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The Governor's 2016 Budget: More Austerity, Less Prosperity

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Governor Tomblin's proposed 2016 budget continues the state's recent trend, with a number of cuts and transfers needed to balance the budget, as the state's revenue problem has yet to be solved. The Rainy Day Fund will once again be tapped, and bills will need to be passed by the legislature to divert previously dedicated revenue. Another round of cuts, the bulk of which target higher education, also helps balance the budget. Fortunate budgetary circumstances, including better than expected investment returns and a drop in the state's K-12 enrollment, prevented deeper budget cuts and greater borrowing from the Rainy Day Fund. This brief examines those priorities, from both the spending and revenue sides, and includes recommendations to strengthen the budget invest to secure the state's future.

Key Findings:

- Appropriations from the base budget total \$4.675 billion, but additional appropriations from the Rainy Day Fund and surplus supplementals will increase total expenditures.
- The governor is proposing using \$25 million from the Rainy Day Fund and \$72 million in budget cuts, among other actions, to close a projected \$195 million budget gap.
- Falling K-12 enrollment and other adjustments to the school aid formula softened the impact of the budget cuts.
- Higher education is once again facing cuts, with state investment in higher education at an eight-year low for 2016.
- With little room in the budget for pay raises, West Virginia public employees remain among the lowest paid nationally. The state also faces serious unaddressed challenges, including an unhealthy, undereducated workforce and too many children living in poverty.
- Growth in budget revenues is slow compared to the past. Adjusting for inflation, base budget revenues are \$685 million less in 2016 compared to 2008. In 2014, General Revenue Fund collections relative to the economy were lower than at any time since 1990. If General Revenue Fund collections were at the average share of the economy, the state would have collected \$431 million more in revenue in 2014. Since the recession, state revenue growth has lagged behind other states, growing only by 4.8 percent compared to 7.4 percent nationally.
- Between 2014 and 2020, the only major sources of revenue growth are from the Personal Income, Sales & Use, and

Severance Taxes. Over the last several years, the reliance on volatile Severance Tax revenues has grown from four percent of General Revenue Fund revenues in 2000 to 12 percent in 2014, while business taxes have declined from 8.3 percent to five percent.

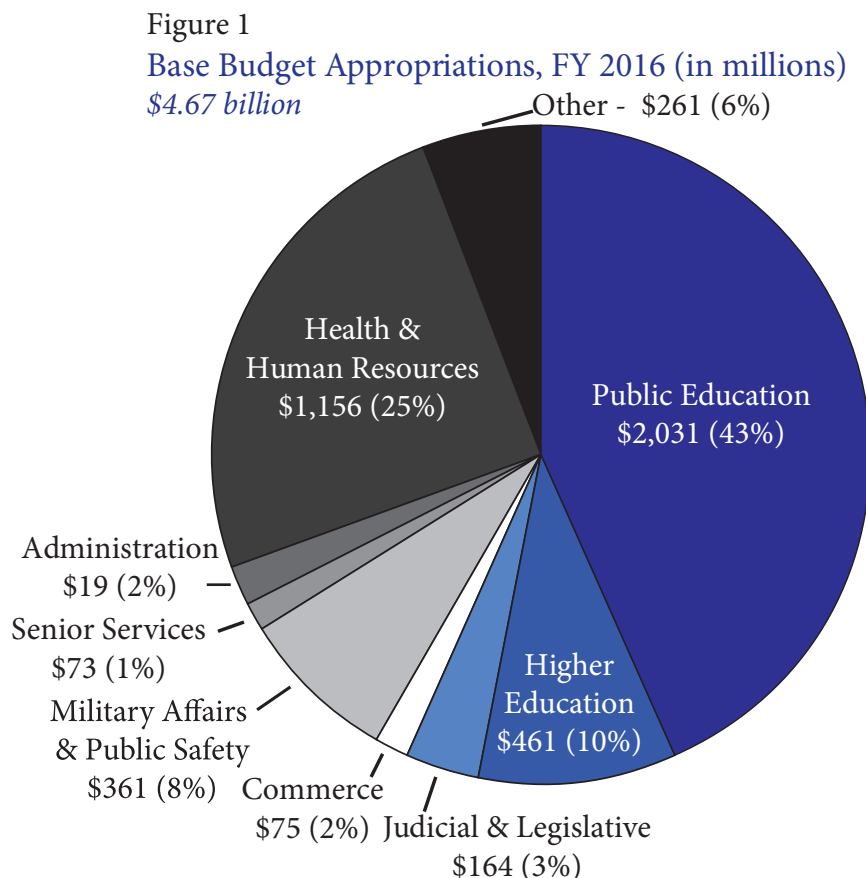
- To make smart investments to grow a more productive, healthier, and vibrant economy, the state will have to find additional resources. This could include modernizing the Personal Income and Sales Tax, increasing taxes on tobacco and alcohol, ending inefficient business tax credits and breeding subsidies, closing corporate tax loopholes, and ensuring that the state always benefits from its rich mineral resources by strengthening the WV Future Fund.

Section One: West Virginia's Investments

The state budget is a reflection of the state's priorities. Continued disinvestment in higher education and other areas puts the state's economic future at risk, while other important programs supporting children and families continue to be vulnerable due to a lack of permanent funding. This section gives a brief overview of Governor Tomblin's proposed 2016 base budget appropriations, including where the budget is changing, how he intends to balance the budget, and how continued spending cuts are making it difficult to invest and grow the state.

Overview of the Governor's 2016 Base Budget Expenditures

Governor Tomblin's proposed 2016 base budget calls for appropriations of \$4.675 billion dollars. But with base budget revenues projected to be only \$4.67 billion, a number of cuts, transfers, and adjustments were necessary to bring the budget into balance. The 2016 proposed base budget appropriations, which include appropriations from the General Revenue Fund, Lottery Fund, and Excess Lottery Fund, total \$4.67 billion, with the largest share of appropriations dedicated to public education at \$2.03 billion, followed by health and human services at \$1.16 billion (**Figure 1**).



Source: WV State Budget Office, Governor's Proposed FY 2016 Executive Budget - Volume 1 Budget Report.

While the 2016 budget proposal includes increased funding for Early Literacy, Truancy Prevention, Work Release Programs, and the state’s share of Medicaid, the 2016 base budget is smaller than the 2015 base budget, requiring another round of budget cuts to bring the budget into balance.

Balancing the 2016 Budget

Once again, this upcoming year’s state budget required a number of spending cuts, transfers, and additional sources of savings in order to balance. The 2015 base budget totaled \$4.81 billion. The 2016 budget would need to total \$4.87 billion to maintain that current level, adjusting for growth in the general costs of government services, along with other adjustments. With base budget revenues projected to total only \$4.67 billion, the 2016 budget is left with a \$195 million gap (**Table 1**).

Table 1

Balancing the 2016 Budget

Item	Amount (thousands)
2015 Base Budget Expenditures	\$4,808,435
2016 Ongoing Base Budget	\$4,870,228
2016 Base Budget Available Revenue	\$4,674,928
2016 Budget Gap	-\$195,300

Source: WV State Budget Office, Governor’s Proposed FY 2016 Executive Budget – Volume 1 Budget Report.

As in 2015, the 2016 proposed budget employs a number of different measures to close the budget gap. First, after the budget proposal was released, the governor announced that \$44 million was available from the teacher’s retirement account (TERS), because, according to the governor, its investment returns were higher than expected. Originally, he had proposed transferring \$68.6 million from the Rainy Day Fund to close the 2016 budget gap but the additional \$44 million from TERS reduced the amount needed to \$25 million.

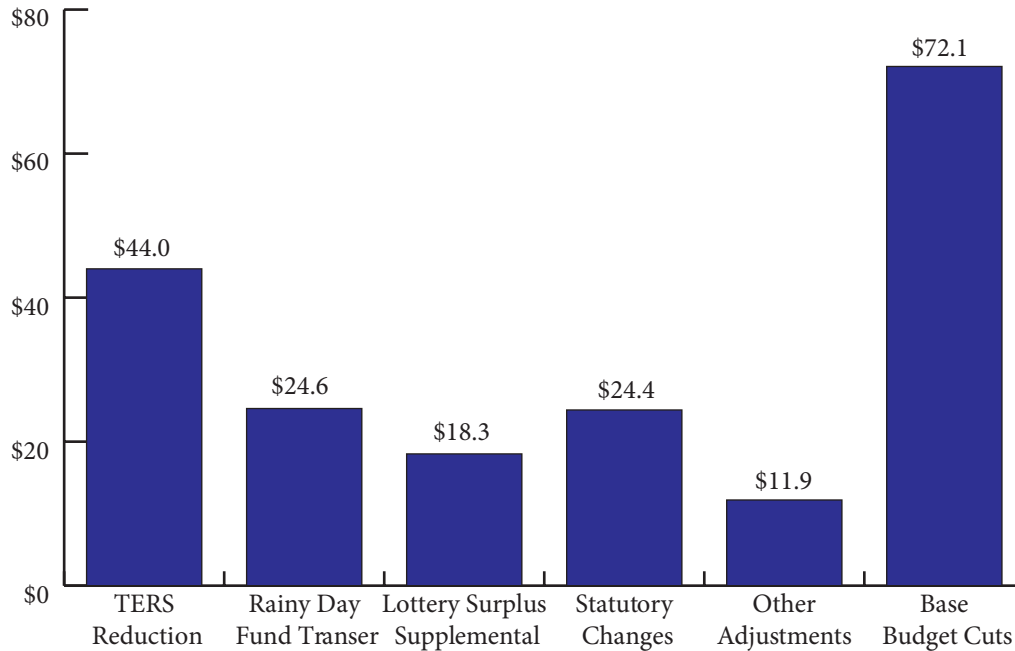
In addition to the \$44 million from TERS and the \$25 million from the Rainy Day Fund, which are being used to fund the state’s share of Medicaid, the governor is also proposing using \$18.3 million from previous years’ surplus lottery funds to help fund Medicaid.

Closing the 2016 budget gap will also rely on a number of statutory changes to redirect dedicated revenue into the General Revenue Fund, freeing up \$24.4 million. The redirected revenue includes \$19.5 million in Sales and Use Tax revenue that would otherwise be sent to the Road Fund and School Building Authority, \$4.3 million in Corporation Net Income Tax revenue originally dedicated to the Public Port Authority, and \$500,000 in Severance Tax revenue originally directed to the Infrastructure Bond Fund.

Finally, the governor is proposing \$11.9 million in base budget adjustments and \$72.1 million in base budget cuts to close the remaining budget gap (**Figure 2**). The bulk of the total \$84 million in cuts and adjustments comes from a reduction in the appropriations sent to local school boards through the school aid formula. Falling student enrollment, along with rising local property taxes, allowed the state to reduce its share of the school aid formula by \$27 million from 2015.

In addition to the \$27 million cut from the school aid formula, other major budget cuts include \$12.0 million from higher education, \$5.7 million from health programs, and a \$1.9 million from local economic development. The governor is also rolling back \$800,000 in funding that the legislature restored to a number of children and family programs (**Table 2**).

Figure 2
Balancing the \$195 Million 2016 Base Budget Gap (in millions)



Source: WV State Budget Office, Governor's Proposed FY 2016 Executive Budget - Volume 1 Budget Report.

Table 2
2016 Major Budget Cuts

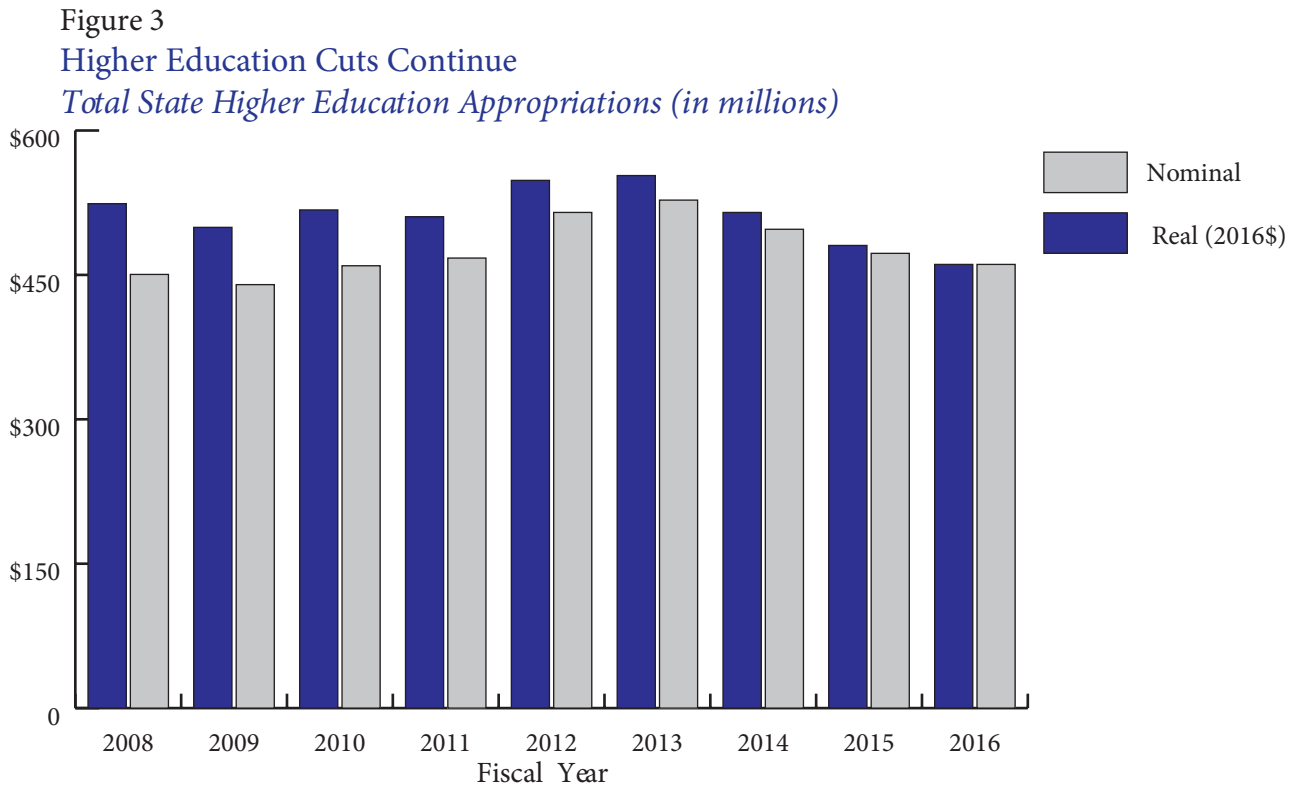
Agency	Item	2015	Proposed 2016	Difference	% Change
WV Development Office	Local Economic Development Assistance	\$1,850,000	\$0	-\$1,850,000	-100%
Division of Health	Primary Care Support	\$8,869,314	\$5,272,861	-\$3,596,453	-40.5%
Division of Health	Health Right Free Clinics	\$4,064,219	\$1,933,609	-\$2,130,610	-52.4%
Consolidated Medical Service Fund	Behavioral Health Program	\$75,181,543	\$72,181,543	-\$3,000,000	-4.0%
Division of Human Services	Children's Trust Fund	\$300,000	\$220,000	-\$80,000	-26.7%
Division of Human Services	Family Resource Networks	\$1,762,464	\$1,612,000	-\$150,464	-8.5%
Division of Human Services	Grants for Licensed Domestic Violence Programs and Statewide Prevention	\$2,500,000	\$2,142,100	-\$357,900	-14.3%
Division of Human Services	Domestic Violence Legal Services Fund	\$400,000	\$370,000	-\$30,000	-7.5%
Division of Criminal Justice Services	Child Advocacy Centers	\$1,702,466	\$1,502,215	-\$200,251	-11.8%
State Aid to Schools	Total Basic State Aid	\$1,187,654,478	\$1,160,025,707	-\$27,628,771	-2.3%
Council for Community and Technical Colleges	Total	\$66,031,048	\$65,096,617	-\$934,431	-1.4%
Higher Education Policy Commission	Total	\$350,465,289	\$339,539,262	-\$10,926,027	-3.1%
Higher Education (Lottery Fund)	Total	\$12,328,344	\$12,214,489	-\$113,855	-0.9%

Source: WV State Budget Office, FY 2016 Budget Bill.

Investments or Cuts: West Virginia's Needs

With tax cuts leading to budget cuts year after year, West Virginia has found itself unable to address a number of areas where it sorely needs investment. One of the biggest areas that is facing cuts, instead of investment, is higher education.

2016's proposed cut of \$12.0 million to higher education comes after cuts of \$13.9 million in 2015 and \$37.9 million in 2014, marking the third straight year of cuts. State investment in higher education will be at an eight-year low in 2016, and will be \$92.3 million below its level in 2013, adjusting for inflation (**Figure 3**).



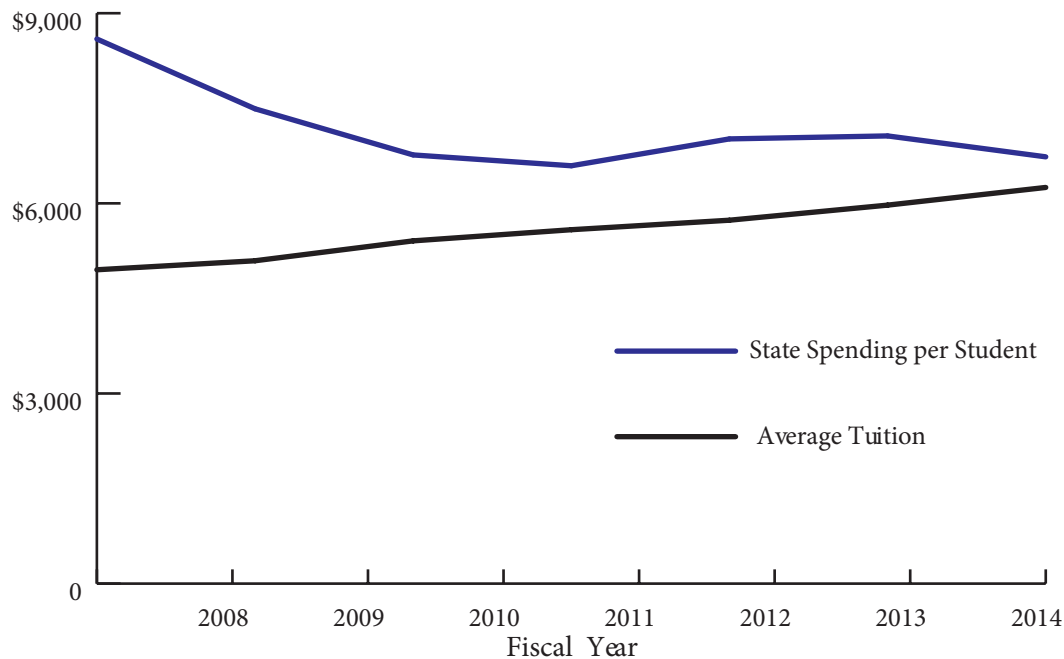
Source: WV State Budget Office, and U.S. Bureau of Economic Analysis.

Even with relatively flat enrollment, state investment in higher education per student fell more than 21 percent from 2008 to 2014. This slashed support has not happened in a vacuum, as average tuition for higher education in West Virginia rose more than 26 percent over that same time period (**Figure 4**).

With tax cuts as the major contributor to West Virginia's budget problems, investment in higher education represents a missed opportunity. Recent tax cuts will have cost the state an estimated \$425 million in 2016. If West Virginia had instead invested that revenue into higher education, it could have provided free tuition for all of its in-state students. The cost of full tuition for all in-state, full-time students at West Virginia's two- and four-year schools was \$249 million in 2013,¹ roughly half the cost of the tax cuts. Instead, West Virginia continues to have the lowest level of education in the country, with only 26.1% of adults over the age of 25 holding at least an associate degree.²

Tight budgets have not only hurt the state's investment in its future workforce, but have also made it harder for the state to attract and retain its own workers. With a growing number of state employees nearing retirement, officials have grown concerned over the state's ability to attract young workers into the public sector.³ Low pay, shrinking benefits, and the constant threat of budget cuts make the state an unattractive employment environment for young workers.

Figure 4
Higher Education Investment Down, Tuition Up



Source: Center on Budget and Policy Priorities.

For example, a recent audit of the West Virginia Division of the Corrections performed by the Legislative Post Audit Division found that pay for West Virginia’s corrections officers ranked among the lowest in the country, while its level of turnover ranked among the highest. The audit also found that high levels of turnover, inexperienced staff, and increased vacancies have resulted in a significant increase in liability and safety issues at correctional facilities.⁴

While state workers received token pay raises last year, the state continues to rank poorly for public sector pay. Overall, West Virginia ranks 47th for average state employee wage and salary, with the state’s average nearly \$11,000 below the national average. Average state employee pay in West Virginia ranks below all but one of its neighboring states (**Table 3**).

Table 3
Average State Employee Wage and Salary

State	Average Annual Wage/Salary
United States	\$54,995
Kentucky	\$43,124
Maryland	\$63,776
Ohio	\$51,243
Pennsylvania	\$55,109
Virginia	\$46,884
West Virginia	\$44,151

Source: WVCPB analysis of U.S. Census Bureau, Current Population Survey Data (2011-2013).

A similar story can be told for teachers in West Virginia. West Virginia ranks 47th among the states for average teacher salary; with the state’s teachers earning \$10,650 less than the national average. Each of West Virginia’s neighboring states

has higher average salaries for teachers (**Table 4**). While the legislature passed an across-the-board pay raise for teachers last year, a lack of revenue and projected deficits make any further investment unlikely.

Table 4
Average Teacher Starting Salary

State	Average Annual Wage/Salary
United States	\$56,103
Kentucky	\$50,203
Maryland	\$64,248
Ohio	\$56,307
Pennsylvania	\$62,994
Virginia	\$48,670
West Virginia	\$45,453

Source: National Education Association, Ranking and Estimates, March 2014.

From the health of its citizens, to their levels of education; from the strength of the economy, to the vulnerability of its children, West Virginia has no shortage of areas which need investment (**Table 5**). A strong state budget address these needs, and create the conditions necessary for a strong economy and a healthy population. But a state budget weakened by tax cuts leaves precious few resources available beyond the basic functions of government to meet the state’s pressing needs.

Table 5
West Virginia Behind Nation in Key Areas

	WV	U.S.	WV Rank
Child Poverty Rate	26.6%	20.0%	8th
Adults with Diabetes Rate	13.0%	10.3%	2nd
Adult Obesity Rate	68.8%	63.8%	3rd
Labor Force Participation	53.6%	62.7%	50th
Adults with a Bachelor's Degree	21.7%	31.0%	50th

Source: Kaiser Family Foundation and U.S. Census Bureau.

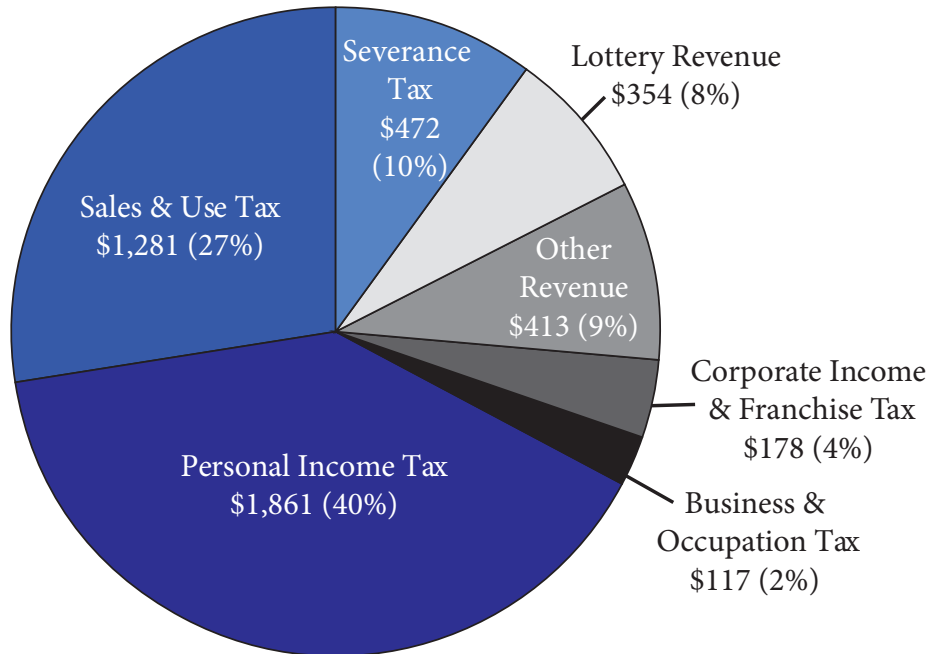
Section Two: Paying for Budget Priorities, 2016 and Beyond

This section explores the how the governor plans to pay for the priorities laid out in his proposed 2016 budget, including how revenues from the budget have changed over time, how revenues will grow in the future, and what revenue options could be explored so smart investments can be made to grow our economy and create a more productive, healthier, and vibrant economy.

Governor’s Proposed Base Budget Revenues

Revenues from the governor’s proposed base budget include \$4.321 billion in general revenues funds and \$353.7 million in revenues from lottery and excess lottery funds, a total of \$4.675 billion. Over two-thirds of the base budget is derived from the Personal Income Tax and Sales & Use Tax, while the Severance Tax makes up over 10 percent. Lottery revenues account for eight percent of the base budget, while the Corporate Income Tax accounts for only four percent. Other revenues, such as the Tobacco Products Tax and the Insurance Tax, provide about nine percent of the state’s general revenues.

Figure 5
Governor's Proposed \$4.675 Billion Base Budget Revenues, FY 2016 (in millions)



Source: WV State Budget Office, Governor's Proposed FY 2016 Executive Budget - Volume 1 Budget Report.

As discussed in the previous section, the governor seeks one-time revenue through supplemental appropriations from special revenue accounts and proposed statutory changes to fund the budget, including \$44.7 million to fund the state's share of Medicaid by tapping Rainy Day Fund A for \$24.6 million and \$18.3 million from 2015's lottery surplus revenues.

Proposed statutory changes include reducing by \$8 million the annual Sales and Use Tax transfer to the School Building Authority, eliminating the transfer of \$4.3 million from the Corporate Net Income Tax to the Public Port Authority, decreasing by \$0.5 million the \$23 million transfer of Severance Tax revenue to the Infrastructure Bond Fund, and a one-time additional transfer of \$15 million from the Treasurer's Abandoned and Unclaimed Property Account to the General Revenue Fund in 2016.

Tax Cuts Still Undermining Investment

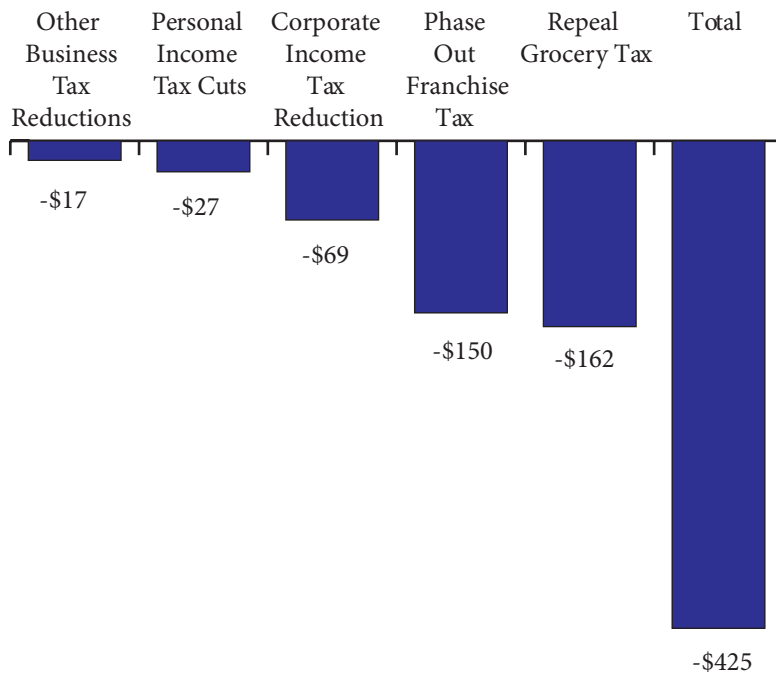
Between 2006 and 2007, West Virginia implemented a number of very large tax cuts that have continued to undermine the state's fiscal health. Over half of these major tax cuts were reductions in business taxes, including the phase-out of the Business Franchise Tax, a reduction in the Corporate Net Income Tax rate from nine percent to 6.5 percent, and several other smaller business tax cuts, which are estimated to reduce revenue by \$236 million this year alone.

To date, there is no evidence that these business tax cuts have provided the supply-side effects that proponents promised. Outside of the Severance Tax, revenues across the board have grown slowly and the Corporate Net Income Tax and Business Franchise tax collections are at a 24-year low. By most economic indicators, the state has performed worse than the nation as a whole. For example, between 2006 and 2012 West Virginia's share of national private-sector establishments, non-mining GDP, and manufacturing GDP have declined.⁵ Between January 2007 and November 2014, West Virginia's share of the national labor force and private employment has also declined.⁶ West Virginia also has a higher unemployment rate, 6.0 percent compared to the national rate in December 2014 of 5.6 percent.⁷

The grocery tax repeal was also a significant factor in reducing the state's revenues over the last several years. Beginning

in 2006, the Sales & Use Tax on groceries was reduced from six percent to zero in 2013. Altogether, the tax cuts have amounted to \$425 million in forgone revenue in 2015 alone (**Figure 6**).

Figure 6
Major General Revenue Tax Reduction Enacted in 2006-2007 (in millions)



Source: West Virginia Department of Revenue.

Budget Failing to Keep Pace with Economy

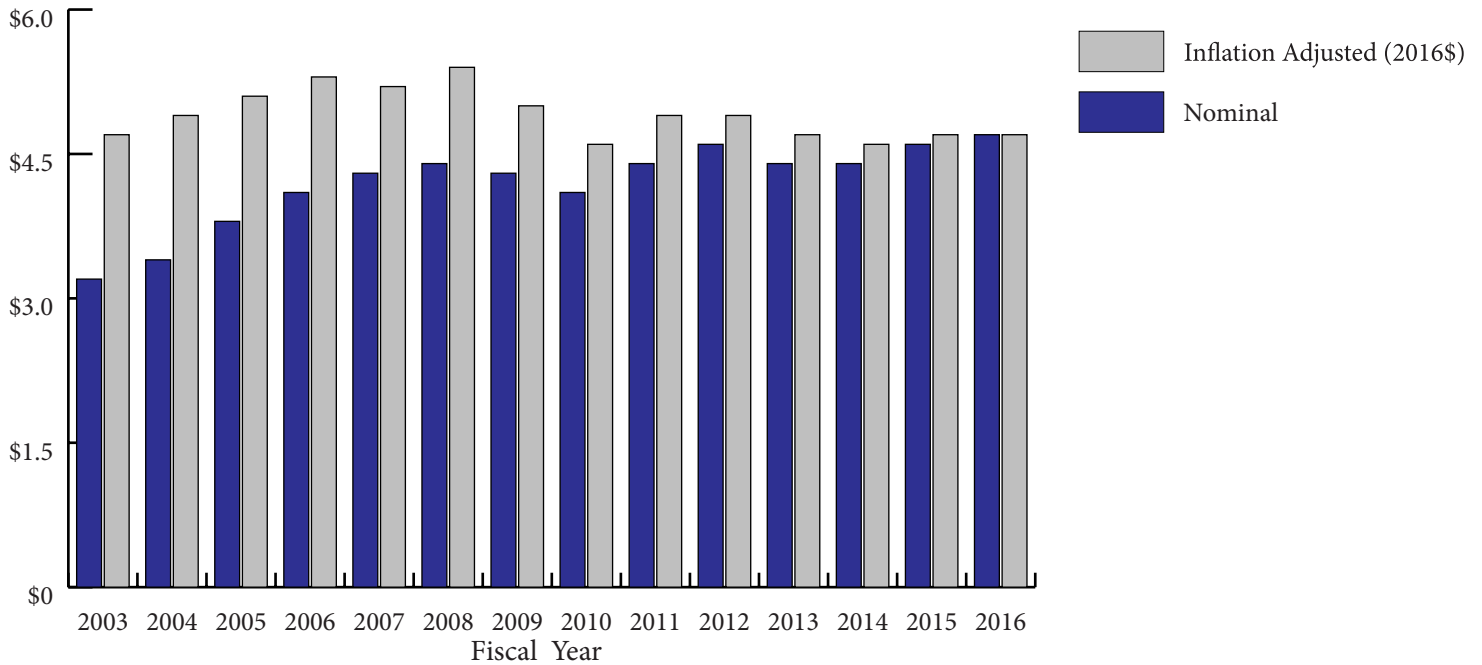
While base budget revenue is expected to grow by \$54.6 million between 2015 and 2016, that growth is anemic compared to the past and well below its average rate. From 2003 to 2012, the base budget grew at an average annual rate of 4.2 percent or \$137 million per year compared to just 0.6 percent or \$59 million per year between 2012 and 2016. The governor’s proposed base budget revenues in 2016 are expected to be nearly \$685 million less than actual revenues collected in 2008 after adjusting for inflation and \$13 million less than in 2003 (**Figure 7**). According to the National Association of State Budget Officers, annual state general revenue fund growth has averaged 5.5 percent between 1979 and 2014 and 1.5 percent after adjusting for inflation.⁸

While looking at budget revenues that are adjusted for inflation helps understand whether revenues are keeping pace with growing costs of public goods, assessing the state’s general revenues relative to the size of the economy better reflects whether the funding available to the state is keeping up with needs, while also taking into account economic growth or stagnation.

West Virginia’s General Revenue Fund collections relative to the size of the state’s economy (personal income) have declined since 2005, from 7.4 percent to just 6.2 percent in 2014 (**Figure 8**). This downward trajectory highlights that the state is investing less as a share of its economy and that its ability to spur economic growth and develop its human and physical capital through its schools, infrastructure, tourism, and health services has declined.

Figure 7

West Virginia Base Budget Revenue Growing Slowly (in billions)

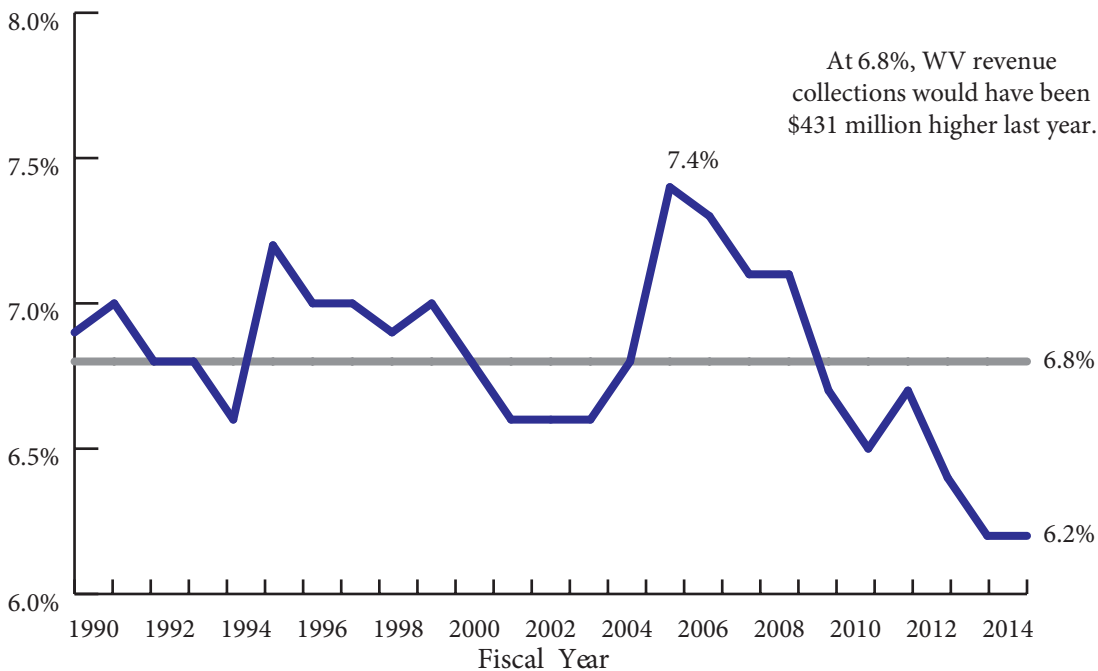


Source: West Virginia State Budget Office and U.S. Bureau of Economic Analysis.

Note: For determining changes in real revenues, these calculations use the U.S. Bureau of Economic Analysis National Income and Product Account Tables, Table 1.1.9 Implicit Price Deflators for Gross Domestic Product, Line 26, State and Local Government Consumption Expenditures and Gross Investment from 3rd Quarter 2002 to 4th Quarter 2014. Fiscal year inflation rates determined through quarterly averages. For fiscal year 2015 and 2016, the author used the average rate of inflation growth between 2002 and 2014 for fiscal year 2015 and 2016.

Figure 8

As State Revenue Falls Relative to Economy, West Virginia Loses Ability to Invest in its Residents
 State General Revenue as Percent of Personal Income in West Virginia

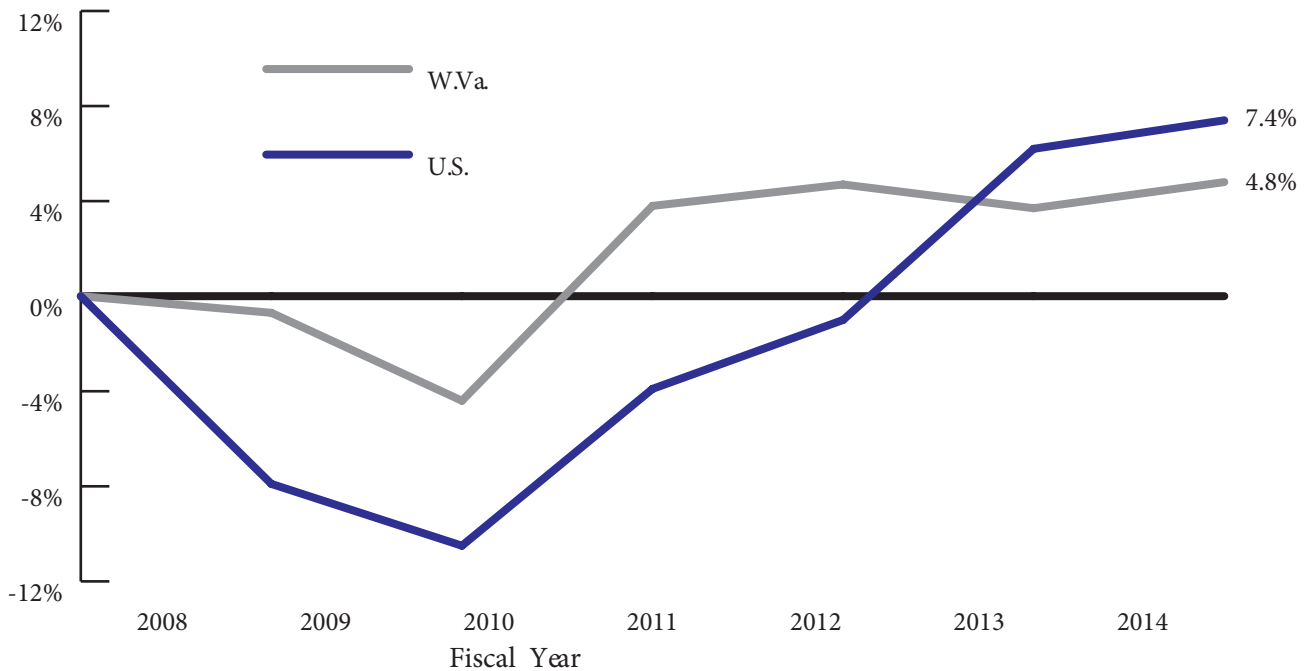


Source: WV State Budget Office and U.S. Bureau of Economic Analysis (Quarterly State Personal Income).

While the state's economy suffered from the Great Recession between 2008 and 2010, General Revenue Fund collections have not rebounded with our growing economy or rebounded as fast as other states. In fact, the share or ratio of the state's general revenue collections relative to its economy in 2014 is lower than at any time since 1990. Between 1990 and 2014, General Revenue Fund collections averaged 6.8 percent of the state's economy (personal income). If the ratio in 2014 had been 6.8 percent, net General Revenue Fund collections would have been \$4.536 billion, or \$431 million more than the \$4.106 billion collected in 2014. This amount is very close to the estimated \$425 million in lost General Revenue Fund tax collections that were the result of several major tax cuts enacted in 2006 and 2007 (see Section One).

Similar to the nation, West Virginia experienced a decline in General Revenue Fund collections during the recession. Although it did not experience as large a dip in revenue growth as other states between 2008 and 2010, its recovery has been slower due to the tax reductions over this period. While national General Revenue Fund collections grew by an annual average rate of 4.5 percent from 2010 to 2014, West Virginia's general revenue fund grew by nearly half that rate at 2.3 percent. Nationally, revenue collections have grown by 7.4 percent from 2008 to 2014, while in West Virginia they have only grown by 4.8 percent (Figure 9).

Figure 9
West Virginia General Revenue Fund Growth Lags Nation



Source: National Association of State Budget Officers, Fall 2014 Fiscal Survey of the States.

Section Three - Projected Revenue Growth and Tax Reform Options

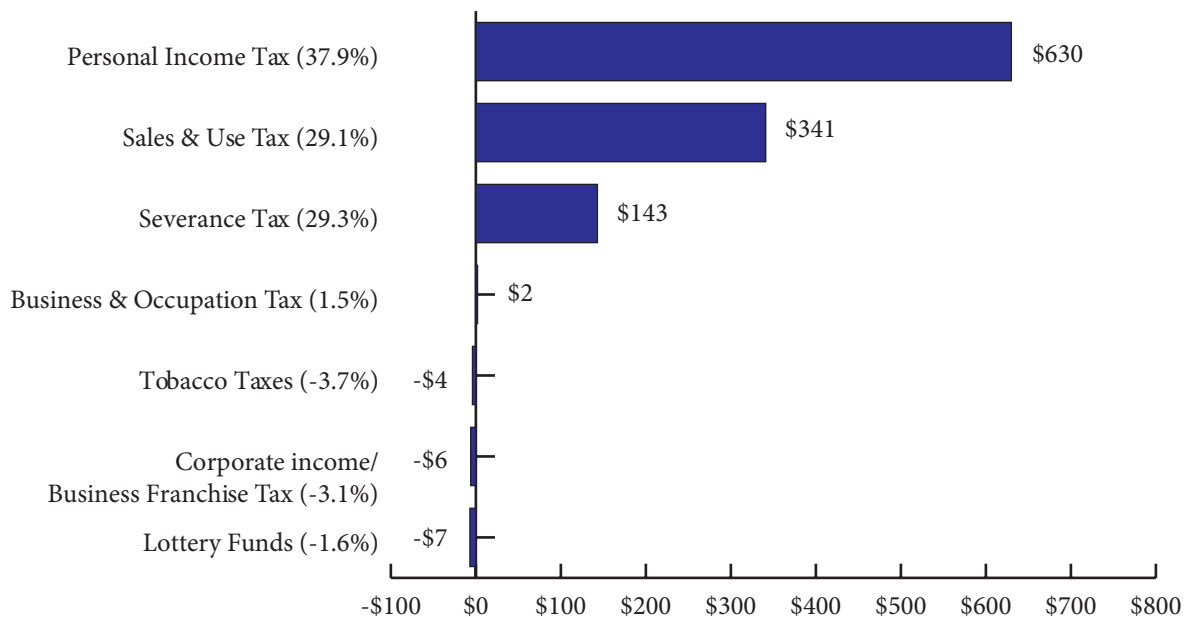
This section will explore the major sources of revenue that fund the base budget and will suggest options for modernizing and reforming the state's major taxes. As shown in the previous section, tax cuts implemented over the last decade have eroded the state's tax base. Reforms are necessary to spur the state's economy and develop its human and physical capital, improving West Virginia's quality of life and providing a more meaningful opportunity for its people to thrive.

From 2014 to 2020, the governor's budget estimates that growth in the Personal, Sales and Use, and Severance Taxes will be the only source of major revenue growth. Personal Income Tax collections are expected to grow from about 40.5 percent

of the general revenue collections in 2014 to 44.1 percent by 2020, while collections from the sales & use and severance tax will remain about the same at 29 percent and 12 percent respectively.

The governor’s 2015 revenue estimates included a much more optimistic outlook for severance tax collections than in 2014. In 2014, the governor estimated the state would collect \$512.4 million in severance taxes in 2019 compared to \$606.3 million in his 2015 estimates, a difference of almost \$94 million. The long-term revenue outlook also improved for the Business & Occupation tax in 2019, from \$99.3 million in the 2014 estimates to \$122 million in the 2015 revenue estimates, a difference of about \$23 million. Meanwhile, 2015 revenue estimates for Sales and Use and Personal Income Tax collections for 2019 were only about \$7.2 million higher than 2014 estimates (**Figure 10**).

Figure 10
Growth in Major Base Budget Reveue Sources from FY 2014 to FY 2020 (in millions)

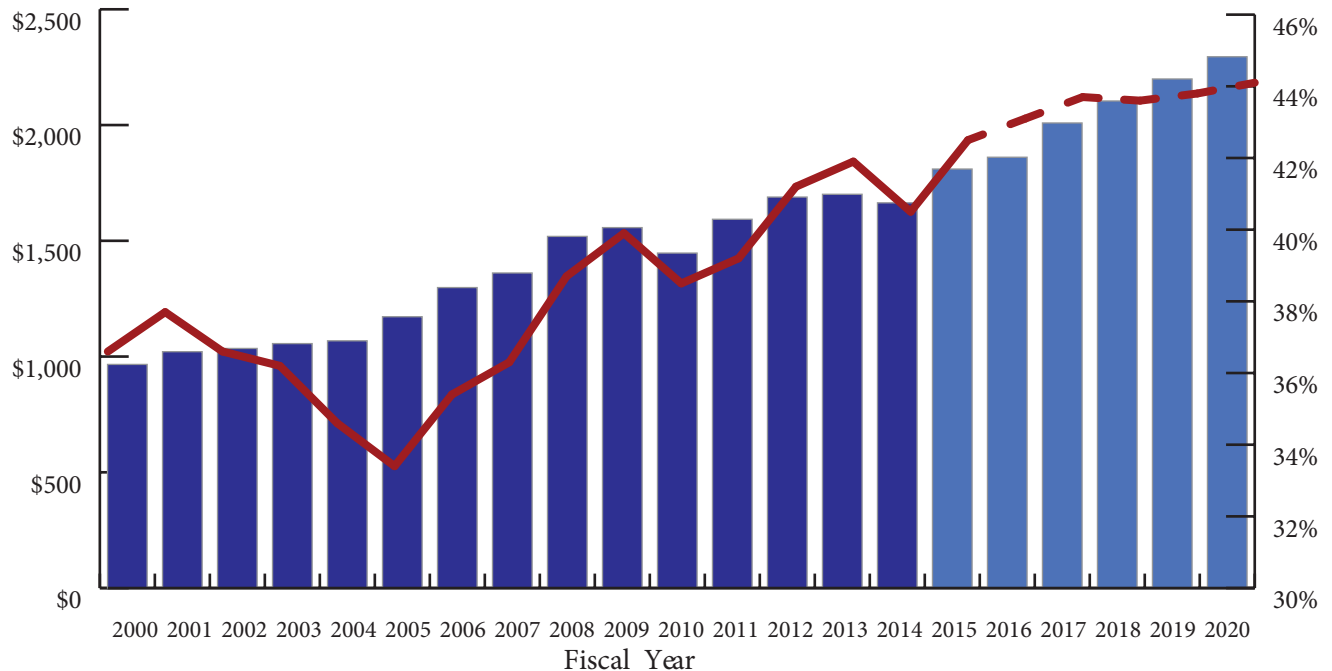


Source: WV State Budget Office, Governor’s Proposd FY 2016 Executive Budget - Volume 1 Budget Report.

Personal Income Tax

The Personal Income Tax applies to the taxable income of resident individuals, estates and trusts. It includes income such as wages and salaries, rental income, capital gains, interest from bank accounts, and some business income. Between 2014 and 2020, the state expects personal income revenues to grow by \$630 million, from \$1.664 billion to \$2.295 billion. Over the last several decades, the state has relied more heavily on Personal Income Taxes to fund General Revenue Fund expenditures, growing from 36.6 percent in 2000 to 40.5 percent in 2014. By 2020, it is expected to grow to 44.1 percent of the General Revenue Fund (**Figure 11**).

Figure 11
 Personal Income Tax Growing Share of General Revenue Fund (in millions)



Source: WV State Budget Office.

Recommendations for Personal Income Tax:

Scale Back Personal Exemptions: West Virginia taxpayers are provided a \$2,000 personal exemption for each household member. It is estimated to reduce revenue by \$136 million per year.⁹ While low- and middle-income families benefit from this exemption, the value of the tax reduction is greater for those in higher tax brackets earning at higher income levels. Unlike the federal government that phases out its personal exemptions, West Virginia does not. If the \$2,000 per person exemption were phased out for joint filers between \$150,000 and \$200,000 and eliminated for those over \$200,000, it would increase revenue by an estimated \$7.5 million and improve the progressivity of our state’s personal income tax.¹⁰

Modernize Personal Income Tax Rates & Brackets: West Virginia has a progressive, graduated personal income tax, where rates and brackets begin at three percent for adjusted gross income between \$0 and \$10,000 and grow to 6.5 percent on adjusted gross income above \$60,000. However, these rates and brackets have been not changed since 1987, when the state’s top personal income rate was reduced from 13 to 6.5 percent. Since then, the progressivity of the state’s personal income tax has diminished – pushing more middle-income households into higher tax rates. For example, in 1987, West Virginia’s top bracket affected just three percent of households compared to 22 percent that were affected in 2014.¹¹ Adjusting for inflation, the top bracket of \$60,000 put in place 1987 is equivalent to over \$128,000 today.¹²

Modernization could include lowering rates for some low- and middle-income residents and increasing them on higher-income residents. For example, raising the top personal income tax rate by one percent (from 6.5 to 7.5%) on taxable income over \$230,000 could increase revenue by an estimated \$25.7 million. Increasing the tax rate to seven percent on those with adjusted gross incomes between \$115,000 and \$150,000, 8.5 percent on incomes between \$150,000 and \$250,000, and 8.9 percent on incomes over \$250,000 could increase revenues by an estimated \$100 million. This could be coupled with rate reduction for middle-class households.

Create Refundable State Earned Income Tax Credit (EITC): Currently, 25 states have enacted EITCs to supplement the federal EITC.¹³ The EITC refundable tax credit for low-income families is designed to encourage and reward work, offset regressive taxes and reduce poverty. In 2015, the estimated cost of a refundable state EITC at five percent of the federal EITC would be \$15 million, at 10 percent \$30 million, 15 percent \$45 million, and \$60 million at 20 percent.

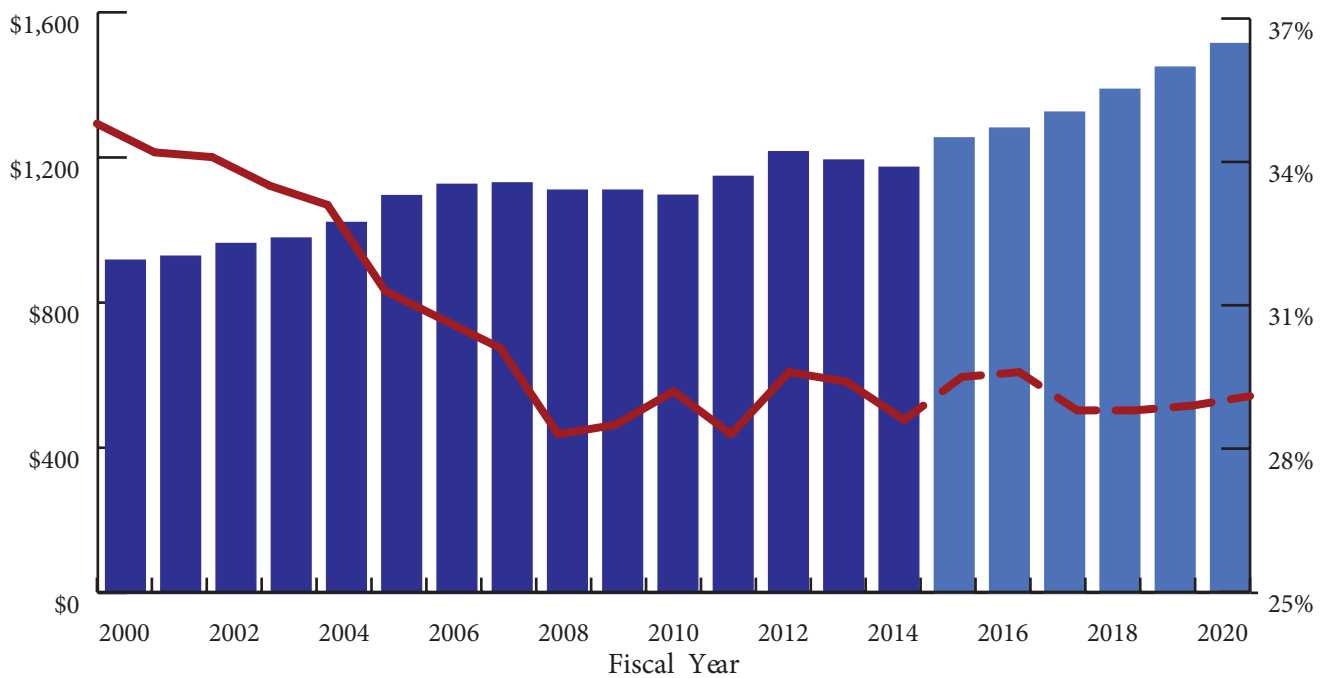
Bonus ~Reinstate the Estate Tax: First enacted in 1904, West Virginia’s estate tax effectively ended in 2005 when the state did not decouple from the federal estate tax changes. Today, 21 states collect over \$4.5 billion per year from their estate tax while West Virginia collects next to nothing. Reinstating this tax could raise an average of \$15 to \$20 million per year.¹⁴

Sales & Use Tax

The Sales and Use Tax is a six-percent consumption tax applied to both good and services. In 2016, the state expects to collect \$1.281 billion in Sales and Use taxes and expects this to grow to \$1.514 billion by 2020. The Sales and Use Tax as share of general revenue fund collections has declined over the last 15 years from about 35 percent of general revenue fund collections to about 29 percent in 2014 (**Figure 12**).

This decline was due to a number of factors, such as sluggish economic growth and an increase in online retail shopping. The central driving factor, however, was the gradual repeal of the grocery tax that began in 2005. Between 1990 and 2000, collections from the Sales & Use Tax mirrored collections from the Personal Income Tax. Over the last decade, however, sales taxes have grown at a much slower pace than personal income taxes. For example, between 2005 and 2014, they grew by only 7.1 percent while personal income taxes grew by 42 percent.

Figure 12
Sales & Use Tax Shrinking as a Share of the General Revenue Fund (in millions)



Recommendations for Sales & Use Tax:

Explore Expanding Sales & Use Tax to More Personal & Professional Services: Over the last several decades West Virginia's economy has shifted from producing goods (e.g. steel) to providing services (e.g. retail), but the tax code has not modernized to keep up with these changes. While West Virginia taxes more services than most states, there are many personal services (e.g. haircuts, health clubs, etc.) that are exempt from the sales tax for no discernible reason.¹⁵ Altogether, the state loses an estimated \$25.5 million from exempting some personal services.¹⁶ West Virginia should also explore the feasibility of expanding the Sales and Use Tax to some professional services, such as accounting and legal services. According to the Federal Tax Administrators, five states tax both legal and accounting services. The forgone revenue associated with these services in West Virginia is estimated to be \$68.6 million and \$14.3 million, respectively.¹⁷

Pass Federal Marketplace Fairness Act: According to the National Council of State Legislators (NCSL), the Marketplace Fairness Act (MFA) "authorizes states that adhere to certain simplifications to require out-of-state retailers that have more than \$1 million a year in out-of-state sales to collect and remit that state's sales taxes." The MFA would close loopholes that give online-only retailers a competitive advantage over brick-and-mortar merchants in West Virginia and around the country. While West Virginia took a good first step in enacting an "Amazon" law that allows it to collect sales taxes from the nation's largest online retailer, it is still losing Sales Tax revenue from other online retailers. According to NCSL, the estimated uncollected Use Tax from all remote sales in West Virginia in 2012 was \$103.3 million.¹⁸ State policymakers should encourage West Virginia's congressional delegation to pass the MFA to help level the playing field and bring in much-needed revenue.

Severance Tax

Growth in severance taxes was driven almost exclusively from the state's natural gas & oil shale development boom. In 2009, natural gas accounted for about 16 percent of severance tax revenues compared to an estimated 35 percent in 2015.

Over the last ten years severance tax revenues going to the General Revenue Fund have nearly doubled, from \$248 million in 2005 to \$489 million in 2014. Over this same period, general revenue collections grew by only 17 percent. Without this rapid growth in Severance Taxes, the state would have experienced much deeper declines in general revenues that could have resulted in much deeper budget cuts (**Figure 13**).

Over the last 15 years, Severance Tax collections as a share of the General Revenue Fund have grown from 5.6 percent to 11.9 percent. The Severance Tax tends to be a very volatile source of revenue, however, and an overreliance on it to fund the state's budget priorities could be problematic over the long term. This is one reason why many mineral-rich states put a portion of their severance tax collections into a permanent trust fund that grows over time as the non-renewable natural resources inevitably deplete.

Recommendations for Severance Tax:

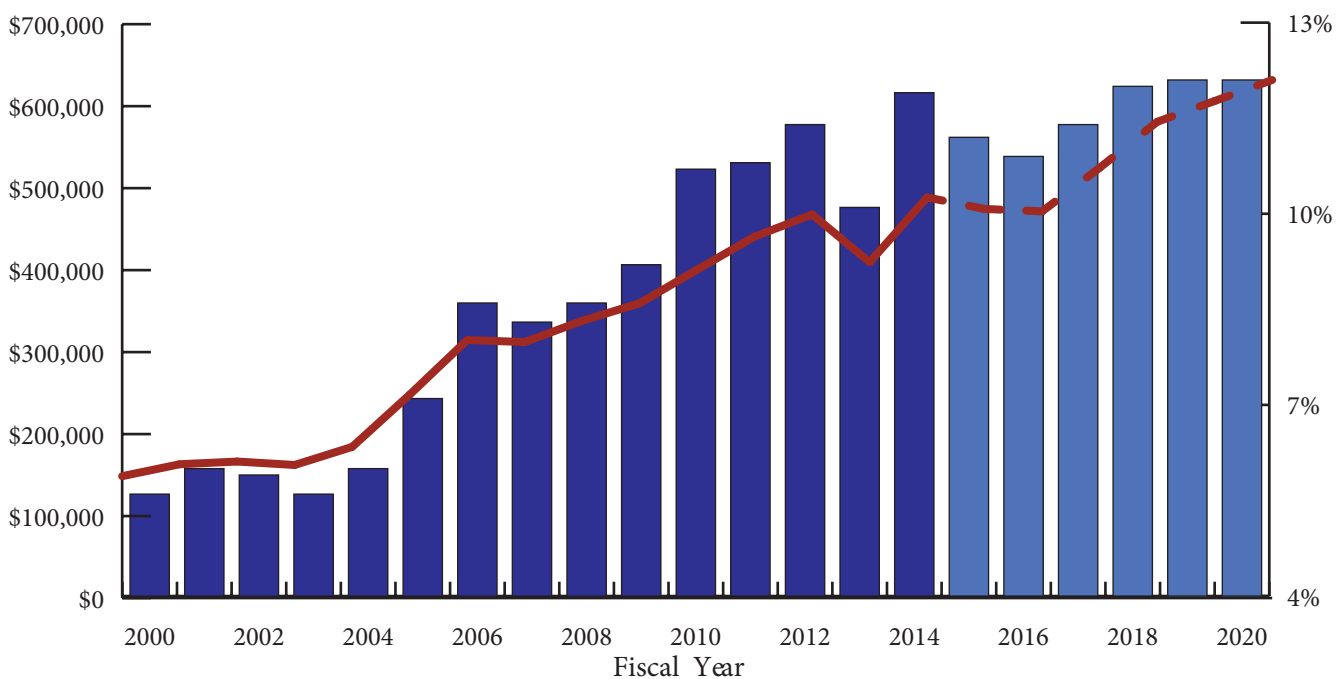
Scale Back Thin-Seam Severance Tax Credit: The coal severance tax rate is five percent, however, the rate for thin-seam coal is just one or two percent, depending on thickness. Altogether, this tax preference is expected to reduce revenue by \$77 million in 2015, up from just \$20 million in 2005. While the intention of this subsidy was to make smaller underground mines in the southern part of the state economically feasible, the credit is mostly applied to metallurgical coal that is usually two to three times as valuable as steam coal. Therefore, scaling back or eliminating this credit is advised since the credit was never meant to apply to metallurgical coal.

Extend Workers' Compensation Debt Taxes: According to the governor's budget report, the workers' compensation debt fund will be paid off by 2016. This debt is currently financed by several revenues sources, including a severance tax on coal (56 cents per ton), natural gas (7.7 cent per MCF), and timber (2.78 percent of gross value). Altogether, these taxes yield about \$80 to \$100 million per year. Because the severance tax is highly exportable, and West Virginia under taxes its mineral wealth compared to many western states, it makes sense to extend these taxes to help balance the budget and fund important public investments and economic diversification.

Explore Taxing Exported Shale Gas at a Higher Rate: While West Virginia was unable to prosper from the coal boom of the last 100 years, it has a chance to get it right with the surge in shale development. The state could explore increasing the severance tax on shale gas and natural gas liquids and offer a refundable credit if it is used in state, similar to what Virginia does with in-state use of coal mined in Virginia. A portion of this revenue could go into the WV Future Fund.

Fund the West Virginia Future Fund: Legislation passed last year creating the West Virginia Future Fund contained several triggers that have to be met in order for the fund to receive severance tax revenues. The triggers should be removed and additional money should be deposited into the West Virginia Future Fund.¹⁹

Figure 13
Severance Tax a Growing Share of the General Revenue Fund (in millions)

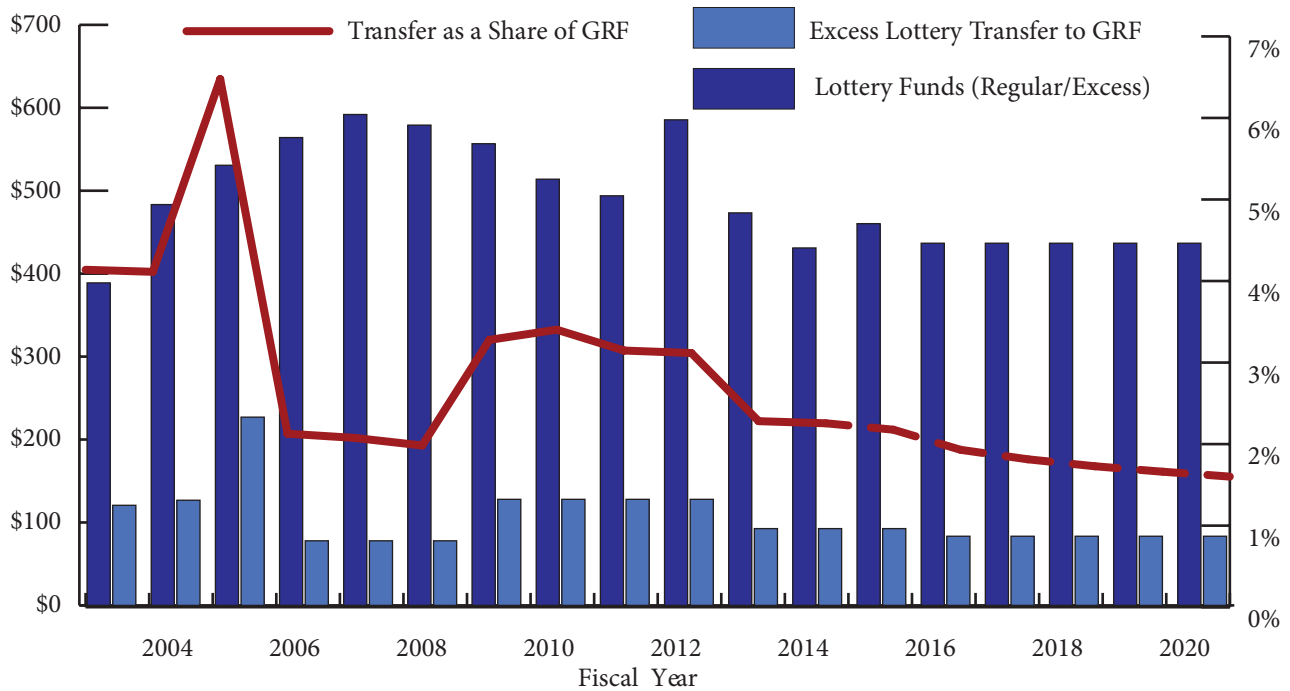


Source: West Virginia State Budget Office.

Lottery Revenue

Revenues from the Lottery Fund and Excess Lottery Fund have slowly declined since 2012, likely due to growing competition from neighboring states. The share of lottery funds transferred to the state's General Revenue Fund also declined from \$127.9 million in 2012 to \$92.6 million in 2014 (Figure 14). The governor's 2016 proposed budget reduces the amount of lottery funds transferred to the General Revenue Fund by \$9.2 million from 2015. At its peak, this transfer accounted for over six percent of General Revenue Fund collections and is expected to shrink from 2.3 percent in 2014 to just 1.6 percent by 2020. As lottery funds shrink, the state will have to find new ways to maintain the programs and services it funds through lottery proceeds.

Figure 14
 Lottery Revenue Declining (in millions)



Source: West Virginia State Budget Office.

Recommendations for Lottery:

Scale Back or Eliminate Greyhound Breeding Subsidies: A recent audit found that the \$29 million in annual lottery revenue that is used to subsidize greyhound racing in the state only yielded \$30 million in sales.²⁰ The audit concluded, “West Virginia could put the casino supplements to better use for the benefit of West Virginians.” Lawmakers should explore drastically scaling back or ending this subsidy.

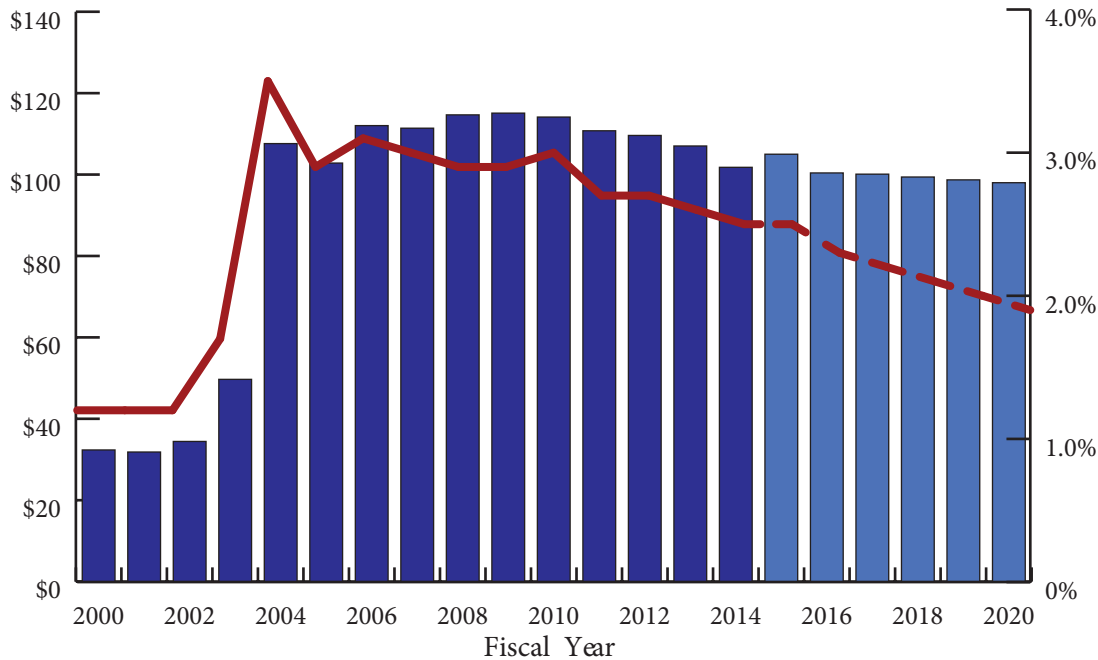
Tobacco Taxes

West Virginia levies a fifty-five cent tax on cigarettes and a seven percent wholesale price tax on other tobacco products including snuff, pipe tobacco and cigars. The tax on tobacco products is expected to account for \$100.4 million in 2016, down from its peak of \$115.1 million in 2009. By 2020, the state is expected to collect approximately \$98 million in tobacco taxes. As a share of general revenue funds, tobacco taxes have steadily declined since 2004 when the tax rate on cigarettes was increased from 17 cents per pack to 55 cents and the seven percent tobacco products tax was implemented in 2013 (Figure 15).

Recommendations for Tobacco Taxes:

Increase the Tobacco Tax: The tax on cigarettes was last increased over a decade ago and West Virginia currently has the 44th lowest cigarette tax among the 50 states.²¹ West Virginia also has a very low tax on non-cigarette tobacco products, with an average rate of 45.4 percent compared to West Virginia’s rate of seven percent.²² Increasing the cigarette tax to \$1.55 per pack and increasing the tax on other tobacco products to 50 percent of wholesale price would provide an estimated \$137.2 million in additional revenues and put West Virginia near the national average of \$1.54 per pack.²³ Additionally, it could drastically reduce health care costs and prevent deaths, teen smoking, and other chronic health conditions associated with tobacco use. West Virginia could also begin taxing E-Cigarette products. For example, Minnesota taxes electronic cigarettes, and e-juice that contains nicotine, at 95 percent of their wholesale price.²⁴

Figure 15
Tobacco Taxes Steadily Declining (in millions)



Source: West Virginia State Budget Office.

Corporate Net Income/Business Franchise Tax

The sharp decline in revenues from the Corporate Net Income and Business Franchise Tax is primarily driven by major reductions in both of these taxes put into place in 2006, 2007, and 2008. The Business Franchise Tax was completely eliminated in 2015 and the Corporate Net Income Tax rate was reduced from 9.0 percent in 2007 to 6.5 percent in 2014.

The state is expected to collect only \$177.5 million from these two taxes this year, \$44 million less than the state collected in 1990. Business taxes are also making up a smaller share of General Revenue Funds. While these two business taxes accounted for almost 13 percent of General Revenue Fund collections in 1990 and 8.3 percent in 2000, that share is expected to drop to only about four percent in 2016 and 3.8 percent in 2020 at \$197 million (**Figure 16**).

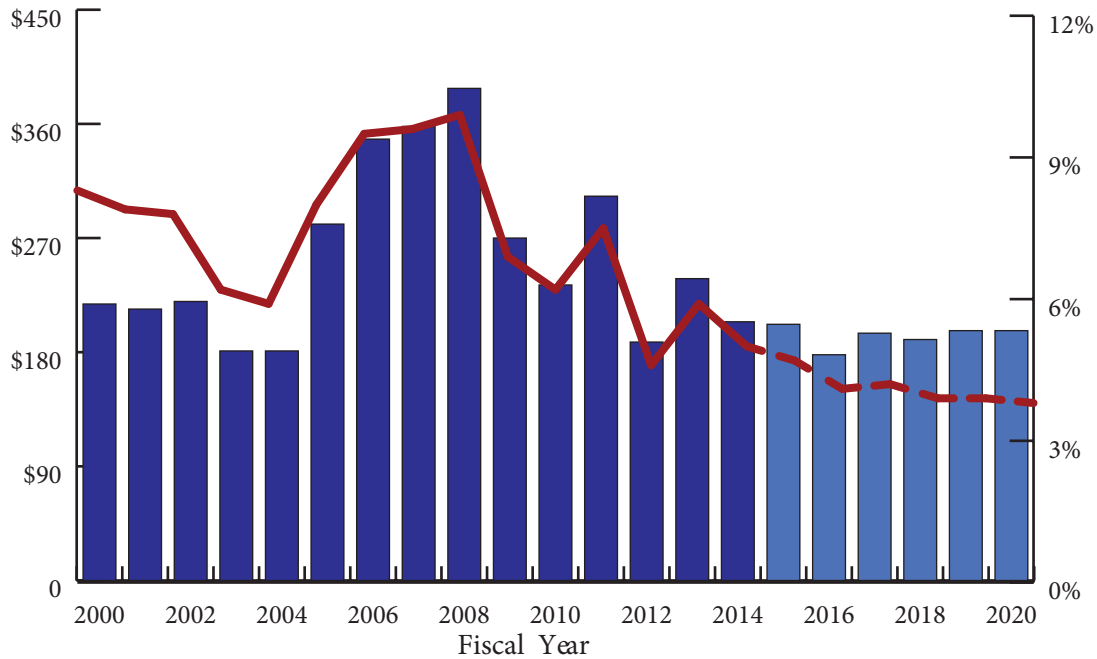
Recommendations for Corporate Net

Scrutinize off-budget tax expenditures: This year the state is expected to spend at least \$422 million through the tax code. About half, \$217 million, is aimed at economic development. There is little evidence regarding how these tax subsidies work or who receives them. All of this indirect spending – including local property tax abatements – should be examined and published online. The state should also explore adding sunset and claw back provisions to business tax subsidies.

Require Corporate Disclosure of Taxes: With the end of the Business Franchise Tax in 2015, many corporations could pay nothing in Corporate Net Income Taxes. West Virginia should explore mandating company-specific corporate tax disclosure by all publicly traded corporations and their subsidiaries doing business here, and explore enacting a corporate minimum tax to ensure that all companies are paying something for the government services they receive.

Close Tax Haven Loopholes: While West Virginia has closed several corporate tax loopholes by enacting combined reporting, requiring corporations to report profits generated in and out of West Virginia, it did not include offshore tax havens beyond the U.S. border. West Virginia should replace its “water’s edge” with “world-wide” combined reporting to include offshore tax havens. According to the U.S. Public Interest Research Group, this could generate an estimated \$9.6 million in additional revenue from the Corporate Net Income Tax.²⁵

Figure 16
Business Taxes Shrinking (in millions)

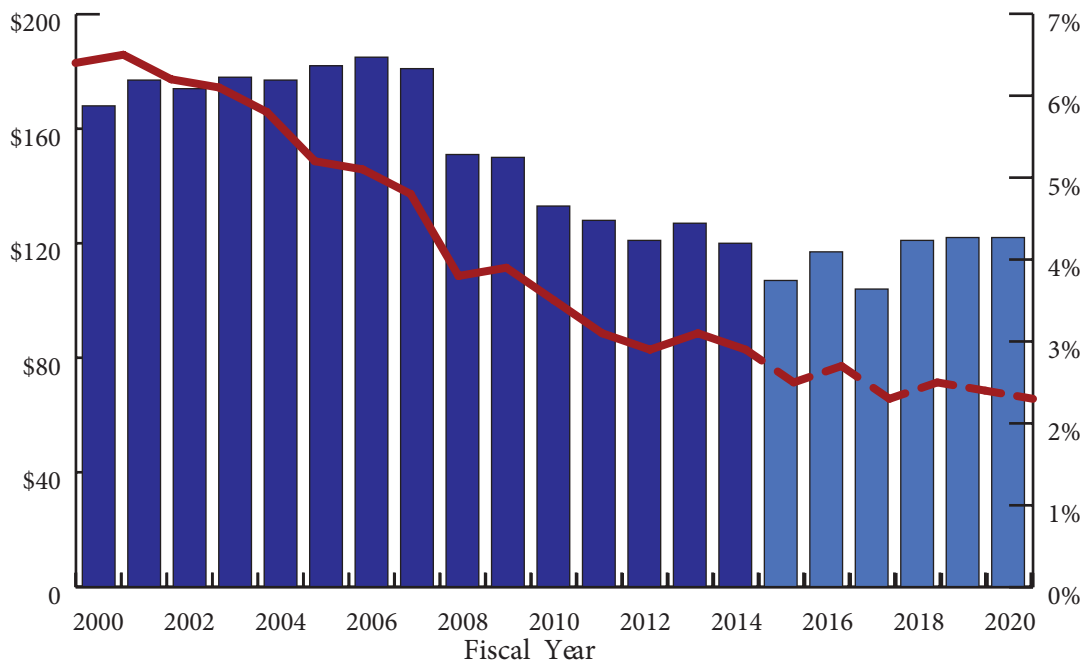


Source: West Virginia State Budget Office.

Business & Occupation Franchise 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 2016, the state expects to collect \$117 million in B&O taxes, \$68.5 million less than 2006. As a share of General Revenue Fund collections, the B&O tax is expected to drop from over 5.2 percent in 2006 to 2.7 percent by 2016, and even further by 2020 (Figure 17).

Figure 17
Business and Occupation Tax Declining (in millions)



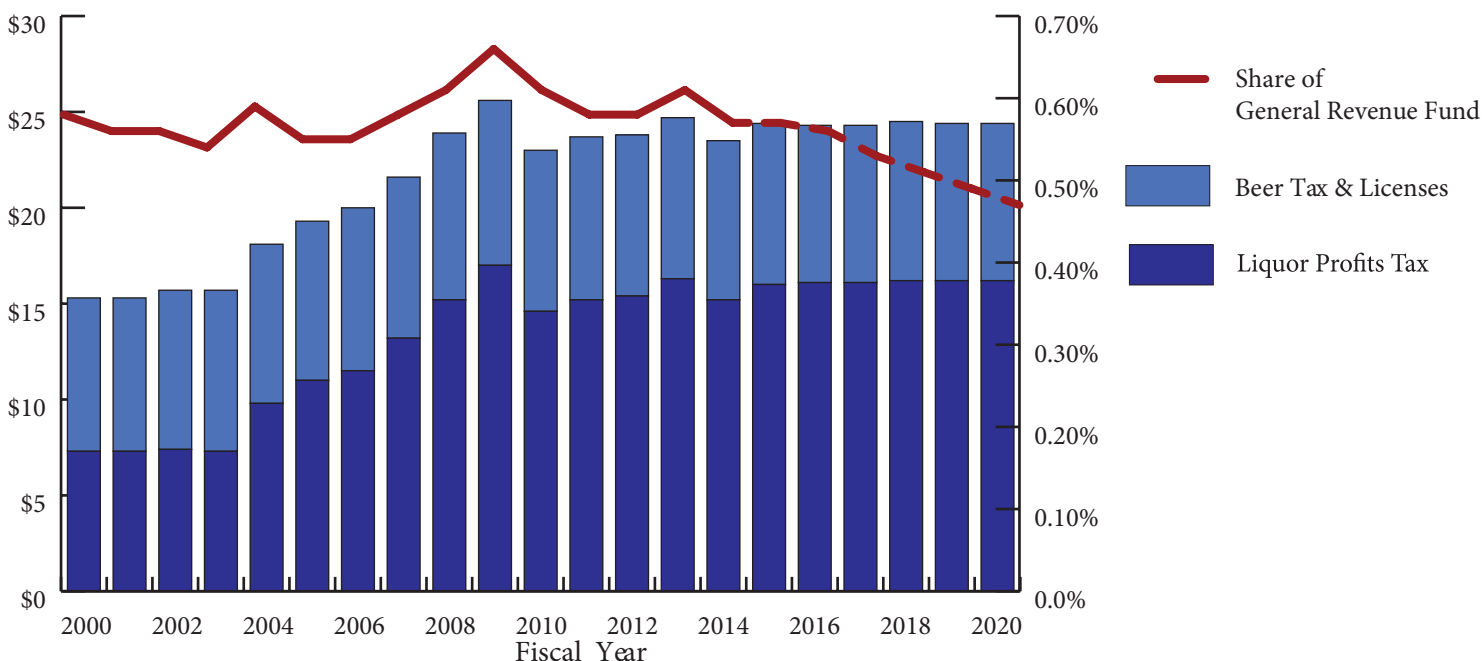
Source: West Virginia State Budget Office.

This is due to several factors, including installation of fuel gas desulfurization systems at existing power plants 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, forgone revenue from the Industrial Expansion and Revitalization Tax Credit against the B&O tax grew from \$23.7 million in 2006 to \$52 million in 2015. As this tax credit expires, it will increase collection in the outgoing years.

Beer & Liquor Taxes

West Virginia levies a host of licenses and fees on the sale of alcohol in the state. Altogether, West Virginia collected \$23.5 million from alcohol sales and licenses in 2014. This included \$15.2 million in revenues from the Liquor Profits Tax and \$8.3 million from Beer Taxes and Licenses. Between 2000 and 2014, these revenues have steadily grown with the economy but have hovered at around 0.6 percent of general revenue funds, a level that is expected to decline (**Figure 18**).

Figure 18
Beer and Liquor Taxes Sliding (in millions)



Source: West Virginia State Budget Office.

Recommendation for Beer & Liquor Taxes:

Raise taxes on alcohol sales: According to the conservative Tax Foundation, West Virginia has the 41st highest tax on liquor (spirits), 19th highest tax on wine, and 34th highest tax on beer in the nation.²⁶ West Virginia should explore raising state tax rates on liquor and beer, including raising the sales tax on liquor from five percent to six percent. Increasing the beer barrel tax from \$5.50 per barrel to \$11.00 per barrel would increase revenue by an estimated \$7.1 million, and requiring the Alcohol Beverage Control Administration to set higher wholesale prices on liquor and wine could yield an additional \$6.5 million to the General Revenue Fund.²⁷

Conclusion

For the third year in a row, the governor is proposing millions in cuts to the state's base budget. Similar to last year, he is asking legislators to make several statutory changes to balance the budget by shifting money between several accounts, making one-time reductions, and by making further cuts to important programs and services that West Virginians rely on every day. For example, instead of making college more affordable and attainable for high school graduates, the governor's additional cuts to higher education will likely result in further increases in college tuition and more debt piled on the backs of college students.

While West Virginia is constitutionally required to have a balanced budget, the state has a structural deficit. This occurs when ongoing revenues are less than ongoing spending. This helps explain why the governor continues to rely on one-time revenues to fund Medicaid and other programs to fund ongoing tax cuts. Supporting ongoing services with one-time revenue changes may work for a while, but it has led to difficulties in meeting ongoing expenses.

West Virginia's path to a stronger economy with more opportunities for everyone to thrive is largely dependent upon the state budget. Unfortunately, over the last several years West Virginia has chosen a path of austerity instead of prosperity. Instead of making crucial investments in higher education, early childhood education and intervention, and in our public employees that keep our communities safe, healthy, and educated, policymakers have decided to make major tax cuts that have largely benefited out-of-state corporations.

Shared prosperity does not happen by accident. It happens when we invest in human and physical capital, like roads, education, early childhood programs, health care, and workforce development. It happens when more people have a chance to reach their full potential.

To put our state on a more sustainable path and one that ensures more people move out of poverty, West Virginia is going to need additional resources. This could include modernizing the Personal Income and Sales tax, increasing taxes on tobacco and alcohol, ending inefficient business tax credits and dog-breeding subsidies, closing corporate tax loopholes, and ensuring that the state always benefits from its rich mineral resources by strengthening the WV Future Fund.

Endnotes

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- 3 Caitlin Cook, "State looks to attract more millennial workers to public sector," *The Charleston Gazette*, January 18, 2015.
- 4 West Virginia Legislature, Joint Committee on Government and Finance, Legislative Post Audit Division, "Examination of the Current Salaries, Turnover, Overtime and Vacancies for Correctional Officer Positions at the West Virginia Division of Corrections" (January 2015).
- 5 WVCPB analysis of U.S. Census Bureau (County Business Patterns) and U.S. Bureau of Economic Analysis data.
- 6 WVCPB analysis of U.S. Bureau of Labor Statistics data.
- 7 Workforce West Virginia, Bureau of Labor Market Information.
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- 13 <http://www.irs.gov/Individuals/States-and-Local-Governments-with-Earned-Income-Tax-Credit>.
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