Senate Plan for Amendment Two Relies on Unrealistic Revenue and Spending Assumptions, Would Quickly Become Unsustainable

By Sean O'Leary
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Overview

The West Virginia State Senate recently released an outline of a plan to eliminate business personal property taxes and use state revenues to reimburse counties, schools, and municipalities for the hundreds of millions of dollars in property tax revenue that would be lost if Amendment Two or the "Property Tax Modernization Amendment" were to pass. While the Senate claims the plan would replace all $500 million+ in lost property tax revenue without raising other taxes – while also allowing for the eventual full elimination of the income tax – the plan is based on unrealistic revenue and spending assumptions that have been highly influenced by the pandemic and the tens of billions of federal aid West Virginia has received in the past two years.

Under normal budget scenarios, the Senate's promised local government reimbursement would quickly become unsustainable. Without major new sources of revenue or painful state budget cuts, it is unlikely the Senate would be able to fulfill its promise to local governments, putting local services like public education, emergency and fire response, parks, libraries, and senior centers at grave risk.

Senate Plan's Revenue and Spending Assumptions are Based on Temporary Federal Pandemic Aid

The Senate plan assumes that the General Revenue Fund will be able to replace up to $590.8 million in lost property tax revenue without any tax increases. According to the plan, General Revenue tax collections are trending up, increasing by an average of $147 million/year, while General Revenue spending is trending down, and has been flat for the past two budget years. By keeping the budget flat, with no spending increases, after four years of $147 million/year increases, the state would have $590.8 million available to reimburse local governments for the lost property tax revenue.

However, estimating $147 million/year average growth is misleading, as the approximation is greatly skewed by the last two years, when federal aid and stimulus checks, high inflation, and high energy prices all boosted state revenues. According to Revenue Secretary Dave Hardy, revenue collections during the pandemic have shown "inexplicable patterns" and federal aid has "temporarily changed our models."[1] Overall, state revenue collections have been boosted by over $12 billion in federal aid over the past two years, with much of that federal support now gone.

Without the unique circumstances creating the revenue boost of the past two years, growth in General Revenue collections is expected to be much lower. Prior to the pandemic, General Revenue growth averaged only $89.4 million/year (Figure 1).

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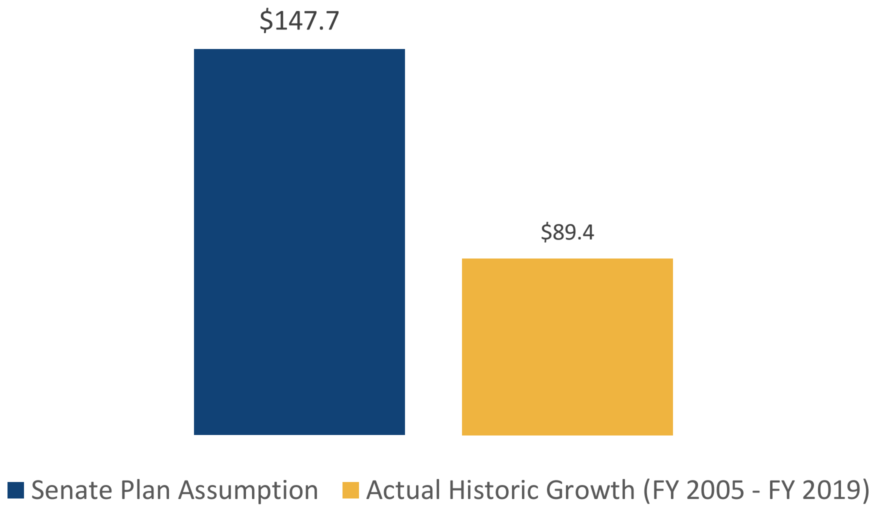
[1] Department of Revenue FY 2023 Budget Overview.

Figure 1

Actual General Revenue Growth Much Lower than Senate Plan's Assumptions

Average annual General Revenue collections growth (millions)



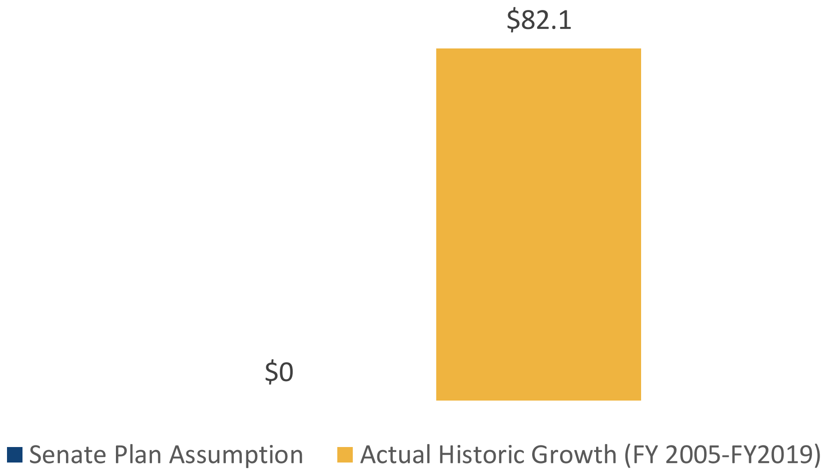
Source: WVCBP analysis of WV State Budget Office data

The Senate plan's assertion that West Virginia's budget has been flat for four years with no spending increases is simply false. Prior to the pandemic, General Revenue spending increased by an average of $82.1 million/year (Figure 2), and West Virginia's overall budget is made up of both state and federal spending. West Virginia was only able to maintain a flat budget with no state spending increases during the pandemic by backfilling the state budget with hundreds of millions of dollars in federal aid. While General Revenue appropriations have been flat, appropriations in the budget have increased sharply, from $5.8 billion in FY 2021 to $9.9 billion in FY 2023. While the federal aid has helped keep the state budget flat, most of those federal dollars were temporary and have already or will soon expire. The FY 2023 budget contains $2.3 billion in federal pandemic aid. For example, the temporary increase in the federal Medicaid match rate saved the state $580 million it would have otherwise had to have spent over the past two fiscal years.

Figure 2

Actual State Spending Growth Much Higher than Senate Plan's Assumptions

Average annual General Revenue spending growth (millions)



Source: WVCBP analysis of WV State Budget Office data

Under normal budget circumstances, instead of $147 million in revenue growth and $0 in spending growth, the state would be seeing only $89 million in revenue growth and $82 million in spending growth, resulting in a much tighter budget picture, with little room to reimburse local governments for the hundreds of millions in lost property tax revenue.

There is little reason to expect that West Virginia's recent extraordinary revenue growth will continue or that the state will be able to maintain a flat budget with no spending increases. State officials expect revenue growth to slow in 2023[2] while budget projections show programs like PEIA and Medicaid will need hundreds of millions in additional state funding in the coming years, all as federal pandemic aid ends. Most concerning, for the past two budget years the state has not produced a Six-Year Financial Plan that would show future projected spending and revenue collections.

Senate Plan Would Result in Years of Budget Deficits

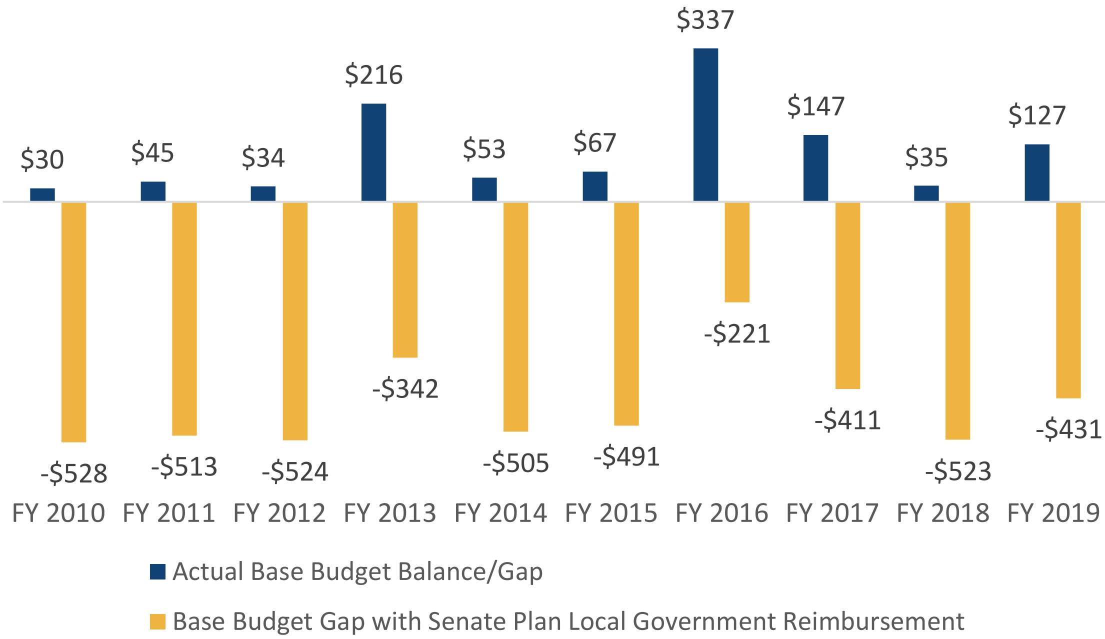
Only with the "inexplicable" revenue growth fueled by pandemic aid and flat budgets backfilled with federal dollars is the Senate's plan feasible. In fact, over the past decade, there is not a single year in which the state would have been able to make the $558 million local government reimbursement without making significant budget cuts or raising taxes (Figure 3).

[2] Ian Karbal, "For WV Gov. Jim Justice, extra cash in state coffers justifies a permanent tax cut. But recently, his own budget office warned that trend may be temporary," *Mountain State Spotlight*, July 19, 2022.

Figure 3

Senate Plan Would Have Created Major Budget Gaps Over the Past Decade

Base Budget balance/gap, actual and with Senate plan reimbursement (millions)



Source: WVCBP analysis of WV State Budget Office data

Local Reimbursement Would Grow Costlier Over Time

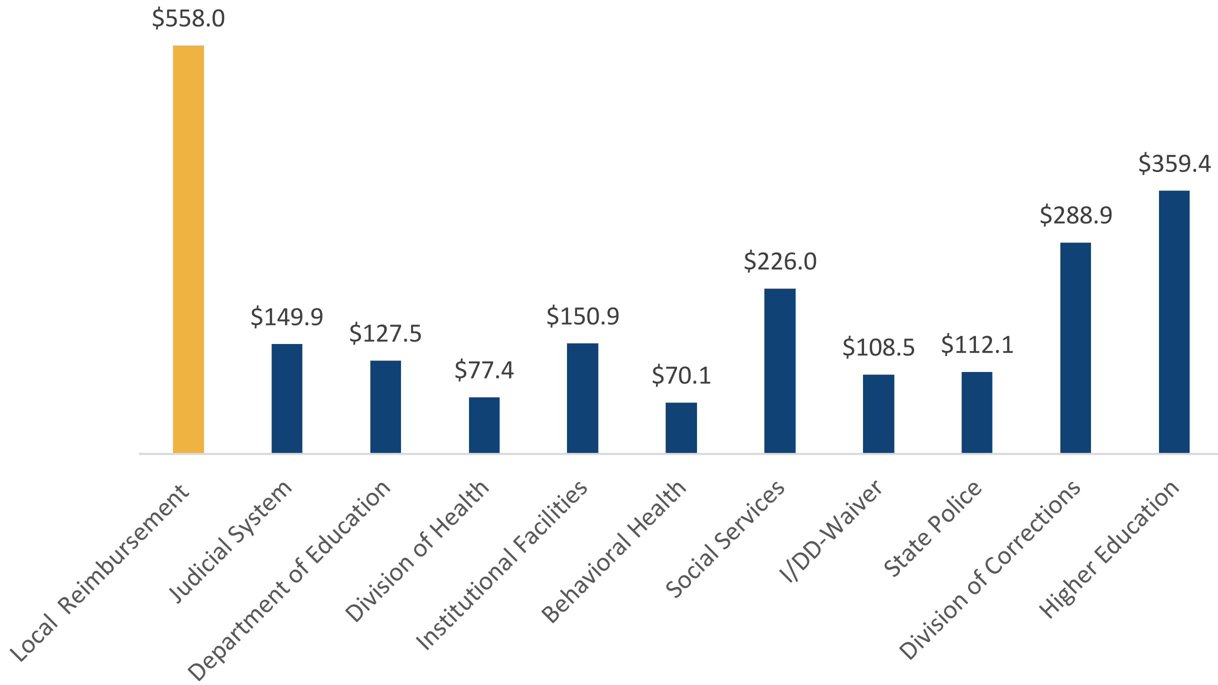
The Senate plan relies on using General Revenue Funds to replace local property tax revenue. However, local property tax revenue historically has grown at a faster rate than the state's General Revenue Fund. Between FY 2015 and FY 2021, property tax revenue in West Virginia grew at an average annual rate of 4.1 percent, compared to 3.1 percent for other major sources of tax revenue (income, sales, severance, and corporate net income). And while the state has multiple sources of revenue, local governments rely heavily on the property tax and rely on its growth to meet rising costs.

At $558 million, the local government reimbursement would be one of the single biggest items in the state budget, accounting for over 12 percent of FY 2023 General Revenue appropriations. That appropriation would be larger than the General Revenue appropriations for the state's entire judicial system, the Department of Education, the Division of Health, state hospitals, behavioral health services, social services, the I/DD-Waiver, the state police, the Division of Corrections, and all of higher education (Figure 4). With property tax revenue growing at 4.1 percent per year, the local government reimbursement would reach $700 million in just six years, accounting for over 15 percent of the General Revenue Fund. The cost of that reimbursement would quickly become unsustainable without reducing the amount provided to local governments, making significant state budget cuts, or passing new taxes.

Figure 4

Senate Plan's Local Government Reimbursement Would Create Major Budget Strain

FY 2023 General Revenue appropriations (millions)



Source: WVCBP analysis of WV State Budget Office data

The state budget would soon become constrained even further, as the Senate plan also calls for the elimination of the income tax. Under the Senate plan, if sales tax revenue increases by five percent or more, year over year, that would trigger an automatic dollar for dollar reduction in the income tax. So while the cost of the local government reimbursement would be growing each year, the amount of resources available to the state to pay for it would be shrinking.

Further, the proposed income tax cut undermines the revenue growth assumptions the Senate plan is based on. In the official FY 2023 revenue estimate, the income and sales tax revenues total $3.7 billion, accounting for 80 percent of the $4.6 billion revenue estimate. If increases in sales tax revenue are offset by equal decreases in income tax revenue, then the $147 million per year revenue growth assumed under the Senate plan would have to come from the other revenue sources, which total only $936 million, meaning those revenue sources would have to grow by more than 15 percent per year if the income tax is being eliminated.

Conclusion

While the Senate Amendment Two plan promises to fully reimburse local governments, the assumptions behind that promise are unrealistic. While federal aid and economic stimulus allowed West Virginia to build up a large surplus, that surplus is largely an illusion, and cannot be relied upon in the future. Under normal budget scenarios, the local government reimbursement plan proposed by the Senate quickly becomes unsustainable, especially when the plan also calls for eliminating the state income tax. Without major new sources of revenue or painful budget cuts, it is unlikely the Senate would be able to fulfil its promise to local governments.

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