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The Governor's FY 2012 Budget: A Good Start, but Room for Improvement

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On January 12, 2011, Acting Governor Tomblin released his budget for Fiscal Year 2012. While many states across the country face major budget shortfalls, forcing lawmakers to make difficult choices, West Virginia's FY 2012 budget contains no major cuts or new taxes. As West Virginia's economy slowly recovers from the recession, the state will emerge fiscally stable.

The governor proposes a state budget of \$11.2 billion for FY 2012. This includes both state and federal appropriated funds. Federal funding was approximately \$496 million less than last year's budget due to the expiration of the American Recovery and Reinvestment Act of 2009 (the Recovery Act). Total state appropriations - including General Revenue, Lottery Funds, Special Revenue and State Road - are only \$32.5 million above the FY 2011 budget. Major changes in the FY 2012 budget include increased funding for education, several one-time salary enhancements for public employees, and a reduction in the sales tax on food.

This brief provides an overview of the state budget, describes the proposed major changes, and looks at budgetary trends. It also offers solutions to ensure that the state continues to provide the public investments needed to help its citizens prosper.

Overview of the base budget

While the governor's proposed budget includes \$11.2 billion in appropriations, more than half of this spending is out of the hands of legislators. Most appropriations are tied to specific funding streams or are constitutional and statutory requirements.

Discretionary spending primarily comes from the base budget, which includes the General Revenue Fund, Lottery, and Excess Lottery Funds. The Governor's FY 2012 base budget totals \$4.37 billion, approximately 4.6 percent larger than the FY 2011 base budget (Table 1).

Table 1

The base budget grew from FY 2011 to FY 2012

Fund Source	FY11 Appropriated	Governor's FY12	Difference	% Change
General Revenue	\$3,742,785,000	\$4,015,621,000	\$272,836,000	6.8%
Lottery	\$166,122,000	\$163,764,000	-\$2,358,000	-1.4%
Excess Lottery	\$266,370,000	\$197,267,000	-\$69,103,000	-35.0%
Total	\$4,175,277,000	\$4,376,652,000	\$201,375,000	4.6%

Source: WVCBP analysis of West Virginia State Budget Office data

Note: Excess Lottery amounts do not double count the \$127.9 million transfer to the General Revenue Fund.

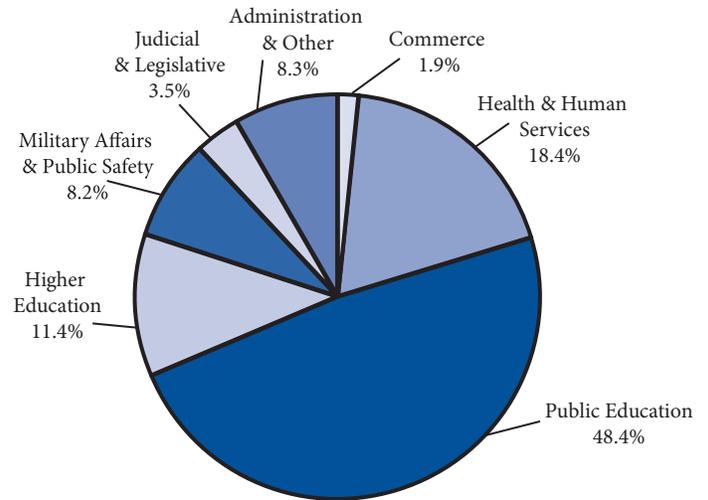
Figure 1 is a breakdown of the total recommended appropriations. Nearly half of the base budget, \$2.12 billion, is related to public education, while Health and Human Services comprises nearly one-fifth or \$803.3 million. Higher education accounts for \$499.5 million, while Military Affairs and Public Safety makes up \$359.5 million.

Major proposed changes

The governor’s proposed budget includes the following major increases:

- + \$110.3 million in increased state aid to schools and \$33 million for higher education.
- + \$31.7 million for one-time salary enhancements for public school personnel. This includes \$800 for professional educators and \$500 for service personnel.
- + \$15.9 million for one-time salary enhancements for state and higher education employees. This includes an enhancement of 2 percent of salary with a floor of \$500.
- + \$63.8 million in ongoing increases to the base budget. These include:
 - + \$8.0 million for Public Employees Retirement System employer contribution,
 - + \$1.5 million in PEIA Premiums,
 - + \$2.6 million for Teachers Retirement System,
 - + \$18.1 million in State Aid to Schools,
 - + \$5.7 million in Teacher Shortage Incentive Pay,
 - + \$7.5 million in non-Medicaid health and human service funding,
 - + \$9.9 million for correctional facilities,
 - + \$2.7 million for higher education,
 - + \$2.5 million for a Workers’ Compensation premium subsidy for volunteer fire departments,
 - + \$984,000 to add 12 underground mine inspectors,
 - + \$250,000 in salary enhancements (pay equity).

Figure 1
Base budget appropriations, FY 2012



Source: WVCBP analysis of West Virginia State Budget Office data.
Note: Does not double count the \$127.9 million transfer from Excess Lottery to General Revenue Fund.

The proposed budget also includes \$26 million in reductions. These include:

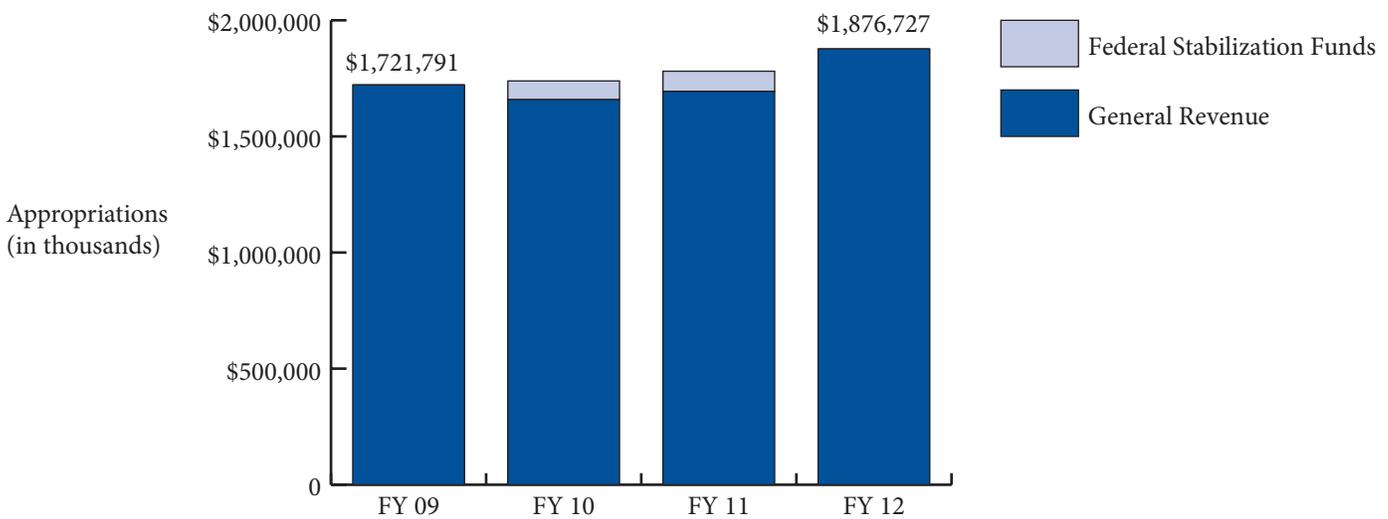
- \$17.8 million for the Teachers Retirement System,
- \$6.9 million for public education,
- \$1.5 million for public safety retirement plans.

For a detailed, line-item breakdown of the increases and decreases in the proposed budget, see Appendix A.

Increases offset loss of federal stimulus funds

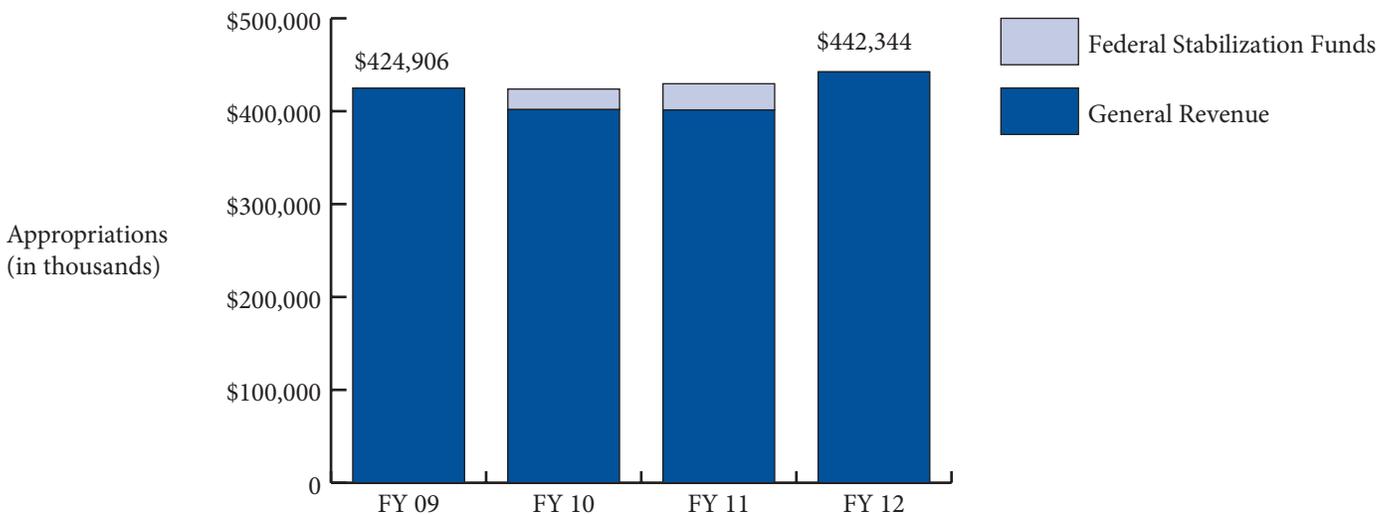
Two areas of the base budget that saw major changes were public education and higher education. The governor's FY 2012 budget recommends a \$183 million increase in state aid for schools and a \$33 million increase for higher education. These increases reflect the proposed one-time pay increases and the exhaustion of federal stabilization funds, which were used to restore large cuts in FY 2010 and FY 2011. Figures 2 and 3 show the federal stabilization funding that West Virginia used in FY 2010 and FY 2011.

Figure 2
State aid for schools in FY 2012 higher than FY 2009 levels



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

Figure 3
Spending on higher education in FY 2012 higher than FY 2009 levels



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

Medicaid smaller share of budget

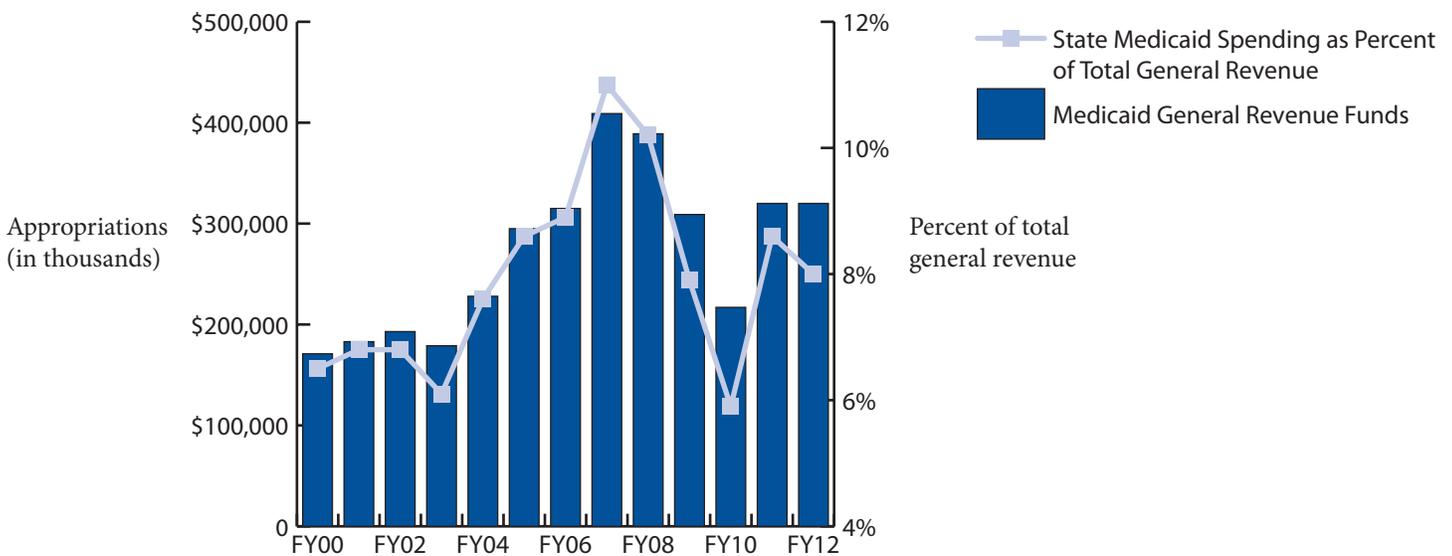
West Virginia’s Medicaid program is the largest program in the budget, totaling \$2.7 billion in FY 2012. This includes \$548 million in state appropriations, \$40.5 million in non-appropriated state funds, and \$2.1 billion in federal funds. Over the last five years, the share of general revenue funds going toward Medicaid has decreased substantially (see Figure 4). In FY 2007, general revenue Medicaid spending was \$400 million and made up approximately 11 percent of the general revenue fund. In FY 2010, it was only \$210 million, or 5.6 percent of the general revenue fund.

The state received additional federal funds through the Recovery Act of 2009, enabling it to decrease its own

spending on the program. The Recovery Act temporarily increased the share of Medicaid paid by the federal government over nine calendar quarters (October 1, 2008, through December 31, 2010). As of September 2010, West Virginia had been awarded \$399 million, or 89 percent of its estimated allotment of \$450 million.

Congress passed legislation in August 2010 that provided additional fiscal relief for states. The legislation extends Medicaid support for another six months. West Virginia will receive an estimated \$81 million for Medicaid funding.

Figure 4
State spending on Medicaid has decreased since 2007 as percent of total general revenue



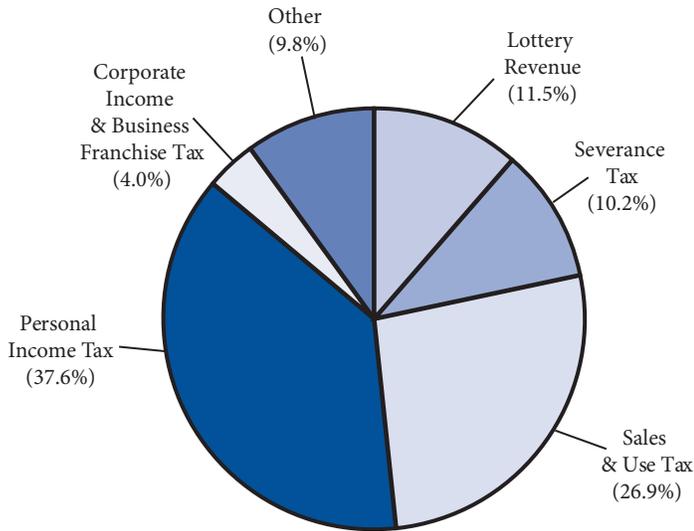
Source: State Expenditure Reports 1998-2009, National Association of State Budget Officers (NASBO), and West Virginia State Budget Office data.

Base budget revenues rebounding

The governor's estimated base budget revenue for FY 2012 is \$4.37 billion. Nearly two-thirds of this revenue comes from the personal income tax and the sales and use tax (Figure 5). Lottery funds provide 11 percent, and severance taxes make up 10 percent.

If the Legislature passes Acting Governor Tomblin's proposal to reduce the sales tax on food from 3 percent to 2 percent, then the base budget revenue will decrease by approximately \$26 million in FY 2012. This equals less than six-tenths of one percent of the total revenue estimated for that year.

Figure 5
Base budget revenue estimates, FY 2012

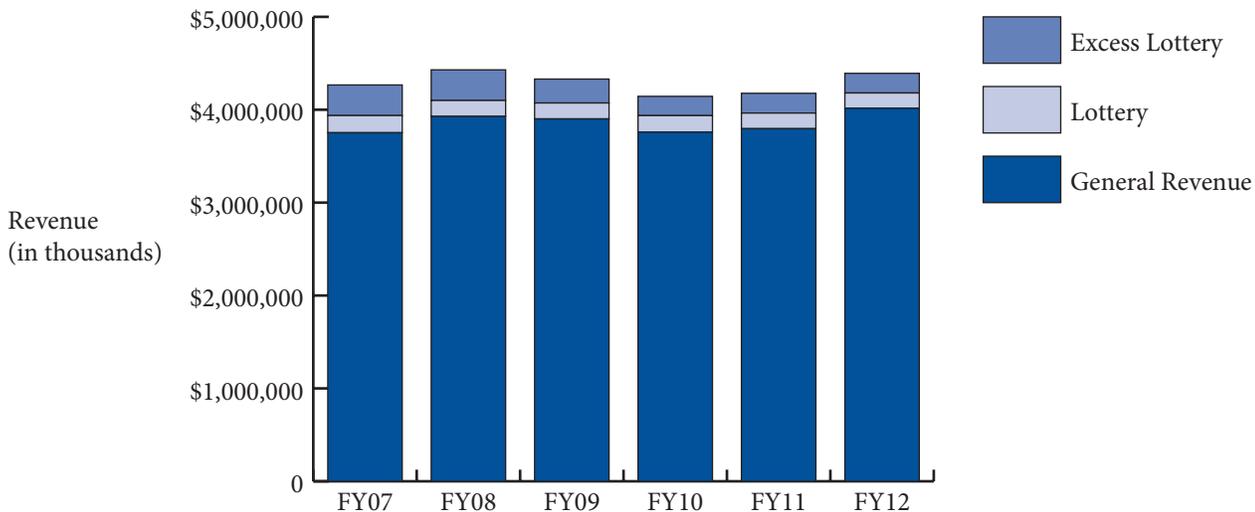


Source: WVCBP analysis of West Virginia State Budget Office data.

Base budget revenues are beginning to rebound from the recession, which officially began in December 2007 and ended June 2009 (Figure 6). The governor's FY 2012 base budget revenue estimate is approximately \$280 million above actual revenues in FY 2010 and \$136 million above FY 2011.

West Virginia has had a budget surplus over the last four fiscal years. This trend continued during the first seven months of FY 2011, with the state \$241 million above revenue estimates. If this trend continues for the remainder of the fiscal year, the state could start FY 2012 with a budget surplus of nearly \$400 million.

Figure 6
Revenues returning to pre-recession levels



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

Note: FY11 and FY12 estimates contained in the Governor's Executive Budget, FY 2012, Vol. I Budget Report.

The disappearing business tax base

In 2006, Governor Joe Manchin launched his Tax Modernization Project aimed at making significant changes to West Virginia’s tax system, particularly its business tax structure. Upon recommendations from the Tax Modernization Project and actions by the state Legislature, policymakers decided to phase out the business franchise tax by 2015 and to reduce the corporate net income tax rate to 6.5 percent by 2014 (see Table 2 for the rate reduction schedule). West Virginia also adopted unitary combined reporting that would close tax loopholes and enacted a manufacturing inventory credit.¹

Because the Legislature did not replace the lost tax revenue with corresponding tax increases, it will become increasingly harder for the state to fund services and programs.

Figure 7 shows the fiscal impact of these business tax changes on the general revenue fund for calendar

Table 2

Business tax rates continue to fall

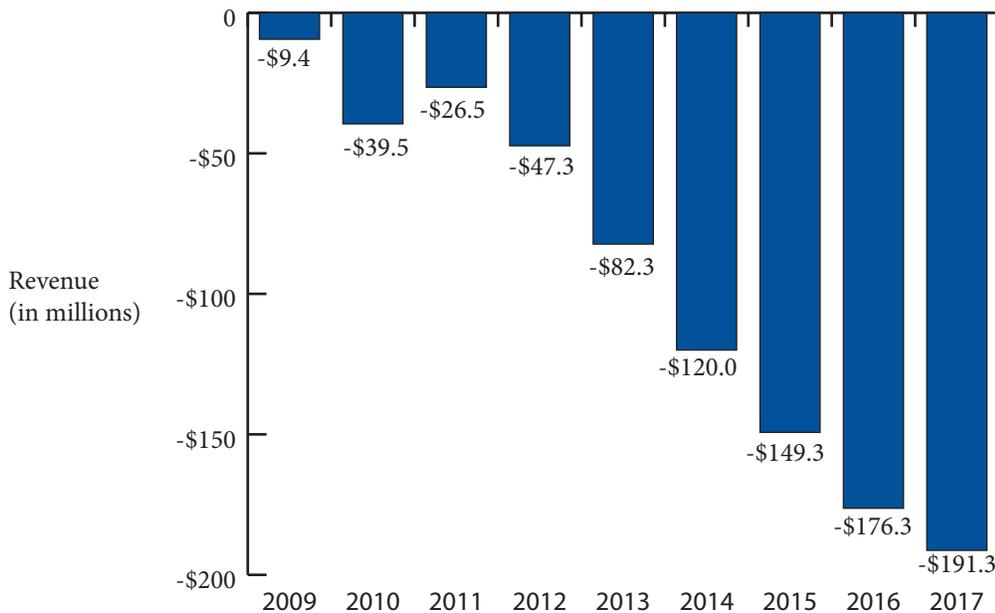
Calendar Year	Business Franchise Tax	Corporate Net Income Tax
2007	0.70%/0.55%	9.00%/8.75%
2008	0.55%	8.75%
2009	0.48%	8.50%
2010	0.41%	8.50%
2011	0.34%	8.50%
2012	0.27%	7.75%
2013	0.21%	7.00%
2014	0.10%	6.50%
2015	0.00%	6.50%

Source: West Virginia Tax Department.

years 2009 to 2017. The total decline in state revenue is approximately \$841 million over the 9-year period. In 2011, the state estimates that these business tax changes will cost the general revenue fund \$26.5 million. By 2019, these business tax changes will reduce revenue by nearly \$200 million a year.

Figure 7

Major business tax cuts cost West Virginia millions in needed revenue



Source: West Virginia Department of Revenue.

In FY 2007, the business franchise and corporate net income taxes comprised approximately 10 percent of general revenue fund collections. As a result of the tax rate reductions, these two taxes are expected to make up just 4 percent of general revenue collections in FY 2012 - half of what they used to average (Figure 8).

Another factor that will erode part of the business tax base is the compromise tax cut deal signed by President Obama in December 2010. Normally, businesses must gradually deduct or depreciate the costs of capital investments in machinery and equipment over a period of several years. Under the tax cut deal, businesses are now allowed to immediately deduct these costs from their gross income between September 8, 2010, and December 31, 2011.

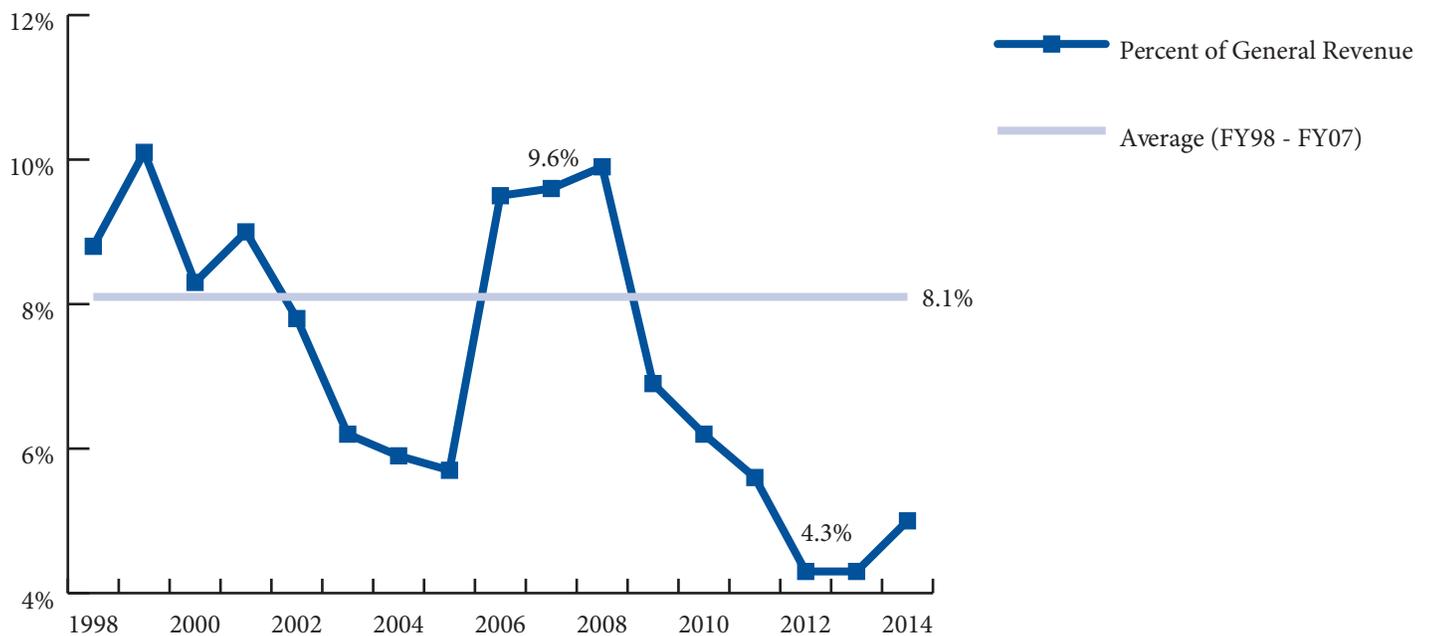
In 2012, businesses will be allowed to deduct half of their capital investment costs, and then apply the regular depreciation schedule to the remaining value of the

investment. These changes will reduce the net income of businesses, and likewise the tax that they must pay.

Since West Virginia uses the federal definition of taxable income when calculating corporate and personal income taxes, this federal change impacts the state's revenues. By allowing businesses to claim more tax deductions, West Virginia's budget revenues will decline. The business expensing provision could cost West Virginia as much as \$123 million from FY 2011 through FY 2013.²

As revenue dwindles from business taxes, West Virginia will need to find ways to replace it. Without sufficient revenue, the state will be hard pressed to meet the needs of its citizens and to have the public investments necessary to propel the state's economy forward.

Figure 8
Percent of general revenue funds from business taxes has fallen with tax cuts



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

Budget outlook

Although there are no budget gaps in FY 2012, projections show a growing funding gap in the years ahead. Current estimates show a shortfall of \$122 million in FY 2013. By 2016 the shortfall is projected to be over a quarter of a billion dollars (Figure 9). However, it is important to note that the projected budget gaps are much smaller than last year's projections.

The decline in lottery revenues resulting from increased out-of-state competition and the business tax reductions are two major contributors to the projected shortfall. In 2016, lottery revenues are projected to be 20 percent lower than they were in 2010, while the business tax reductions will cost the state a projected \$176 million in revenue that same year.

Other factors affecting the long-term budget outlook include health and pension liabilities and the growing cost of health care.

Building a stronger budget

This year, legislators have several opportunities to build a stronger budget that will address the projected gaps while avoiding program cuts that would negatively impact West Virginia's communities and economic recovery.

Modernize unemployment insurance

By making improvements to the state's unemployment insurance system, such as extending coverage to part-time workers and individuals who must leave work due to compelling family reasons, West Virginia would be eligible to receive \$22 million from the Recovery Act and avoid borrowing from the Rainy Day Fund.³ West Virginia has until August 2011 to act.

Decouple from business expensing

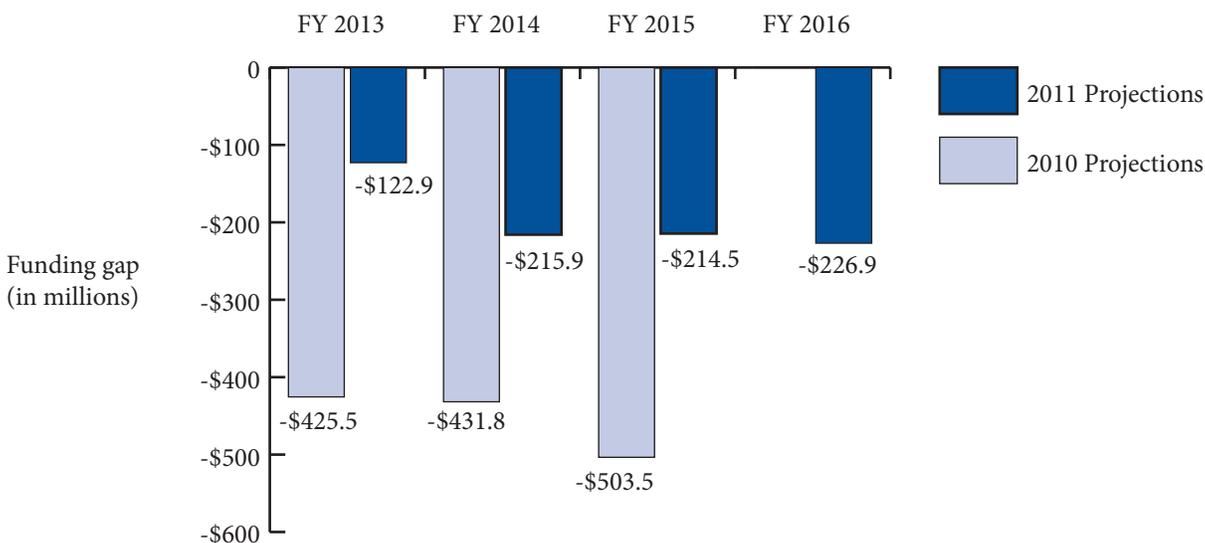
By decoupling from the business expensing provision of the recent tax-cut deal, West Virginia could save the budget an estimated \$123 million in FY 2011 through FY 2013.⁴

Implement the Affordable Care Act

By implementing health reform, state and local governments could save an estimated \$107 billion over the next 10 years. Under the Affordable Care Act, the West Virginia Legislature must set up a health care exchange by 2014. This exchange will serve as a marketplace for consumers to purchase health insurance. If the exchange offers strong consumer protections and broader access to health care coverage, it should reduce administrative overhead and reduce health care premiums.

Figure 9

West Virginia projected to have budget shortfalls in years ahead



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

Don't overreact to the OPEB liability

While the growing cost of retiree health care is a concern for state and local governments, West Virginia should not overreact by redirecting hundreds of millions of general revenue dollars into the Retiree Health Benefit Trust or by cutting essential services and programs.⁵ Completely prefunding other post employment benefits (OPEB) is not required, nor is it a viable option for West Virginia. The state would be wise to find a common sense, incremental approach toward addressing the liability. Overreaction could damage West Virginia's ability to make important public investments that provide the foundation of the state's economy.

Increase the tax on tobacco products

West Virginia has one of the lowest tobacco taxes in the nation. A \$1.00 increase will yield an estimated \$133 million in revenue.⁶ This revenue will help address the future budget shortfalls and replace the \$26 million of general fund revenue lost if the tax on food is reduced from 3 percent to 2 percent.

Scrutinize tax expenditures

West Virginia should make tax expenditures part of the budget process and evaluate the effectiveness of tax credits, like the thin-seam coal tax credit, which cost the state \$68 million in 2008.

Create a permanent severance tax trust fund

West Virginia should follow the lead of other states rich in natural resources like Wyoming and New Mexico, and use a permanent severance tax trust fund to convert depleting natural resources into a source of sustainable wealth.

Invest in the workforce

The number of West Virginia workers with jobs and the number of those in the labor force are at the lowest point in 17 years. Although West Virginia gained close to 10,000 jobs last year, many of these jobs went to people who live outside the state.⁷ A major boost in workforce training could improve the state's labor force and make West Virginia more competitive with surrounding states. A recent University of Kentucky study found that workforce training in Kentucky was 10 times more effective than tax cuts in creating jobs.⁸

Endnotes

- 1 For more information, see: Ted Boettner, "High Costs, Dubious Benefits," West Virginia Center on Budget and Policy, February 2008.
- 2 Nicholas Johnson and Ashali Singham, "Business Expensing Proposal Would Add to State Fiscal Problems," Center on Budget and Policy Priorities, Updated December 16, 2010.
- 3 For more information, see: Paul Miller, "Last Chance for Unemployment Modernization," West Virginia Center on Budget and Policy, January 2011.
- 4 Johnson and Singham, "Business Expensing Proposal."
- 5 For more information, see: Elizabeth Paulhus and Ted Boettner, "Mountain or Molehill? Putting OPEB in Perspective for West Virginia," West Virginia Center on Budget and Policy, January 2011.
- 6 Campaign for Tobacco-Free Kids, "Phasing in the \$1.00 cigarette tax increase in West Virginia will reduce state revenues and public health benefits," January 26, 2011.
- 7 Data obtained from Workforce West Virginia.
- 8 Kenneth R. Troske, "An Examination of Incentives to Attract and Retain Businesses in Kentucky," Center for Business and Economic Research, University of Kentucky, January 18, 2007.

Appendix A

Governor’s proposed base budget additions and changes above five percent

Department	Program/ Service	FY 2011	Governor’s Proposed FY 2012	Difference	Percent Change
Executive	Volunteer Fire Dept. Workers’ Compensation	\$0	\$2,500,000	\$2,500,000	-
Executive	Chesapeake Bay Watershed	\$0	\$125,000	\$125,000	-
Executive	Criminal Convictions and Habeas Corpus	\$0	\$2,103,811	\$2,103,811	-
Administration	Travel Management	\$0	\$1,824,016	\$1,824,016	-
Administration	West Virginia Public Employees Grievance Board	\$989,882	\$1,091,281	\$101,499	10.3%
Administration	Ethics Commission	\$665,694	\$756,333	\$90,639	13.6%
Administration	Real Estate Division	\$612,371	\$1,001,599	\$389,228	63.6%
Commerce	Division of Miners’ Health, Safety, and Training	\$10,436,119	\$12,083,791	\$1,647,672	15.8%
Commerce	Division of Energy	\$1,721,002	\$1,926,576	\$205,565	11.9%
Education	English as a Second Language	\$0	\$350,000	\$350,000	-
Education	School Nurse Funding	\$584,535	\$292,267	(\$292,268)	-50.0%
Education	Student Enrichment Program	\$6,152,000	\$0	(\$6,152,000)	-100.0%
Education	Education of Institutionalized Juveniles and Adults	\$15,862,209	\$16,754,725	\$892,516	5.6%
Education	State Aid to Schools	\$1,693,680,913	\$1,876,727,413	\$183,046,500	10.8%
Education	GED Testing	\$583,792	\$816,079	\$232,287	39.8%
Education and the Arts	Workshop Development	\$1,424,307	\$1,816,149	\$391,842	27.5%
Health and Human Resources	Health Right Free Clinics	\$3,749,336	\$4,449,336	\$750,000	20.0%
Health and Human Resources	Institutional Facilities Operations	\$85,860,352	\$91,883,218	\$6,022,866	7.0%
Health and Human Resources	Child Protective Services Case Workers	\$17,643,317	\$19,144,547	\$1,501,230	8.5%
Health and Human Resources	Title XIX Waiver for Seniors	\$2,000,000	\$7,500,000	\$5,500,000	275.0%
Health and Human Resources	Specialized Foster Care	\$365,729	\$621,895	\$256,166	70.0%
Health and Human Resources	Grants for Licensed Domestic Violence Programs and Statewide Prevention	\$2,000,000	\$2,500,000	\$500,000	25.0%
Health and Human Resources	Medical Services Administrative Costs	\$14,413,708	\$24,504,239	\$10,090,531	70.0%
Health and Human Resources	Indigent Burials	\$1,700,000	\$2,550,000	\$850,000	50.0%
Military Affairs and Public Safety	Payments to Federal, County, Regional Jails	\$20,000,000	\$26,000,000	\$6,000,000	30.0%
Military Affairs and Public Safety	State Police Communications and Equipment	\$877,864	\$1,268,968	\$391,104	44.6%
Military Affairs and Public Safety	State Police Vehicle Purchase	\$521,800	\$887,200	\$365,400	70.0%
Military Affairs and Public Safety	Veterans’ Cemetery	\$0	\$372,338	\$372,338	-
Military Affairs and Public Safety	Community Corrections	\$3,500,000	\$5,000,000	\$1,500,000	42.9%

Department	Program/ Service	FY 2011	Governor's Proposed FY 2012	Difference	Percent Change
Military Affairs and Public Safety	Davis Center for Girls	\$0	\$900,000	\$900,000	-
Transportation	State Rail Authority	\$3,385,589	\$2,394,338	(\$991,251)	-27.8%
Higher Education	New River Community and Technical College	\$5,248,676	\$5,783,523	\$534,847	10.2%
Higher Education	Eastern West Virginia Community and Technical College	\$1,906,570	\$2,095,489	\$188,919	9.9%
Higher Education	Kanawha Valley Community and Technical College	\$3,737,641	\$4,116,068	\$378,427	10.1%
Higher Education	Southern West Virginia Community and Technical College	\$7,985,386	\$9,188,397	\$1,203,011	15.1%
Higher Education	West Virginia Northern Community and Technical College	\$7,120,613	\$7,863,969	\$743,356	10.4%
Higher Education	West Virginia University - Parkersburg	\$8,942,043	\$9,913,988	\$971,945	10.9%
Higher Education	Bridgemont Community and Technical College	\$3,607,883	\$3,968,360	\$360,477	10.0%
Higher Education	Mountwest Community and Technical College	\$5,464,151	\$6,026,365	\$562,214	10.3%
Higher Education	Blue Ridge Community and Technical College	\$2,737,366	\$3,014,578	\$277,212	10.1%
Higher Education	Pierpont Community and Technical College	\$7,683,748	\$8,429,636	\$745,888	9.7%
Higher Education	Tuition Contract Program	\$0	\$1,446,030	\$1,446,030	-
Higher Education	West Virginia University, School of Health Sciences - Eastern Division	\$2,415,161	\$2,644,119	\$228,985	9.5%
Higher Education	School of Osteopathic Medicine	\$6,901,010	\$7,595,095	\$694,085	10.1%
Higher Education	Marshall Medical School	\$11,388,523	\$12,633,365	\$1,244,842	10.9%
Higher Education	West Virginia University, School of Health Sciences	\$15,970,048	\$18,026,332	\$2,056,284	12.9%
Higher Education	West Virginia University, School of Health Sciences - Charleston Division	\$2,427,569	\$2,689,150	\$261,581	10.8%
Higher Education	Rural Health Outreach Program	\$570,863	\$605,940	\$35,077	6.1%
Higher Education	School of Osteopathic Medicine, BRIM Subsidy	\$160,236	\$174,475	\$14,239	8.9%
Higher Education	Bluefield State College	\$5,882,611	\$6,578,289	\$695,678	11.8%
Higher Education	Concord University	\$9,175,771	\$10,173,960	\$998,189	10.9%
Higher Education	Fairmont State University	\$15,611,661	\$17,826,358	\$2,214,697	14.2%
Higher Education	Glenville State College	\$5,974,510	\$6,803,596	\$829,086	13.9%

Department	Program/ Service	FY 2011	Governor's Proposed FY 2012	Difference	Percent Change
Higher Education	Shepherd University	\$10,153,214	\$11,220,846	\$1,067,632	10.5%
Higher Education	West Liberty University	\$8,440,109	\$9,309,779	\$869,670	10.3%
Higher Education	West Virginia State University	\$9,877,879	\$10,937,280	\$1,059,401	10.7%
Higher Education	Marshall University	\$49,551,205	\$54,222,898	\$4,671,693	9.4%
Higher Education	Marshall University School of Medicine, BRIM Subsidy	\$932,587	\$1,015,462	\$82,875	8.9%
Higher Education	West Virginia University	\$104,489,885	\$116,704,020	\$12,214,135	11.7%
Higher Education	West Virginia University School of Medicine, BRIM Subsidy	\$1,285,775	\$1,400,038	\$114,263	8.9%
Higher Education	West Virginia University Institute for Technology	\$7,836,746	\$8,702,241	\$865,495	11.0%
Higher Education	VISTA E-Learning	\$274,522	\$300,000	\$25,478	9.3%
Higher Education	State Priorities - Brownfield Professional Development	\$739,246	\$805,565	\$66,319	9.0%
Higher Education	Rural Health Initiative - Medical Schools Support	\$438,996	\$483,265	\$44,269	10.1%
Higher Education	West Virginia State University Land Grant Match	\$1,752,280	\$1,908,000	\$155,720	8.9%
Higher Education	West Virginia University - Potomac State	\$4,211,706	\$4,692,845	\$481,139	11.4%