

Balancing the State Budget: Raise Revenues before Cutting Programs

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The Union Building
723 Kanawha Blvd E, Ste 300
Charleston, WV 25301-2727
Tel: 304-720-8682
www.wvpolicy.org

Report Highlights

(Full report and references available at www.wvpolicy.org.)

Governor Manchin's proposal to cut nearly \$200 million in spending from next year's budget would jeopardize the state's economic recovery and hurt those most affected by the recession. Instead of reducing spending, the report recommends six options for raising revenues that would bridge the state's budget gap without reducing public services.

Why Spending Cuts Should Be the Option of Last Resort

The no-frills budget originally proposed by the Governor in February was only 1.87 percent above this year's budget. There are no easy cuts to be made. Extracting \$200 million from next year's spending would:

- *Impede economic recovery.* Public spending, especially in times of recession, helps fuel the economy, stabilize businesses, and preserve jobs. Economists view state government spending as having a strong stimulus effect, generating \$1.36 in economic activity for every dollar spent. The same effect – in reverse – applies to reductions in public spending: A \$200 million state budget cut would translate into an overall economic loss of \$272 million.
- *Trigger further job loss.* State spending supports thousands of jobs in both the public and private sectors. Spending cuts would result in lay-offs not only of public employees, but also of workers in private sector companies that contract with the state to provide a wide range of goods and services. For example, a 2003 study by the WVU Bureau of Business and Economic Research found that a 10-percent reduction in Medicaid spending would result in the loss of 3,268 jobs statewide.
- *Erode public services that support and protect the state's most vulnerable citizens.* Reduced spending would jeopardize essential services, such as public health, law enforcement, and services for children, seniors and people with disabilities. Many of these programs have been operating with little or no increase in recent years and are unable to absorb further cuts without reducing services. At the same time, rising unemployment is boosting demand for safety net programs, since only 36 percent of jobless West Virginians receive unemployment insurance.

Revenue Strategies that Promote Recovery and Equity

Unlike the federal government, states must balance their budgets rather than operate with a deficit. Difficult decisions must be made. In the absence of ideal solutions, the preferred options should be those that do the least harm to the economy and to the families who are struggling to make ends meet. The report examines six options for balancing the state budget by (1) maximizing existing funding, and (2) increasing certain taxes, primarily on the businesses and individuals most able to pay them. No single revenue option will fill the budget gap, but a combination of these alternatives could balance the state budget without worsening the recession, furthering job loss, or reducing needed services.

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Revenue Option	Est. Gain
<p>A. Use federal Recovery Act funds allotted for state fiscal stabilization.</p> <p>The State Fiscal Stabilization Fund included in the federal Recovery Act provides two block grants for states, one of which is to be used at the discretion of the governor to avert cuts in government services, such as public safety and law enforcement, services for the elderly and people with disabilities, and child care. \$48.5 million is allotted to West Virginia for this purpose and could be used to reduce the shortfall by one-fourth.</p>	\$48.5 million
<p>B. Tap portion of state's Rainy Day Funds.</p> <p>The state has two Revenue Shortfall Reserve Funds (Rainy Day Funds). The combined total of the state's two funds was \$455 million at the end of January 2009, up 1.5 percent from the end of December 2008. State officials strive to keep 10 percent of the General Revenue Fund in reserve, or roughly \$400 million. Even within these parameters, the current balance would allow \$50 million to be used to fund FY 2010 state expenditures.</p>	\$50 million
<p>C. Delay certain business tax cuts and credits.</p> <p>Last year, the Legislature voted to eliminate the Business Franchise Tax over the next six years and create a state tax credit for manufacturers to offset their property taxes on inventories. By delaying the Business Franchise Tax reduction for one year, the state could collect an additional \$15 million in revenue, primarily from out-of-state business owners and investors. If the state implemented a one-year suspension of the manufacturer's credit for inventory, the estimated revenue gain would be \$11 million.</p>	\$26 million
<p>D. Reinstate West Virginia's estate tax.</p> <p>West Virginia could restore millions of dollars in lost revenues by reinstating the state's estate tax at its 2001 level, prior to passage of a federal law that phases out the tax by 2010. Revenue from the state's estate tax was \$21.1 million in 2000, prior to changes in the federal law. As of 2007, 23 states had some form of estate or inheritance tax.</p>	\$21 million
<p>E. Increase personal income tax for highest earners.</p> <p>West Virginia has a graduated, marginal personal income tax (PIT) rate that begins at three percent and ends at 6.5 percent. Increasing the marginal tax rate by 0.5 percentage point for taxpayers with incomes between \$200,000 and \$250,000, by 1 percentage point for incomes between \$250,000 and \$300,000, and by 2 percentage points for incomes over \$300,000 could increase revenue by an estimated \$89 million. Currently, 15 states have higher PIT rates than West Virginia.</p>	\$89 million
<p>F. Apply 25 percent of proposed tobacco tax increase to general revenue.</p> <p>The proposed tobacco tax would generate \$120 million, including \$110 from cigarette and \$10 million from smokeless tobacco. Supporters recommend that the tobacco tax revenues be dedicated Medicaid and other public programs that benefit lower-income people. Since these public programs are supported in part by the General Revenue Fund, it would be reasonable to use a quarter of the projected tobacco tax revenues -- \$30 million -- to reduce the shortfall.</p>	\$30 million
TOTAL FOR ALL OPTIONS	\$264.5 million