Flat Budgets, Flat Expectations:
The West Virginia Fiscal Year 2023 Budget Proposal

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Overview

For the second year in a row, Governor Jim Justice has proposed a "flat" budget for Fiscal Year (FY) 2023, with only minor changes from the FY 2022 budget. While the state is currently enjoying large budget surpluses, those surpluses are the result of billions in federal aid, artificially low revenue estimates, and continued unpredictability from the pandemic. Despite the temporary nature of these surpluses, the West Virginia Legislature is pursuing permanent tax cuts that would overwhelmingly benefit the wealthy, while continuing to neglect public programs and services that are in desperate need of investment. And once again, the governor did not include a six-year plan in the budget, leaving the future budget picture murky, and questions about potential budget deficits unanswered.

Key Findings

- FY 2023 base budget appropriations are $123 million above the FY 2022 final enrolled budget.
- Most of the increase in the FY 2023 budget comes from a proposed public employee pay raise, at $108 million.
- While FY 2022 revenue collections are already $531 million above that year's revenue estimate, the revenue estimate for FY 2023 is only $75.8 million more than the FY 2022 estimate, which will likely lead to another year of large, artificially-inflated surpluses.
- With the pandemic ongoing, the increased federal match rate for Medicaid under the CARES Act is expected to stay in effect in 2022, saving the state an estimated $200 million. However, budget projections from the Department of Health and Human Resources show significant budget shortfalls for Medicaid in the coming years.
- While the state is currently enjoying a budget surplus, proposed plans to cut the income, severance, and property taxes could jeopardize future budgets.

Governor's Proposed FY 2023 Base Budget

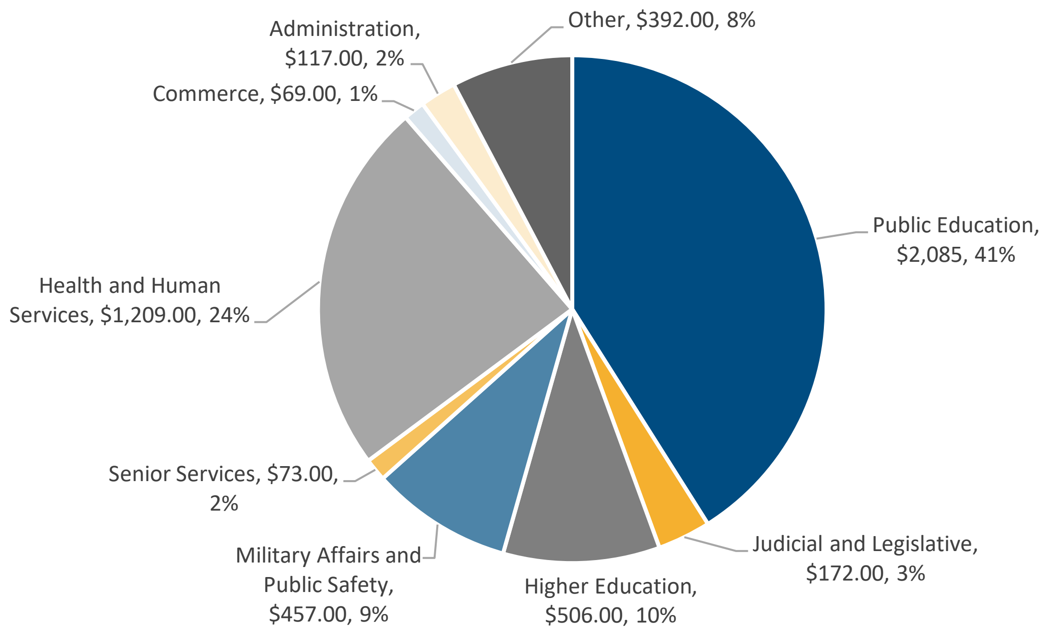
Governor Justice's proposed FY 2023 base budget appropriations total $5.08 billion, including $4.65 billion from the General Revenue Fund and $415.7 million from the Lottery funds. The FY 2023 proposed budget is $123 million above the FY 2022 final enrolled budget, and $161 million below FY 2021 actual expenditures. Public education and health and human services are the two largest areas of the FY 2023 base budget, accounting for nearly two-thirds of base budget appropriations (Figure 1).

Governor Justice has once again proposed what he describes as a "flat" budget for FY 2023, with almost no changes from the FY 2022 budget. The only major changes include $108.0 million for a five percent public employee pay raise, $40.9 million for a new medical services contract for incarcerated people, $30.4 million to reverse a cut to higher education funding made during FY 2022, and small increases for tourism, the Jobs and Hope program, and the new Intermediate Court of Appeals (Figure 2). Other areas of the budget are left untouched, meaning no new state investments to make higher education more affordable, increase access to child care and paid leave to help workers get back to work, improve K-12 schools, or address looming issues regarding the fiscal sustainability of the Public Employees Insurance Agency (PEIA) or Medicaid.

Figure 1

FY 2023 Base Budget Appropriations Remain Similar to FY 2022 Appropriations

Governor's proposed base budget appropriations, FY 2023 (millions)

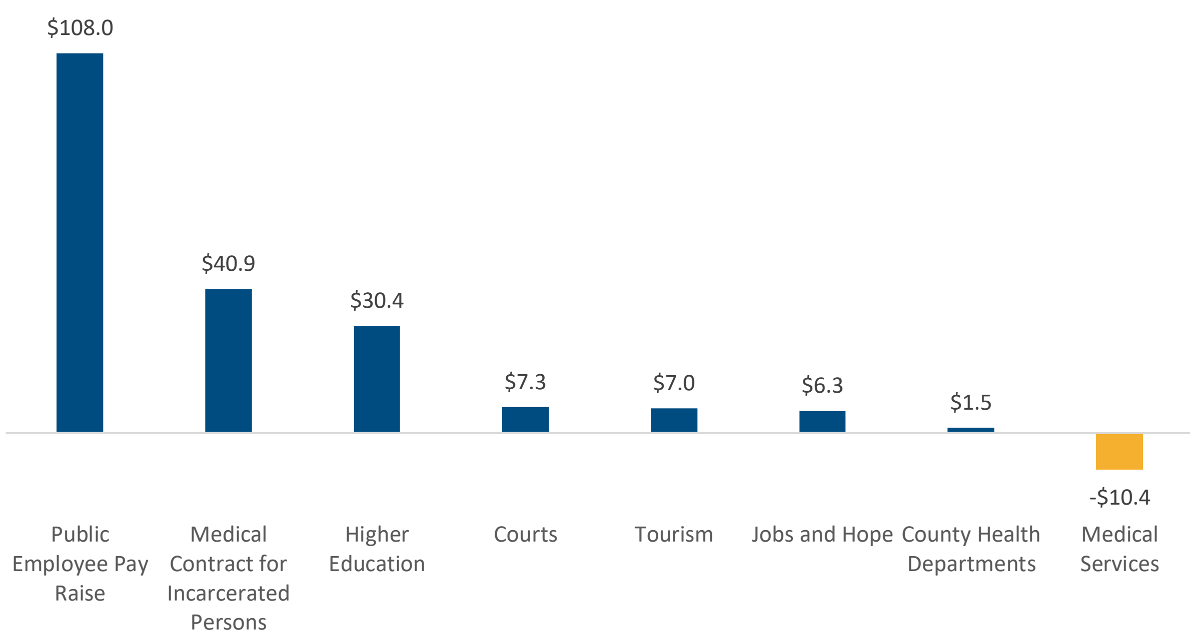


Source: West Virginia State Budget Office

Figure 2

Flat Budget Means Few New Investments in the State's Needs

Change in General Revenue appropriations, FY 2022 – FY 2023 (millions)



Source: West Virginia State Budget Office

Medicaid Reserve Funds Once Again Help Balance the Budget

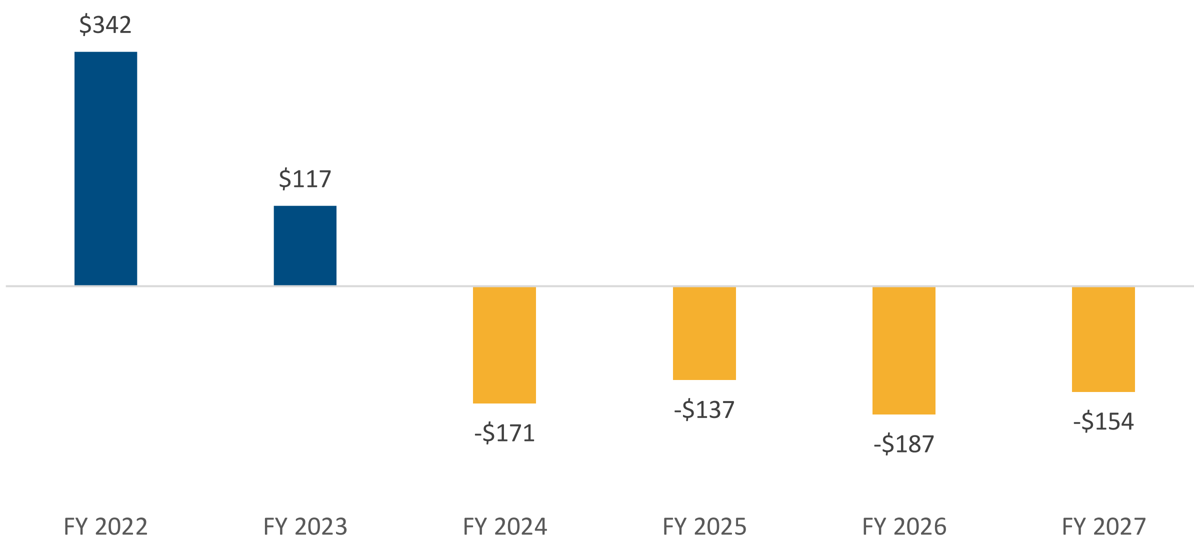
For the past several years, West Virginia has relied on tapping Medicaid reserve funds to keep the budget balanced, and the state is doing so again in FY 2023. A number of factors have allowed West Virginia to build up a large reserve of Medicaid funding in recent years. The state's Federal Medical Assistance Percentage (FMAP) has grown over time, from 71.09 percent in 2014 to 74.99 percent in 2020, meaning the federal government is providing more Medicaid funding.[1] The Coronavirus Aid, Relief, and Economic Security (CARES) Act increased the FMAP by an additional 6.2 percentage points for the duration of the public health emergency, bringing West Virginia's 2022 FMAP to 80.9 percent.[2] The CARES Act's increased FMAP provided the state with $580 million in 2020 and 2021, and will provide an estimated $200 million in 2022.[3] In addition, costs savings from prescription drugs and managed care organizations, as well as fewer medical procedures performed during the pandemic, all contributed to the program's reserve fund.

The Medicaid reserves have helped the state balance the budget during the pandemic, and FY 2023's proposed "flat" budget and public employee pay raise were made possible in large part due to a $143 million "budget adjustment" to Medicaid that is being offset by the reserve fund. However, such maneuvers are quickly depleting the reserves. The reserve fund is expected to be exhausted in FY 2024, and Medicaid will be facing a $171 million shortfall in that year (Figure 3). The "surpluses" the state is currently enjoying quickly shrink once the Medicaid reserves are depleted and the enhanced FMAP reverts back to its pre-pandemic rate.

Figure 3

Medicaid Reserves Help Contribute to Budget Surpluses, But Will Soon Be Exhausted

Medicaid six-year plan, after state budget adjustment, FY 2022 – FY 2027 (millions)



Source: West Virginia Department of Health and Human Resources

[1] Congressional Research Service, "Medicaid's Federal Medical Assistance Percentage (FMAP)" (2020), accessed from https://sgp.fas.org/crs/misc/R43847.pdf.
[2] Kaiser Family Foundation, "Federal Medical Assistance Percentage (FMAP) for Medicaid and Multiplier," (2022), accessed from https://www.kff.org/medicaid/state-indicator/federal-matching-rate-and-multiplier/?currentTimeframe=0&sortModel=%7B%22colId%22:%22Location%22,%22sort%22:%22asc%22%7D.
[3] Jennifer Sullivan, "States to Get Enhanced Medicaid Funding Through 2021," (Center on Budget and Policy Priorities, February 1, 2021).

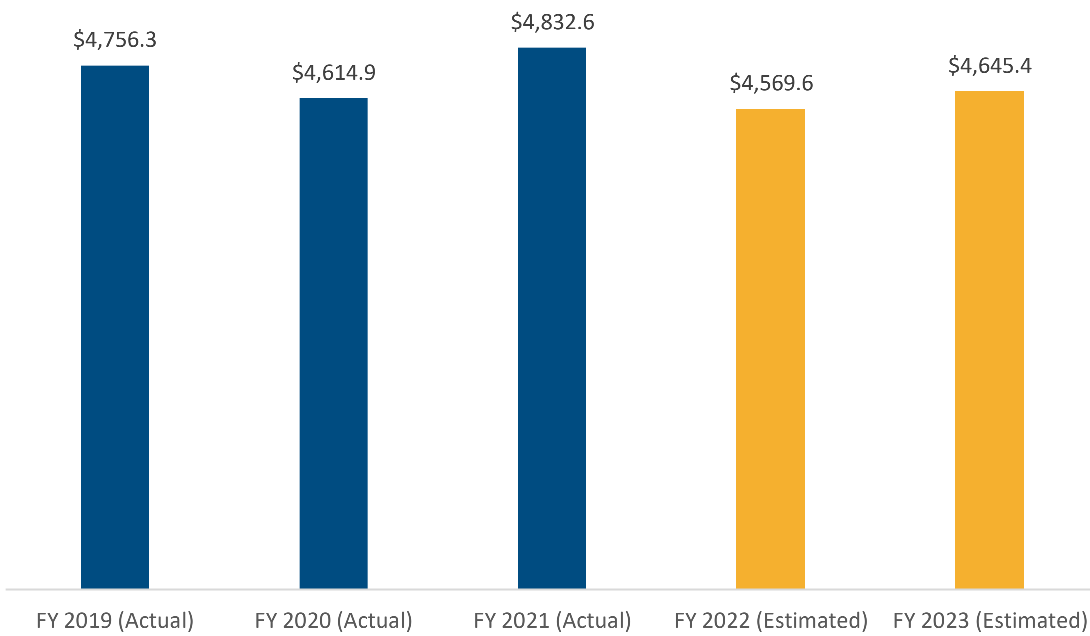
Low Revenue Estimates and Federal Aid Have Created Current Budget Surplus

As of January 2021, West Virginia's FY 2022 budget is running a healthy surplus, with revenue collections exceeding estimates by $531 million. However, much of the revenue surplus is due to an artificially low revenue estimate for FY 2022. Despite the state experiencing a slow and steady recovery throughout the year, the revenue estimate for FY 2022 was $263.0 million below actual revenue collections in FY 2021, and $45.3 million below actual revenue collections in FY 2020, years that were both strongly negatively impacted by the pandemic. The revenue estimate for FY 2023 is only $75.8 million above the estimate for FY 2022 (Figure 4).

Figure 4

FY 2023 Revenue Estimate Below Pre-Pandemic Collections

General Revenue collections, actual and estimated (millions)



Source: West Virginia State Budget Office

In addition to low revenue estimates helping to manufacture surpluses, state revenue collections during the pandemic have been boosted by over $12 billion in federal aid over the past two years (Table 1). However, much of that federal support is now gone.

Table 1

Federal Stimulus Packages Have Boosted Tax Revenue in West Virginia

CARES Act and other relief funding for West Virginia, 2020 and 2021

Relief Funding Source	Amount
Stimulus Checks	$4.9 billion
Enhanced Unemployment Benefits	$1.3 billion
Pandemic Unemployment Assistance	$168 million
Pandemic Emergency Unemployment Compensation	$192 million
Paycheck Protection Program	$1.8 billion
State CARES Act Relief Funding	$1.3 billion
American Rescue Plan Act (ARPA) State and Local Funding	$1.9 billion
Enhanced Medicaid Match Rate	$580 million

Source: Institute on Taxation and Economic Policy, U.S. Department of Labor, Center on Budget and Policy Priorities, WV Governor's Office, U.S. Small Business Administration

Even with most of the federal aid having come and gone – and taking into account the ongoing pandemic – the revenue estimate for FY 2023 is still overly conservative. The official revenue estimate for FY 2023 of $4.645 billion would only be an increase of $75.8 million above the revenue estimate for FY 2022, despite the fact that the revenue collections for FY 2022 are already $531 million above that year's estimate. The official FY 2023 revenue estimate would imply that the state's economy and tax revenue are going to take a major step back in the next year – an assumption which we do not currently have reason to believe is likely to be accurate.

With that said, the West Virginia Department of Revenue also prepared an "unofficial" revenue estimate, showing FY 2023 revenues projected to total $5.465 billion, $819.6 million above the official estimate (Table 2). However, it is important to note that legislators are bound by the official estimate, and cannot appropriate anything from the General Revenue Fund above that official estimate of $4.645 billion. By failing to include an additional expected $820 million in the state budget, the Justice Administration is tying the hands of legislators while denying state agencies and programs the resources they need. Meanwhile, some state lawmakers are already citing the manufactured revenue "surplus" from FY 2022 to argue for tax cuts that would quickly deplete the surplus funds and set the state up for severe budget problems in future years.

Table 2

A Conservative Official Revenue Estimate Will Likely Lead to More Artificially-Inflated Surpluses

Official and unofficial FY 2023 General Revenue estimates (millions)

Revenue Source	FY 2023 Official Estimate	FY 2023 Unofficial Estimate	Difference
Personal Income	$2,190.0	$2,491.0	$301.0
Sales	$1,510.5	$1,645.0	$134.5
Severance	$250.0	$477.4	$227.4
Corporate Income	$150.0	$285.7	$135.7
Other	$544.9	$565.9	$21.0
Total	**$4,645.4**	**$5,465.0**	**$819.6**

Source: West Virginia Department of Revenue FY 2023 Fiscal Forecast

Proposal to Cut the Personal Income Tax Would Quickly Create Budget Problems

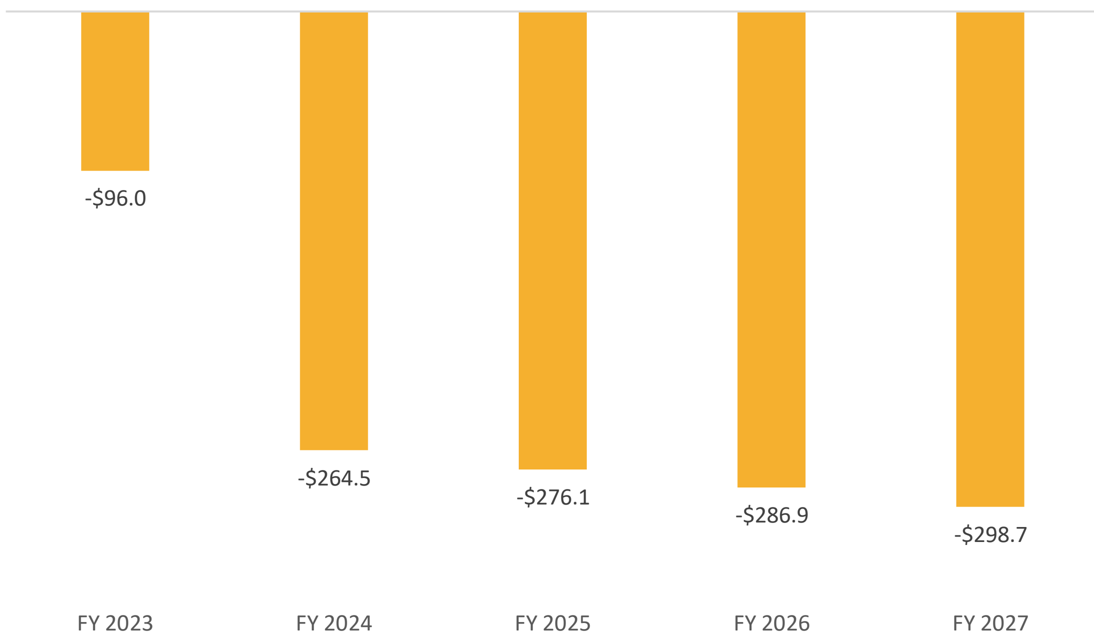
HB 4007, introduced during the 2022 West Virginia legislative session, would cut the state personal income tax by 10 percent, while setting up a procedure to use current and future revenue surpluses to cut it even further with the ultimate goal of the tax's full elimination.

HB 4007 starts with an initial 10 percent cut to the state's tax brackets, which would go into effect on January 1, 2023. This would cost the state an estimated $264.5 million in its first full fiscal year (2024). That cost would grow each year, reaching nearly $300 million in FY 2027, as the income tax is one of the state's strongest sources of revenue growth (Figure 5).

Figure 5

Revenue Losses from HB 4007's Initial Income Tax Cut Grow Larger Over Time

Estimated revenue loss from HB 4007's proposed initial 10 percent cut to the income tax (millions)



Source: HB 4007 fiscal note and WV State Budget Office data

What's more, those significant revenue losses would grow even larger thanks to the bill's proposed Stabilization and Future Economic Reform (SAFER) Fund. Each year, 50 percent of any revenue surpluses the state sees would be diverted from the state's Rainy Day Fund to the SAFER Fund, an account whose funds can only be used to further cut the income tax.

As such, West Virginia's artificially low revenue estimate for FY 2023 could lead to even bigger revenue loss in FY 2024. If the state simply meets its "unofficial" revenue estimate of $5.465 billion, it would end the year with an $820 million "surplus," half of which would be placed into the SAFER Fund where it could only be used to further cut the income tax on top of the initial 10 percent cut. Artificially low revenue estimates create a compounding effect of forcing budget cuts while generating manufactured surpluses that then lead to even further tax cuts.

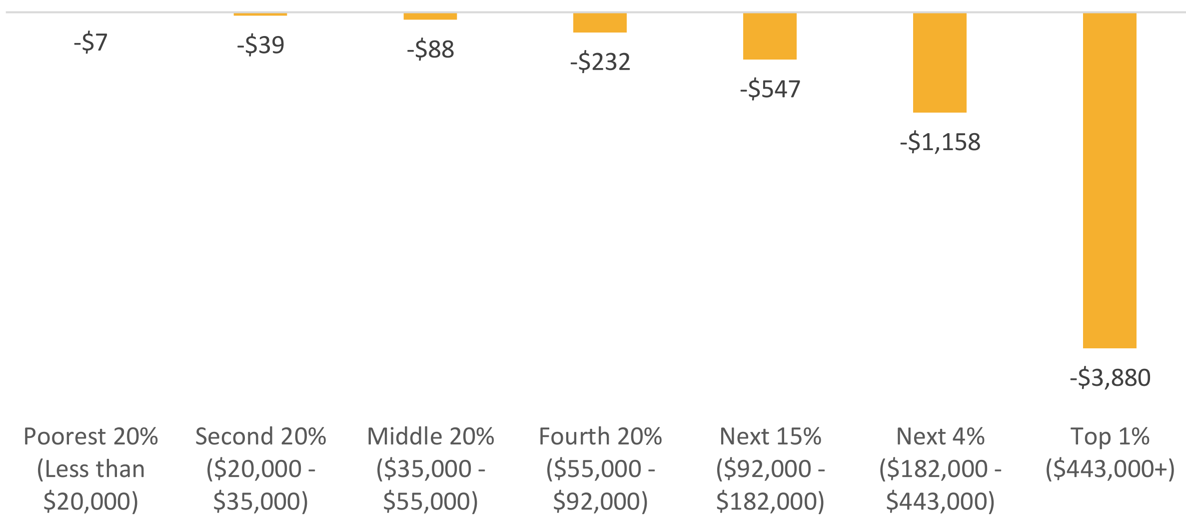
Unlike past personal income tax cut proposals, HB 4007 does not include any offsetting revenue to replace the revenue lost from slashing the income tax, aside from the appropriations from the SAFER Fund, which would only offset revenue loss in the year it is appropriated. As the income tax is cut more and more over time, legislators would be forced to consider ongoing, steep budget cuts to offset the lost revenue.

And while low- and middle- income West Virginians would likely bear the brunt of budget cuts to public services and programs, they would receive little of the savings from the income tax cut. The bill's initial rate reduction generates the greatest savings for the state's highest income earners, with relatively meager savings for middle-and low-income households. Middle-income West Virginia households, with incomes between $35,000 and $55,000, would receive an average tax cut of just $88, compared to an average tax cut of $3,880 for the wealthiest one percent of West Virginians, or those with incomes above $443,000. On average, the wealthiest 20 percent of West Virginians would receive 70 percent of the initial tax cut, with the wealthiest one percent of West Virginians receiving 16 percent of the tax cut (Figure 6).

Figure 6

Wealthiest West Virginians Benefit the Most from HB 4007's Initial Income Tax Cut

Average tax change by income group from HB 4007's proposed initial 10 percent reduction to state personal income tax rates



Source: Institute on Taxation and Economic Policy

Further reductions to the personal income tax rates would necessarily follow the same pattern, as the state's progressive income tax rate structure means that the cuts to the tax would overwhelmingly favor the wealthy. Meanwhile, the resulting loss in revenue would undermine state investments in education, infrastructure, health, and other public services that benefit everyone. Even fully eliminated, 70 percent of the $2 billion tax cut would go to the wealthiest 20 percent of households in the state. A household in the top one percent in West Virginia would receive a tax cut that is 44 times as large as that of a household in the middle 20 percent.[4]

The Consequences of Flat Budgets

Artificially low revenue estimates have kept the budget flat in FY 2022 and FY 2023, preventing the West Virginia Legislature from making any new investments despite large budget surpluses. Further, past tax cuts – and the resulting loss in revenue – have led to years of underinvestment in health care, education, children, workers, and families, and have also contributed to the state's unsustainable reliance on reserves and federal aid to keep the budget balanced.

FY 2023's "flat" budget of $4.645 billion in general revenue spending is $668 million below general revenue spending in FY 2013, adjusting for inflation (Figure 7). State expenditures on higher education alone are down $95 million during that time frame, and while per pupil spending on K-12 education was up 23.2 percent

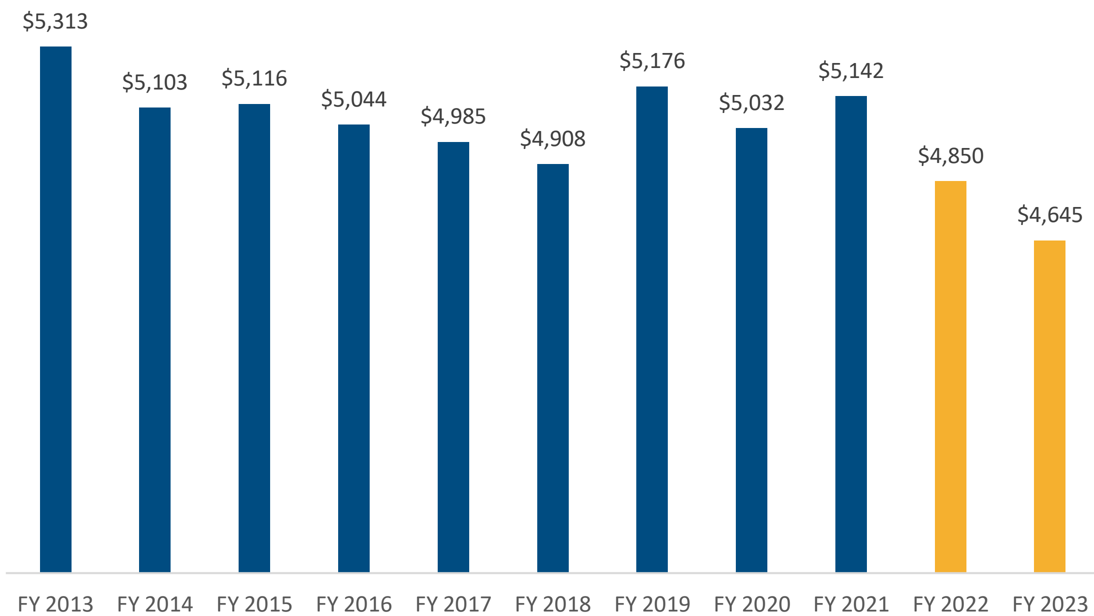
[4] Institute on Taxation and Economic Policy analysis of HB 4007 (2022).

nationally from 2013 to 2019, it was up only 7.9 percent in West Virginia. While West Virginia once invested $432 more per student than the national average, it now invests a concerning $1,177 less (Figure 8).

Figure 7

West Virginia's Shrinking Budget

General Revenue expenditures, actual (FY 2013 – 2021) and budgeted (FY 2013 – FY 2023) (inflation-adjusted 2022 dollars, millions)

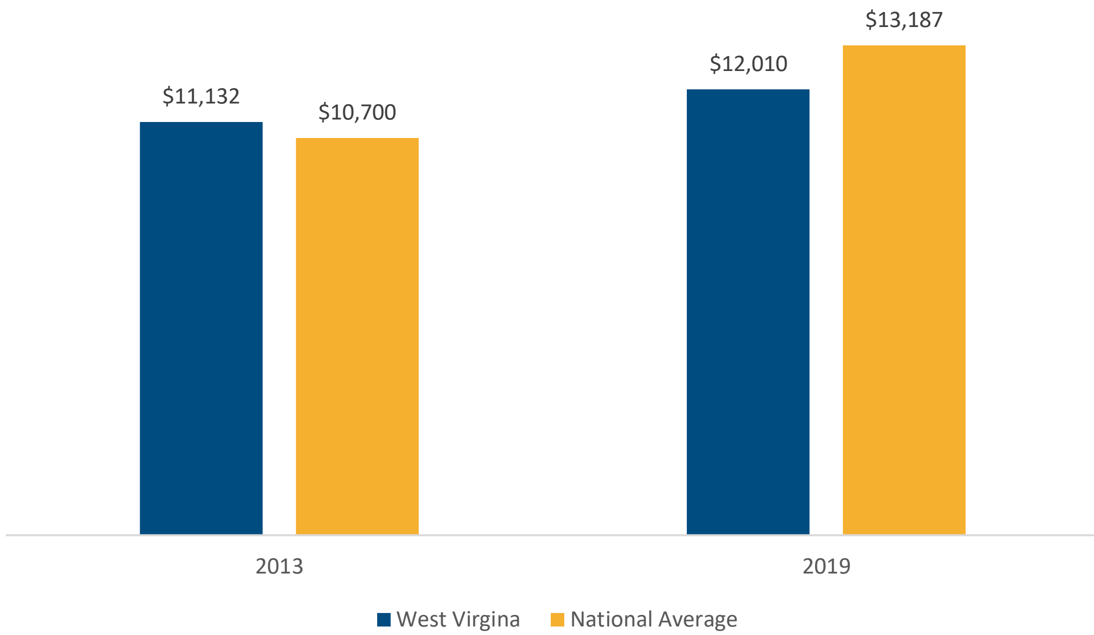


Source: West Virginia State Budget Office and Bureau of Labor Statistics

Figure 8

West Virginia's Investment in Education is Falling Behind

Per pupil amounts for current spending of public elementary-secondary school systems, West Virginia and national average, FY 2013 and FY 2019



Source: U.S. Census Bureau, Public Elementary-Secondary Education Finance Data

With artificially low revenue estimates preventing appropriate levels of spending on public programs – and given the current effort to dedicate future surpluses to further tax cuts – lawmakers are not adequately able to address current needs or to make new and necessary investments. Nor are they able to properly prepare for several required expenditure needs the state is expected face in the coming years, such as looming shortfalls in the state's Public Employees Insurance Agency and Medicaid. Make no mistake, these needs will likely require additional revenue in the coming years, even if the budget remains "flat," and the state will be left to scramble to continue funding its required programs and commitments.

Conclusion

West Virginia was fortunate to make it through another year of the pandemic and recession without any significant budget problems. But without both federal aid and artificially low expectations, the surpluses the state is currently experiencing wouldn't exist. And instead of using these temporary surpluses to make needed investments that benefit all Mountaineers and carefully plan for future budget requirements, West Virginia lawmakers are once again pursuing expensive and ineffective tax cuts that disproportionately benefit the wealthiest in our state.

Past tax cuts have already failed West Virginia, creating no economic growth, forcing cuts to higher education and public health, and leading to a decade of underinvestment. It is critical that West Virginia does not double down on these past failures. A surplus manufactured by low revenue estimates and federal aid should not be used to pay for tax cuts for the wealthy. Instead, we should be looking for ways to both meet our current needs and invest in our people and communities to build a stronger, more equitable economy.

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