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The Case Against Austerity:
Why Protecting Investments in West Virginia Families and Communities is Key to COVID-19 Recovery

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Introduction

With West Virginia still feeling the impacts of the COVID-19 pandemic recession, the state's leaders face difficult choices in the upcoming legislative session. The choices legislators make will help determine whether or not West Virginia will have a swift and equitable recovery with an economy that works for everyone.

West Virginia has spent the past decade cutting taxes with little to show for it. Instead of delivering on the promised growth, these cuts have hurt investments in West Virginia, leading to one of the weakest economies heading into the recession. Before the pandemic, West Virginia was consistently losing jobs, and was facing a cumulative $683 million deficit over the next four years.[1] And since the pandemic hit the state in March, tax revenue is down another $117 million, tens of thousands of jobs have been lost, and the state is years away from a full recovery.

Unfortunately, Governor Justice and legislative leaders have signaled that they desire even more tax cuts, despite the overwhelming evidence and West Virginia's own experience that tax cuts only lead to painful budget cuts that would result in a longer, slower recovery for the state.

By raising revenue, West Virginia can protect economy-boosting jobs and maintain public investments where they are needed most. Keeping resources flowing to workers, families, schools, and communities will boost the state's recovery, and keep it moving forward into the future.

Key Findings

- Months into the COVID-19 pandemic recession, West Virginia is down tens of thousands of jobs and tens of millions in tax revenue.
- Even before the pandemic, West Virginia was facing structural revenue challenges and significant budget shortfalls in the years ahead.
- Experience shows that budget cuts will only slow down the state's recovery, hurting families and making the recession worse.
- Experience also shows that more tax cuts will fail to produce growth, and in fact will lead to budget cuts that will further harm the economy.
- The pandemic recession has disproportionately impacted low-income workers, while high-income earners have nearly fully recovered.
- By abstaining from ineffective tax cuts, and instead raising the revenue necessary to prevent harmful budget cuts, West Virginia can keep money flowing to families and communities, and recover faster, benefiting residents and businesses.

1 West Virginia State Budget Office. FY 2020 Budget Six Year Plan.

Budget Cuts Will Stall West Virginia's Recovery

When West Virginia's Governor Jim Justice released his FY 2021 budget proposal in January of 2020 – before the COVID-19 pandemic was a major concern – West Virginia's budget situation was one of stagnating revenues preventing any major new investments and one-time budget maneuvers preventing any spending cuts. Proposed General Revenue spending was down $50 million from the previous year, while revenues were $460 million below their original estimates.[2]

Surplus Medicaid funds prevented any major spending cuts in the FY 2021 budget, but projections showed the state was facing a cumulative $663 million budget gap over the next four years, 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.[3]

Then the pandemic hit, causing widespread unemployment and a major reduction in economic activity. To date, state tax revenue is down $117 million since March.[4]

State policy makers often respond to recessions with spending as well as tax cuts, but both of these approaches make a difficult situation worse. Spending cuts reduce the state's ability to meet increased need for services, just as that need is increasing, and tax cuts make the revenue crisis worse. This approach delays economic recoveries, exacerbating the economic pain to communities and families.

In contrast, state spending can spur economic activity, and make the investments that set future generations up for success. State spending is a significant share of West Virginia's economy. The state's base budget of roughly $5.0 billion makes up more than 6 percent of the state's economy.[5]

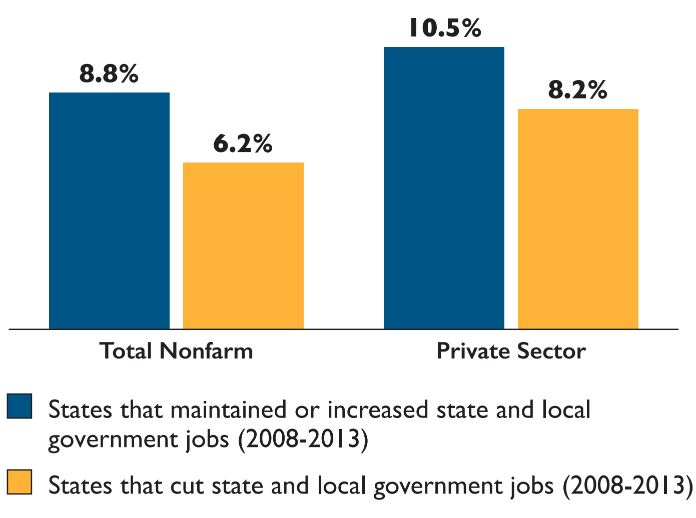
Public revenues support schools in every community in the state, as well as pay for roads and their upkeep, affordable health care for families, and other essential infrastructure such as broadband and systems to maintain clean air and water. State spending also draws down billions of dollars in federal funding that support communities and West Virginia's economy. Salaries paid to state employees and state purchases of goods and services bolster businesses throughout the state.

During recessions, this spending can slow the pace of job losses and increase the speed of recoveries. After the Great Recession, states that maintained or added state and local jobs experienced smaller increases in unemployment rates and recovered their lost jobs faster. Between 2008 and 2013, states that maintained or grew their public workforce had fully recovered all jobs lost in the recession, while states that cut their public workforce were still below pre-recession job levels. As the nation recovered, these states that supported their public workforce continued to outperform the other states through the recovery period of 2009 to 2015. In short, the more a state cut their state and local public-sector workforce, the fewer private-sector jobs they tended to add in the first six years of the recovery (Figure 1).

FIGURE 1

States That Cut Public Sector Jobs Experienced Slower Recoveries After the Great Recession

Change in total and private sector jobs, 2009-2015



Source: Economic Policy Institute

2 Ibid.

3 Ibid.

4 WVCBP analysis of WV State Tax Department data.

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

Tax Cuts Make a Bad Situation Worse

West Virginia's recovery from the Great Recession was made worse by expensive, ineffective tax cuts that have cost the state hundreds of millions of dollars annually, leading to years of painful budget cuts, while failing to deliver any of the promised economic growth.

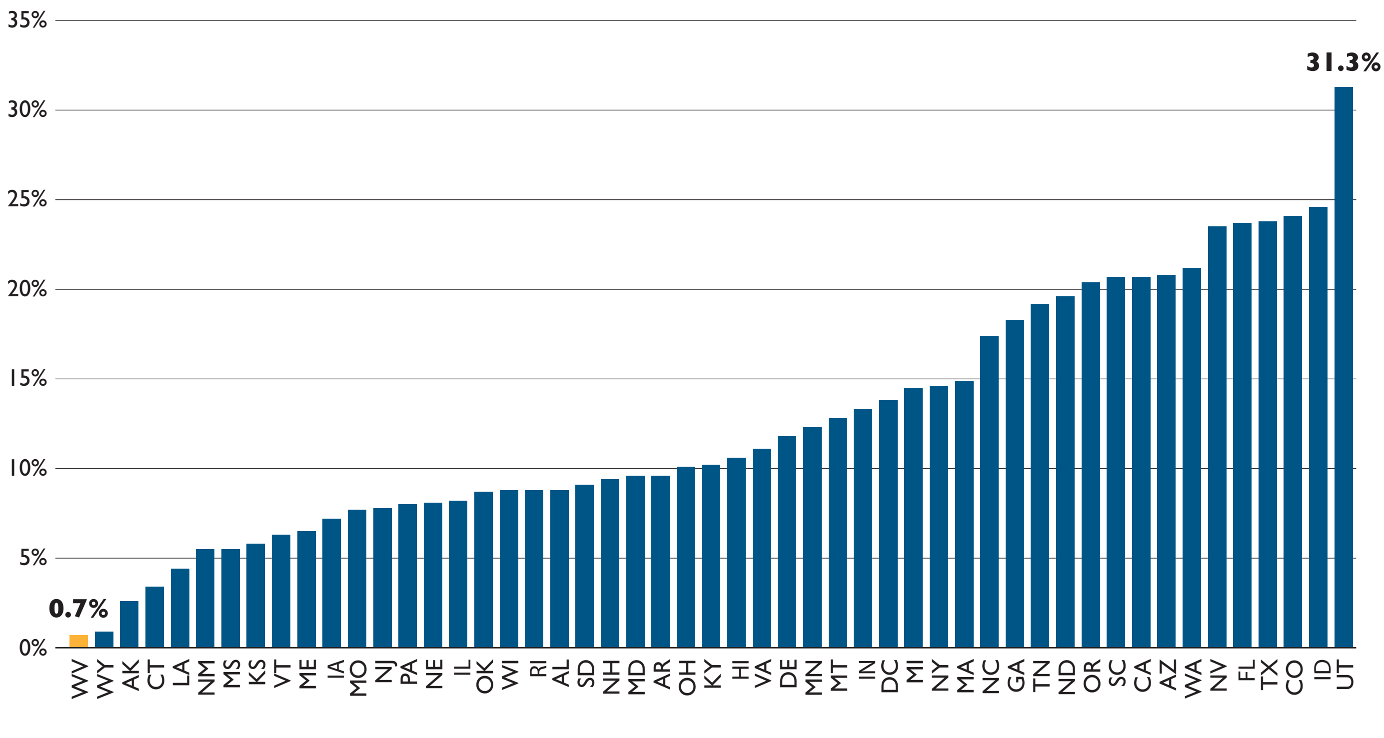
Beginning in 2007, West Virginia enacted a series of cuts to the corporate income tax rate, from 9.0 percent to 6.5 percent, while fully eliminating the business franchise tax, at an annual cost of $205 million. Other tax cuts, including the elimination of the sales tax on groceries and changes to the personal income tax, pushed the total cost to $425 million annually.[6] As a share of the economy, West Virginia's corporate net income tax/business franchise tax revenue fell from 0.7 percent of private sector GDP in FY 2007, to just 0.3 percent in FY 2019.[7]

At the time, these tax cuts were called the "most pro-growth tax reform in the country,"[8] and came with a promise to put the state in a better position to compete both regionally and at the national level.[9] Instead, total nonfarm employment grew by only 0.7 percent from 2009 to 2019 in West Virginia, the lowest growth in the country over that time (Figure 2). In fact, before the pandemic hit, West Virginia was one of only 12 states to lose jobs in calendar year 2019.[10]

FIGURE 2

Tax Cuts Failed to Deliver Promised Growth to West Virginia

Total nonfarm employment growth, 2009-2019



Source: WVCBP analysis of Bureau of Economic Analysis data

6 West Virginia Tax Department. "Significant West Virginia Tax Reductions Since 2006."

7 WVCBP analysis of U.S. Bureau of Labor Statistics and WV State Tax Department data.

8 Chris Edwards, "Fiscal Policy Report Card on America's Governors: 2008," Cato Institute, October 2008.

9 Curtis S. Dubay, "What West Virginia Needs to Do in Order to Compete in the 21st Century," Tax Foundation testimony to West Virginia Legislature, December 11, 2006 https://files.taxfoundation.org/legacy/docs/sb20061211.pdf.

10 WVCBP analysis of U.S. Bureau of Labor Statistics, Current Employment Statistics data.

The revenue losses and lack of economic growth from these tax cuts forced the state to make painful budget cuts over the past decade, particularly in the one area where West Virginia needed investment – higher education. West Virginia has historically had one of the smallest shares of college graduates in its workforce, leading to lower levels of labor force participation and lower incomes. In FY 2021, base budget funding for higher education is down $128 million from FY 2008, adjusting for inflation.[11] Enrollment in higher education has been on the decline in recent years, as these cuts to higher education have forced tuition increases and hurt the state's investment in its future workforce.[12]

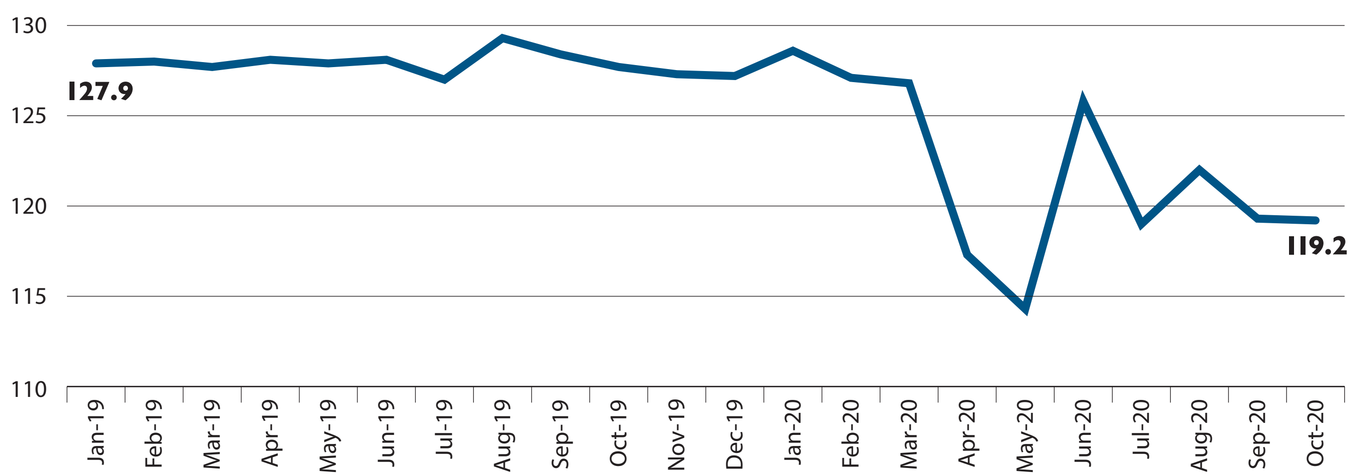
West Virginia is not alone when it comes to tax cuts failing to deliver for states. A large body of economic research makes clear that a majority of economists agree tax cuts do little to boost economies.[13] Of the five states that cut taxes in the wake of the Great Recession, four trailed the US in job growth. Tax-cutting states in the two prior recessions also trailed the US in job growth.[14]

The biggest economic effect of tax cuts is the damage done from the budget cuts used to pay for them. Kansas provides cautionary tales of the dangers tax and budget cutting policies can exact on a state's economy.[15] After cutting its top income tax rate and making large portions of business income tax-exempt, Kansas schools saw major cuts to their budgets,[16] while dozens of scheduled road projects were canceled.[17] In return, the tax cuts did little to improve economic outcomes in Kansas, with one study showing the decline in state spending necessitated by tax cuts made Kansas perform worse economically than similar states on jobs, poverty, home values, and per capita income.[18]

FIGURE 3

West Virginia Down 7,600 State and Local Government Jobs During the Pandemic

Total state and local government employment, West Virginia, seasonally adjusted (thousands)



Source: WVCBP analysis of Bureau of Economic Analysis data

11 Sean O'Leary, "Trouble Ahead, The West Virginia FY 2021 Proposed Budget," West Virginia Center on Budget and Policy, February 2020.

12 Sean O'Leary, Higher Education Funding Cuts Have Hurt Students and the State's Future," West Virginia Center on Budget and Policy, November 2019.

13 Michael Mazerov, "State Taxes and State Economic Performance," Center on Budget and Policy Priorities (prepared for NCSL Task Force on State and Local Taxation), January 17, 2017.

14 Michael Leachman and Michael Mazerov. "State Personal Income Tax Cuts: Still a Poor Strategy for Economic Growth." Center on Budget and Policy Priorities. May 14, 2015. https://www.cbpp.org/research/state-budget-and-tax/state-personal-income-tax-cuts-still-a-poor-strategy-for-economic.

15 Michael Mazerov, "Kansas Provides Compelling Evidence of Failure of 'Supply-Side' Tax Cuts." Center on Budget and Policy Priorities. January 22, 2018.

16 Michael Leachman, "Timeline: 5 Years of Kansas' Tax-Cut Disaster." Center on Budget and Policy Priorities. May 24, 2017. https://www.cbpp.org/blog/timeline-5-years-of-kansas-tax-cut-disaster.

17 Elle Moxley, "Kansas Cuts More Road Projects Owing To Bleak Budget Outlook." KMUW. December 15, 2016.

18 Dan S. Rickman and Hongbo Wang, "Two Tales of Two U.S. States: Regional Fiscal Austerity and Economic Performance." Oklahoma State University. March 19, 2017.

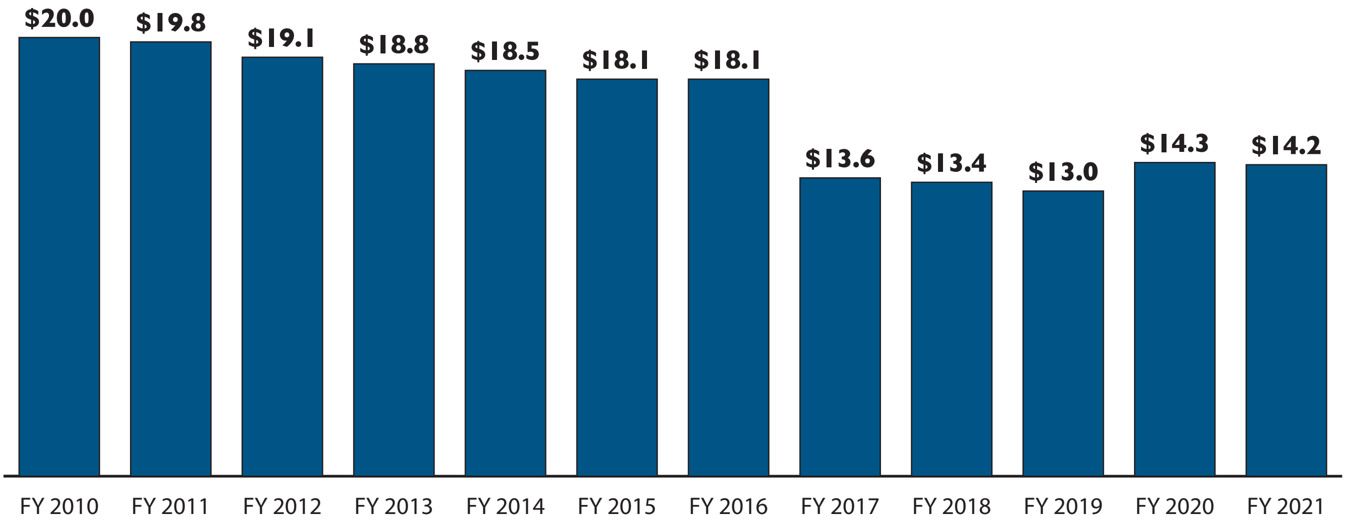
Tax cuts and poor economic performance also left West Virginia ill-prepared to deal with the pandemic. The FY 2021 budget proposal was balanced with $108 million in one-time surplus Medicaid funding, while the state already had very low expectations for revenue collections in FY 2021, which were projected to be below FY 2020 levels even before the pandemic. As of October 2020, the state has lost 7,600 state and local government jobs since March, which has held back the state's recovery (Figure 3).[19]

Tax and budget cuts have not only hurt West Virginia's economic response to the pandemic and recession, but also the state's public health response. Funding for local and public health services has eroded over the decade, and is down nearly 30 percent from FY 2010, adjusting for inflation. This hampers local public health departments' ability to provide robust, needed services. These departments were already struggling in the face of the state's ongoing opioid epidemic, and their hardship has only increased as they are now being asked to lead local response to the pandemic with insufficient funds to adequately do so (Figure 4).

FIGURE 4

Funding for Local Public Health Services Down 30 Percent Before the Pandemic

State aid for basic and local public health services, FY 2010 – FY 2021, millions (inflation adjusted 2020 dollars)



Source: WVCBP analysis of WV State Budget Office data

With West Virginia already in a precarious budget situation that includes declining revenue, looming deficits, and a struggling economy, more ineffective tax cuts is not the answer.

New Revenue Can Fuel Recovery, Address State Needs

Decades of research and West Virginia's own experience show that cutting taxes will lead to budget cuts, which during a recession will delay the state's recovery. West Virginia's twin problems of looming deficits and stalling recovery are not a signal for more tax cuts. Instead, they call for the generation of new revenue to protect the economy-boosting jobs and investments that keep money flowing to workers, families, and communities.

In response to the pandemic, state officials from around the country have urged Congress to increase federal aid to states. While the federal government has the borrowing power to help states backfill lost revenues, federal lawmakers have yet to approve the funding states need, and historically, such aid has fallen short of need.[20] Instead of cutting jobs and essential services and scaling back economy-boosting public investments, West Virginia could fund its recovery by raising its own revenue.

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

20 "Out of Balance Cuts in Services Have Been States' Primary Response to Budget Gaps, Harming the Nation's Economy." Center on Budget and Policy Priorities. April 18, 2012.

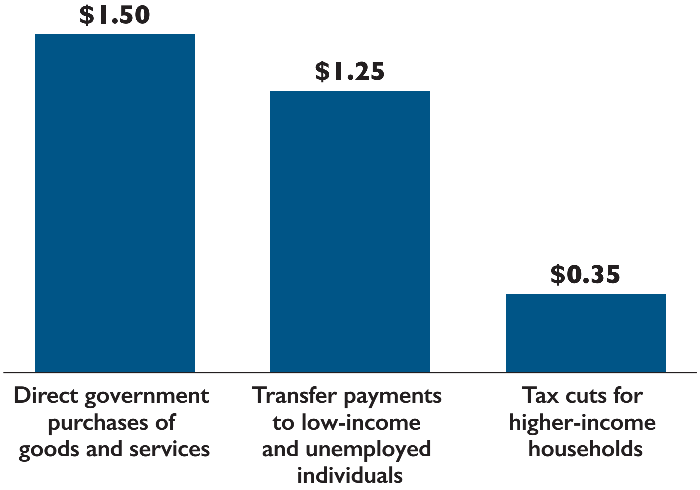
The Congressional Budget Office (CBO) estimates that each dollar spent on direct government purchases of goods and services generates an average of $1.50 in economic activity, while direct income assistance to low-income families and unemployed workers generates an average of $1.25 in economic activity. In contrast, the CBO estimates that every dollar in tax cuts for higher income households creates only $0.35 in economic activity.[21]

These investments have an immediate positive impact on the economy, supporting both public- and private-sector jobs.[22] Raising revenue to protect or even increase state spending and jobs would stabilize the workforce and prevent a second wave of layoffs and lost income. It would also prevent worsening inequality through budget cuts that disproportionately harm low-income families.

FIGURE 5

Direct Spending and Low Income Assistance are a Better Boost to the Economy than Tax Cuts

Average economic impact of every $1.00 spent



Source: The Roosevelt Institute

The Pandemic Recession Has Hit Low- and Middle-Income Families the Hardest

While the pandemic has been a globally shared experience, history and recent evidence of the pandemic recession show that wealthy households are harmed much less by recessions. Low- and moderate-income families suffer the brunt of recession, with lagging wealth, income, and employment levels long after wealthy families have recovered.

After the Great Recession, it took 11 years for the lowest-income families to recover their previous income levels, compared to just four years for the wealthiest families. The wealthiest 5 percent of households recovered their 2007 level of income by 2011, while the bottom 20 percent did not recover until 2018.[23]

The pandemic recession is already showing the same pattern, particularly in West Virginia. Joblessness remains a major problem, with more than 81,101 West Virginians collecting unemployment in the week ending November 7. That's nearly six times higher than the week ending March 14, and more than even the worst week of the Great Recession.[24] Relatedly, demand for food assistance, cash assistance, and housing assistance are all up during the pandemic recession.[25]

In contrast, workers in high-income households were less likely to lose their jobs, and have gained back those lost jobs more quickly. For example, employment in low-wage industries (wages less than $27,000/ year) fell by 28 percent between January and April in West Virginia, compared to just 8.5 percent for high-wage industries (wages greater than $60,000/year). As of October, employment in low-wage industries in West Virginia is still down 11 percent since January, compared to just 3.5 percent for high-wage industries (Figure 6).

21 Kitty Richards, "Bolstering state economies by raising progressive taxes." The Roosevelt Institute. July 2020.

22 Ethan Pollack, "Dire States: State and Local Budget Relief Needed to Prevent Job Losses and Ensure a Robust Recovery." Economic Policy Institute. November 19, 2009.

23 Josh Bivens, "Inequality is slowing US economic growth: Faster wage growth for low- and middle-wage workers is the solution." Economic Policy Institute. December 12, 2017.

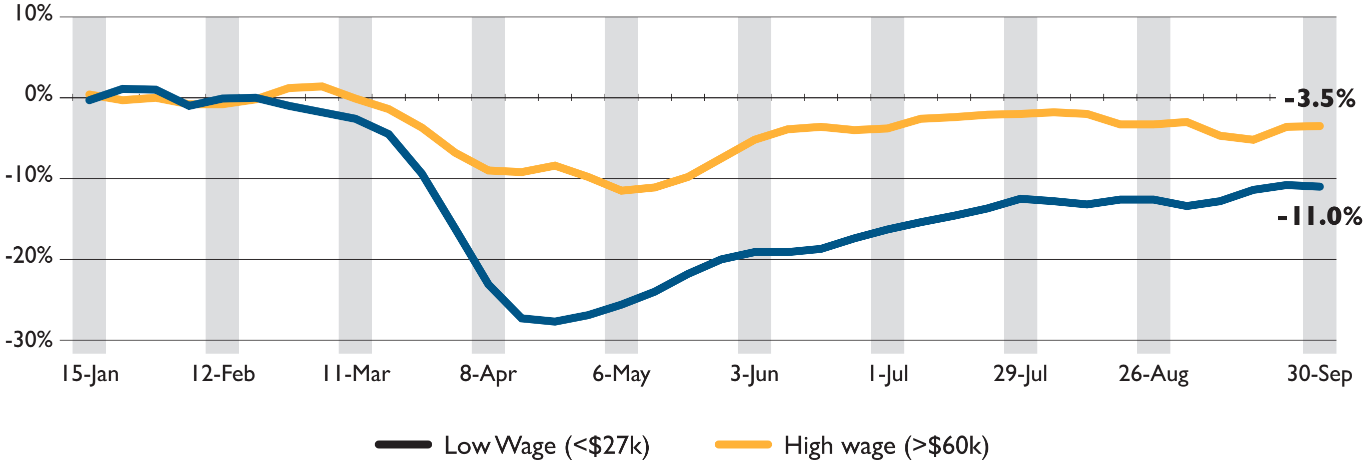
24 O'Leary, Sean, "Tracking the Coronavirus Economic Impact in West Virginia," West Virginia Center on Budget and Policy, November 2020.

25 Ibid.

FIGURE 6

Low-Wage Workers Hit Harder and Recovering Slower in West Virginia

Percent change in employment from January 2020, West Virginia



Source: Opportunity Insights

Further, the country's largest corporations are turning record profits[26] and the stock market is experiencing record growth. The wealthiest 10 percent of households own 88.2 percent of all stocks and mutual funds,[27] so have likely seen their wealth grow during the pandemic.

High-income households are also more likely to save, and less likely to spend, which prevents money from circulating in communities and the local economy, and slows recoveries. The average household typically spends about 88 cents of every dollar it earns, while the wealthiest households spends just 53 cents of every dollar they earn.[28]

During the pandemic recession these saving rates have likely gone up. West Virginians with low incomes have increased spending by nearly 6 percent since January, while spending is flat for high-income West Virginians.[29]

Higher savings and lower spending mean that wealthy households are putting less of their income back into a stalled economy. Increasing taxes on the highest incomes would put that money to use funding schools, health care, jobs, and direct support for families struggling during the pandemic recession — all of which will stimulate the economy and boost the recovery.

What's more, just as the evidence shows that cutting income and other taxes does little to promote growth, the evidence also shows that raising taxes on high-income individuals and households and investing that revenue is good for the economy.

Several states have had success growing their economies after increasing taxes on households with the highest incomes. For example, in 2013 Minnesota raised income taxes on high incomes and used the revenue to pay down a budget deficit, increase investment in public education, establish full-day kindergarten for Minnesota children, and expand Medicaid.[30] In the subsequent years, Minnesota saw higher job, per capita income, and overall economic growth than its neighboring states. States across the country which have enacted similar tax reforms since 2000 have had similar results.[31]

26 Oxfam America. "Pandemic Profits Exposed." July 22, 2020.

27 Board of Governors of the Federal Reserve System, "Distribution of Household Wealth in the U.S. since 1989: Corporate equities and mutual fund shares by wealth percentile group. Survey of Consumer Finances and Financial Accounts of the United States." Accessed December 1, 2020.

28 Josh Bivens, "Inequality is slowing US economic growth: Faster wage growth for low- and middle-wage workers is the solution," Economic Policy Institute, December 12, 2017.

29 Chetty, Raj, et. Al, "Percent change in all consumer spending," Opportunity Insights Economic Tracker, Data accessed December 1, 2020.

30 Dan S. Rickman and Hongbo Wang, "Two Tales of Two U.S. States: Regional Fiscal Austerity and Economic Performance." Oklahoma State University. March 19, 2017.

31 Wesley Tharpe, "Raising State Income Tax Rates at the Top a Sensible way to Fund Key Investments." Center on Budget and Policy Priorities, February 2019.

Investment, Not Cuts, Will Put West Virginia on the Path to Recovery

West Virginia is still far from recovered from the economic damage of the coronavirus. By maintaining or increasing resources for state and local investments, the state can stabilize both the public and private workforce and keep up economy-wide spending.

Low- and middle-income families in West Virginia have borne the brunt of the current crisis, and stand to gain the least from tax proposals like eliminating the income tax. And those same families would be hurt the most by the budget cuts that inevitably follow tax cuts. More tax cuts tilted toward the wealthy would further weaken the jobs market and take money out of communities across the state.

Wealthy households are faring better during the pandemic recession than households with lower incomes, while spending less of each dollar they earn to fuel West Virginia's economic recovery. Taxing these high-income households is a good strategy to prevent budget cuts that would further harm families who are already struggling, while promoting a faster, more inclusive recovery. Tax policy options for West Virginia include:

- ***Scale back personal exemptions.*** West Virginians are provided a $2,000 personal exemption from their state income tax for each household member. Unlike the federal government, however, which phases out personal exemptions as income rises, 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 $18.7 million and help make the state's income tax based more on ability to pay.[32]
- ***Reinstate the estate tax.*** Changes to federal tax law resulted in the de facto repeal of West Virginia's estate tax. Only the very wealthiest West Virginians paid the estate tax. In fact, so few West Virginians pay the federal estate tax that the IRS does not disclose how many. The estate tax raises revenue for public services that contribute to a stronger economy, protect against extreme levels of income inequality, and ensure that the most affluent cannot avoid paying taxes on certain forms of wealth. Re-enacting West Virginia's estate tax for estates over $1 million would raise an estimated $20.0 million, reduce inequality, and close a loophole that allows unrealized capital gains to go untaxed at the state level.[33]
- ***Modernize personal income tax rates and brackets.*** West Virginia's personal income tax schedule has not changed since 1987, when the state's top personal income rate was reduced from 13 percent to 6.5 percent, and applies to incomes above $60,000. Adjusting brackets and rates would better reflect modern income levels. This can be accomplished by consolidating lower brackets and adding new high-income rates and brackets. States as diverse as Connecticut, Hawaii, Maryland, Minnesota, New York, North Dakota, and Ohio are some examples where brackets already exist at around $100,000 ($250,000 for married filers). In West Virginia, a new bracket at $176,500 would affect only the top 20 percent of taxpayers in the state.[34]

32 Institute on Taxation and Economic Policy analysis.

33 Institute on Taxation and Economic Policy analysis.

34 Institute on Taxation and Economic Policy analysis.

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