WEST VIRGINIA CENTER ON BUDGET & POLICY

Issue Brief

Trouble Ahead:
The West Virginia FY 2021 Proposed Budget

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Overview

Governor Jim Justice's FY 2021 budget is largely unchanged from FY 2020, with stagnating revenues preventing any major new spending and one-time budget maneuvers preventing any spending cuts. While the FY 2021 budget is stable because of a large surplus in Medicaid, the state faces significant budget gaps in the coming years that may require more revenue if the state wants to avoid large cuts to important programs and services.

Key Findings

- General Revenue collections are expected to be down $56.8 million in FY 2021, leading to an overall flat budget from FY 2020.
- $108 million in one-time, surplus Medicaid funds are being used to prevent budget cuts.
- Severance tax revenues are projected to decline sharply in FY 2021, $106 million below FY 2020 estimates. Due to the reduction of the severance tax on steam coal, this trend will likely continue for years to come.
- Slow revenue growth is resulting in no reinvestment in higher education and several other budget areas.
- Despite little new spending, West Virginia faces significant budget gaps in the coming years. This could be made worse by proposed business tax cuts currently under consideration by the 2020 legislature.

Governor's Proposed FY 2021 Base Budget

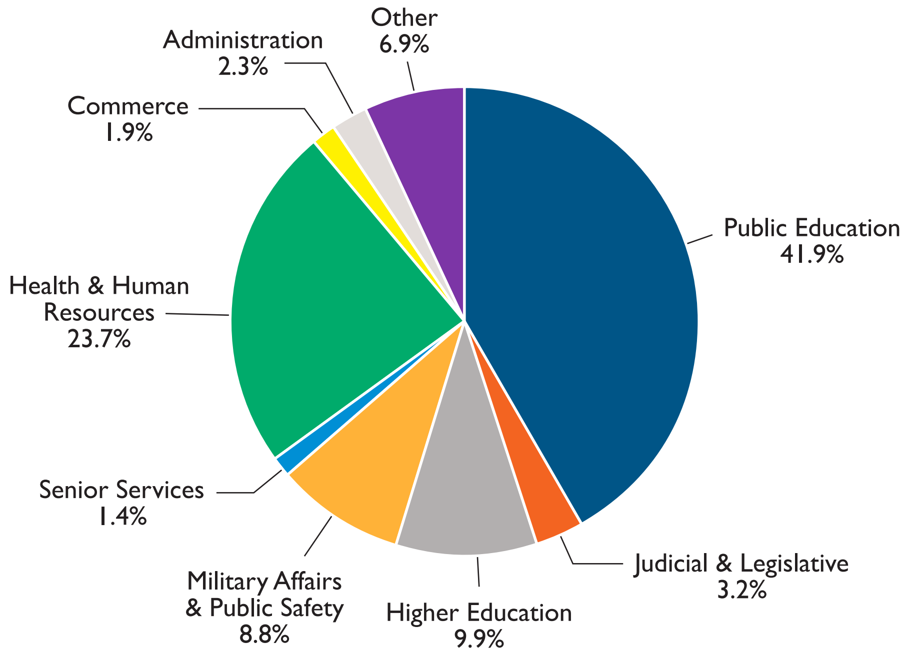
Governor Justice's proposed FY 2021 base budget appropriations total $5.053 billion, including $4.59 billion from the General Revenue Fund and $468 million from the Lottery funds (including re-appropriated surpluses). General Revenue spending is down $50.9 million, or 1.1 percent, from FY 2020's final approved budget. The two largest areas are appropriations for public education and health and human services, which make up more than two-thirds of the base budget (Figure 1).

Most of the changes in the FY 2021 proposed budget come from Medicaid. According to the State Budget Office, the state's Medicaid has accrued a surplus balance of $309 million (Figure 2). A number of factors have contributed to growth of this surplus. The state's Federal Medical Assistance Percentage has grown from 71.09% in 2014 to 74.99% in 2020. A higher FMAP means the federal government is providing more Medicaid funding. The increase in West Virginia's FMAP means the state is receiving approximately $117 million more in federal Medicaid funding. In addition, enrollment in Medicaid has declined, by about 50,000 people, and the state has realized costs savings from prescription drugs and managed care organizations.

Figure 1

Education and Healthcare are the Biggest Pieces of the Base Budget

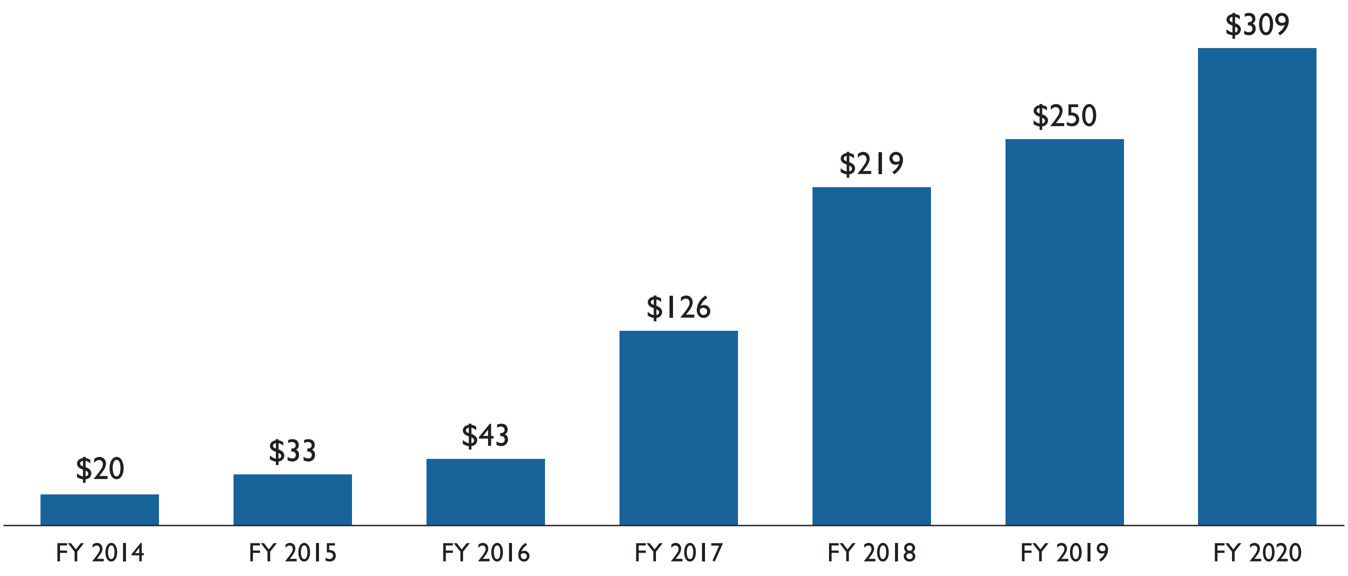
Governor's Proposed Base Budget Appropriations, FY 2021



Source: West Virginia State Budget Office

Figure 2

Medicaid Surplus Revenue Funds, FY 2014 – FY 2020 (millions)



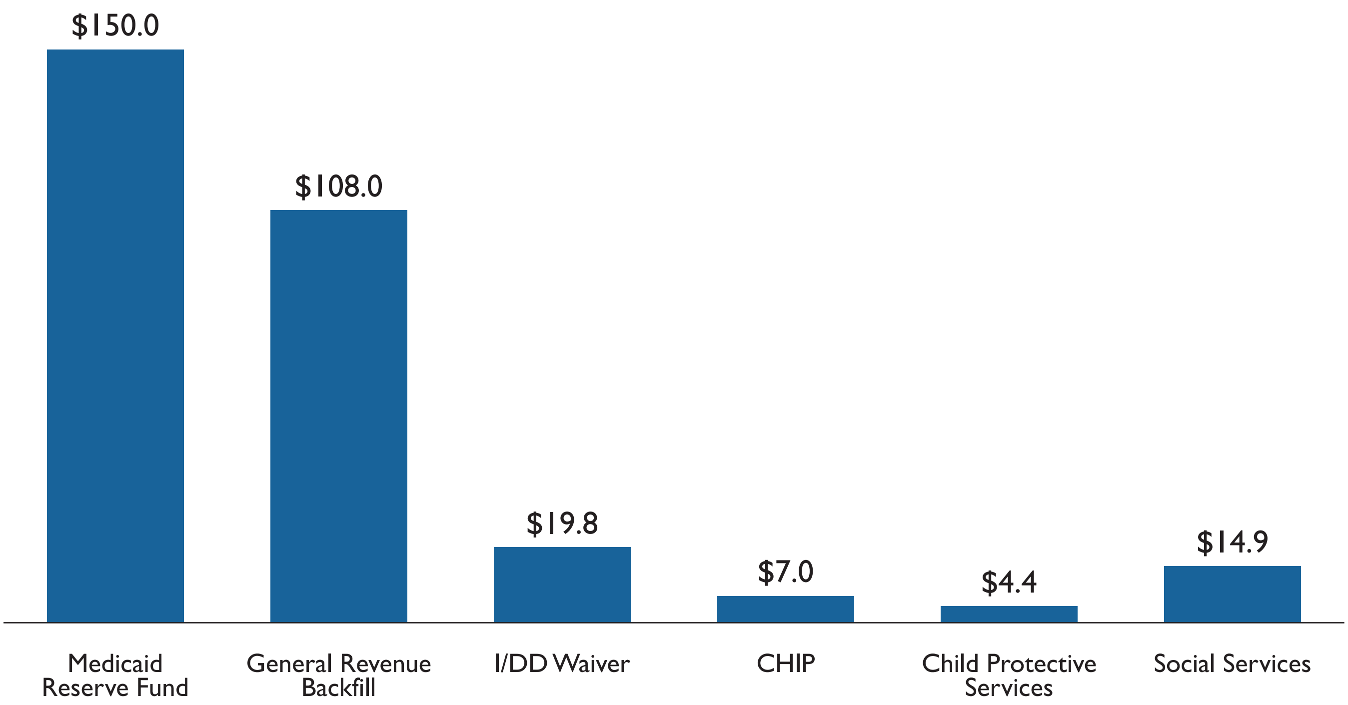
Source: West Virginia State Budget Office

The governor is proposing to allocate $150 million of that balance into a Medicaid reserve fund to help with potential future Medicaid shortfalls. Senate Bill 633 would create the Medicaid Families First Reserve Fund, consisting of the $150 million in excess state Medicaid funds, as well as additional funds appropriated by the legislature, investment income, and other contributions. Beginning in FY 2021, the legislature would be authorized to transfer money from the fund to "stabilize" the state's Medicaid program, with written authorization from the governor.

The remainder of the balance is being used to backfill cuts to Medicaid from General Revenue, with the savings being redirected to the Intellectual and Developmental Disabilities waiver program, eliminating the program's 1,060-person waitlist. The Medicaid savings are also being redirected to the Children's Health Insurance Program (CHIP), as well as increasing funding for Child Protective and Social Services (Figure 3).

Figure 3

Governor's Proposals for Medicaid Surplus Revenue Funds, FY 2021 (millions)



Source: West Virginia State Budget Office

Other areas of the budget seeing minor increases over FY 2020 include $7 million for tourism, $3.3 million for the Mountaineer Challenge Academy, $11.2 million for the Supreme Court, $1 million for community food programs, $300,000 for WV Food Banks, $2.8 million for commuter rail, and $12 million for the Milton Flood Wall.

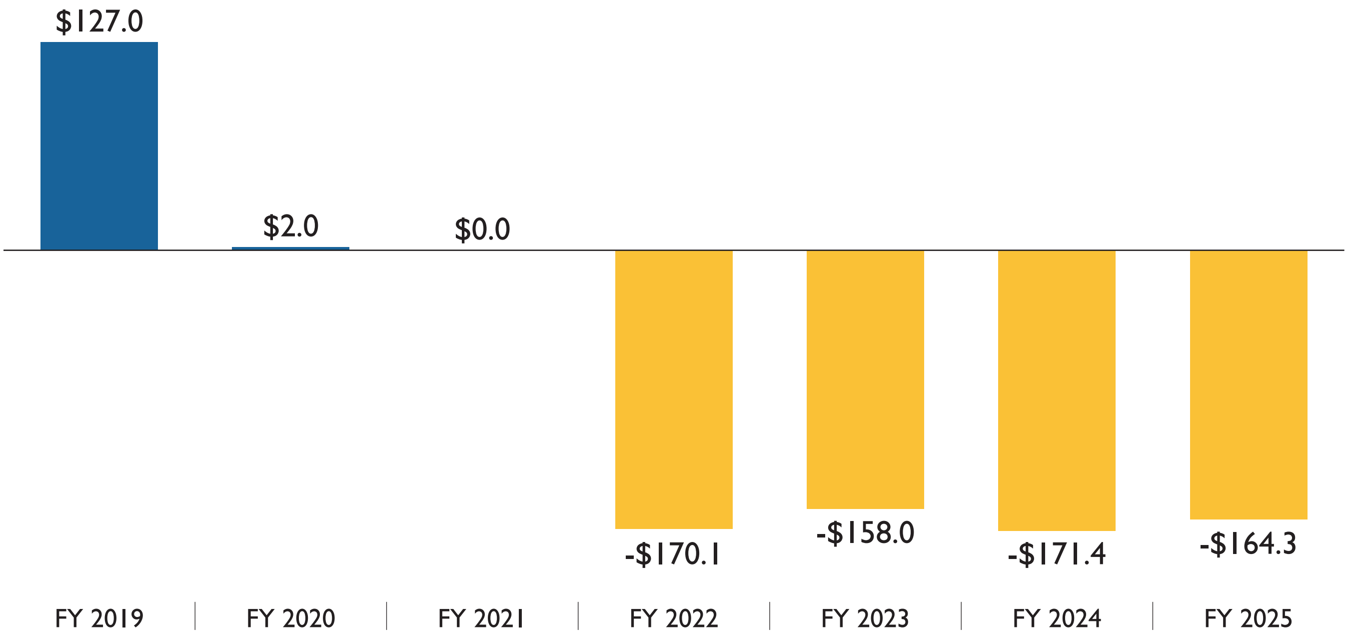
Areas of Concern

The FY 2021 budget proposal is balanced without any major spending cuts, in large part by one-time use of Medicaid surplus funds. Without those one-time funds, the state is facing significant budget gaps starting in FY 2022. According to projections from the State Budget Office, West Virginia is facing a $170 million budget gap in FY 2022, a $158 million gap in FY 2023, a $171 million gap in FY 2024, and a $164 million gap in FY 2025. This cumulative $663 million budget gap occurs despite no new spending on higher education, declining state spending on the school aid formula, and only $157 million in new spending for Medicaid over that time frame.

Figure 4

West Virginia Facing Significant Budget Gaps in Coming Years

Projected Budget Surpluses/Gaps through FY 2025 (millions)



Source: West Virginia State Budget Office

With large budget gaps on the horizon, there is still no permanent plan for addressing public employee health insurance costs. During the 2019 Legislative Session, West Virginia used a budget surplus to set up a Public Employees Insurance Agency (PEIA) Reserve Fund with $150 million to offset future cost increases for PEIA health insurance benefits. Without changes to PEIA, or a more permanent funding source, however, the reserve fund is projected to be depleted by FY 2022, a year when the state is already facing a projected $170.1 million budget gap.

The state has also seen a dramatic rise in spending on foster care. The number of children in foster care has risen dramatically in recent years, and, with it, spending on Social Services has increased by $135 million since FY 2010, a 182 percent increase.

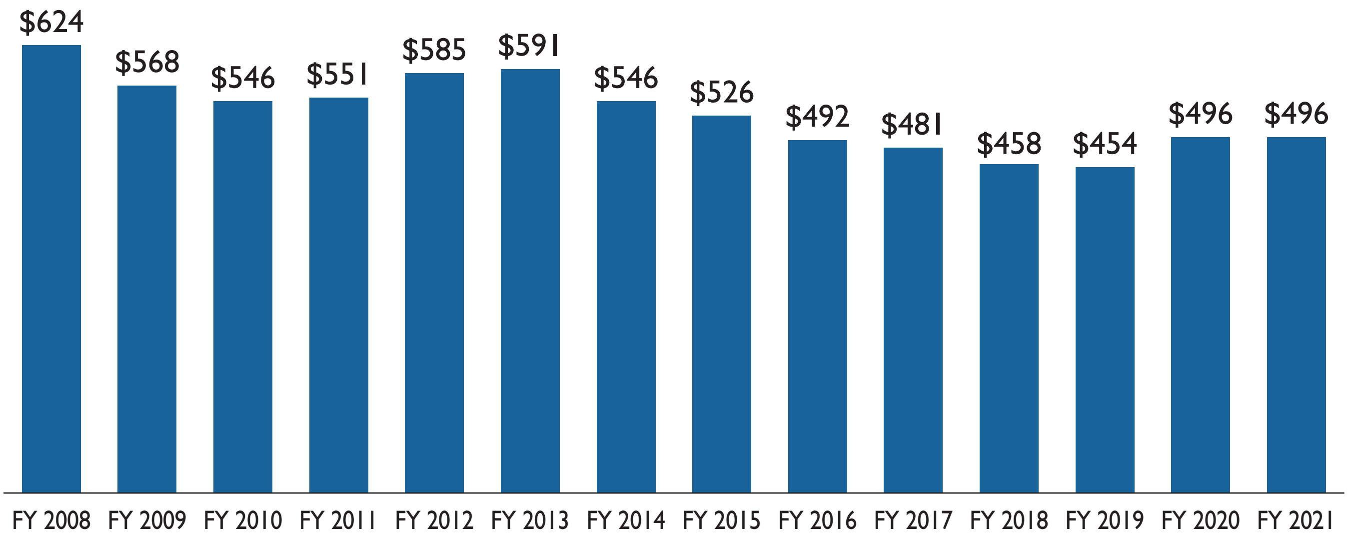
Once again, one area of the budget that should be of major concern for the state's policymakers is higher education. After seeing a modest increase in the FY 2020 budget, higher education has no increases in the FY 2021 budget, and no increases in future budget projections.

Base Budget funding for higher education in the FY 2021 budget is down $32 million from its peak in FY 2013, and adjusting for inflation, is down $128 million from FY 2008 (Figure 5). These cuts to higher education have hurt the state's investment in its workforce causing tuition increases that are most likely responsible for the state's declining enrollment.

Figure 5

Higher Education Funding Down $128 Million from FY 2008, Adjusting for Inflation

Base Budget Higher Education Funding, 2019 inflation adjusted dollars (millions)



Source: WVCBP analysis of West Virginia State Budget Office and Bureau of Labor Statistics data

Declining School Enrollment Continues to Impact the State Budget

At $1.22 billion, state funding for local PreK-12 schools through the school aid formula is the single-largest line item in the state budget, accounting for 26.7 percent of general revenue appropriations. In recent years, the state has saved significant amounts of money through the school aid formula due to the boom in natural gas production and pipeline construction leading to large increases in local property taxes. Increased local property tax revenue, in turn, increases the local share of the school aid formula and reduces the state's share.

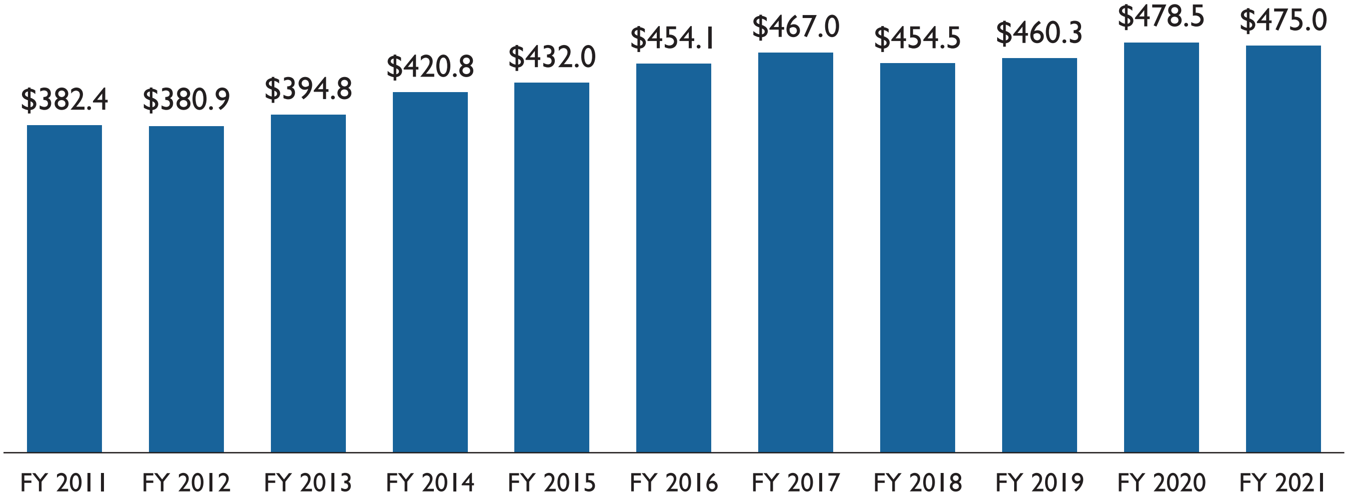
Between FY 2008 and FY 2020, the local share of the school aid formula increased from 23.7 percent of the total allowance to 28.5 percent, reducing the state's share by $80.1 million. That trend is slowing, however, and will reverse in FY 2021, as low gas prices and a decline in pipeline construction saw local property tax revenues fall. And, for the first time in years, the local share of the school aid formula fell, increasing the state's share by $3.4 million (Figure 6).

While rising local property tax revenue, even if temporary, is a positive development that has saved the state money, other savings in the school aid formula represent negative signs. School enrollment has been on the decline in West Virginia, a sign of an aging population and weak economy. Since 2008, West Virginia school enrollment fell by 17,700 students. Since the school aid formula is based, in part, on enrollment, the decline has resulted in significant savings for the state. If enrollment had simply remained flat since 2008, the state's share of the school aid formula would be $81.9 million higher in FY2021.

Figure 6

Growth in Local Share Slowing

Local Share of the School Aid Formula, FY 2008-FY2021 (millions)



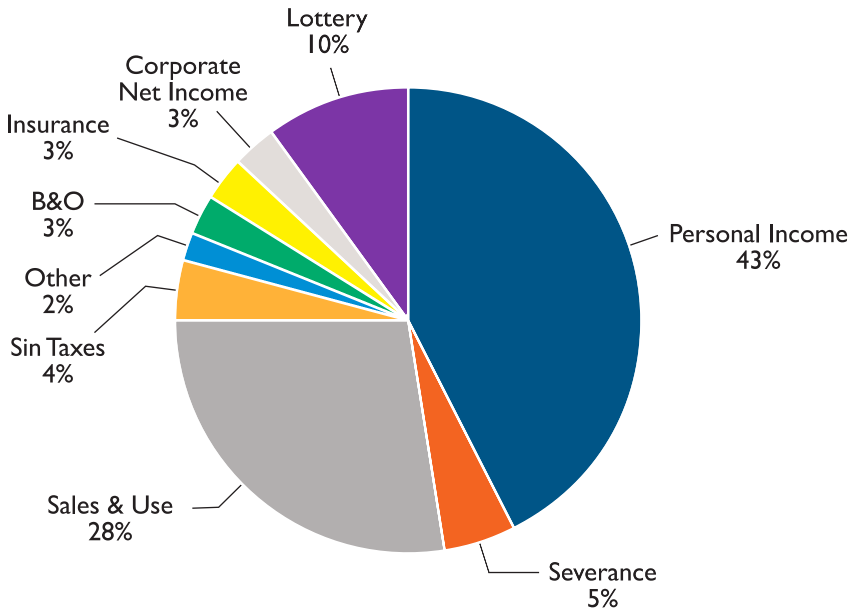
Source: West Virginia Department of Education

West Virginia Continues to Have a Revenue Problem

FY 2021 base budget revenues are expected to total $5.02 billion. The largest sources of revenue continue to be the personal income tax and sales tax, together accounting for 71 percent of total base budget revenue (Figure 7).

Figure 7

FY 2021 Base Budget Revenues



Source: West Virginia State Budget Office

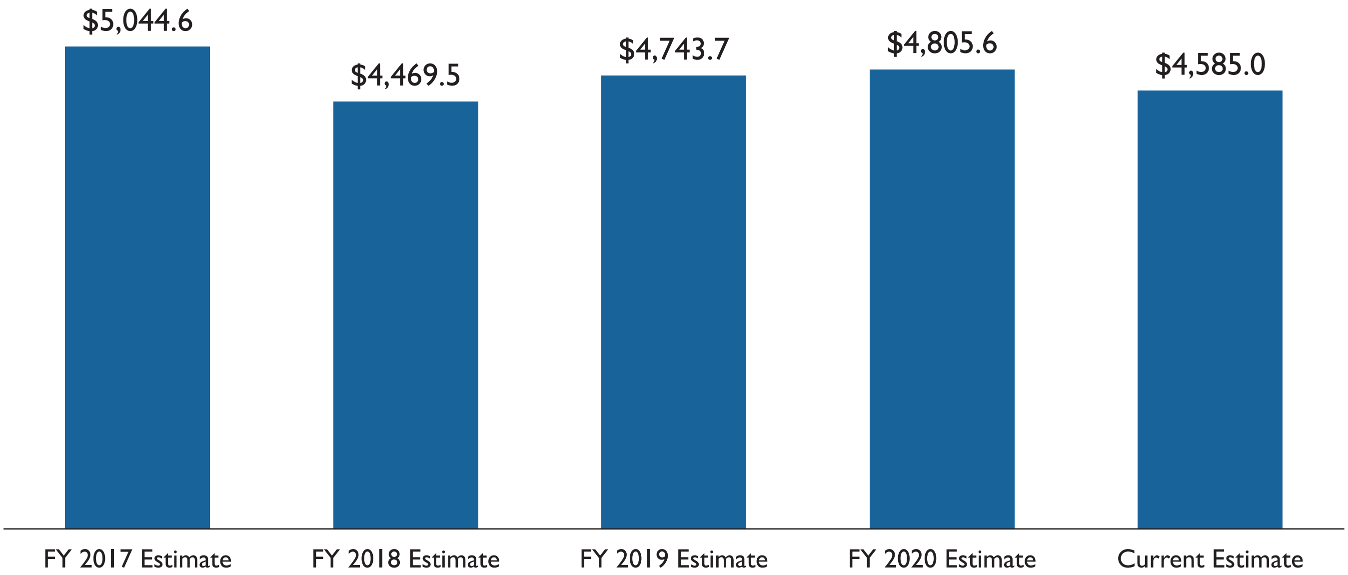
While rising energy prices and natural gas pipeline construction gave state revenues a boost in recent years, that boost has shown to be temporary, with little revenue growth in the state's foreseeable future. For FY 2020, General Revenue collections are running $33.3 million below estimates as of December 2019. Revenues are expected to decline, with FY 2021's General Revenue estimated collection $56.8 million below FY 2020.

FY 2021's estimated revenues are far below the state's initial expectations. In FY 2017, the state projected the General Revenue fund would be at $5.04 billion, $460 million higher than this year's estimate(Figure 8).

Figure 8

FY 2021 General Revenue Far Below Initial Estimates

FY 2021 General Revenue Estimates (thousands)



Source: West Virginia State Budget Office

The main source of West Virginia's revenue problems is the severance tax. Low natural gas prices and the continuing decline of the coal industry, as well as cuts to the coal severance tax, have caused a major decline in severance tax revenues. The governor's FY 2021 budget estimates that severance tax revenue will total $254 million in FY 2021, a $106 million drop compared to FY 2020, and $209 million below FY 2019. Future projections show little recovery for the severance tax, with revenues remaining below FY 2018's levels through FY 2025.

While the severance tax is in a free fall, other sources of revenue are stagnating. Both the personal income tax and the sales tax, the state's two biggest sources of general revenue, are projected to see almost no growth in FY 2021, and little growth in the following year. Personal income tax revenues in FY 2021 are projected to be $2.156 billion, an increase of only 0.04 percent from FY 2020. Revenues are projected to increase by an average of only 2.6 percent per year through FY 2025.

A similar story is told for the sales tax. Sales tax revenues in FY 2021 are estimated to be $1.422 billion, a 2.3 percent increase from FY 2020, and are expected to grow at that same rate through FY 2025.

Manufacturing Property Tax Cut Would Make Budget Problems Worse

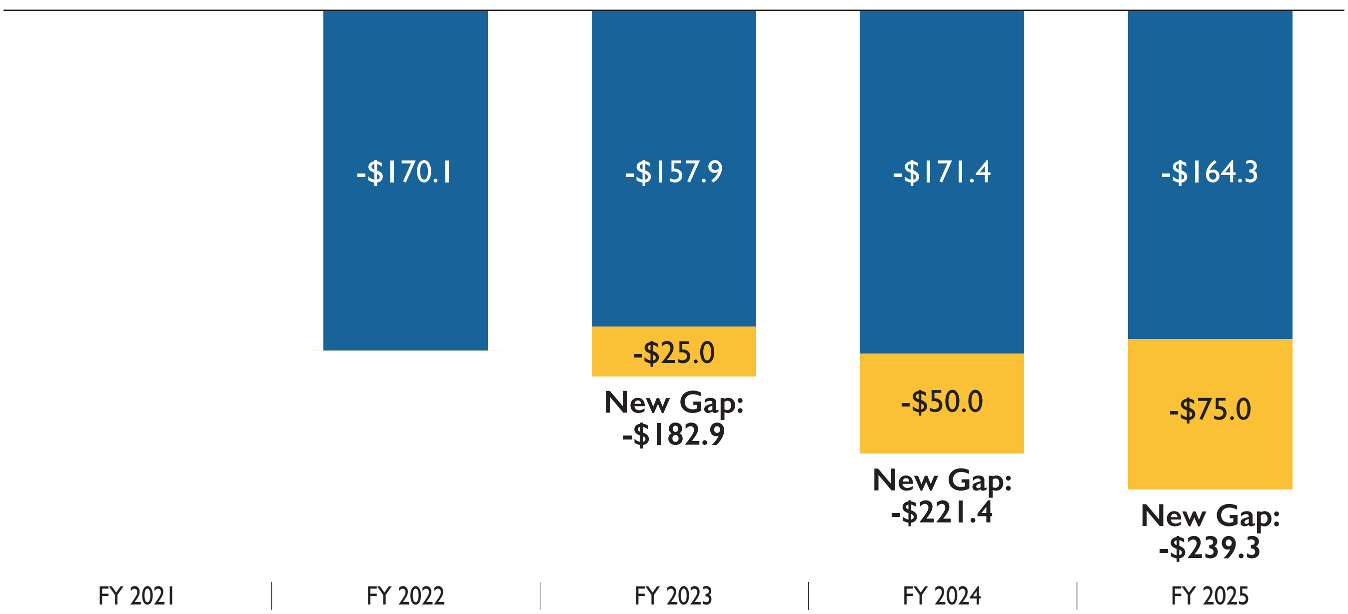
A proposal to amend the state's constitution to eliminate the business inventory, machinery, and equipment property tax is again a major part of the 2020 legislative agenda. This time, the proposal, Senate Joint Resolution 8, would only eliminate the tax for manufacturers, at a cost of $100 million. All other businesses would continue to pay the property tax on their inventories and equipment.

West Virginia's property tax revenue largely funds schools and local governments. While the proposal calls for the state to reimburse schools and local governments from the General Revenue Fund, the state is currently facing large budget gaps, which this proposal would only make worse (Figure 9). This would undoubtedly result in less funding from the state for education and other budget priorities.

Figure 9

More Business Tax Cuts Would Make Budget Problem Worse

Projected Budget Gaps With and Without Senate Joint Resolution 8 (millions)



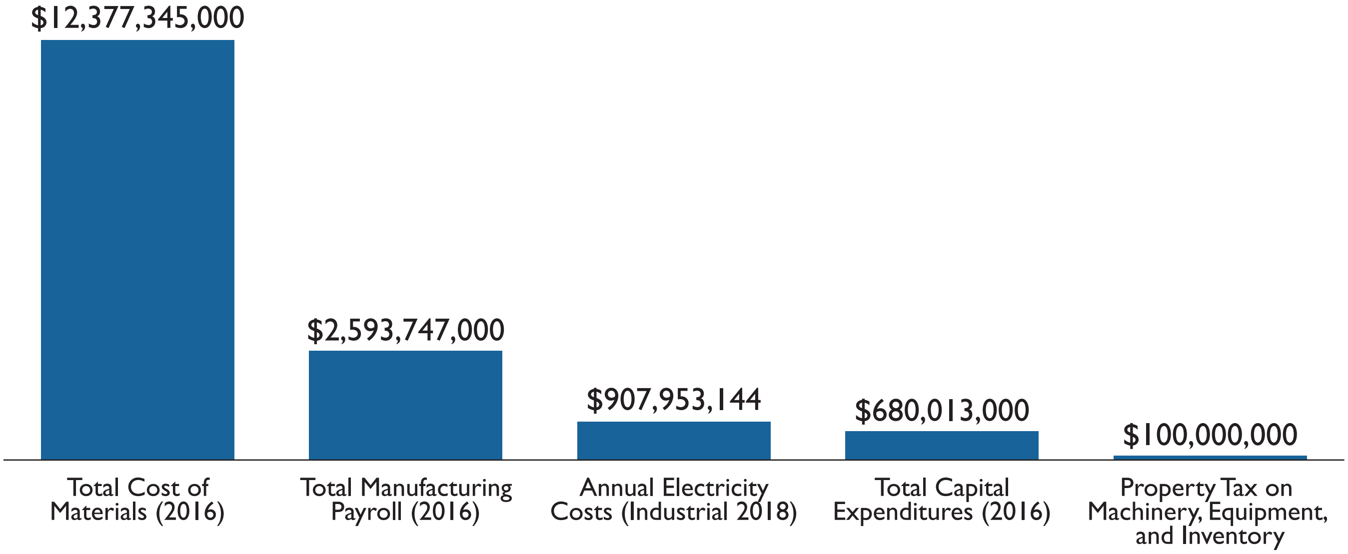
Source: WVCBP analysis of State Budget Office data and SJR 8 text

Further, this proposal, like past business tax cuts, would be largely ineffective at creating economic growth. There is no obvious relationship between manufacturing employment growth and industrial property tax rates, or between states that do and do not tax business personal property. This is in no small part since state and local taxes, including the property tax on inventory, machinery, and equipment are only a small fraction of the cost of doing business. For example, manufacturers in West Virginia spent $16.56 billion on materials, payroll, utilities, and capital expenditures in 2016. The property tax on manufacturing machinery, equipment, and inventory accounted for only 0.6 percent of those costs (Figure 10).

Figure 10

Machinery, Equipment, and Inventory Property Tax is a Small Fraction of Manufacturing Costs

Manufacturing Costs in West Virginia



Source: U.S. Census Bureau Annual Survey of Manufacturers, U.S. Energy and Information Administration, and WV State Tax Department

Conclusion

While West Virginia was fortunate to avoid any major spending cuts in the FY 2021 budget, despite stalling revenues, this was only due to the availability of one-time surplus Medicaid funding. West Virginia continues to have a structural budget deficit and has never replaced the revenue lost due to major tax cuts enacted between 2006 and 2015. With faltering severance tax revenue, and little growth elsewhere, it is vital for West Virginia to raise additional revenues to both meet current needs and to invest in our people and communities to build a stronger economy. Options to raise revenue could include:

- Raising the severance tax on natural gas - $100 million
- Reversing cuts to the severance tax on steam coal - $64 million
- Enacting worldwide combined reporting - $68 million
- Reinstating the estate tax - $20 million
- Legalizing and taxing cannabis - $58 million

Source: "Who Pays? Rethinking West Virginia's Tax System", January 2020, WV Center on Budget and Policy

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