financial Plan, the only substantial source of revenue growth in the base budget over the next five years will be personal income tax collections. Base budget revenue is expected to grow by \$551 million to \$5.1 billion in FY 2018 (**Figure 7**). During this same time, personal income taxes are expected to grow by \$470.9 million or from 39.3 percent to 44.3 percent of the base budget. Meanwhile, sales and use taxes are expected to grow by \$156 million over this period.

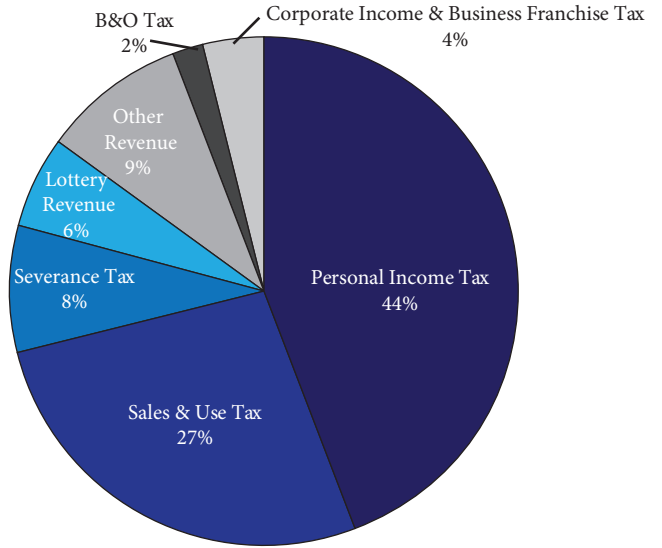


Figure 6  
FY 2014 Base Budget Revenue (\$4.51 billion)



Source: WV Budget Office FY 2014 Executive Budget.

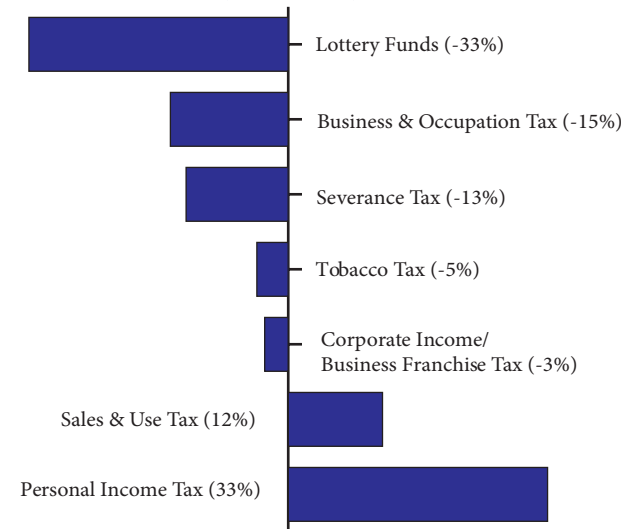
Figure 7  
FY 2018 Base Budget Revenue (\$5.1 billion)



Source: WV Budget Office FY 2014 Executive Budget.

The base budget's only two sources of major revenue growth are personal income and sales and use taxes from FY 2012 to FY 2018. The reliance of personal income tax growth over the coming budget years is driven mostly by the anticipated revenue loss of severance, tobacco, business and occupation, a deteriorating sales and use tax base and staggering lottery revenue revenues. All together these revenue sources make up over 90 percent of the base budget (Figure 8).

Figure 8  
Growth of Major Sources of Revenue from FY 2012 to FY 2018 (estimated)



Source: WVCBP analysis of WV Budget Office FY 2014 Executive Budget

### Severance Tax

The severance tax provides 10 percent of the base budget's revenue. While severance taxes have always been a large piece of the base budget, they have been a growing share over the last several years due to the increase in coal prices and development of the Marcellus shale natural gas play. In FY 2004, severance taxes made up just five percent of the base budget.



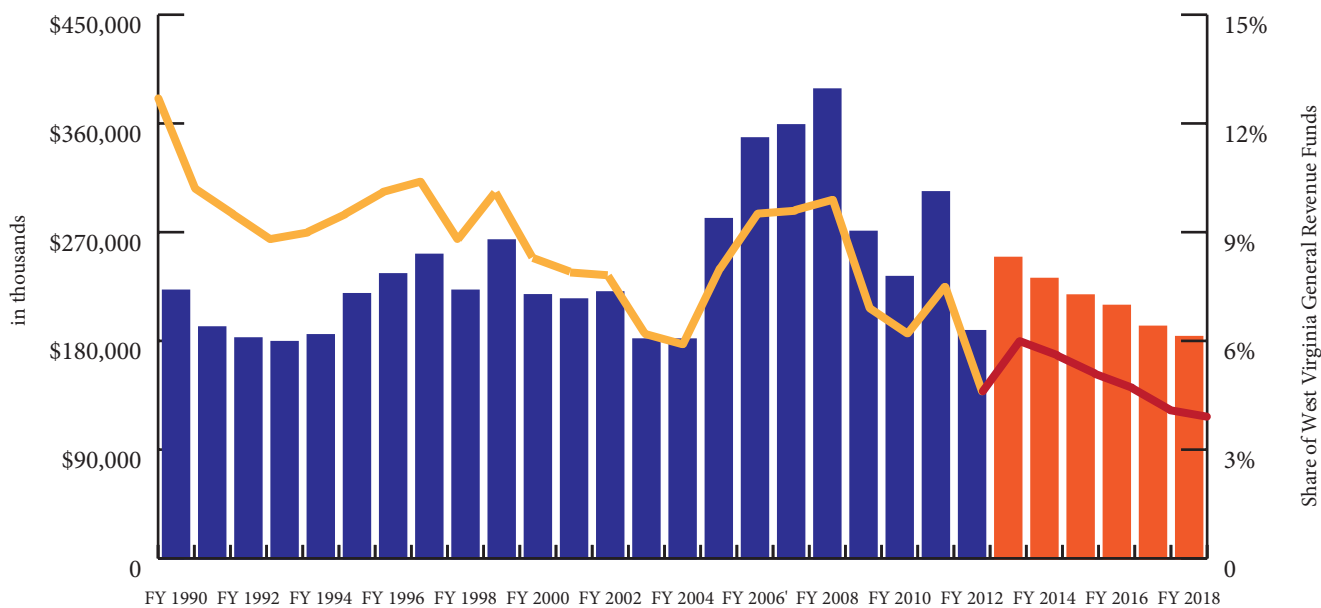
Over the next five years severance tax collections are expected to drop significantly, from \$431.3 million in FY 2014 to just \$408.8 million by FY 2018. By FY 2018 severances taxes are projected to make up just eight percent of the base budget. This is largely due to the dramatic drop in coal severance taxes over this period. For example, the state collected \$410.2 million in non-natural gas severance taxes in 2012 and is expected to collect just \$346.5 million in 2017. Meanwhile, severance taxes from natural gas are expected to grow from \$57.7 million in 2012 to \$129.5 million in 2017.<sup>8</sup>

#### Corporate Net Income and Business Franchise Tax

While the severance tax share of base budget revenue has grown over the last several years, the corporate income and business franchise taxes have been a declining source of the state’s revenue. This is largely due to the large business tax cuts put in place in 2007 and 2008. The business franchise tax is scheduled to be completely eliminated by 2015 and the corporate net income tax rate will be reduced from 9.0 percent in 2007 to 6.5 percent in 2014. All together, estimated revenue loss will be nearly \$200 million per year once fully implemented.<sup>9</sup>

Over the last two decades, the state has relied less on business taxes to fund general revenues expenses. The state collected less in business taxes than it did 23 years ago, dropping from \$221.5 million in FY 1990 to just \$173.5 million in FY 2012 (**Figure 9**). It is important to recognize that these are nominal numbers; they are not adjusted for inflation or economic growth.

Figure 9  
Corporate Net Income and Business Franchise Taxes at 23-Year Low



Source: West Virginia State Budget Office data.

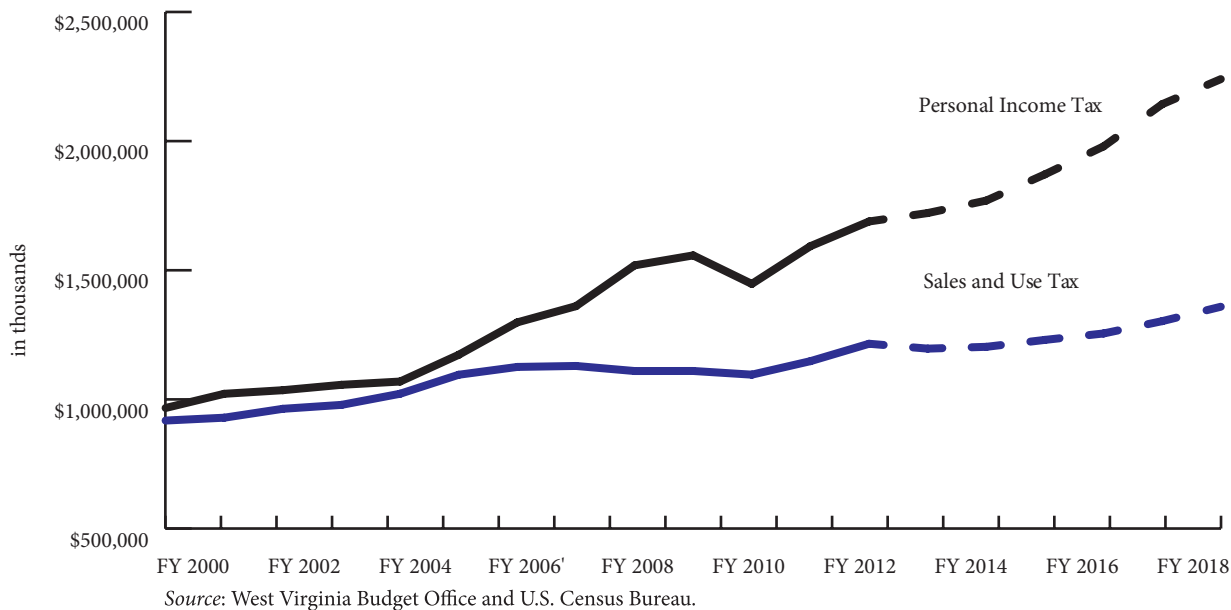
Business taxes are also making up a smaller share of general revenue funds. While business taxes made up 12.7 percent of general fund revenues in 1990, in 2014 their share is expected to be just 4.6 percent. This number is expected to drop even further over the coming years, with business taxes expected to be just 3.9 percent of general revenue collections in FY 2018 at \$183.2 million. For FY 2014 to FY 2018, the governor is also including an additional \$4.3 million in the business tax estimated from funds that were previously dedicated to the Special Railroad and Enhancement Fund.

#### Sales and Use Tax

While the sales and use tax is not declining in nominal terms, it is playing a smaller role in funding general revenue expenditures. In FY 2005, the sales tax made up approximately 31 percent of general revenue fund collections and the personal income tax comprised 34 percent. For FY 2014, the share of general revenue fund collections from sales tax is

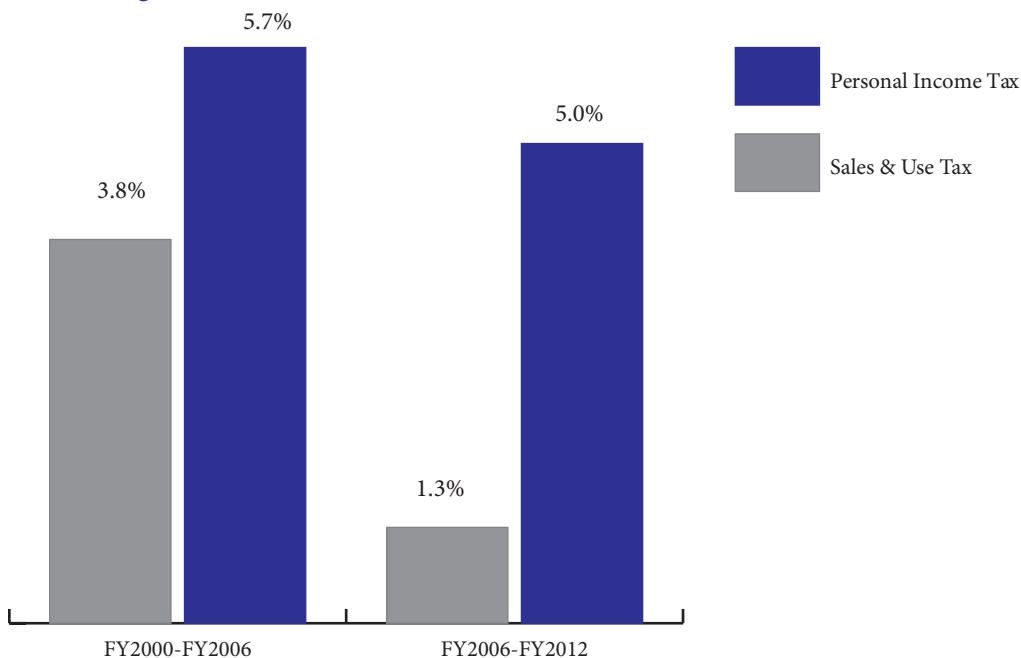
expected to drop to 28 percent while personal income taxes will grow to over 39 percent. Sales and use tax collections have stagnated over the last several years and are expected to grow slowly in the future (**Figure 10**).

Figure 10  
Personal Income Tax Outpacing Sales & Use Tax



Sales tax collections have slowed dramatically over the last six years compared to the early 2000s (**Figure 11**). Between FY 2000 and FY 2006 sales and use taxes grew by an average annual rate of 3.8 percent compared to 5.7 percent for personal income taxes. Between FY 2006 and FY 2012, however, this rate dropped to 1.3 percent for sales and use taxes while personal income taxes remained nearly the same.

Figure 11  
Average Annual Sales and Personal Income Tax Growth Rate



Source: West Virginia State Budget Office and U.S. Census Bureau.

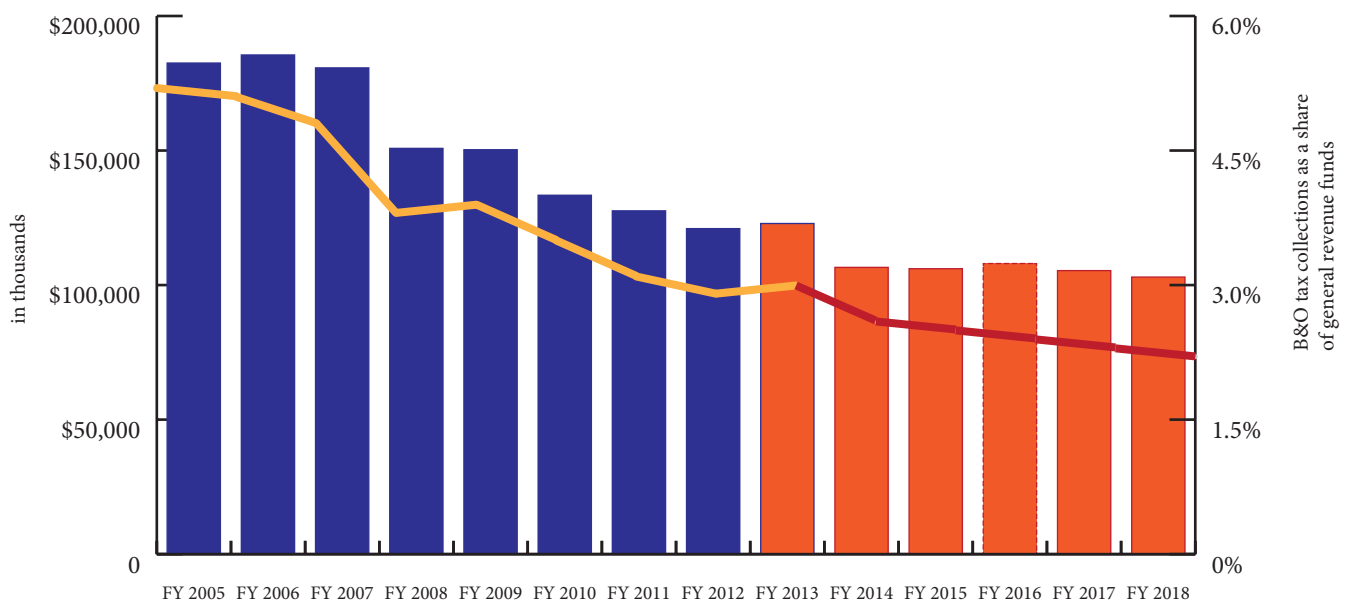
One of the central reasons for the sluggish growth in sales tax collections is the gradual elimination of the food sales tax from 2006 to 2013. In 2013, the state is expected to lose \$174 million in sales tax revenue from the reduction of the food tax.<sup>10</sup> This amounts to about 14.5 percent of anticipated sales and use tax collection in FY 2014.

Two other factors are also leading to slower sales tax collections compared to personal income tax collections. First, the state’s weak economic recovery continues to reduce demand because many households in West Virginia continue to pay down the debt they incurred during the housing and credit bubbles. Lastly, online retail sales – where many retailers and shoppers can avoid paying the sales tax - continue to grow as a share of total retail sales. As mentioned above, the governor’s proposal to apply the sales tax to any out-of-state retailer that maintains a warehouse, office, or other facility in the state (a.k.a. Amazon law) is a step in the right direction.

*Business & Occupation Tax*

The Business & Occupation Tax (B&O Tax) is a tax on units of activity or gross receipts that applies to public utilities, electric power generation and natural gas storage. In FY 2014, the state is expected to collect \$106.6 million in B&O taxes. It collected nearly \$75 million more in B&O taxes eight years earlier in FY 2006 (Figure 12). As a share of general revenue collections, the B&O tax is expected to drop from over five percent in FY 2006 to 2.6 percent by FY 2014, and even further by FY 2018.

Figure 12  
Business & Occupation Tax Shrinking



Source: West Virginia Executive Budget, FY 1988 - FY 2014.

The deterioration of B&O tax collections is due to several factors, including installation of fuel gas desulfurization systems at existing power plants that are subject to a lower tax rate, the retiring of some West Virginia coal-fired power plants, and growth in tax credits against the B&O tax. For example, the value of the forgone revenue from the Industrial Expansion and Revitalization Tax Credit against the B&O tax grew from \$23.7 million in 2006 to \$54.9 million in 2012.<sup>11</sup>

*Lottery Revenues*

Over the next several years, lottery revenues are expected to make up a smaller share of the base budget. In FY 2014, the state is expected to use \$365.5 million in lottery revenues for base budget expenditures. This amounts to 8.1 percent of base budget revenue. However, from FY 2015 to FY 2018 the state expects to use just \$298.9 million per year from lottery revenues. By FY 2018, lottery revenues are expected to make up just 5.9 percent of base budget revenues.

## Tobacco Taxes

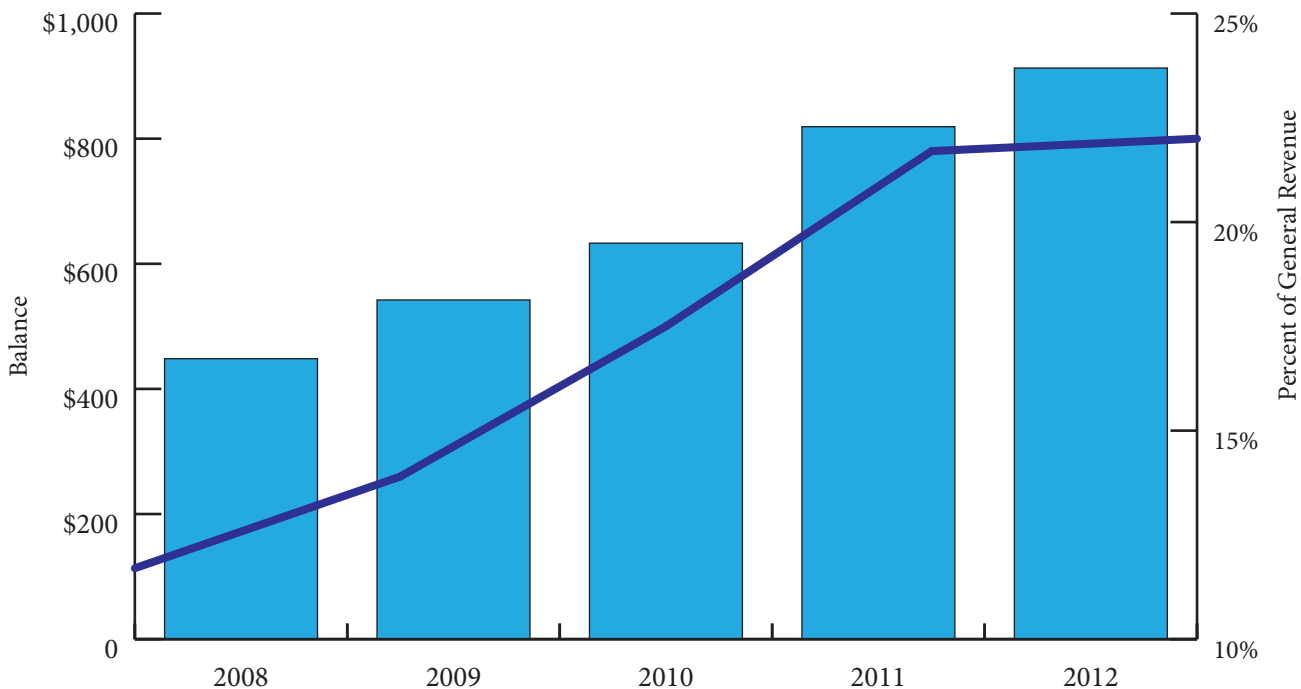
The tax on tobacco products is expected to account for \$108.1 million in FY 2014, down from \$115.1 million in FY 2009. By FY 2018 the state is expected to collect \$104.7 million in tobacco taxes. Currently, West Virginia ranks 44th lowest in taxing cigarettes at just 56 cents per pack.

## Rainy Day Funds Top \$900 Million

West Virginia has one of the largest and most well funded rainy day funds in the country. West Virginia ended 2012 with \$912.9 million in its two primary budget stabilization funds – Rainy Day Funds A and B (**Figure 13**). Despite doubling since 2008, and adding almost \$100 million in 2012 alone, West Virginia did not tap into its rain day funds to fill in FY 2014’s budget gaps, instead choosing to enact \$75 million in spending reductions.

The rainy day funds have also been quickly growing as a share of general revenue expenditures. While the rainy day fund balance has more than doubled since 2008, general revenue expenditures have only grown 8.3 percent. As a result, the rainy day fund balance as a share of general revenue expenditures has grown from 11.7 percent to 22 percent between 2008 and 2012 (**Figure 13**). Only Alaska and Wyoming have a larger balance, and only a handful of states have balances over 10 percent of general expenditures. For FY 2012, the national average was five percent. As of February 28, 2013, the balance of the rainy day funds was \$915.9 million.<sup>12</sup>

Figure 13  
More than \$900 Million in Rainy Day Funds



Source: WV Executive Budget, Vol. I, Budget Report, FY 2010-2014.

Note: Rainy Day A&B balance expressed at end of calendar year. General Revenue Funds are actuals for end of SFY of each year.

## Projected Budget Gaps are Shrinking

The Six Year Financial Plan in the FY 2014 Executive Budget shows substantial budget gaps in the coming years’ budgets. General and Lottery revenues are expected to fall short of projected spending by an average of \$162 million per year between FY 2015 and FY 2018. These gaps are much smaller, however, than what was projected in last year’s Executive Budget, and are shrinking each year (**Figure 14**). For example, the projected budget gap for FY 2016 was cut in half from \$375 million to \$192 million between FY 2013’s and FY 2014’s budget projections. And FY 2017’s budget gap is less than one-third of its projection

from a year ago.

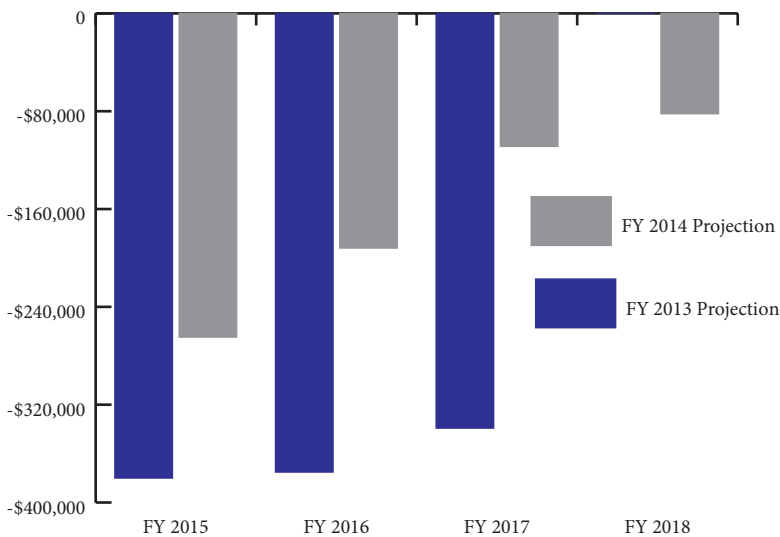
But while this year's budget gap projections are smaller than last year's, so are revenue projections. General and lottery revenue projections are down by about \$100 million for both FY 2015 and FY 2016 from last year's projections. The shrinking budget gaps are not due to rising revenue projections.

One explanation for the smaller projected budget gaps this year is the 7.5 percent budget cut put into place for FY 2014. This lowers the baseline for future projections, in effect lowering future spending. For example, in this year's budget, higher education appropriations are shown to increase by \$2.5 million over what was budgeted for FY 2013. But that is before the 7.5 percent budget cut is accounted for, which cuts higher education by \$34.8 million. That cut was not anticipated in FY 2013's projections, which is why projections for higher education spending are lower in FY 2014's projections than they were in FY 2013's.

Other areas of the budget exempted from the 7.5 percent cut are showing smaller spending projections than from a year ago. State aid to schools is projected to be \$1.21 billion. Other areas of the budget exempted from the 7.5 percent cut are showing smaller spending projections than from a year ago. State aid to schools is projected to be \$1.21 billion in FY 2015, down from last year's projections of \$1.24 billion, while Medicaid spending is projected to be \$664 million in FY 2015, down from last year's projection of \$705 million. Slower than expected growth in these areas is contributing to closing of the projected budget gaps.

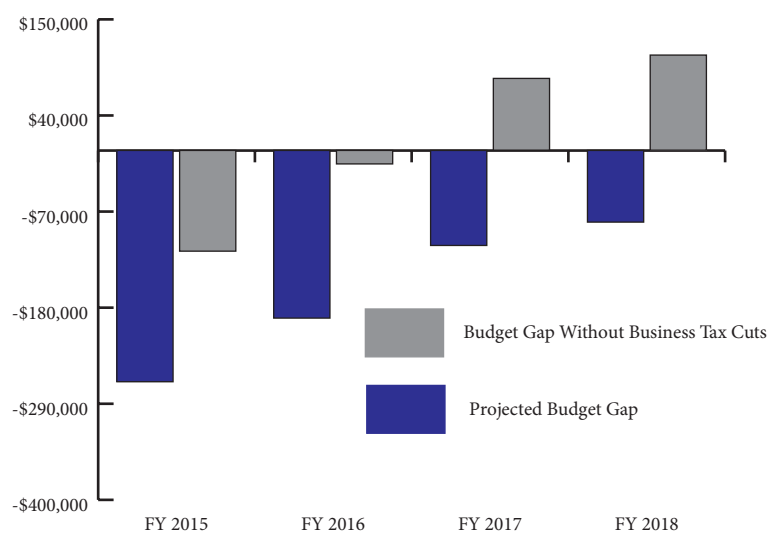
The budget gaps would be even smaller, and the state would be running surpluses, if it was not for the business tax cuts put in place in 2007 and 2008. These tax cuts will cost the state \$149.3 million in 2015; without them, the budget gap would only be \$115.5 million instead of \$264.8 million, and the state would be running a surplus by 2017 (Figure 15).

Figure 14  
Shrinking Budget Gaps (millions of dollars)



Source: Governor's Executive Budget, Volume 1, FY 2013-2014.

Figure 15  
Business Tax Cuts Contribute to Budget Shortfalls (millions of dollars)



Source: Governor's Executive Budget, Volume 1, FY 2014 and West Virginia Department of Revenue.

## Conclusion

The governor's budget recommendation for the 2014 fiscal year that starts July 1 includes nearly \$35 million in cuts from last year's budget, most coming from higher education. These cuts are the result of inadequate revenue growth that has been driven primarily from self-inflicted tax cuts that has deprived the budget of revenue. Without additional revenues,

West Virginia could continue to face budgets that fall short of meeting the state's growing needs and revenue growth that is not enough to make the investments necessary for West Virginia to prosper. To this end, lawmakers should look at several ways to boost revenue over the coming years. This could include raising the tax on cigarettes and other tobacco products. For example, raising the cigarette tax from 55 cents per pack to \$1 per pack could yield \$120.8 million per year and also provide public health benefits that could lower state health care costs.<sup>13</sup>

It is vital that lawmakers consider both sides of the budget – expenditures and revenue – when adopting this year's budget. The state needs to take a balanced approach by controlling costs in Medicaid and the state corrections system while at the same time securing enough revenue to ensure the long-term fiscal health of the state.

## Endnotes

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- 4 Data from U.S. Census Bureau, Public Elementary–Secondary Education Finance Data, 2010.
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- 7 Ibid.
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- 13 New Revenues, Public Health Benefits & Costs Savings from A \$1.00 Cigarette Tax Increase in West Virginia," Campaign for Tobacco-Free Kids, January 28, 2013. Retrieved from <http://www.tobacco-free-wv.com/wp-content/uploads/2013/02/WV-Tax-Hike-Benefits-1-1-28-13.pdf>.

Appendix A

FY 2014 Budget Reductions – General Revenue Fund

| Department     | Agency/Program                          | FY 2013<br>Enrolled | FY 2014<br>Proposed | Reduction    | Percent<br>Change |
|----------------|---|---------------------|---------------------|--------------|-------------------|
| Executive      | Governor's Office                       | \$5,547,731         | \$4,969,316         | -\$578,415   | -10.4%            |
| Executive      | Auditor's Office                        | \$3,764,313         | \$3,486,565         | -\$277,748   | -7.4%             |
| Executive      | Treasurer's Office                      | \$3,928,147         | \$3,644,918         | -\$283,229   | -7.2%             |
| Executive      | Dept of Agriculture                     | \$12,218,989        | \$11,407,927        | -\$811,062   | -6.6%             |
| Executive      | Conservation Agency                     | \$10,358,848        | \$9,475,342         | -\$883,506   | -8.5%             |
| Executive      | Attorney General                        | \$5,941,802         | \$5,514,137         | -\$427,665   | -7.2%             |
| Executive      | Secretary of State                      | \$1,307,638         | \$1,220,022         | -\$87,616    | -6.7%             |
| Administration | Office of Secretary                     | \$16,925,756        | \$15,921,260        | -\$1,004,496 | -5.9%             |
| Administration | Division of Finance                     | \$920,761           | \$852,955           | -\$67,806    | -7.4%             |
| Administration | Division of General Services            | \$4,001,030         | \$3,710,167         | -\$290,863   | -7.3%             |
| Administration | Division of Purchasing                  | \$1,178,280         | \$1,093,584         | -\$84,696    | -7.2%             |
| Administration | Travel Management                       | \$1,824,403         | \$1,588,585         | -\$235,818   | -12.9%            |
| Administration | Ethics Commission                       | \$755,507           | \$703,013           | -\$52,494    | -6.9%             |
| Administration | Children's Health Insurance Agency      | \$10,925,578        | \$9,987,748         | -\$937,830   | -8.6%             |
| Commerce       | Geological and Economic Survey          | \$3,541,626         | \$3,286,373         | -\$255,253   | -7.2%             |
| Commerce       | WV Development Office                   | \$23,081,854        | \$19,904,432        | -\$3,177,422 | -13.8%            |
| Commerce       | Division of Labor                       | \$3,427,325         | \$3,179,163         | -\$248,162   | -7.2%             |
| Commerce       | Occupational Safety and Health Fund     | \$200,000           | \$185,275           | -\$14,725    | -7.4%             |
| Commerce       | Division of Natural Resources           | \$17,513,566        | \$16,256,299        | -\$1,257,267 | -7.2%             |
| Commerce       | Workforce WV                            | \$145,000           | \$87,877            | -\$57,123    | -39.4%            |
| Commerce       | Office of Secretary                     | \$392,275           | \$364,104           | -\$28,171    | -7.2%             |
| Commerce       | Division of Energy                      | \$1,926,542         | \$1,782,864         | -\$143,678   | -7.5%             |
| Education      | Early Retirement Notification Incentive | \$275,000           | \$235,000           | -\$40,000    | -14.5%            |
| Education      | MATH Program                            | \$396,251           | \$366,532           | -\$29,719    | -7.5%             |
| Education      | Assesment Programs                      | \$2,529,284         | \$2,339,588         | -\$189,696   | -7.5%             |
| Education      | 21st Century Fellows                    | \$297,188           | \$274,899           | -\$22,289    | -7.5%             |
| Education      | English as a Second Language            | \$350,000           | \$100,000           | -\$250,000   | -71.4%            |
| Education      | Teacher Reimbursement                   | \$297,188           | \$100,000           | -\$197,188   | -66.4%            |
| Education      | Hospitality Training                    | \$343,642           | \$315,899           | -\$27,743    | -8.1%             |
| Education      | Foreign Student Education               | \$97,079            | \$89,798            | -\$7,281     | -7.5%             |
| Education      | Teacher Mentor                          | \$842,034           | \$592,034           | -\$250,000   | -29.7%            |
| Education      | National Teacher Certification          | \$400,000           | \$150,000           | -\$250,000   | -62.5%            |
| Education      | Principals Mentorship                   | \$79,250            | \$69,250            | -\$10,000    | -12.6%            |



|                          |   |              |              |              |         |
|--------------------------|---|--------------|--------------|--------------|---------|
| Education                | Elementary/Middle Alternative Schools                                   | \$1,000,000  | \$900,000    | -\$100,000   | -10.0%  |
| Education                | Student Enrichment Program  | \$6,200,000  | \$4,666,144  | -\$1,533,856 | -24.7%  |
| Education                | 21st Century Learners   | \$2,602,870  | \$2,466,026  | -\$136,844   | -5.3%   |
| Education                | WV Holocaust Education  | \$15,000     | \$13,875     | -\$1,125     | -7.5%   |
| Education                | Regional Education Service Agencies                                     | \$3,990,000  | \$3,690,750  | -\$299,250   | -7.5%   |
| Education                | Educational Program Allowance   | \$450,000    | \$416,250    | -\$33,750    | -7.5%   |
| Education                | Albert Yanni Vocational Program   | \$142,650    | \$131,951    | -\$10,699    | -7.5%   |
| Education                | Program Modernization - Vocational Division                             | \$956,014    | \$884,313    | -\$71,701    | -7.5%   |
| Education                | FFA Grant Awards  | \$12,428     | \$11,496     | -\$932       | -7.5%   |
| Education                | Pre-Engineering Academy Program   | \$286,804    | \$265,294    | -\$21,510    | -7.5%   |
| Education and the Arts   | Office of Secretary   | \$6,526,826  | \$6,185,256  | -\$341,570   | -5.2%   |
| Education and the Arts   | Educational Broadcasting Authority                                      | \$5,644,888  | \$5,237,378  | -\$407,510   | -7.2%   |
| Environmental Protection | Environmental Quality Board   | \$145,105    | \$134,454    | -\$10,651    | -7.3%   |
| Environmental Protection | Division of Environmental Protection                                    | \$8,096,288  | \$7,510,922  | -\$585,366   | -7.2%   |
| Environmental Protection | Air Quality Board   | \$101,893    | \$94,465     | -\$7,428     | -7.3%   |
| DHHR                     | Division of Health Central Office                                       | \$83,110,103 | \$77,569,541 | -\$5,540,562 | -6.7%   |
| DHHR                     | Human Rights Commission   | \$1,401,162  | \$1,299,925  | -\$101,237   | -7.2%   |
| DHHR                     | WV Works Separate State Program   | \$4,750,000  | \$3,250,000  | -\$1,500,000 | -31.6%  |
| DHHR                     | Child Welfare System  | \$1,735,815  | \$1,239,868  | -\$495,947   | -28.6%  |
| DHHR                     | Grants for Licensed Domestic Violence Programs and Statewide Prevention | \$2,500,000  | \$2,312,500  | -\$187,500   | -7.5%   |
| DHHR                     | Sexual Assault and Prevention   | \$250,000    | \$0          | -\$250,000   | -100.0% |
| DHHR                     | Indigent Burials  | \$2,550,000  | \$2,050,000  | -\$500,000   | -19.6%  |
| MAPS                     | Adjutant General - State Militia  | \$21,030,650 | \$16,710,103 | -\$4,320,547 | -20.5%  |
| MAPS                     | Adjutant General - Military Fund  | \$200,000    | \$185,000    | -\$15,000    | -7.5%   |
| MAPS                     | Division of Corrections - Central Office                                | \$708,384    | \$657,447    | -\$50,937    | -7.2%   |
| MAPS                     | Fire Commission   | \$81,156     | \$75,069     | -\$6,087     | -7.5%   |
| MAPS                     | Division of Juvenile Services   | \$46,013,944 | \$43,441,737 | -\$2,572,207 | -5.6%   |
| Revenue                  | Office of Secretary   | \$789,697    | \$733,223    | -\$56,474    | -7.2%   |
| Revenue                  | Tax Division  | \$27,583,106 | \$25,587,056 | -\$1,996,050 | -7.2%   |
| Revenue                  | State Budget Office   | \$1,117,060  | \$804,706    | -\$312,354   | -28.0%  |
| Revenue                  | WV Office of Tax Appeals  | \$668,147    | \$620,107    | -\$48,040    | -7.2%   |
| Revenue                  | Division of Prof and Occup Licenses - State Athletic Commission         | \$55,990     | \$51,847     | -\$4,143     | -7.4%   |
| Transportation           | State Rail Authority  | \$2,581,378  | \$2,389,003  | -\$192,375   | -7.5%   |

|                  |   |              |              |              |       |
|------------------|---|--------------|--------------|--------------|-------|
| Transportation   | Division of Public Transit                                  | \$2,786,009  | \$2,577,058  | -\$208,951   | -7.5% |
| Transportation   | Public Port Authority                                       | \$408,955    | \$379,304    | -\$29,651    | -7.3% |
| Transportation   | Aeronautics Commission                                      | \$1,374,775  | \$1,272,456  | -\$102,319   | -7.4% |
| Higher Education | New River Community and Technical College                   | \$6,305,522  | \$5,832,608  | -\$472,914   | -7.5% |
| Higher Education | West Virginia Council for Community and Technical Education | \$863,576    | \$798,808    | -\$64,768    | -7.5% |
| Higher Education | Eastern West Virginia Community and Technical College       | \$2,100,509  | \$1,942,971  | -\$157,538   | -7.5% |
| Higher Education | Kanawha Valley Community and Technical College              | \$4,125,664  | \$3,816,239  | -\$309,425   | -7.5% |
| Higher Education | Southern West Virginia Community and Technical College      | \$9,228,731  | \$8,536,576  | -\$692,155   | -7.5% |
| Higher Education | West Virginia Northern Community and Technical College      | \$7,893,643  | \$7,301,620  | -\$592,023   | -7.5% |
| Higher Education | West Virginia University - Parkersburg                      | \$10,916,188 | \$10,097,474 | -\$818,714   | -7.5% |
| Higher Education | Bridgemont Community and Technical College                  | \$3,973,597  | \$3,675,577  | -\$298,020   | -7.5% |
| Higher Education | Mountwest Community and Technical College                   | \$6,352,577  | \$5,876,134  | -\$476,443   | -7.5% |
| Higher Education | Transit Training Partnership                                | \$80,000     | \$74,000     | -\$6,000     | -7.5% |
| Higher Education | Community College Workforce Development                     | \$918,000    | \$849,150    | -\$68,850    | -7.5% |
| Higher Education | Blue Ridge Community and Technical College                  | \$5,138,415  | \$4,753,034  | -\$385,381   | -7.5% |
| Higher Education | College Transition Program                                  | \$333,500    | \$308,488    | -\$25,012    | -7.5% |
| Higher Education | West Virginia Advance Workforce Development                 | \$3,644,020  | \$3,370,719  | -\$273,301   | -7.5% |
| Higher Education | Technical Program Development                               | \$2,261,100  | \$2,091,518  | -\$169,582   | -7.5% |
| Higher Education | Pierpont Community & Technical College                      | \$8,443,703  | \$7,810,425  | -\$633,278   | -7.5% |
| Higher Education | WVU School of Health Science - Eastern Division             | \$2,646,269  | \$2,409,623  | -\$236,646   | -8.9% |
| Higher Education | School of Osteopathic Medicine                              | \$7,978,095  | \$7,264,642  | -\$713,453   | -8.9% |
| Higher Education | Marshall Medical School                                     | \$13,828,384 | \$12,591,761 | -\$1,236,623 | -8.9% |
| Higher Education | WVU-School of Health Sciences                               | \$19,300,013 | \$17,574,081 | -\$1,725,932 | -8.9% |
| Higher Education | WVU School of Health Sciences - Charleston Division         | \$2,704,448  | \$2,462,599  | -\$241,849   | -8.9% |
| Higher Education | Rural Health Outreach Program                               | \$606,231    | \$553,018    | -\$53,213    | -8.8% |
| Higher Education | Bluefield State College                                     | \$6,593,442  | \$6,003,814  | -\$589,628   | -8.9% |
| Higher Education | Concord University  | \$10,206,804 | \$9,294,046  | -\$912,758   | -8.9% |
| Higher Education | Fairmont State University                                   | \$17,880,671 | \$16,281,666 | -\$1,599,005 | -8.9% |

|                  |   |               |               |               |        |
|------------------|---|---------------|---------------|---------------|--------|
| Higher Education | Glenville State College                                   | \$7,206,804   | \$6,489,479   | -\$717,325    | -10.0% |
| Higher Education | Shepherd University                                       | \$11,228,474  | \$10,224,351  | -\$1,004,123  | -8.9%  |
| Higher Education | West Liberty University                                   | \$9,322,524   | \$8,488,844   | -\$833,680    | -8.9%  |
| Higher Education | West Virginia State University                            | \$10,954,389  | \$10,657,707  | -\$296,682    | -2.7%  |
| Higher Education | Marshall University                                       | \$54,348,822  | \$49,488,599  | -\$4,860,223  | -8.9%  |
| Higher Education | Marshall University Medical School<br>BRIM Subsidy        | \$1,015,462   | \$924,653     | -\$90,809     | -8.9%  |
| Higher Education | West Virginia University                                  | \$116,272,285 | \$105,874,466 | -\$10,397,819 | -8.9%  |
| Higher Education | Jackson's Mill  | \$351,480     | \$320,048     | -\$31,432     | -8.9%  |
| Higher Education | VISTA E-Learning  | \$300,000     | \$273,172     | -\$26,828     | -8.9%  |
| Higher Education | State Priorities - Brownfield<br>Professional Development | \$806,198     | \$734,102     | -\$72,096     | -8.9%  |
| Higher Education | Rural Health Initiative - Medical<br>Schools Support      | \$480,988     | \$437,975     | -\$43,013     | -8.9%  |
| Higher Education | WV Autism Training Center                                 | \$2,111,572   | \$1,922,742   | -\$188,830    | -8.9%  |
| Higher Education | West Virginia State University Land<br>Grant Match        | \$1,908,000   | \$1,737,374   | -\$170,626    | -8.9%  |
| Higher Education | West Virginia University - Potomac<br>State               | \$4,690,189   | \$4,270,762   | -\$419,427    | -8.9%  |

#### FY 2014 Budget Reductions – Lottery Revenue Fund

| Department             | Agency/Program  | FY 2013<br>Enrolled | FY 2014<br>Proposed | Reduction    | Percent<br>Change |
|------------------------|---|---------------------|---------------------|--------------|-------------------|
| Commerce               | West Virginia Development Office -<br>Division of Tourism   | \$7,364,005         | \$6,821,634         | -\$542,371   | -7.4%             |
| Commerce               | Division of Natural Resources                               | \$3,398,344         | \$3,151,511         | -\$246,833   | -7.3%             |
| Education              | State Department of Education                               | \$30,611,626        | \$28,720,723        | -\$1,890,903 | -6.2%             |
| Education and the Arts | Challenger Learning Center                                  | \$118,750           |                     | -\$118,750   | -100.0%           |
| Education and the Arts | Statewide STEM 21st Century<br>Academy                      | \$150,000           | \$130,000           | -\$20,000    | -13.3%            |
| Education and the Arts | Fairs and Festivals   | \$2,061,556         | \$1,752,333         | -\$309,223   | -15.0%            |
| Education and the Arts | Preservation West Virginia                                  | \$765,715           | \$650,858           | -\$114,857   | -15.0%            |
| Education and the Arts | Archeological Curation/Capital<br>Improvements              | \$51,641            | \$47,922            | -\$3,719     | -7.2%             |
| Education and the Arts | Historic Preservation Grants                                | \$563,750           | \$526,314           | -\$37,436    | -6.6%             |
| Education and the Arts | West Virginia Public Theatre                                | \$198,550           | \$103,742           | -\$94,808    | -47.8%            |
| Education and the Arts | Tri-County Fair Association                                 | \$22,562            | \$20,870            | -\$1,692     | -7.5%             |
| Education and the Arts | George Tyler Moore Center for the<br>Study of the Civil War | \$61,858            | \$52,580            | -\$9,278     | -15.0%            |
| Education and the Arts | Greenbrier Valley Theater                                   | \$158,913           | \$100,000           | -\$58,913    | -37.1%            |
| Education and the Arts | Theater Arts of West Virginia                               | \$265,000           | \$200,000           | -\$65,000    | -24.5%            |
| Education and the Arts | Marshall Artists Series                                     | \$59,565            | \$55,098            | -\$4,467     | -7.5%             |
| Education and the Arts | Grants for Competitive Arts Program                         | \$1,021,250         | \$944,656           | -\$76,594    | -7.5%             |
| Education and the Arts | West Virginia State Fair                                    | \$49,875            | \$46,134            | -\$3,741     | -7.5%             |

|                        |  |              |              |            |       |
|------------------------|--|--------------|--------------|------------|-------|
| Education and the Arts | Contemporary American Theater Festival                               | \$94,763     | \$87,656     | -\$7,107   | -7.5% |
| Education and the Arts | Independence Hall  | \$45,125     | \$41,741     | -\$3,384   | -7.5% |
| Education and the Arts | Mountain State Forest Festival                                       | \$63,175     | \$58,437     | -\$4,738   | -7.5% |
| Education and the Arts | WV Symphony  | \$94,763     | \$87,656     | -\$7,107   | -7.5% |
| Education and the Arts | Wheeling Symphony  | \$94,763     | \$87,656     | -\$7,107   | -7.5% |
| Education and the Arts | Save the Music   | \$30,000     | \$27,750     | -\$2,250   | -7.5% |
| Education and the Arts | Appalachian Children's Chorus  | \$90,250     | \$83,481     | -\$6,769   | -7.5% |
| Education and the Arts | Huntington Symphony  | \$99,763     | \$92,281     | -\$7,482   | -7.5% |
| Education and the Arts | Library Commission   | \$12,185,884 | \$11,467,423 | -\$718,461 | -5.9% |
| Senior Services        | Senior Citizen Centers and Programs                                  | \$2,470,000  | \$2,286,264  | -\$183,736 | -7.4% |
| Senior Services        | Roger Tompkins Alzheimers Respite Care                               | \$2,296,137  | \$2,125,542  | -\$170,595 | -7.4% |
| Senior Services        | Regional Aged and Disabled Resource Center                           | \$935,000    | \$864,875    | -\$70,125  | -7.5% |
| Senior Services        | Legislative Initiatives for the Elderly                              | \$10,000,000 | \$9,256,131  | -\$743,869 | -7.4% |
| Senior Services        | Long Term Care Ombudsmen   | \$321,325    | \$297,226    | -\$24,099  | -7.5% |
| Senior Services        | West Virginia Help Line  | \$200,000    | \$185,000    | -\$15,000  | -7.5% |
| Senior Services        | In-Home Services and Nutrition for Senior Citizens                   | \$4,500,000  | \$4,165,259  | -\$334,741 | -7.4% |
| Higher Education       | Marshall Medical School - RHI Program and Site Support               | \$471,258    | \$429,115    | -\$42,143  | -8.9% |
| Higher Education       | WVU Health Sciences - RHI Program and Site Support                   | \$1,294,995  | \$1,179,188  | -\$115,807 | -8.9% |
| Higher Education       | RHI Program and Site Support - District Consortia                    | \$2,213,469  | \$2,015,526  | -\$197,943 | -8.9% |
| Higher Education       | RHI Program and Site Support - RHEP Program Administration           | \$169,731    | \$154,553    | -\$15,178  | -8.9% |
| Higher Education       | RHI Program and Site Support - Grad Med Ed and Fiscal Oversight      | \$98,709     | \$89,882     | -\$8,827   | -8.9% |
| Higher Education       | Minority Doctoral Fellowship   | \$150,000    | \$136,586    | -\$13,414  | -8.9% |
| Higher Education       | Health Sciences Scholarship  | \$251,542    | \$229,047    | -\$22,495  | -8.9% |
| Higher Education       | Vice Chancellor for Health Sciences - Rural Health Residency Program | \$267,882    | \$243,926    | -\$23,956  | -8.9% |
| Higher Education       | MA Public Health Program and Health Science - Technology             | \$62,483     | \$56,895     | -\$5,588   | -8.9% |
| Higher Education       | Marshall University Graduate College Writing Project                 | \$25,000     | \$22,764     | -\$2,236   | -8.9% |
| Higher Education       | Health Sciences Career Opportunities Program                         | \$378,192    | \$344,372    | -\$33,820  | -8.9% |
| Higher Education       | HSTA Program   | \$1,543,868  | \$1,405,802  | -\$138,066 | -8.9% |
| Higher Education       | Center for Excellence in Disabilities                                | \$350,000    | \$318,701    | -\$31,299  | -8.9% |