

February 16, 2016

Confronting the Fiscal Gap

The Governor's Amended 2016 Budget and Proposed 2017 Budget

Ted Boettner and Sean O'Leary

Governor Tomblin's plan for closing an estimated \$381 million budget gap for the current fiscal year (FY 2016) and a \$466 million shortfall for the 2017 state budget (FY 2017) includes a mix of spending cuts and budget reductions, as well as tapping the Rainy Day Fund, using surplus and one-time revenues, and raising taxes on tobacco and telecommunications services. These large projected budget gaps come on top of a \$195 million budget shortfall that was closed last year in the 2016 budget.

The state's consecutive budget gaps derive from many factors, including significant tax cuts implemented over the last decade, the state's weak economy over the last two years – especially in the energy sector - and growth in its Medicaid program.

The governor's recommended 2017 base budget (general revenue and lottery funds) is approximately \$4.682 billion, only \$1.6 million more than the 2016 base budget appropriations enacted last spring. After the governor's across-the-board cuts of four percent or \$94.3 million in the 2016 budget, the governor's 2017 base budget plan is only \$92.7 million more than the current 2016 base budget.

While the governor has taken some positive steps this year – including a more balanced approach that includes additional tax revenue, funding to help partially close the \$120 million shortfall in PEIA, and resourceful ways to utilize one-time revenue – the state still has many unmet needs that require additional revenue to improve the state's long-term growth and fiscal health.

This brief will examine both the governor proposals for the 2016 budget and the 2017 budget, along with exploring the impact of recent and possible future budget cuts, and the underlying factors that are driving the state's fiscal gaps. The brief will also explore steps policymakers can take to ensure that the budget not only provides a better foundation for economic prosperity but that it also protects vulnerable children and families and helps push more people out of poverty.

KEY FINDINGS

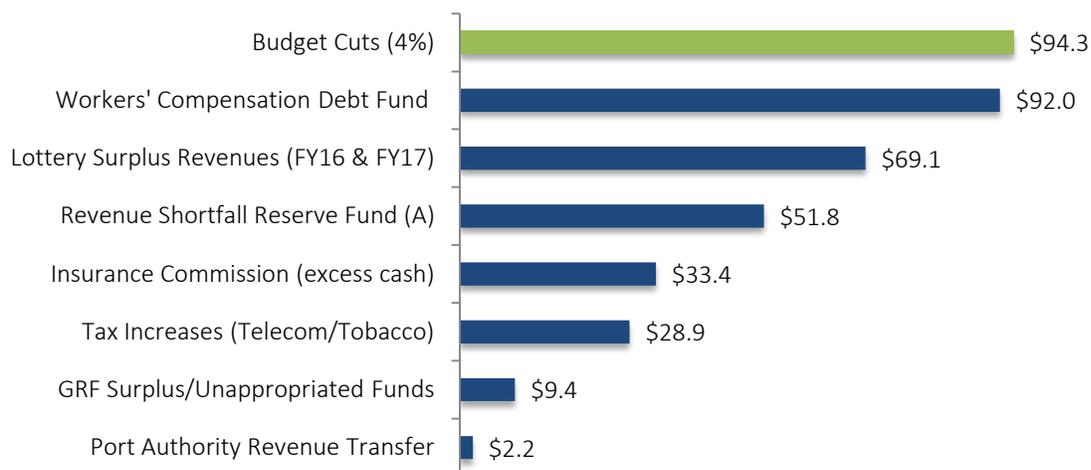
- The governor's plan for closing the estimated \$381 million budget gap for 2016 includes \$94.3 million in across-the-board spending cuts and \$287 million in revenue from various sources, including the Workers' Compensation Debt Fund, surplus revenue funds, the Revenue Shortfall Reserve Fund A, excess cash, and tax modest increases.
- To close the estimated \$466 million 2017 budget gap, the governor proposes a mix of tax increases, spending cuts, and budget reductions – including \$152 million in new revenues and \$77.1 million in cuts to programs and services.
- The large budget gaps are mostly due to the erosion of the state's tax base from tax cuts enacted between 2007 and 2015 and the state's weak energy sector, which has led to lower severance tax collections. If general revenue fund investments as a share of the economy were at the two-decade average, the state would have an estimated \$465 million in additional revenue.
- The Affordable Care Act also helped save the state nearly \$15 million in the 2017 budget, despite growing Medicaid costs.
- The state's budget woes over the last few years could have been much worse had it not been for declining student enrollment in public education and increases in property taxes from shale development.
- While raising the tax on tobacco products is a move in the right direction, the tax increase needs to be high enough to curb health care costs and save lives. Similar to the proposed sales tax on telecommunications, it is also regressive, hitting low-income people the hardest.
- Since 2008, the state has reduced higher education investment by over \$120 million, after adjusting for inflation. Meanwhile, tuition at the state's four-year colleges has grown by 32.4 percent during this time period, shifting costs to students and potentially jeopardizing quality at our public universities.
- To improve the state's fiscal health and its economy, policymakers need to consider additional revenue sources. Otherwise, the state will continue to underinvest in its workforce and diminish its ability to provide long-term economic growth and improve the health of its communities.

GOVERNOR'S PROPOSED AMENDED 2016 BUDGET

In response to a projected \$250 million budget shortfall for 2016, the governor announced in October of 2015 that he was making a four percent across-the-board budget cut to most agencies of \$94.3 million and other adjustments to close the remaining budget gap, including tapping the Rainy Day Fund.¹ Since this time, the 2016 budget gap has grown to an estimated \$381 million.

Figure 1: FY 2016 budget gap closed mostly with existing revenue

Base budget gap for FY 2016 = \$381 million



Source: WV State Budget Office.

Mid-year 2016 base budget cuts

The governor's mid-year across-the-board cuts of approximately four percent include cuts to various agencies and programs, with the bulk coming from health and human services, K-12 education, higher education, and military affairs and public safety.

Figure 2: Three-fourths of mid-year cuts targeted at health and human services, public education and higher education



Source: WV State Budget Office.

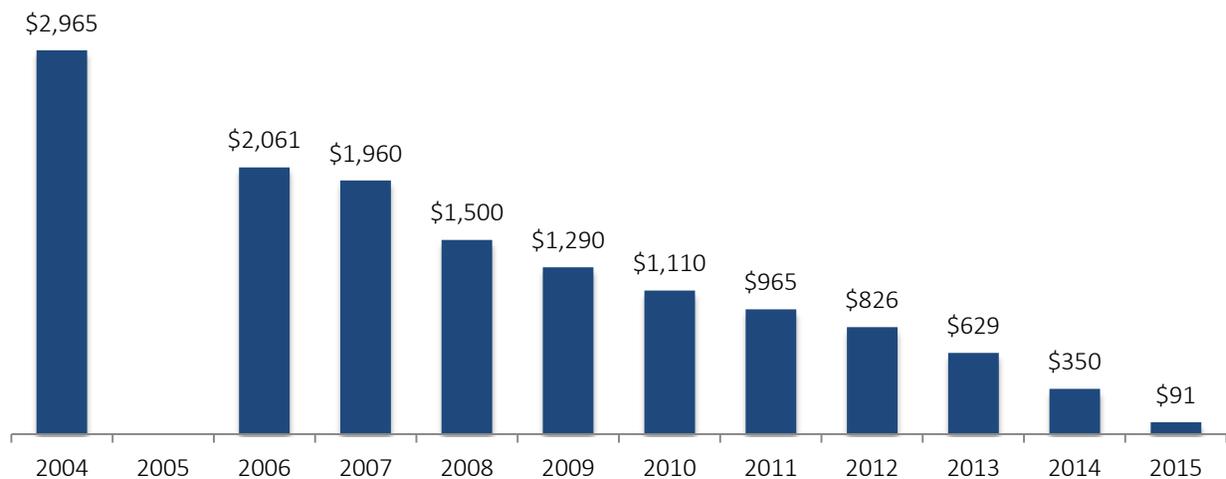
On top of the \$94.3 million in budget cuts, the governor is asking the legislature to make \$287 million in additional adjustments that include diverting payments from the Workers' Compensation Debt Fund, enacting a sales tax on telecommunications services, increasing tobacco taxes, using surplus revenues from lottery and the general revenue fund, tapping the Rainy Day Fund, and transferring money from expiring accounts within the WV Insurance Commission.

Dedicated Workers' Compensation Debt Fund revenues

The governor is proposing to use approximately \$92 million in funding for the 2016 budget that would otherwise go into the Workers' Compensation Debt Fund. Since 2006, the state has dedicated revenues from the personal income tax, lottery funds, a 56-cent per ton fee on coal, a 4.7 cents per thousand cubic foot tax on natural gas, surcharges on workers' compensation policies, and an assessment to self-insured employers, to pay down the Fund's liability.

The liability in the Worker's Compensation Debt Fund has shrunk considerably over the last ten years. In 2004, the debt was amortized at just under \$3 billion and by the middle of 2015 it had a balance of just under \$91 million. Recent reports indicate that the balance was zero as of January 2016.²

Figure 3: Workers' Compensation Debt Fund balance, 2004-2015
(in millions)



Source: WV State Budget Office, FY2005-FY 2017 Executive Budget, Volume 1 Budget Report.

Note: Balances are for June 31st of each year. 2005 was not available.

Now that liability in the Worker's Compensation Debt Fund is fully repaid, the governor is proposing to continue three dedicated Worker's Compensation Debt Fund taxes until the end of the 2016 fiscal year in June 2016. This includes approximately \$53 million in personal income tax collections and \$39 million in severance related taxes on natural gas and coal (discussed above).

Termination of the temporary severance taxes is estimated to reduce severance tax revenues by an estimated \$113.1 million in FY 2017.

Sales tax on telecommunications services

The governor is proposing a sales tax on telecommunications services that includes telephone and cellphone services (excluding internet data plans) and ancillary services. While the governor did not provide a breakdown, most of the revenue will likely come from cellphone services. Currently, the state has a \$3 9-1-1 surcharge that applies to cellphones and local governments also apply a 9-1-1 fee to landline services and Internet services.

While all states have some sort of tax or fee on wireless services, West Virginia has the 46th lowest wireless service taxes in the nation according to the conservative Tax Foundation.³ While this tax promotes horizontal equity by applying the sales tax to more services, it is also not based on the ability to pay and will hit low- and moderate-income families harder than wealthier West Virginians. The governor anticipates that the sales tax on telecommunications services will provide \$10 million for the FY 2016 budget and \$60 million for FY 2017 and thereafter.

Tobacco products tax increase

The governor proposed tobacco tax changes include increasing the cigarette tax from 45 cents to \$1 per pack, increasing the wholesale tax on other tobacco products from six percent to 12 percent, and also a 7.5-cent per milliliter tax on electronic cigarettes. Altogether, the proposed tobacco tax increases would provide \$18.9 million to the 2016 budget and \$78 million for the 2017 budget. Currently, West Virginia has the 46th lowest cigarette tax (per pack) and 44th lowest tax on other tobacco products in the nation.⁴ Only North Carolina and Minnesota tax electronic cigarettes.

While the tobacco tax is highly regressive, it can play an important role in reducing health care costs and saving lives.⁵ Unfortunately, the tobacco tax increases proposed by the governor are not high enough to substantially improve health outcomes or bring in enough revenue to help pay for budget priorities.⁶ However, West Virginia is taking a positive step in taxing electronic cigarettes, which may have harmful health side effects.⁷

Other proposed revenue changes

On top of raising taxes, diverting revenue from expiring debt, and making budget cuts, the governor also proposes several other revenue adjustments to close the 2016 budget gap:

General Revenue Fund: The governor is proposing to use a small unappropriated balance of \$250,000 and a \$9.1 million unappropriated balance from general revenue funds that he vetoed last year in the 2016 budget. Also, the governor is transferring \$2.2 million of dedicated corporate net income taxes that would have gone to the Special Railroad Intermodal Enhancement Fund run by the WV Public Port Authority to pay down debt on a bond.

Lottery and Excess Lottery: The proposed \$69 million in lottery and excess lottery revenue proposed for 2016 includes \$17.9 million in surpluses from previous years, \$2 million in an

unappropriated balance from the governor's veto last year, \$24.2 million from ending the discretionary Licensed Racetrack Modernization Fund by eliminating the racetrack modernization fund for 2016 and 2017, and \$25 million from anticipated lottery and excess lottery surpluses at the end of FY 2016.

Special Revenue: The governor is proposing to appropriate \$51.8 million from the state's Revenue Reserve Shortfall Fund A (Rainy Day Fund) for the 2016 budget. The balance in the Revenue Shortfall Reserve Fund A is \$479 million as of January 31, 2016, while the Revenue Shortfall Reserve Fund B has a balance of \$376 million (\$855 million = total balance in Rainy Day Funds). He is also proposing to use "excess cash" from three accounts located in the WV Insurance Commission that are not included in the budget, including \$26 million from the Insurance Commission Fund, \$2.6 million in the Examination Revolving Fund, and \$4.8 million from the WV Health Insurance Plan Fund (see next section for more detail).

GOVERNOR'S PROPOSED 2017 BASE BUDGET

Governor Tomblin's proposed 2017 base budget appropriations total \$4.68 billion, including \$4.3 billion from the General Revenue Fund, \$135.6 million from the Lottery Fund, and \$219.5 million from the Excess Lottery Fund. More than two thirds of the base budget appropriations support education and health and human services (**Figure 4**).

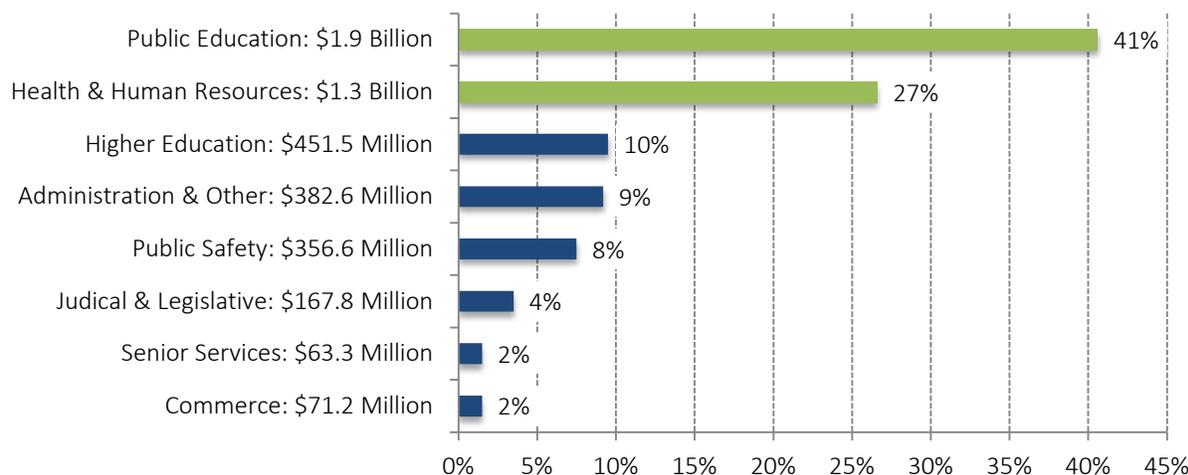
The governor's 2017 proposed base budget is \$1.6 million less than the 2016's base budget, before the four-percent mid-year cuts from 2015. Like recent years' budgets, the 2017 budget has a sizable gap. While most areas of the base budget will see cuts once again in 2017, not all of the changes to the budget are reductions.

The 2017 budget includes a \$43.5 million for the Public Employees Insurance Agency (PEIA), funding to help stop a sharp increase in insurance premiums for public employees. The proposed budget also includes a \$3.2 million increase for the state's Birth-to-Three program, bringing funding for that program up to \$6.0 million, and a \$6.6 million increase for Juvenile Services in the Department of Military Affairs and Public Safety. Spending cuts in the 2017 base budget include \$2 million from the Department of Commerce, \$16 million from the Department of Education, \$13.7 million from the Department of Military Affairs and Public Safety, and \$13.8 million from Higher Education.

Revenues from the governor's proposed base budget for 2017 include a total of \$4.682 billion, with \$4.262 billion from general revenue funds and \$420 million from lottery and excess lottery funds (Figure 5). More than two-thirds of the base budget revenues come from income and sales tax collections, while about nine percent comes from lottery funds, eight percent comes from both the corporate net income tax and sin taxes on alcohol and tobacco and six percent from severance tax collections.

Figure 4: More than two-thirds of base budget spending supports education and health and human services

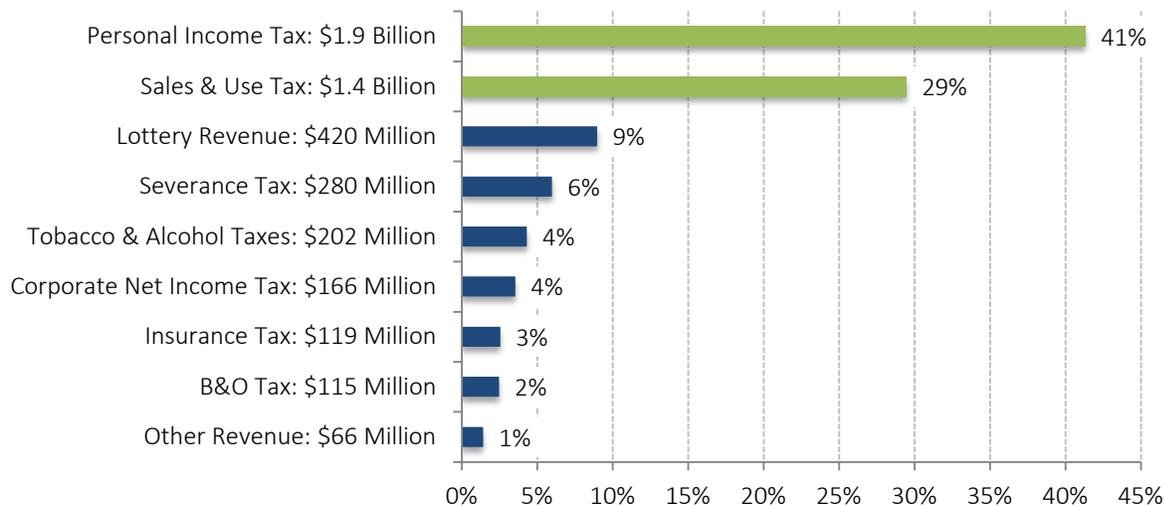
Governor’s FY 2017 base budget appropriations = \$4.682 billion



Source: WV State Budget Office.

Figure 5: More than two-thirds of base budget revenues come from income and sales tax collections

Governor’s FY 2017 base budget revenue appropriations = \$4.682 billion



Source: WV State Budget Office.

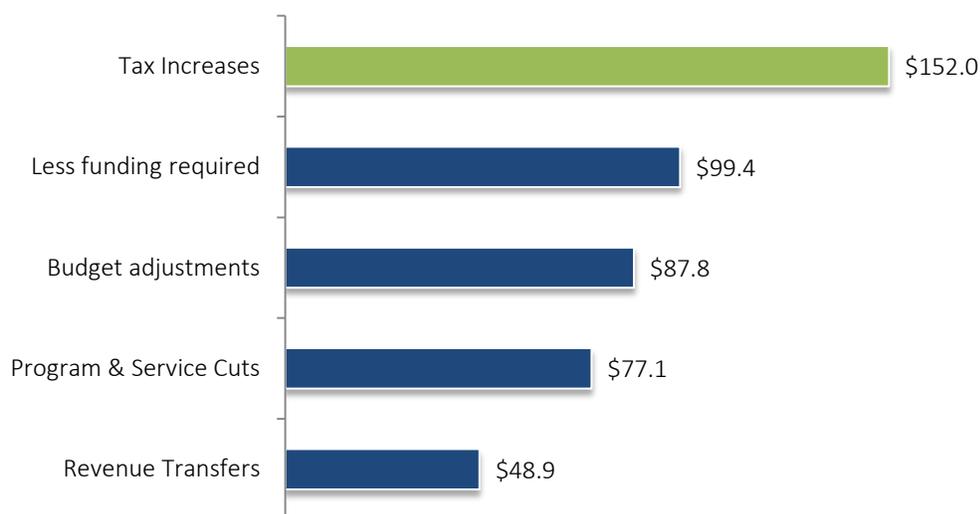
The growth in the base budget revenue estimate from 2016 to 2017 is mostly driven by the governor’s proposed tax increases (tobacco products and sales tax on telecommunications) and growth in the personal income tax collections, while several revenue sources are projected to decline. For example, severance tax estimates are down to \$280 million from \$525 million last year. And the corporate net income tax estimate declined from \$195 million to just \$166 million

in this year's revenue estimate. The reductions are one of the main reasons the governor is proposing to increase the tobacco tax and the sales tax on telecommunications.

Closing the 2017 budget gap of \$466 million

To close the \$466 million shortfall, Governor Tomblin has proposed a mix of spending cuts, budget reductions, and tax increases. On the spending side, he proposes \$77.1 million in program and service cuts to the budget. These include \$3 million from the State Department of Education, \$15.6 million from the Department of Health and Human Services, \$14.5 million from Department of Military Affairs and Public Safety, and \$11.8 million from the Higher Education Policy Commission. Some of the programs affected by the cuts include Assessment Programs, Elementary/Middle Alternative Schools, and 21st Century Assessment and Professional Development in the State Department of Education; and State Aid for Local and Basic Public Health Services, Tobacco Education, Behavioral Health, and Institutional Facilities Operations in DHHR.

Figure 6: 2017 budget gap closed mostly with spending expenditure reductions
Base budget gap for FY 2017 = \$466.5 million



Source: WV State Budget Office.

In addition to spending and program cuts, Governor Tomblin is also proposing reductions. These reductions, which total \$99.4 million, are not program or service cuts, but rather areas of the budget where less was needed than anticipated. For example, declining enrollment and rising local property taxes resulted in the School Aid Formula requiring \$33.6 million less than anticipated. Other budget reductions include \$18.7 million for Medicaid, \$10.0 million for DHHR due to CHIP now being fully funded through the Affordable Care Act, and \$33.6 million due to contract savings for PEIA.

Governor Tomblin also proposes \$87.8 million in other budget adjustments. These include not increasing base funding for the Public Defender's Office by \$17.4 million, instead funding it

through a supplemental bill, canceling a planned \$51.0 million state employee pay raise, and stopping a \$10 million transfer to the Infrastructure Council.

Finally, on the revenue side, the governor is proposing to use \$152 million in tax increases and about \$49 million in revenue transfers - which largely direct funds back into General Revenue that were dedicated for other purposes. Most of the tax increases are also included the governor's proposal to close the 2016 budget gap, including the sales tax on telecommunications and an increase in taxes on tobacco products. Here is a breakdown of the proposed tax increases and revenue transfers:

- Eliminating the dedication of **\$5 million** from personal income taxes to pay down the OPEB liability – reduction from \$35 million to \$30 million.
- Ending the revenue transfer to the Public Port Authority, which increases general revenue funds by **\$4.3 million**.
- Suspending the **\$9 million** transfer of sales and use taxes to the Division of Highways for road maintenance and repair.
- A one-time suspension of **\$4 million** of sales and use collections to the WV School Board Authority.
- Utilizing **\$78 million** from the proposed tobacco tax increase.
- Utilizing **\$60 million** from the adoption of a sales and use tax on telecommunications.
- Extending the sales and use tax to medical equipment used for non-home uses to replace the severance tax on behavioral health care providers. This is expected to provide **\$14 million** in matching funds for the state's Medicaid program.
- Utilizing **\$7.8 million** in general revenue fund anticipated surpluses and **\$18.4 million** from ending the discretionary transfer from excess lottery to general revenue fund.

MAJOR TRENDS IMPACTING WEST VIRGINIA'S BUDGET

Over the last several years, West Virginia has faced significant budget gaps. On top of the severe budget gaps in the 2016 and 2017 budgets highlighted above, the state also had a budget gap of \$75 million in the 2014 budget and \$216 million in the 2015 budget. The budget gaps are largely the result of phased-in tax cuts, a weak economy, and growth in Medicaid spending. The budget gaps could have been worse, if it had not been for West Virginia's declining student population and rising property tax collections from the development of shale gas in the northern part of the state.

Recent budget trends also show that the state is investing less, especially in higher education. Over the last five years, almost all state agencies have seen a decline in appropriations. These trends highlight that the state has a revenue problem that will need to be addressed if it is going to grow a healthier economy where more people have the opportunity to thrive.

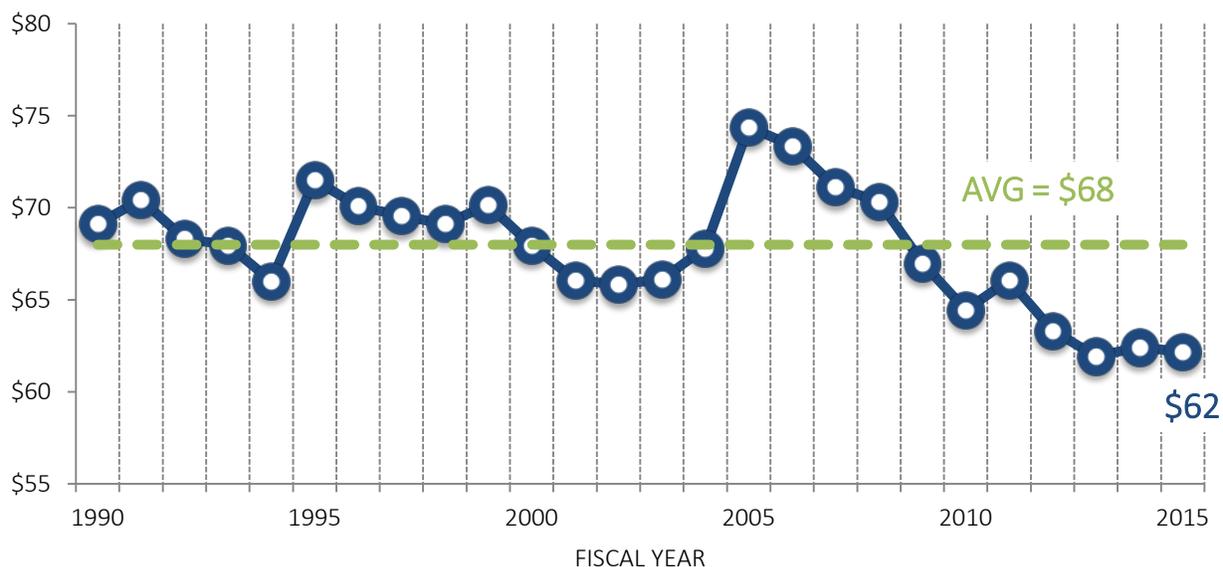
Tax cuts continue to drive budget gaps

Since 2007, the state has phased out both the grocery tax on food and the business franchise tax. It has also lowered the corporate net income tax rate and created some additional tax

credits for businesses and low-income families. Altogether, these tax changes have reduced revenues annually by at least \$415 million. As the chart below shows, general revenue funds as a share of the state's economy (personal income) are at their lowest point in over 25 years. If West Virginia collected the average amount over this period - \$68 dollars per \$1,000 of personal income – that state would have had an estimated \$445 million more in general fund revenues in 2015.

Figure 7: As revenue falls relative to the state's economy, West Virginia loses ability to invest in economic growth

General revenue funds per \$1,000 of WV personal income, 1990-2015



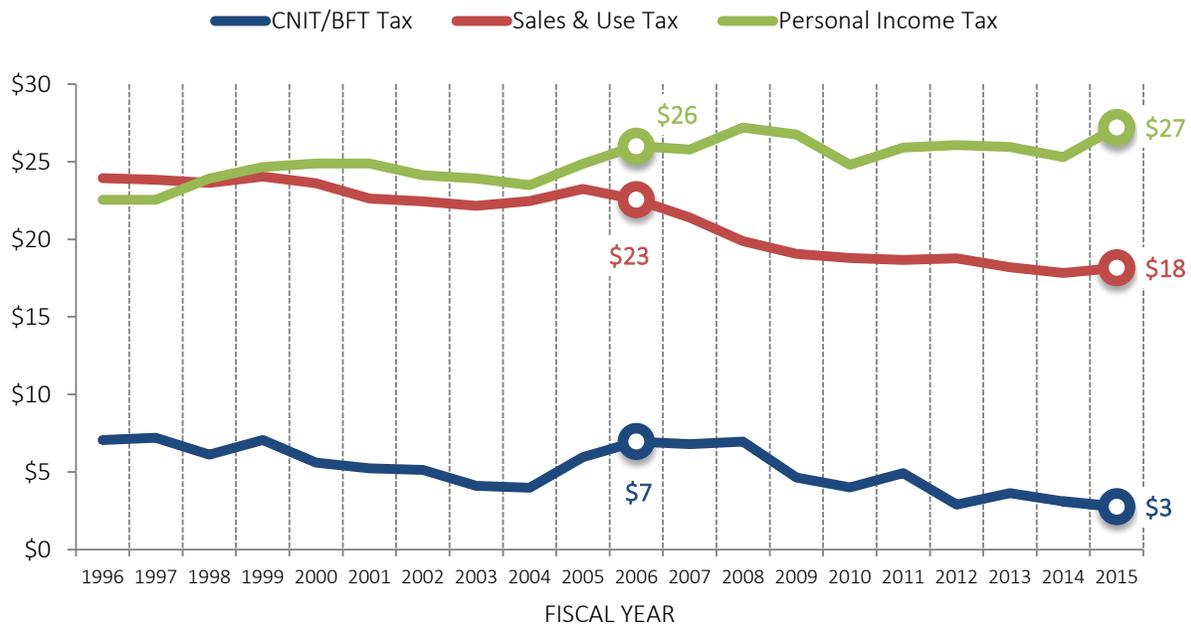
Source: WVCBP analysis of WV State Budget Office and U.S. Bureau of Economic Analysis data.

While personal income tax collections have slightly grown as a share of the state's economy, both sales taxes and businesses have shrunk considerably. In 2006, the state collected \$23 dollars in sales taxes per \$1,000 in personal income compared to just \$18 in 2015. Business tax collections have dropped by over half, from \$7 dollars per \$1,000 in personal income to just \$3 dollars. In 2006, the state collected \$348 million in business taxes compared to just \$186 million in 2015. This is mostly due to cuts in business taxes and the grocery tax.

Taken together with the state's large budget gaps, the state continues to have a structural deficit in its budget despite the large cuts in services that have already taken place (**Figures 7 and 8**). While the tax cuts in the late 2000s have been central to the state's woes, the state's poorly performing economy is also a culprit.

Figure 8: Elimination of business franchise and grocery tax major driver of state budget gaps

Select WV taxes per \$1,000 of WV personal income, 1996-2015



Source: WVCBP analysis of WV State Budget Office and U.S. Bureau of Economic Analysis data

Weak economy also boosting budget gaps

While West Virginia weathered the Great Recession better than most states, it has fallen into hard economic times over the past two years, especially in 2015. While the state’s unemployment rate (seasonally adjusted) declined to 6.3 percent in December of 2015 from 7.6 percent in August of 2015, West Virginia still has the fifth-highest rate in the nation - 1.3 percentage points higher than the national average of 5.0 percent.⁸ While most of the country is experiencing relatively good job growth, West Virginia has shed over 10,000 jobs since the end of 2014 and has about 11,800 fewer jobs than before the Great Recession in November of 2007.

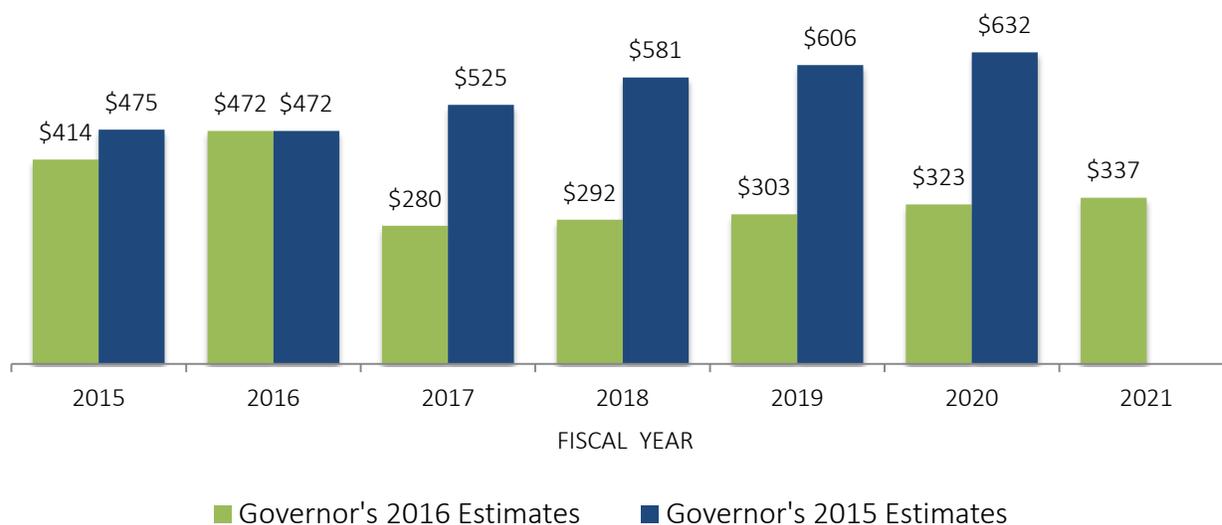
At the heart of West Virginian’s woes is the collapse in energy prices, especially natural gas, and steeper declines in southern West Virginia coal production that is a result of stiffer competition from cheap and abundant natural gas, competition from cheaper Western coal, and growing demand and use of cleaner energy. Over the last year, West Virginia has experienced a decline of more than 5,000 jobs in mining and logging industries that is reflective of these economic modalities.⁹

In 2015, the governor estimated that the general revenue fund would collect \$471 million in severance taxes for the current 2016 budget. So far, the state has only collected about \$121 million during the first seven months of the 2016 budget – a ten-year low for the state. This

comes on top of the previous year's shortfall when severances tax collections were about \$75 million below estimates.

Because of the state's weak energy sector, the governor significantly revised his severance tax estimates by almost half, or \$240 million, for his 2017 budget.

Figure 9: Major revision in severance tax projections in 2016
(in millions)



Source: WV State Budget Office, Executive Budget for FY 2016 and FY 2017, Budget Report, Volume 1.

The recent negative labor market and energy industry trends are also happening at the same time the state is losing population and becoming grayer, with fewer workers in the labor force to support the state's tax base. For example, only 68 percent of the state's prime-age working population was employed compared to over 73 percent right before the Great Recession in 2006.¹⁰

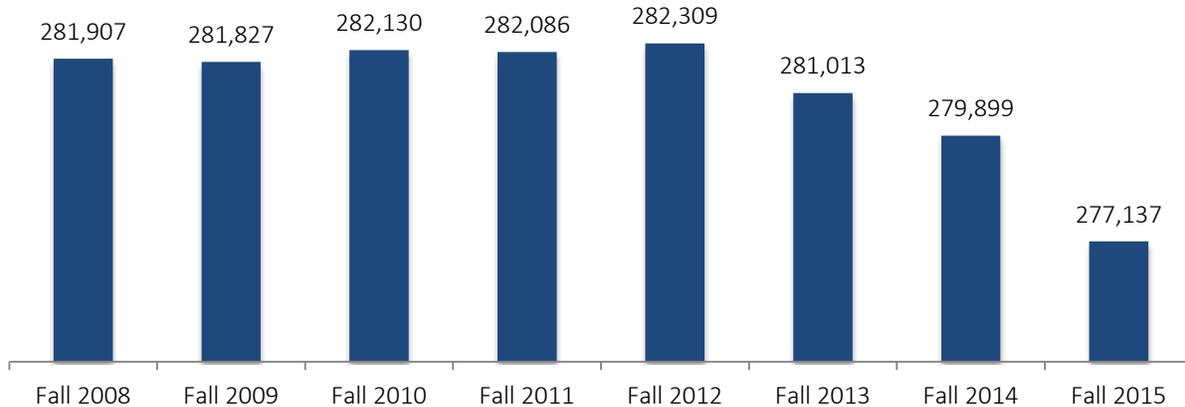
Declining student enrollment easing budget gaps

One area of the budget that has been shrinking is state funding for K-12 public schools. The 2017 proposed budget appropriates \$1.10 billion for the state's share of the school aid formula, a decline of \$48 million from 2016. The school aid formula determines the amount of state funding for public schools. A total allowance is calculated through several steps and is based on enrollment in the local school districts. The local districts' share of the allowance is based on local property tax revenue, while the state's share is determined by deducting the local share from the total allowance.

K-12 enrollment in West Virginia has dropped in recent years, which has affected the school aid formula. For example, enrollment has fallen by roughly 5,172 students since 2012 (**Figure 10**). The school aid formula determines the number of teachers funded based on enrollment. With enrollment dropping by over 5,000 students, the number of teachers funded by the school aid

formula has fallen by nearly 300. This has reduced the total allowance for professional educators in the school aid formula by \$17.8 million since 2012.

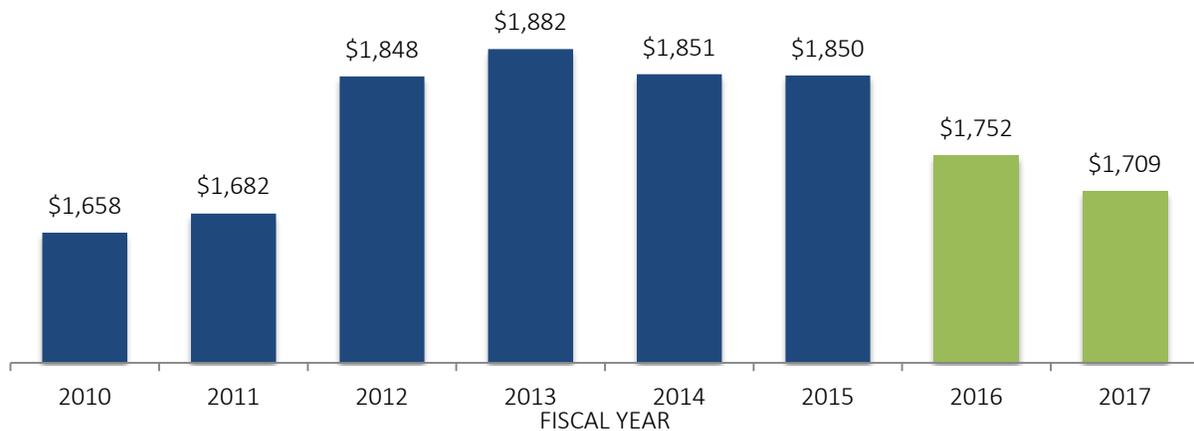
Figure 10: Drop in K-12 student enrollment in West Virginia



Source: WV State Department of Education.

Overall, the total allowance calculated by the school aid formula has declined by \$15 million from 2012 to 2017, largely due to declining enrollment. But that is not the only factor affecting the school aid formula’s impact on the budget. At the same time decreasing enrollment has caused the total allowance to fall, rising property tax revenues have increased the local share. The influx of natural gas drilling activity in several West Virginia counties in recent years has led to large increases in property tax revenues.

Figure 11: Falling student enrollment and rising property taxes easing budget gaps
Total State Aid to Schools (millions)



Source: WV State Budget Office, Governor’s Executive Budgets, FY 2012-2017.

Note: Actual expenditures FY 2010-2015, budgeted expenditures FY 2016, proposed expenditures FY 2017

The increase in property tax revenue in turn increases the local share of the school aid formula, which has grown by \$86.6 million from 2012 to 2017. With declining enrollment leading to a smaller total allowance, and rising property tax revenue leading to a larger local share, state aid

to schools has declined \$172.5 million from 2013 to 2017 (Figure 11). Without the declining enrollment and rising property tax revenue, the state’s budget gaps in recent years would have been even larger.

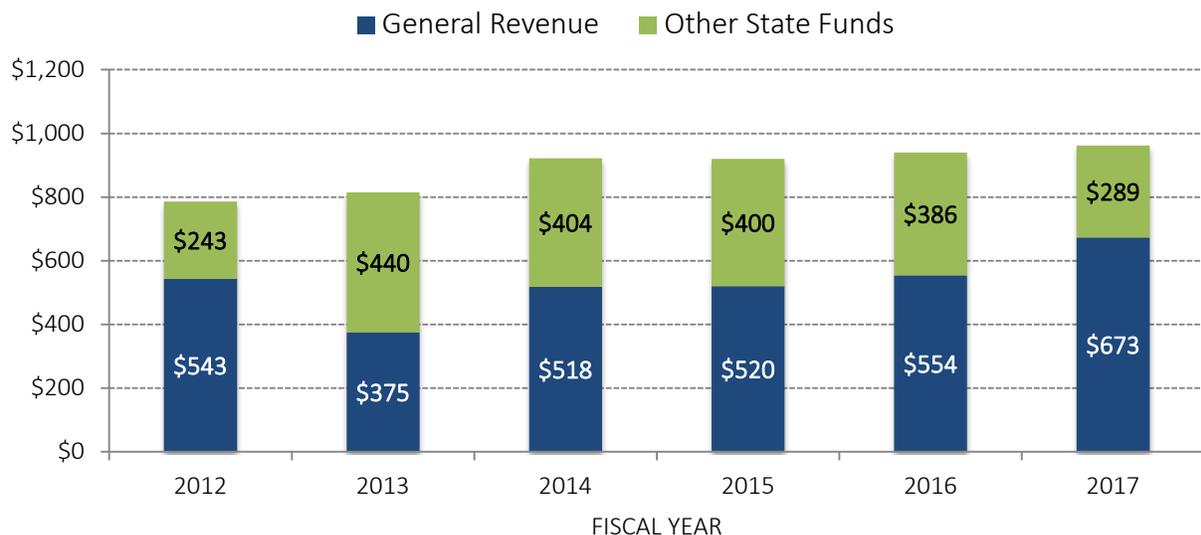
Medicaid growing part of state budget, but Medicaid expansion easing budget problems

At over \$4.0 billion, Medicaid is the state’s largest program. State funding for Medicaid is “matched” by federal dollars, with the federal government covering 71.42 percent of West Virginia’s Medicaid costs in 2016. West Virginia funds its share of the Medicaid program from four main sources: the General Revenue Fund, Lottery Funds, the Health Care Provider Tax, and the Medical Services Trust fund.

In contrast to other areas of the budget, state spending on Medicaid has steadily increased, both overall and as a share of the total budget. In 2017, West Virginia plans to spend \$962 million on Medicaid, including \$673 million from the General Revenue Fund, an increase of \$22 million from 2016 (Figure 12). A number of factors have led to increased state spending on Medicaid, including rising health care costs, a declining federal match rate, and the expansion of coverage under the Affordable Care Act. The estimated increase in state funding for 2017, due to the expansion, is \$17 million.

The state has become more reliant on General Revenue funds to pay for Medicaid. As Health Care Provider Tax revenue has remained flat and the Medicaid Trust Fund has been depleted, more General Revenue funds have been needed for Medicaid. The share of General Revenue funds used for Medicaid has increased from 13.1 percent in 2012 to 15.5 percent in 2017, putting strain on other areas of the budget.

Figure 12: State spending on Medicaid on the rise
(in millions)



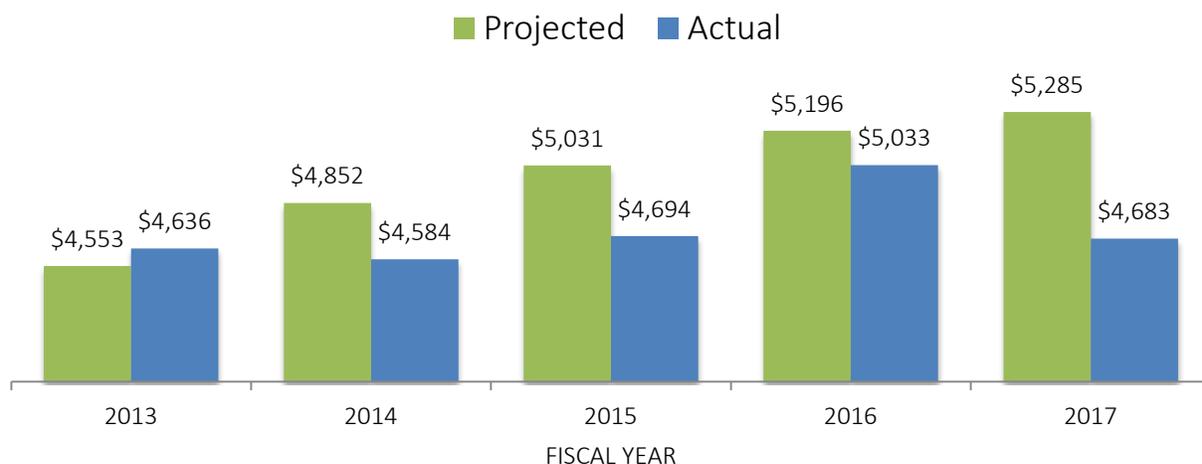
Source: National Association of State Budget Officers and WV State Budget Office.

While Medicaid costs are growing, the state also saved money in the budget from the expansion of Medicaid. For example, part of the governor’s plan to close the 2016 budget gap includes expiring excess cash of \$4.8 million from the West Virginia Health Insurance Plan Fund, or AccessWV, the state’s high-risk health insurance pool. With the implementation of the Affordable Care Act guaranteeing health insurance coverage either through Medicaid or the Federal Insurance Exchange, the state no longer needs to offer coverage through AccessWV. The Affordable Care Act also now fully pays for the Children’s Health Insurance Program (CHIP), saving the state nearly \$10 million in 2017.

The Shrinking Base Budget

West Virginia’s revenue problems have led to major budget cuts every year for the past several years, leading to a base budget that is smaller in nearly every category. In 2012, the state’s Six Year Financial Plan projected base budget expenditures to total \$5.29 billion in 2017. Instead, Governor Tomblin’s proposed base budget for 2017 totals \$4.68 billion, more than \$600 million less than what was projected (**Figure 13**).

Figure 13: 2017 base budget \$600 million less than projected in 2012
Actual and Projected Base Budget Expenditures, FY 2013-2017 (millions)



Source: WV State Budget Office, Executive Budgets.

Cuts have affected nearly every major area of the budget. Aside from Medicaid and the State Supreme Court, every major department has less funding in the FY 2017 proposed budget than what was spent in FY 2012. Overall, the base budget has grown by only 1.1% over the past five years (**Table 1**).

Table 1: Base budget spending down across the board
FY 2012 Actual and FY 2017 Proposed Base Budget Expenditures (thousands)

Department	FY 2012	FY 2017	Difference	Percent Change
Legislature	\$31,082	\$24,022	-\$7,060	-23%

Judicial	\$126,817	\$143,760	\$16,943	13%
Executive	\$60,051	\$36,570	-\$23,481	-39%
Administration	\$165,480	\$114,779	-\$50,701	-31%
Commerce	\$90,071	\$71,173	-\$18,898	-21%
Education	\$2,074,822	\$1,928,645	-\$146,177	-7%
Education and the Arts	\$52,825	\$49,510	-\$3,315	-6%
Environment	\$12,309	\$6,633	-\$5,676	-46%
Health and Human Resources	\$847,518	\$1,261,494	\$413,976	49%
Military Affairs & Public Safety	\$366,541	\$356,579	-\$9,962	-3%
Revenue	\$205,964	\$168,490	-\$37,474	-18%
Transportation	\$7,589	\$5,885	-\$1,704	-22%
Veterans Assistance	\$10,604	\$10,499	-\$105	-1%
Senior Services	\$64,224	\$63,280	-\$944	-1%
Higher Education	\$514,890	\$451,495	-\$63,395	-12%
Misc. Boards & Commissions	\$64,989	\$55,000	-\$9,989	-15%
Total Base Budget	\$4,630,776	\$4,682,814	\$52,038	1.1%

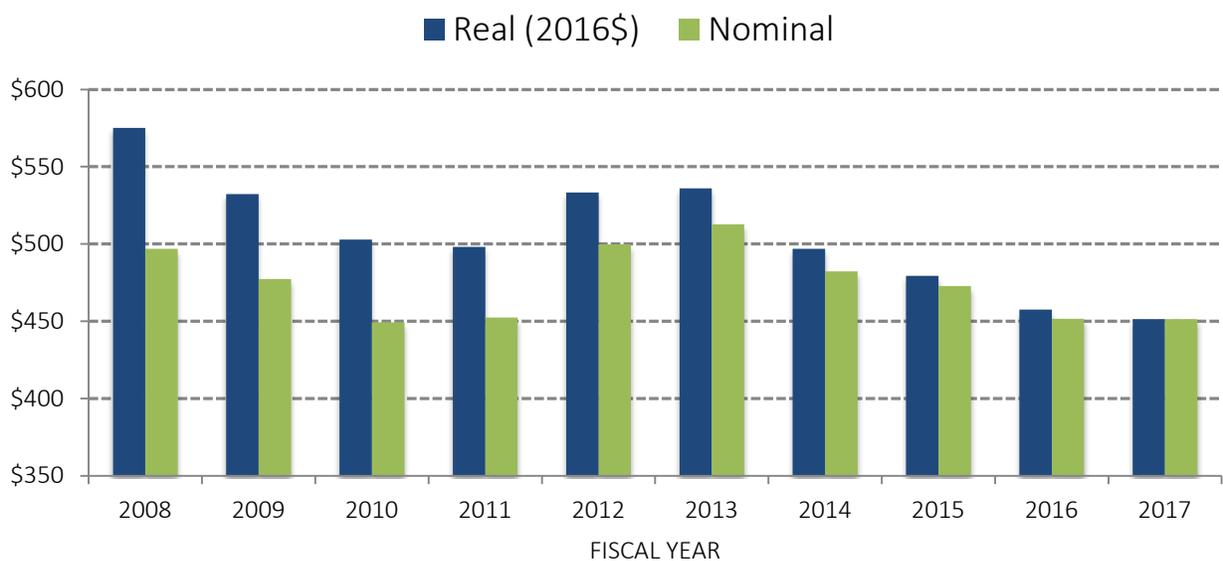
Source: WV State Budget Office, Governor's Executive Budgets, FY 2014 and FY 2017.

Note: Total does not double count transfer from Excess Lottery to General Revenue.

Years of cuts threaten higher education

Governor Tomblin's proposed budget for 2017 includes another round of cuts to higher education; coming on the heels of budget cuts in 2014, 2015, and two rounds of cuts in 2016. State investment in higher education will be at an eight-year low in 2017, and will be \$124 million below its 2008 level, adjusting for inflation.

Figure 14: West Virginia has made substantial cuts to higher education (in millions)

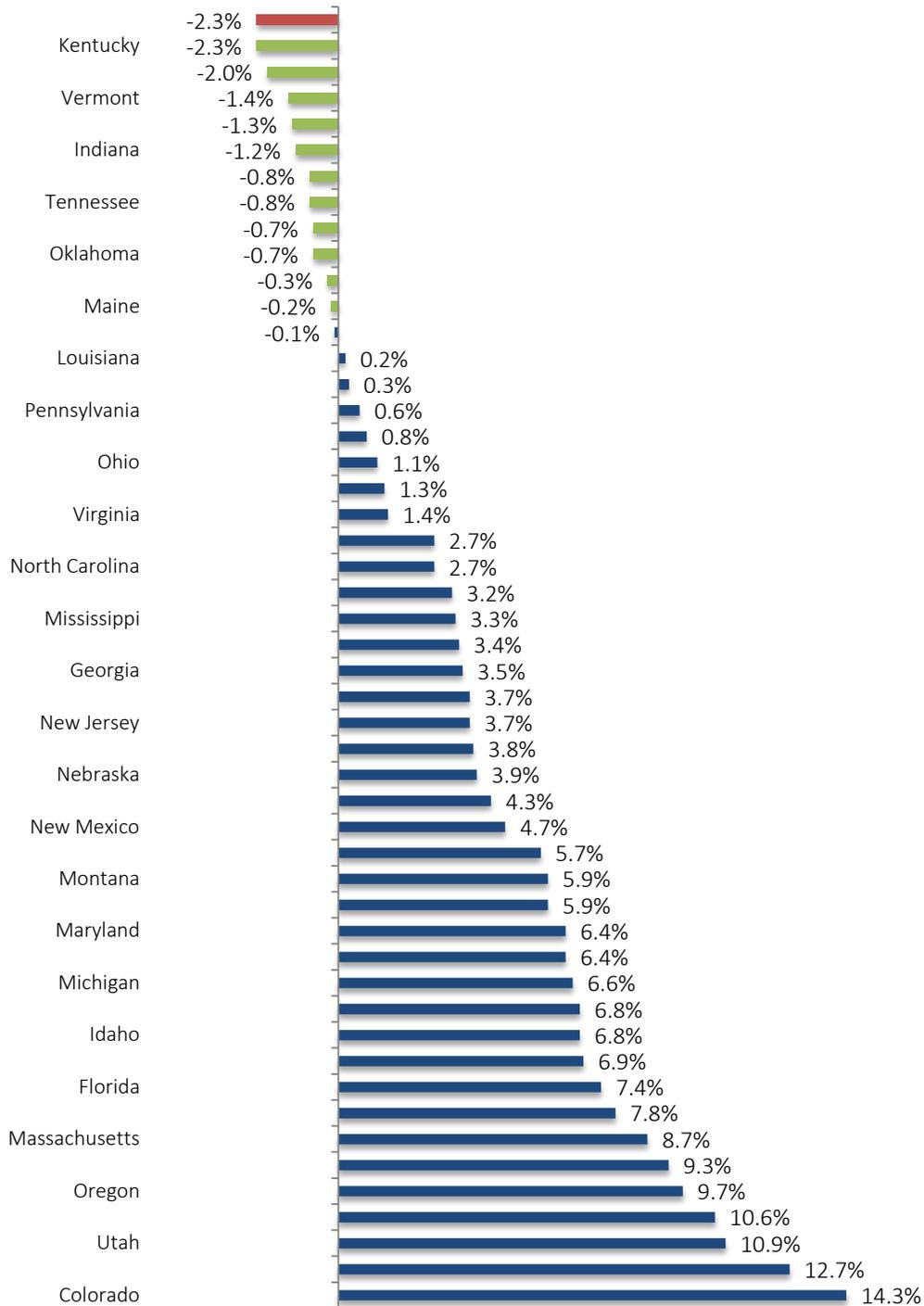


Source: WV State Budget Office, Governor's Executive Budgets, FY 2012-2017.

Note: Actual expenditures FY 2010-2015, budgeted expenditures FY 2016, proposed expenditures FY 2017.

Figure 15: Most states increased higher education funding last year, but West Virginia made the biggest cut

Percent change in state spending per student, inflation adjusted



West Virginia's latest round of budget cuts to higher education comes at a time when most states are restoring the cuts they made to higher education during the Great Recession. While 47 states spent less on higher education per student in FY 2015 than they before the recession, West Virginia was one of only thirteen states that saw a cut in state spending per student last year (**Figure 15**). According to the Center on Budget and Policy Priorities, tuition at the state's four-year colleges has increased by 34.2 percent from 2008 to 2015 in West Virginia, after adjusting for inflation.¹¹

While public colleges and universities across the state have increased tuition to compensate for the budget cuts, making a college education less affordable for West Virginia families, there are no plans to restore higher education funding in future budgets. West Virginia already has one of the least-educated workforces in the country. As the state's economy continues to struggle, a growing share of future jobs will require a college education. Investing in higher education to keep tuition affordable and quality high at public colleges and universities would help West Virginia develop the skilled and diverse workforce it will need to grow its economy.

CONCLUSION: INVESTING IN WEST VIRGINIA'S FUTURE

For the fourth year in a row, the state is facing significant budget problems that stem from large cuts in taxes in previous years and its weak economy. Governor Tomblin's plan for dealing with the budget gaps for 2016 and 2017 includes a mix of cuts to programs and services, one-time transfers and surplus revenues, and tax increases to help balance the budget.

While the governor is proposing additional revenues to help balance the budget for the first time in four years, it won't be enough to reverse the major cuts in programs such as higher education or provide any additional resources to help deal with many of the state's pressing problems or significant unmet needs. For example:

- In 2015, 35 states and District of Columbia had higher income eligibility limits for child care assistance than West Virginia and the state's frozen reimbursement rates to child care centers mean many are unable to stay afloat.
- West Virginia ranks fourth-lowest in the country in both state employee pay, with the state's average nearly \$11,000 below the national average, and average teacher salary, with West Virginia's teachers earning \$10,650 less than the national average.
- While West Virginia ranks last in the share of adults aged 25 and older with a bachelor's degree or higher, the state has drastically cut higher education funding, causing soaring tuition.
- Despite having high rates of childhood poverty and the nation's lowest labor force participation rate among prime-age workers, the state has neither a state Earned Income Tax Credit or a childcare tax credit to help lower poverty and boost workforce participation.

- While the southern coalfields continue to lose population and income from the collapse in coal production over the last decade, there is little to nothing being done to diversify the region's economy.

To improve the state's fiscal health and make much needed investments that will improve our state's economy, policymakers will need to address the state's revenue problem. By generating new revenue to invest in the building blocks of our state, we can begin to build an economy where more people have an opportunity to thrive and improve our quality of life. For example, Investments in customized workforce training, manufacturing extension partnerships, universal pre-k, job subsidies for displaced workers, summer schools and career academes have a much greater "bang for the buck" than misguided business tax cuts that do little to spur long-term economic growth and development.¹²

While the state's economy is relatively weak compared to most states, state investments as a share of the economy are at a two-decade low - the result of large reductions to the state's tax base over the last ten years. A budget that supports a shared prosperity and a better future for our children needs to invest more and cut less. Below are some recommendations to do just that.

RECOMMENDATIONS¹³

- **Increase cigarette tax to at least \$1.55 per pack.** While Governor Tomblin took a step in the right direction by increasing tobacco taxes, it won't be enough to provide long-term funding for programs such as Medicaid nor will it help reduce health care costs and save lives associated with tobacco use. By increasing the cigarette tax to \$1.55 per pack and increasing the wholesale price on other tobacco products from seven percent to 50 percent, the state could collect an additional \$61 million beyond Governor Tomblin's tobacco tax increase proposal of 45 cents per pack and 12 percent wholesale tobacco products tax.
- **Modernize sales tax on services.** West Virginia's sales and use tax continues to have holes in it because it excludes many personal services (e.g., barber shops, nail salons, etc.) and digital downloads (software, music, games, etc.). Closing these tax expenditures could increase revenue by \$9.5 million annually.
- **Extend Workers' Compensation Fund Debt tax on natural gas.** With the Workers' Compensation Fund now essentially paid off, extending the existing tax on natural gas would be a prudent way to fund infrastructure and other budget priorities. The tax is highly exportable since at least 80 percent of natural gas production flows out of the state and is owned by mostly large multinational corporations that reside outside of West Virginia.
- **Enact a higher severance tax on natural gas liquids.** A new severance tax incentive, based on a higher rate for natural gas liquids, with a credit to related in-state industries, may encourage ethane cracking and other chemical manufacturing to create in-state jobs

while generating additional tax revenue for investment in infrastructure and human capital. If West Virginia increased its severance tax on natural gas liquids from five to ten percent, it would increase revenue by an estimated **\$168 million over the next five years**. A portion of this revenue could go into the WV Future Fund.

- **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. 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.
- **Raise taxes on alcohol sales:** 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. These funds could help pay for substance abuse treatment and other budget priorities.
- **Enact a refundable West Virginia Earned Income Tax Credit (EITC).** Twenty-six states and the District of Columbia have enacted earned income tax credits to supplement the federal EITC. The EITC is a proven tool to fight poverty, increase labor force participation, help low-income working families make ends meet and has lasting effects such as improving the health, educational achievement, and earnings of children who are EITC recipients. A refundable WV EITC at 15% of the federal credit would **cost approximately \$47 million** and could be paired with a tobacco tax increase or a sales tax increase to help offset the regressivity of these taxes.

END NOTES

¹ “Governor Tomblin Announces Reduction in Fiscal 2016 Budget,” Office of the Governor Earl Ray Tomblin, October 5, 2015. Retrieved from <http://www.governor.wv.gov/media/pressreleases/2015/Pages/Governor-Tomblin-Announces-Reduction-in-Fiscal-2016-Budget.aspx>

² David Gutman, “WV Senate advances planned tax cut for coal, gas.” Charleston Gazette-Mail, February 6, 2016. Retrieved from <http://www.wvgazette.com/news/20160206/wv-senate-advances-planned-tax-cut-for-coal-gas>

³ Richard Borean, “How High Are Cell Phone Taxes in Your State?,” Tax Foundation, October 8, 2014. Retrieved from <http://taxfoundation.org/blog/how-high-are-cell-phone-taxes-your-state>

⁴ Ann Boonn, “State Cigarette Excise Rates and Rankings,” Campaign for Tobacco-Free Kids, January 5, 2016. Retrieved from <http://www.tobaccofreekids.org/research/factsheets/pdf/0097.pdf>

⁵ Ann Boonn, “Raising Cigarette Taxes Reduced Smoking, Especially Among Kids,” Campaign for Tobacco-Free Kids, October 11, 2013. Retrieved from <http://www.tobaccofreekids.org/research/factsheets/pdf/0146.pdf>

⁶ Chuck Marr and Chye-Ching Huang, “Higher Tobacco Taxes Can Improve Health and Raise Revenue,” Center on Budget and Policy Priorities, March 19, 2014 (Updated). Retrieved from <http://www.cbpp.org/research/higher-tobacco-taxes-can-improve-health-and-raise-revenue>

⁷ Julia Belluz, “E-cigarettes and health – here’s what the evidence actually says,” VOX, August 24, 2015. Retrieved from <http://www.vox.com/2015/6/26/8832337/e-cigarette-health-fda-smoking-safety>

⁸ WVCBP analysis of U.S. Bureau of Labor Statistics, Local Area Unemployment Statistics (LAUS)

⁹ WVCBP analysis of U.S. Bureau of Labor Statistics, Current Employment Statistics (CES)

¹⁰ The Pew Charitable Trusts, “Fiscal 50: State Trends and Analysis,” Retrieved from <http://www.pewtrusts.org/en/multimedia/data-visualizations/2014/fiscal-50#ind3>

¹¹ Michael Mitchell and Michael Leachman, “Years of Cuts Threaten to Put College Out of Reach for More Students,” Center on Budget and Policy Priorities, May 13, 2015. Retrieved from <http://www.cbpp.org/research/state-budget-and-tax/years-of-cuts-threaten-to-put-college-out-of-reach-for-more-students>

¹² Tim Bartik, “What Should Michigan Be Doing to Promote Long-Run Economic Development?,” W.E. Upjohn Institute, 2009. Retrieved from http://research.upjohn.org/up_workingpapers/160

¹³ Recommendations from Ted Boettner, “West Virginia Tax Policy & Shared Prosperity: Recommendations to Joint Select Committee on Tax Reform,” WV Center on Budget and Policy, October 20, 2015. Retrieved from <http://www.wvpolicy.org/wp-content/uploads/2015/10/WVCBP-Recommendations-to-Tax-Reform-Committee2.pdf>