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On the Brink: Closing West Virginia's Budget Gap

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Introduction

Governor Jim Justice introduced the first budget proposal of his administration at the beginning of the 2017 legislative session, his FY 2018 budget proposal, would close a nearly \$500 million budget gap by raising \$450 million in new revenue, as well as targeted budget cuts totaling \$26.6 million. The governor's proposals are a step in the right direction after several years of deep budget cuts totaling \$600 million.

As the legislative session went on, both the House and the Senate produced their own plans close the budget gap, both relying on significant budget cuts, as well as tax reforms. However, as the legislative session drew to a close, and key pieces of legislation failed to pass, the legislature passed a budget with no new revenue. Instead, the legislature resorted to dipping into the Rainy Day Fund to balance the budget, in addition several large budget cuts.

With Governor Justice expected to veto the budget passed by the legislature, the state's fiscal status for FY 2018 remains unclear. If the governor vetoes the budget, he will have to call the legislature back into a special session to work out a new plan, which will likely include both some form of tax reform as well as some budget cuts.

Significant tax cuts implemented over the last decade, continued declines in coal production, falling natural gas prices, and a weak economy have all contributed to the state's consecutive budget gaps in recent years.

In addition to changes to the base budget, Governor Justice has also proposed substantial revenue increases for the State Road Fund, totaling more than \$190 million. These revenues help reverse the trend of the Road Fund declining power to maintain the state's highway systems.

Despite facing a one of the largest budget gaps in the state's history, on top of multiple years of budget cuts and falling revenue, some legislators are considering tax reforms that will lead to further tax cuts while shifting the state's tax load onto working families.

This brief examine each of the governor's proposals for closing the FY 2018 budget gap, as well as the counter proposals from legislators, and the underlying factors that are creating the multi-year budget crisis. The brief will also provide common sense tax reforms that rebalances the state's upside down tax system while providing enough revenue to prevent further budget cuts and allowing the state to invest in its needs.

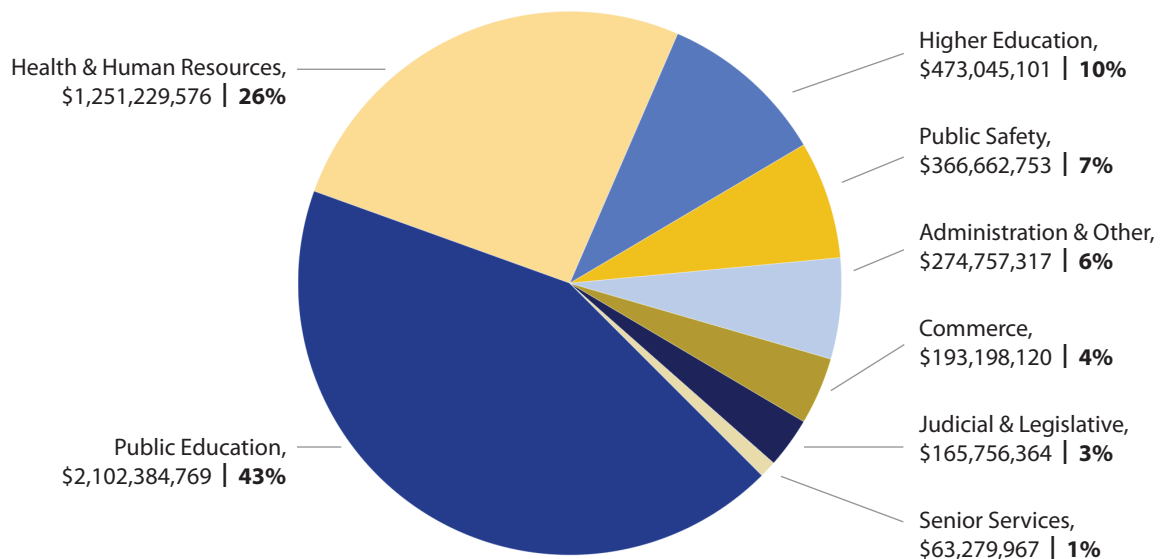
Key Findings

- The governor's plan for closing the estimated \$497 million budget gap for FY 2018 includes \$450 million in new revenue, largely from increased sales and business taxes.
- The governor's revised budget proposals include smaller increases in sales and business taxes, but also include increased taxes on tobacco and sugary-sweetened beverages.
- The proposed FY 2018 base budget totals \$4.89 billion. Increases over the FY 2017 budget include the proposed \$105 million Save Our State fund, and increased base budget appropriations for Medicaid.
- The budget passed by the legislature is balanced with large cuts to higher education and Medicaid, while taking \$90 million from the Rainy Day Fund.
- Most areas of the budget are spending less in FY 2018 than in FY 2012.
- Tax cuts, falling natural gas prices, and a weak economy are the primary reasons for the state's continued budget problems.
- The governor has proposed \$191 million in new revenue for the Road Fund, increasing investment in the state's highway system.
- To prevent future budget problems and begin reinvesting in the state, lawmakers should look at policies that rebalance the tax system while providing sufficient revenue.

Governor's Proposed FY 2018 Base Budget

Governor Justice's proposed 2018 base budget appropriations total \$4.89 billion, including \$4.5 billion from the General Revenue Fund, \$130.9 million from the Lottery Fund, and \$227.2 million from the Excess Lottery Fund. 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
Governor's FY 2018 Base Budget Appropriations
\$4.89 billion



Source: WV State Budget Office.

The governor's proposed FY 2018 base budget is \$202 million more than the FY 2017 budget, before FY 2017's mid-year cuts are applied, a 4.3 percent increase. Much of the increase is due to the use of one-time revenue for Medicaid in the FY 2017 budget, which resulted in a \$126.4 million decrease in base budget appropriations in the FY 2017 budget. These other funds, which include the Rainy Day Fund, are not being used for Medicaid in the FY 2018 budget, resulting in an increase in base budget appropriations.

The other major increase in the FY 2018 base budget is a \$105 million one-time expenditure for the governor's proposed "Save Our State (SOS)" fund. The SOS fund, appropriated to the Department of Commerce, provides funding for new infrastructure and economic development projects, but there are currently no further details on how the funding would be used.

Other major expenditure changes in the proposed FY 2018 base budget include those to the Department of Education. The state's share of the school aid formula increased \$7.3 million, largely due to a decline in the local share and a planned pay raise for teachers. In addition, appropriations for the Teachers' Retirement System and its unfunded liability increases by \$73.5 million from FY 2017's enrolled budget. Most other areas of the budget see only minor changes from FY 2017, aside from the actions taken to close the budget gap described in the next section (**Table 1**).

TABLE 1

Major Expenditure Changes in FY 2018 General Revenue Budget (thousands)

	FY 2017	FY 2018 (proposed)	Difference	Explanation
Division of Labor	\$2,555	\$0	-\$2,555	Eliminated general revenue funding, moved to special revenue
Development Office	\$10,965	\$116,436	\$105,471	Save Our State Fund
State Department of Education	\$89,941	\$82,338	-\$7,603	Eliminated RESAs; reduced Teachers' Retirement Savings Realized
State Aid to Schools	\$1,766,349	\$1,848,442	\$82,093	Increased Teachers' Retirement System; School Aid Formula changes
Educational Broadcasting Authority	\$4,648	\$0	-\$4,648	Eliminated general revenue funding
Division of Health	\$69,267	\$71,690	\$2,423	Increased Birth-to-Three program
Human Services	\$843,987	\$979,242	\$135,255	Medicaid Trust Fund appropriation reduced from \$161 million to \$32 million, increasing General Revenue appropriations.
Higher Education	\$400,208	\$390,211	-\$9,997	4.4% cut to WVU and Marshall

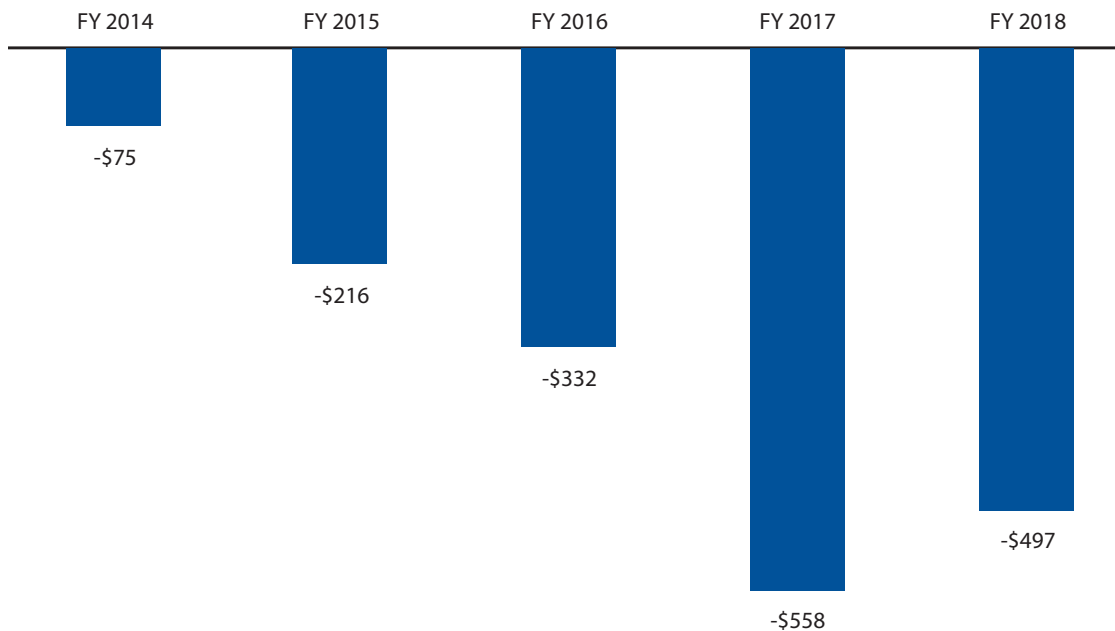
Source: WV State Budget Office.

Closing the FY 2018 Base Budget Gap

The FY 2018 budget is the fifth year in a row that projected revenues have fallen short of expenditures, resulting in a budget gap. The FY 2018 budget gap stands at \$497 million, which, while smaller than the FY 2017 gap, is still one of largest budget gap in recent years (**Figure 2**).

FIGURE 2

Persistent Base Budget Gaps Since FY 2014 (millions)



Source: WV State Budget Office.

Note: Revenues for FY 2017 are currently \$79 million below estimate.

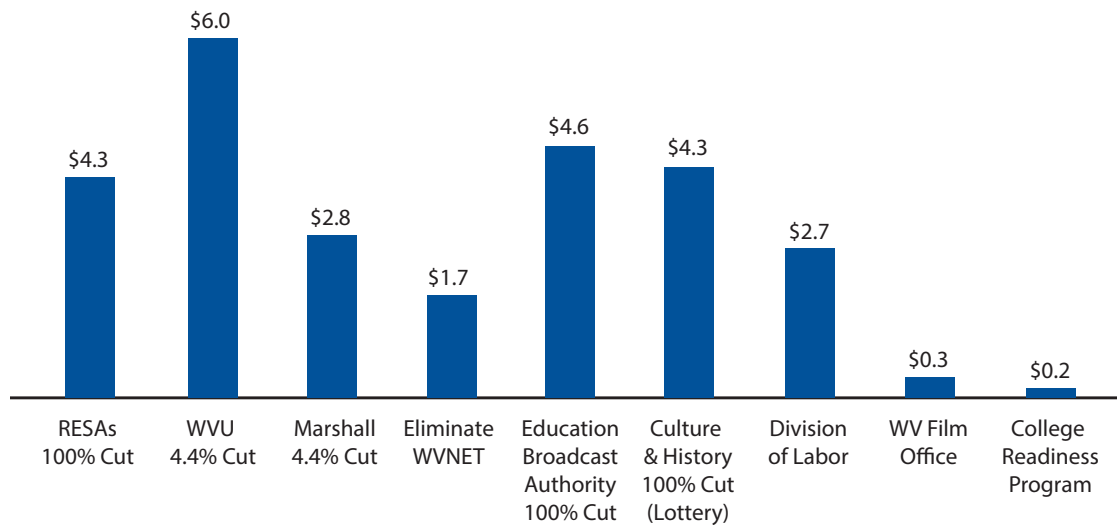
The combined budget gaps from FY 2014 to FY 2016 have totaled \$1.18 billion. Past budgets have relied heavily on budget cuts to close the previous gaps, with the state enacting over \$600 million in cuts in recent years, compared to only \$100 million in new tax revenue from increased tobacco taxes. The state has also relied on a number of one-time sources of revenue, including multiple withdrawals from the Rainy Day Fund. In 2014, the state's Rainy Day Fund had a balance of \$955 million. After several years of dips into the fund to balance the state budget, the fund is down to \$635 million.

Governor Justice's proposal to close the FY 2018 base budget gap is a departure from previous years. Rather than across-the-board budget cuts, the governor has proposed a small number of targeted cuts, and several new revenue measures to close the budget gap. In addition, he has offered up three different proposals: the Executive Budget document, a revised proposal, and an "alternative budget," which spells out what cuts would need to be enacted to close the budget gap with no new revenue.

In both the original and revised budget proposals, Governor Justice calls for \$26.8 million in targeted budget cuts. The cuts include a 4.4 percent cut to both West Virginia and Marshall Universities, and the elimination of state funding for both Regional Education Service Agencies and the Education Broadcast Authority, including funding for West Virginia Public Broadcasting (**Figure 3**). Other major budget actions proposed on the expenditure side to close the budget gap include canceling a planned across-the-board two percent pay raise for public employees, saving \$52.5 million, and using one-time revenue to fund Public Defender services, saving the General Revenue Fund \$18.3 million.

FIGURE 3

Governor’s Proposed FY 2018 Base Budget Cuts (millions)



Source: WV State Budget Office.

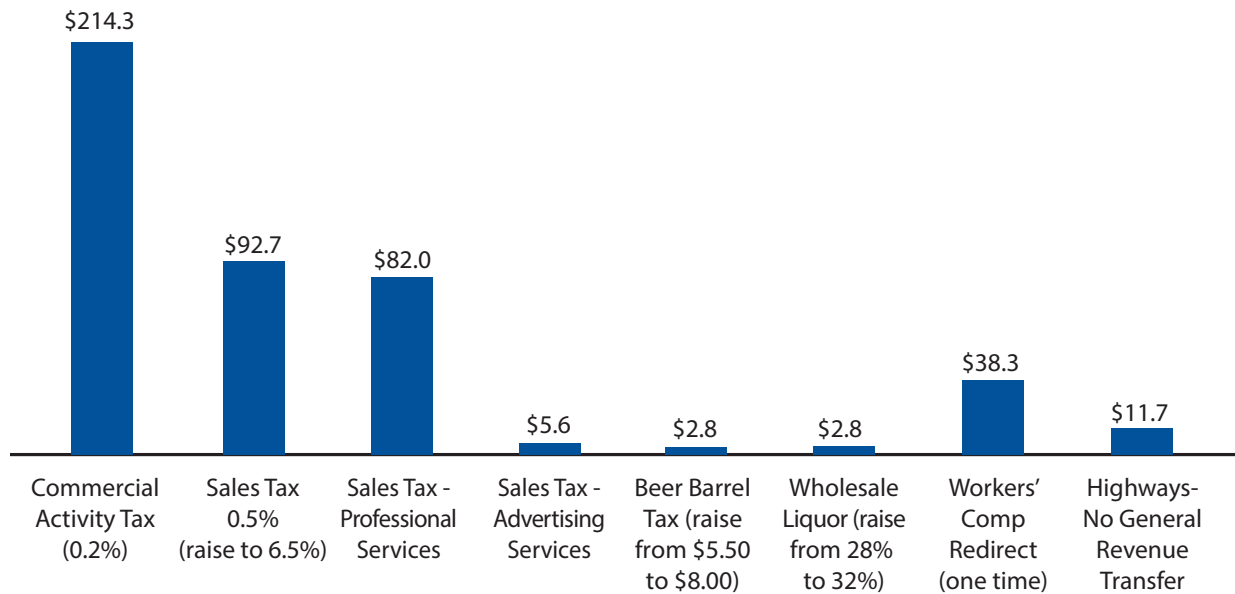
In addition to the budget cuts included in the original budget proposal, in his revised plan the governor proposed spreading out appropriations to his Save Our State (“SOS”) fund over three years, reducing the impact on the FY 2018 base budget by \$70 million. He also proposed “smoothing” the annual required contribution for the teachers’ retirement system, which would reduce the state’s payment in the FY 2018 budget by \$40.75 million. The governor also noted that he would be open to further cuts of up to \$50 million in total, but left it to the legislature to identify where to make them.

In both his original and revised budget proposals, Governor Justice proposes significant increases in revenue to help close the budget gap. In the original proposal, he proposes raising \$400 million in new revenue. Most significant was the introduction of a new Commercial Activity Tax of 0.2 percent on businesses, which would raise an estimated \$214.3 million. The proposed revenue measures also included increasing the sales tax from 6.0 percent to 6.5 percent as well as broadening the sales tax base to include professional and advertising services. The proposal also increases the beer barrel and wholesale liquor taxes. Other revenue measures include a one-time redirection of Workers’ Compensation severance tax revenue to the general revenue, and canceling a general revenue transfer to the Department of Highways (**Figure 4**).

FIGURE 4

Governor’s Proposed Revenue Measures (millions)

Total: \$450 million

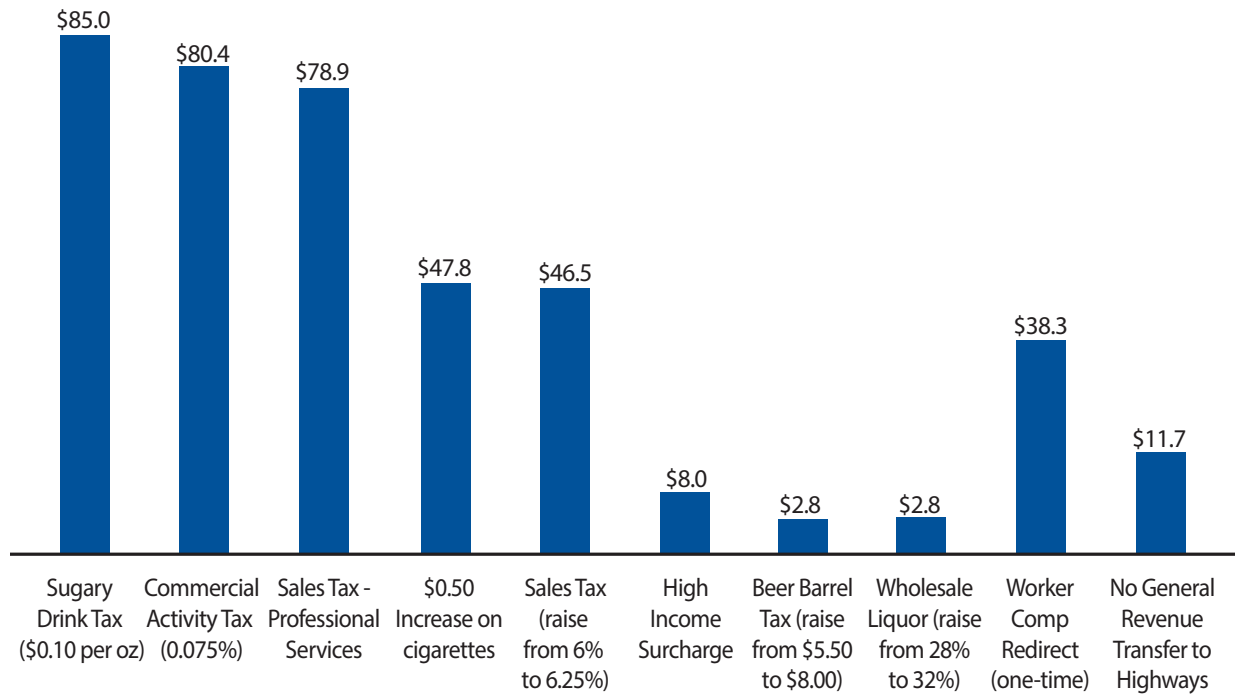


Source: WV State Budget Office.

In his revised plan, the governor proposed a smaller increase in the sales tax, from 6.0 percent to 6.25 percent, while still broadening the base to include professional services, but not advertising services. He also proposed a smaller Commercial Activity Tax of 0.075 percent instead of 0.2 percent. The governor’s revised proposal keeps the increases on the beer barrel and wholesale liquor taxes, and also increases the tax on sugary sweetened drinks and cigarettes, as part of a “Better Health Initiative for WV.” Finally, the governor proposed a new high-income surcharge of \$500 for annual incomes above \$200,000, \$750 for incomes above \$250,000, and \$1,000 for incomes above \$300,000 (**Figure 5**).

FIGURE 5

Governor’s Revised Proposed Revenue Measures (millions). Total \$402 million

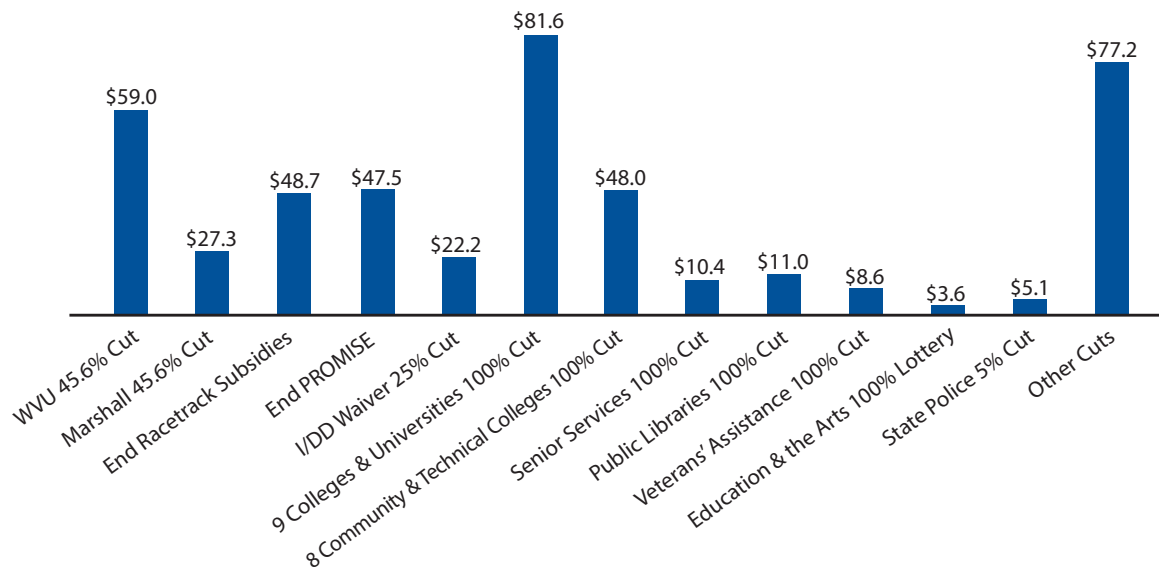


Source: WV Governor’s Office.

The governor’s “alternative” budget spells out the spending cuts needed to balance the budget, absent any new revenue. These include major cuts to higher education, including closing several colleges, eliminating the PROMISE scholarship program, and eliminating state funding to Senior Services, public libraries, Veterans’ Assistance, and Education and the Arts, among other cuts (Figure 6).

FIGURE 6

**Governor’s Alternative Budget Cuts (millions)
Proposed Cuts if No New Revenue Passes. Total \$450 million**



Source: WV Governor’s Office.

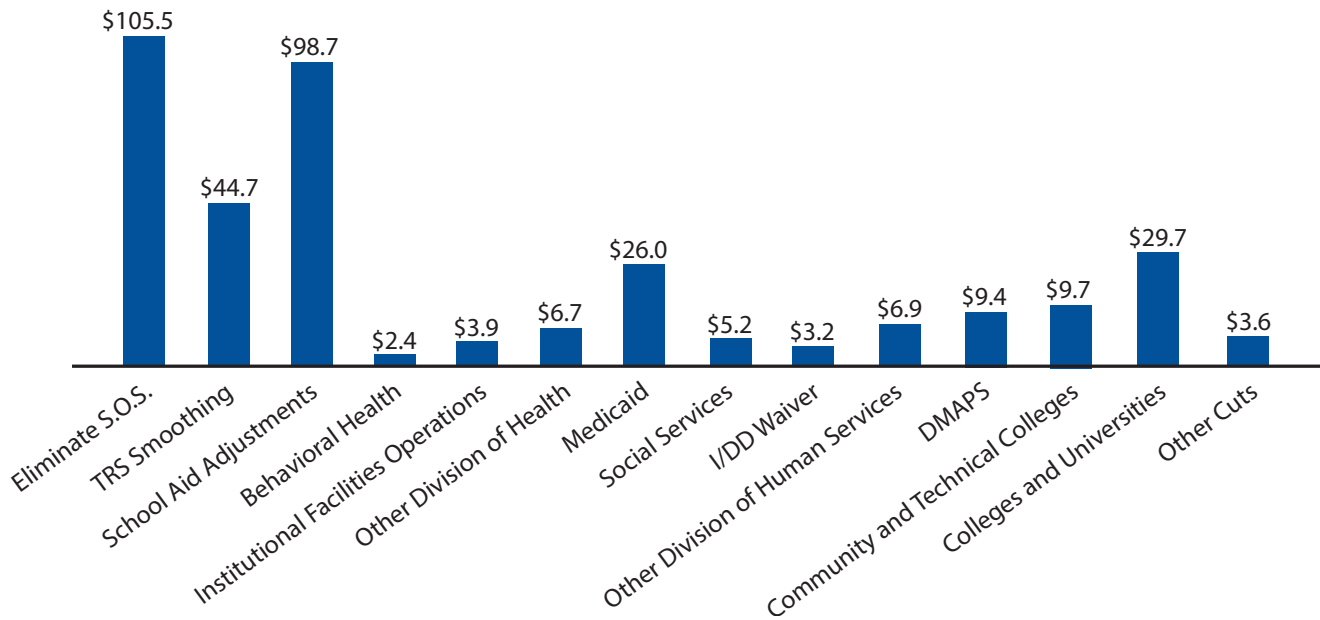
Legislative Proposals to Balance the Budget

In the final week of the session, both the House and the Senate introduced separate budget bills, both taking different approaches from the governor to closing the budget gap.

The Senate’s budget appropriated \$402.6 million less from the General Revenue Fund than Governor Justice’s proposal, balancing the budget largely through spending cuts (**Figure 7**).

FIGURE 7

Senate’s Base Budget Framework (millions) \$450 Million Budget Gap



Source: WV Legislature.

The biggest single change from the governor’s proposal is the elimination of funding for Governor Justice’s Save Our State Fund, which saves \$105.5 million.

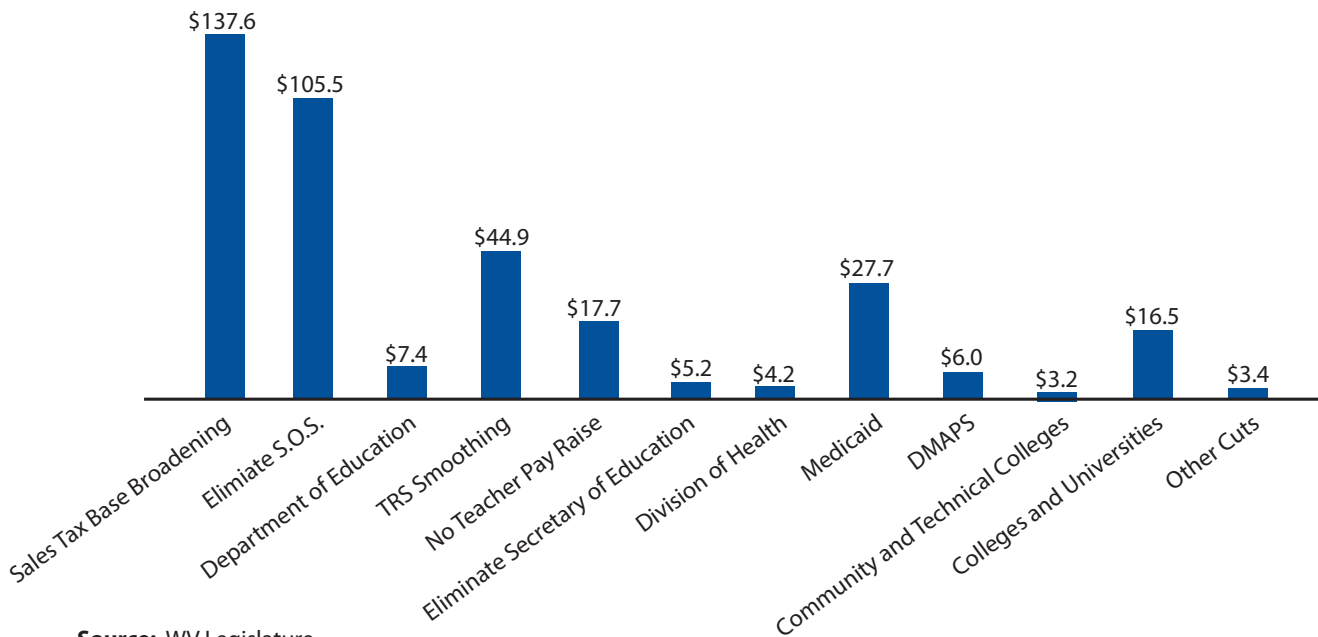
Another major change from the governor’s proposal concerns the Department of Education. The Senate’s budget cuts appropriations for the Department of Education by \$141 million, with two major changes. First, the school aid formula is adjusted to increase the local share of K-12 education, lessening the state’s share by \$98.7 million. The Senate’s proposal would allow local school districts to raise property taxes to offset the lost of state funding. The Senate bill also keeps the governor’s proposal to “smooth” payments to the Teachers’ Retirement Unfunded Liability, saving \$44.7 million.

In addition, there are cuts to Medicaid in the Senate budget. General revenue appropriations for Medicaid are cut by \$64.7 million, but are partially offset by increases in Excess Lottery and Trust Fund appropriations. Cuts to other areas of DHHR total \$28.9 million below the governor’s proposal.

Finally, after years of cuts totaling \$55 million, higher education would face cuts totaling \$41.6 million below the governor’s proposal, including \$10 million in cuts to community and technical colleges and \$31 million in cuts to public four-year colleges and universities. The \$41.6 million in cuts to higher education come on top of Governor Justice’s proposed cuts to higher education, bringing the total from FY 2017 to FY 2018 to \$51.6 million. Funding for Higher Education from the General Revenue Fund would be \$115 million below FY 2013 levels for FY 2018 under the Senate’s budget bill.

The House budget bill also is significantly smaller than the governor’s proposal, appropriating \$258 million less from the General Revenue Fund (**Figure 8**).

FIGURE 8
New Revenue and Cuts in House Base Budget Proposal (millions)



Source: WV Legislature.

Unlike the Senate proposal, the House budget relies on new revenue from SB 484, which expands the sales tax base to include telecommunications, personal services, and “direct-use” taxes on purchases by communications and transportation businesses. This would raise \$137 million in new revenue for FY 2018. Provisions in the bill reducing the sales tax rate in later years, however, would eventually result in decreased sales tax revenue.

As does the Senate bill, the House budget bill eliminates funding for the governor’s proposed Save Our State fund, and also “smooths” payments for the Teacher’s Retirement System.

While the Senate bill cuts K-12 education while authorizing local school districts to raise taxes to offset the loss, the House bill takes a different approach. It cuts public-education funding by eliminating RESAs and testing for 9th-and 10th-grade students. The House bill also cancels a planned raise for teachers and service personnel.

Under the House proposal, the Office of the Secretary of Education and the Arts would be eliminated, and various Education and Arts programs moved to other areas of the budget.

General Revenue funding for Medicaid is cut by \$42 million, which is partially offset by increased lottery appropriations. Other DHHR programs are cut by a total of \$4.2 million, including eliminating funding for Tobacco Education, Cardiac Project, Center for End of Life, Osteoporosis and Arthritis Prevention, the Women’s Commission, and Healthy Lifestyles.

DMAPs is cut by \$6 million, with most of the cuts coming from the Division of Corrections.

The House bill also zeros out funding for all West Virginia public colleges, and instead appropriates all the funding to the Higher Education Policy Commission and the Council for Community and Technical colleges. In total, the amount appropriated is effectively a \$19.7 million cut from the governor’s proposal, but the House leaves it to the HEPC and CCTC to determine which colleges will be cut and by how much.

What the Legislature Passed

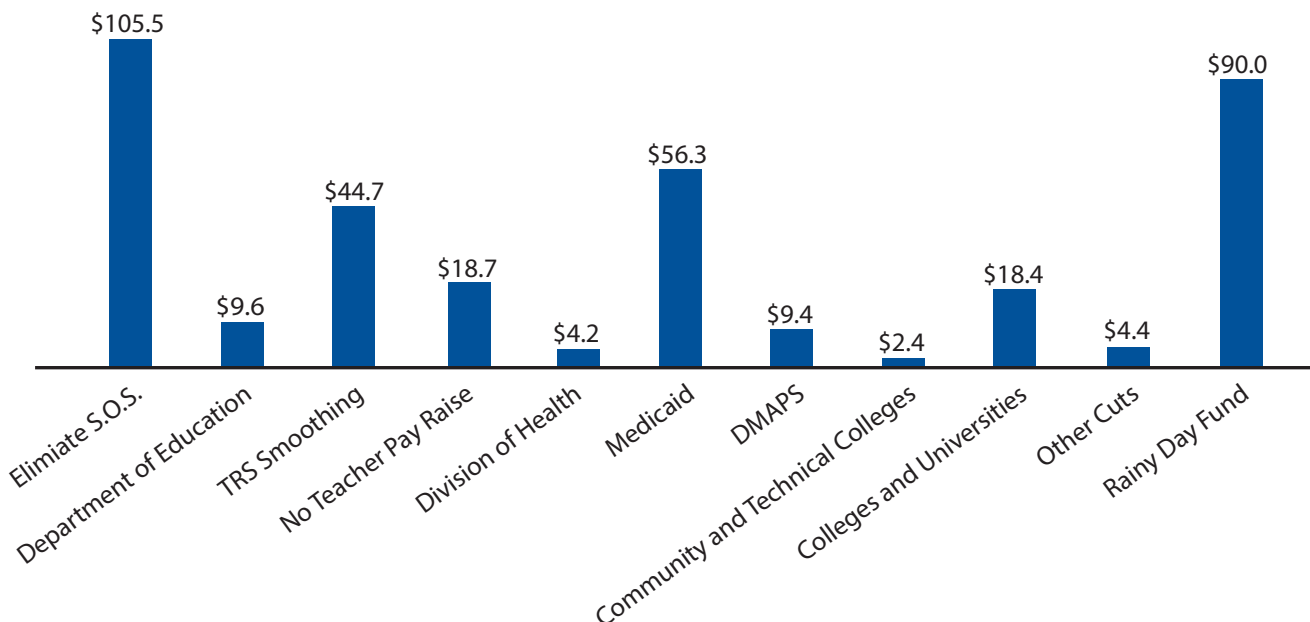
With time running out in the legislative session, the legislature passed a final budget that was neither the House or Senate proposal, nor was it the governor's proposal. Instead, the legislature passed a budget with no new revenue, relying on steep cuts and the Rainy Day Fund to balance the budget.

The final budget passed by the legislature closely matched the Senate proposal, with a few changes. Both save \$105.5 million by eliminating the governor's Save our State Fund, and both smooth payments to the Teachers' Retirement System, saving \$44.7 million. Unlike the Senate proposal, however, the final budget did not include the changes to the school aid formula that would have increased the local share of school funding, saving the state \$98 million. Instead, the school aid formula is largely left untouched, with the exception of canceling the teacher pay raise, which reduces the state's appropriation by \$19 million.

The final budget also contains major changes for funding Medicaid. The final budget cuts general revenue appropriations for Medicaid by \$187.9 million. This cut is partially offset by increased lottery appropriations, and by taking \$90 million from the Rainy Day Fund and using it for Medicaid. Altogether, Medicaid appropriations in the final passed budget are \$56.3 million below the governor's proposal. Since Medicaid spending is matched at a roughly 3-to-1 ratio by the federal government, a \$56 million cut to Medicaid would result in roughly \$168 million in lost federal funding.

The final budget keeps most of the other cuts throughout the budget, including eliminating DHHR programs like the Cardiac Project, the Center for End of Life, the Office of Healthy Lifestyles, and the Tobacco Education Program. The final budget also cuts Higher Education by a total of \$20.8 million from the governor's proposal (**Figure 9**).

FIGURE 9
Budget Passed by Legislature Balanced by Cuts and Rainy Day Fund (millions)



Source: WV Legislature.

Taking \$90 million from the Rainy Day Fund would drop the fund's balance below 15 percent of the General Revenue Fund, which is the level required for the state to maintain its bond rating. By relying heavily on the Rainy Day Fund, and not including any of the governor's revenue proposals, it is expected that the governor will veto the budget bill, and call the legislature back into a special session to continue working on a plan to balance the budget.

Years of Cuts Impacting the Budget

Even with \$450 million in new revenue in Governor Justice’s proposed FY 2018 budget, spending in nearly every major area of FY 2018 budget is less than what is was before the recent budget gaps began, as multiple years of budget cuts have added up.

Adjusting for inflation, proposed General Revenue expenditures in the FY 2018 budget are only 1.3 percent higher than General Revenue expenditures in FY 2012. Only Medicaid, the Commerce Department (due to the Save Our State fund), and the Judiciary have seen an increase in General Revenue spending since 2012. Spending in all other major areas of the budget are down in FY 2018 compared to FY 2012, including \$98.6 million less for higher education, \$98.4 million less for K-12 education, and \$22 million less for public safety.

TABLE 2

Cuts Impacting All Areas of the Budget

**FY 2012 Actual and FY 2018 Proposed General Revenue Expenditures (thousands)
(inflation adjusted 2017\$)**

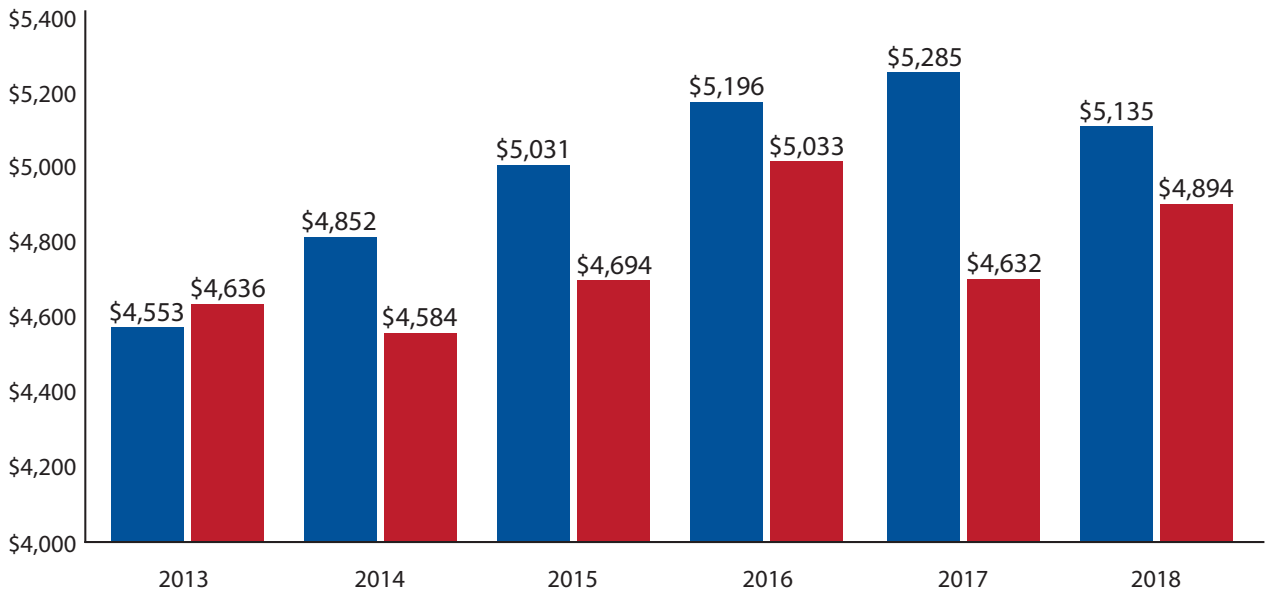
Department	FY 2012	FY 2018	Difference	Percent Change
Legislature	\$33,357	\$23,997	-\$9,360	-28.1%
Judicial	\$136,098	\$141,760	\$5,662	4.2%
Executive	\$64,402	\$34,186	-\$30,216	-46.9%
Administration	\$137,947	\$60,977	-\$76,970	-55.8%
Commerce	\$76,280	\$154,661	\$78,381	102.8%
Education	\$2,107,675	\$2,009,192	-\$98,483	-4.7%
Education & The Arts	\$36,823	\$25,815	-\$11,008	-29.9%
Environmental Protection	\$13,209	\$6,475	-\$6,734	-51.0%
Health & Human Resources	\$909,538	\$1,232,123	\$322,585	35.5%
Military Affairs & Public Safety	\$388,918	\$366,663	-\$22,255	-5.7%
Revenue	\$34,178	\$26,400	-\$7,779	-22.8%
Transportation	\$8,144	\$5,478	-\$2,666	-32.7%
Veterans Assistance	\$11,380	\$10,161	-\$1,220	-10.7%
Bureau of Senior Services	NA	\$17,252	NA	NA
Higher Education	\$488,854	\$390,211	-\$98,643	-20.2%
TOTAL	\$4,446,820	\$4,505,350	\$58,530	1.3%

Source: WV Legislature. Bureau of Labor Statistics.

The proposed FY 2018 budget is substantially smaller than the state initially projected. Including the governor’s proposed new revenues, the FY 2018 base budget is \$244 million below the projected FY 2018 budget from the FY 2014 Six Year Plan created by the governor (**Figure 10**).

FIGURE 10

Actual and Projected Base Budget Expenditures, FY 2013-2018 (millions)



Source: WV State Budget Office.

Major Drivers of the State Budget Crisis

There are several key drivers of the state’s budget crisis, including major tax cuts that were phased in over the last 10 years, the decline of coal production and natural gas prices, and an economy that has stagnated for more than a decade. While one of the few areas of growth in the state budget has been Medicaid and health insurance for public employees, these changes have only modestly impacted the state’s growing budget gaps over the last few years compared to these other factors.

Tax Cuts Enacted Since 2006

Since 2006, the state has phased in major tax reductions that have contributed to its structural revenue imbalance. These include eliminating the sales tax on groceries, reducing the corporate net income tax rate, and ending the business franchise tax. Other smaller tax reductions over this period include the creation of the Family Tax Credit, doubling of the homestead exemption, repeal of the Alternative Minimum Tax and Corporate Charter Tax, expansion of the prescription drug exemption and pass-through sales tax exemption for contractors, elimination of business registration renewal fees, and new tax credits for manufacturing (including the inventory credit). Altogether, these tax cuts have reduced base budget revenue by well over \$425 million annually.

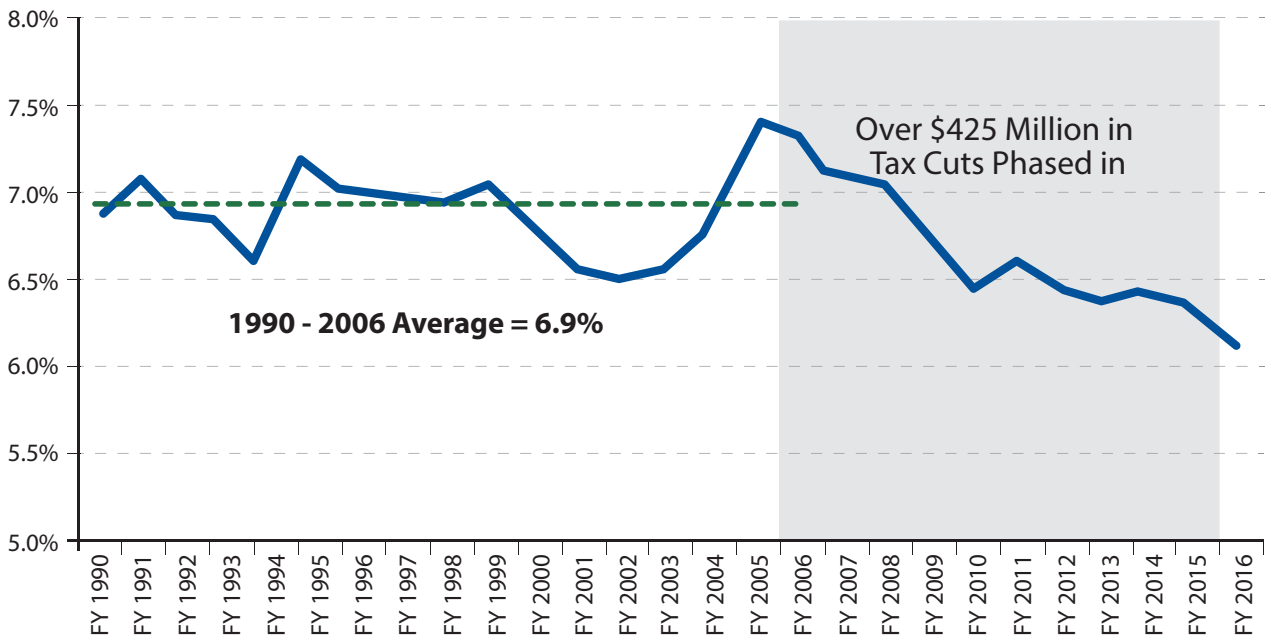
TABLE 3
Major Tax Rate Reductions Since 2006

Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Grocery Sales Tax Rate	6%	5%	4%	3%	3%	3%	2%	1%	0%	0%	0%
Business Franchise Tax Rate	.70%	.70%	.55%	.55%	.48%	.41%	.34%	.27%	.21%	.10%	0%
Corporate Net Income Tax Rate	9.0%	9.0%	8.75%	8.75%	8.5%	8.5%	8.5%	7.75%	7.0%	6.5%	6.5%

Source: WV Department of Revenue.

Between 2008 and 2016, General Revenue fund collections have only grown by 4.4 percent. Meanwhile, personal income in the state has grown by 19 percent over this period. Tax revenues as a share of West Virginia’s economy are at their lowest point since 1990. Between 1990 and 2006 – before the tax cuts took effect – general revenue collections were about 6.9 percent of the state’s economy. Today, they are less than six percent. If state revenues were 6.9 percent of the West Virginia economy in 2016, the state would have collected \$576 million in additional revenue (Figure 11).

FIGURE 11
General Revenue Fund Collections as a Share of West Virginia’s Economy (personal income)



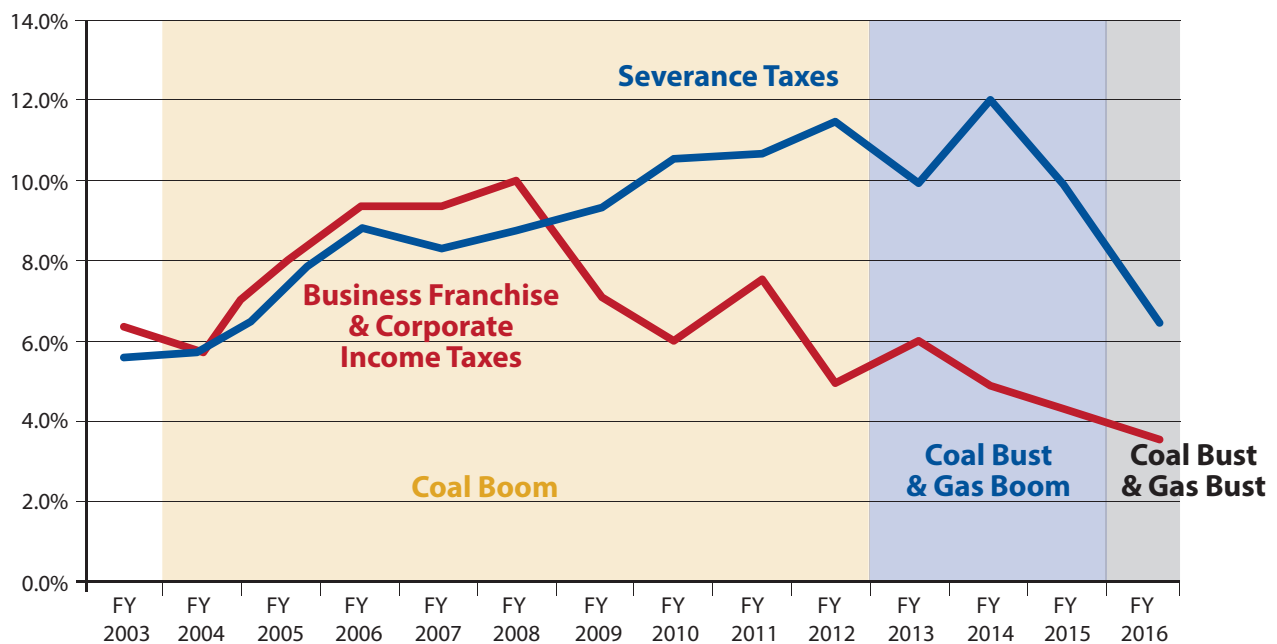
Source: WV State Budget Office and U.S. Bureau of Economic Analysis.

Decline of Coal Production and Natural Gas Prices

As West Virginia enacted major tax reform in 2006 and 2007, it was in the midst of a budget surplus thanks to a sharp increase in coal prices that led to a large growth in coal severance taxes. Coal mining economic output (GDP) grew threefold from 2004 to 2011 (\$3 billion to \$9.8 billion); meanwhile, shale gas development began to take off just as the coal boom reached its peak. Between 2011 and 2014, natural gas and oil economic output grew nearly fourfold from \$1 billion to just over \$4 billion. While the rapid growth of shale development in the state over this period helped stabilize severance tax collections, just as the coal boom ended, both coal mining and oil and gas output began to decline after 2014, causing a decline in severance tax collections (**Figure 12**).

FIGURE 12

Severance Taxes and Business Franchise/Corporate Income Taxes as a Share of General Revenue Collections



Source: WV State Budget Office.

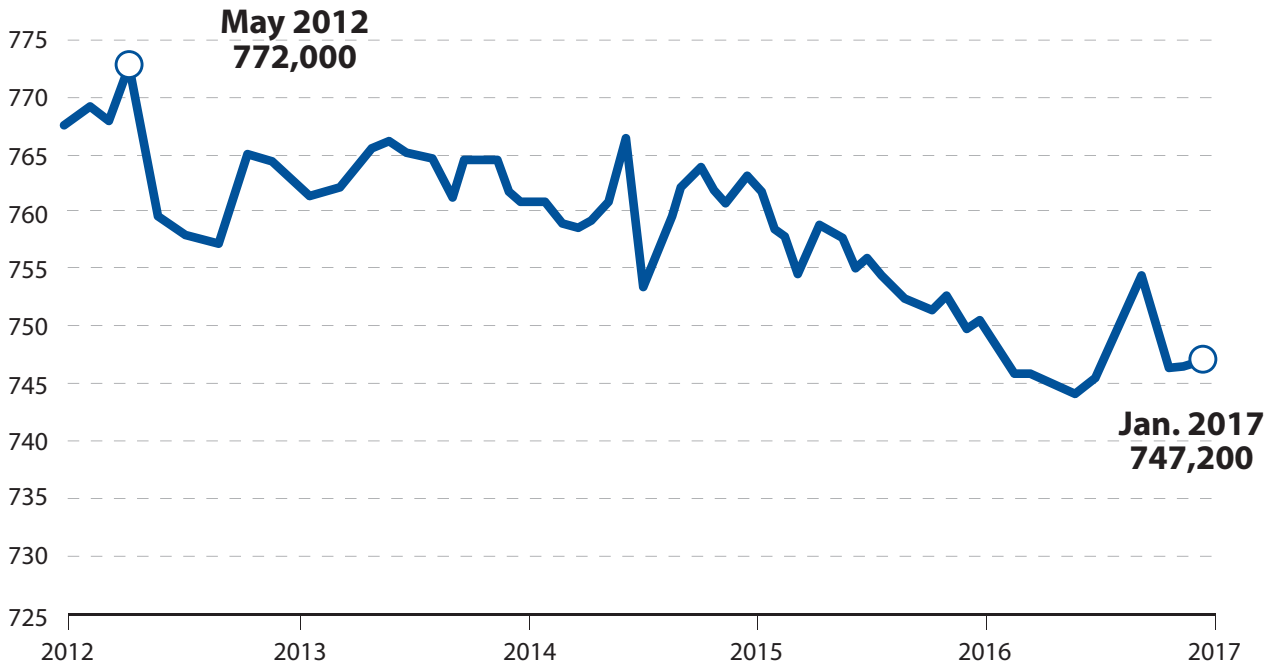
Rapidly growing severance tax collections from 2004 to 2014 helped mask the state's structural revenue imbalance from the large corporate tax cuts that were phased in over this period, but this is no longer the case. In 2014, severance taxes and business taxes made up 16.9 percent of general revenue fund collections, but by 2016, they dropped to just 10 percent of general revenue fund collections. In 2016, tax collections from the corporate net income and business franchise tax were \$244 million below their peak in 2008 and have declined from 14 percent of the general revenue fund to below four percent. Meanwhile, severance taxes have declined by \$212 million from 2014 to 2016.

Business Tax Cuts Have Not Coincided With Job Growth

West Virginia has yet to recover from the Great Recession. While the state entered the recession somewhat later than most states, it had approximately 13,000 fewer nonfarm jobs in January 2017 than it did when the recession began (December 2007). The state's private sector is especially weak. With approximately 6,800 fewer private-sector jobs in January 2017 than in January 2005. Looking at post-recession employment (after June 2009) in West Virginia, the state has nearly 25,000 fewer nonfarm jobs today (**Figure 13**). The private sector is down approximately 23,000 jobs since March 2012 (**Figure 14**).

FIGURE 13

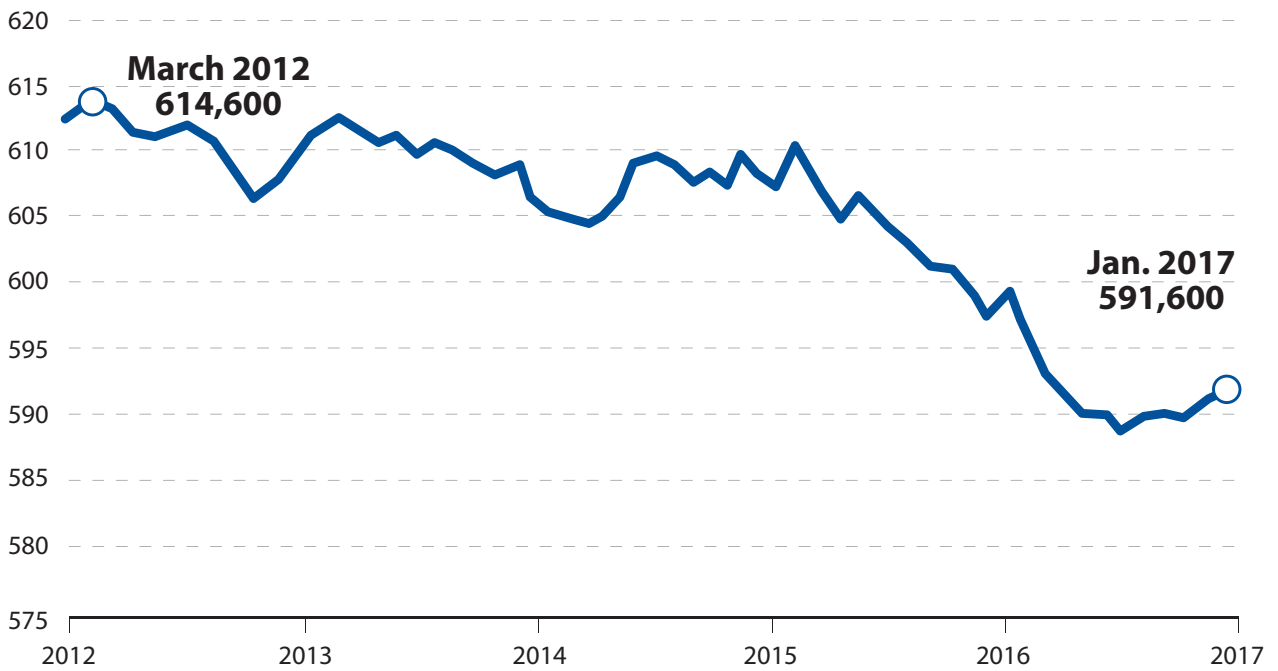
WV Nonfarm Employment Down Nearly 25,000 from Post-Recession Peak (thousands)



Source: U.S. Bureau of Labor Statistics, Current Employment Statistics (Seasonally Adjusted, February 2017).

FIGURE 14

WV Private Sector Employment Down 23,000 from Post-Recession Peak (thousands)

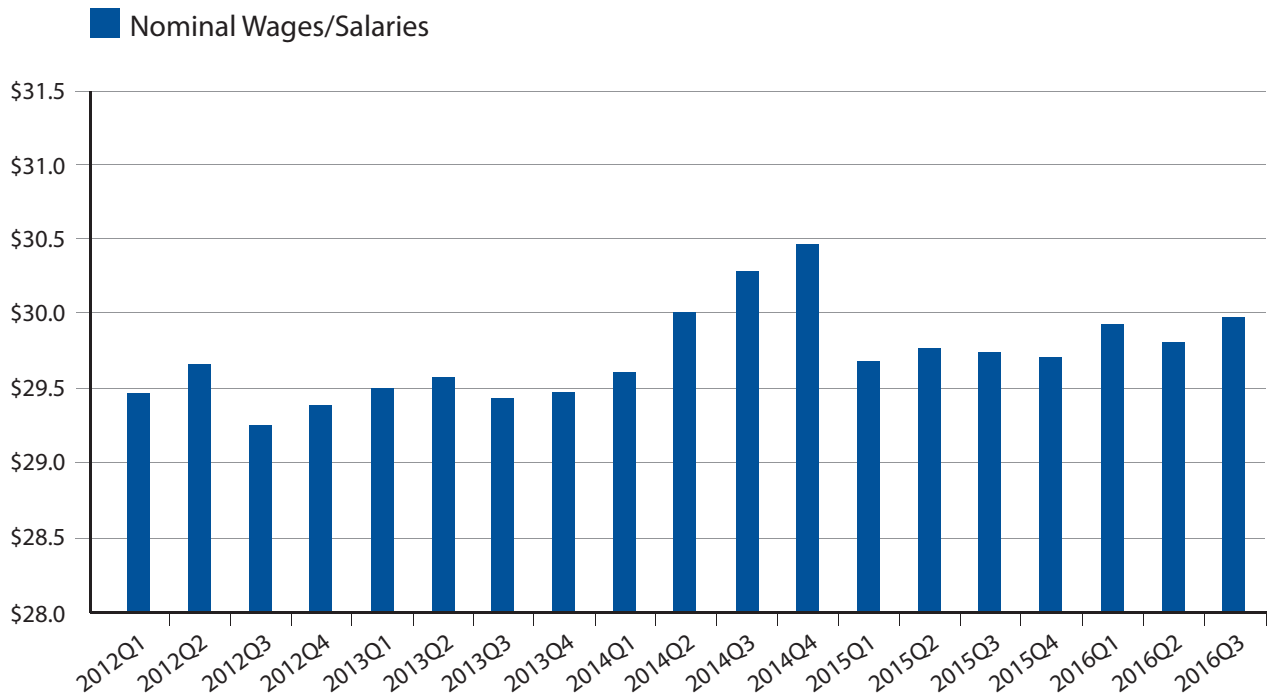


Source: U.S. Bureau of Labor Statistics, Current Employment Statistics (Seasonally Adjusted, February 2017).

Wages and salaries in the state have also stagnated over the last several years. Over the last two years, wages and salaries have declined nominally by \$500 million since their peak at the end of 2014. Adjusting for inflation, wages and salaries are approximately \$1.2 billion below where they were at the beginning of 2012 (**Figure 15**).

FIGURE 15

Wages and Salaries have Stagnated in West Virginia Since 2012
(Expressed in Billions, Annualized)



Source: U.S. Bureau of Economic Analysis and U.S. Bureau of Labor Statistics
Note: Wages and salaries are adjusted using quarterly Consumer Price Index for All Urban Consumers.

Jobs, wages, and coal are not the only thing that is declining in West Virginia. West Virginia is one of only handful of states that is experiencing a decline in its population. From 2010 to 2016, West Virginia’s population declined by an estimated 21,909 or 1.2 percent. This was the largest percentage-point decrease in population of any state over this period.

Justice Proposes Increased Funding for Roads

Governor Justice made several proposals to increase funding for the state’s road system. This includes a \$20 increase in vehicle registration fees to fund a 20-year general obligation bond of \$400 (requires voter approval), a \$1 increase on the state’s only toll road to fund a \$500 million bond on the West Virginia Turnpike over 20 years, and an increase in the motor fuel tax of 10 cents a gallon. Governor Justice also proposed to increase the limit on federal Garvee bond capacity from \$200 million to \$500 million. Altogether, this amounts to \$1.4 billion in additional funding capacity for the state’s roads.

A month after the governor released his plans for increased road funding, he made several changes to his proposal. This included offering an \$8 EZ-Pass to all West Virginians and raising the Turnpike tolls to \$4 instead of \$3, while using the additional \$2 for roads other than the Turnpike. Governor Justice also lowered his proposed gasoline tax increase from 10 cents to 4.5 cents a gallon. The governor has stated the these plans would create 25,000 to 48,000 jobs in the state, however, those estimates have yet to be verified.

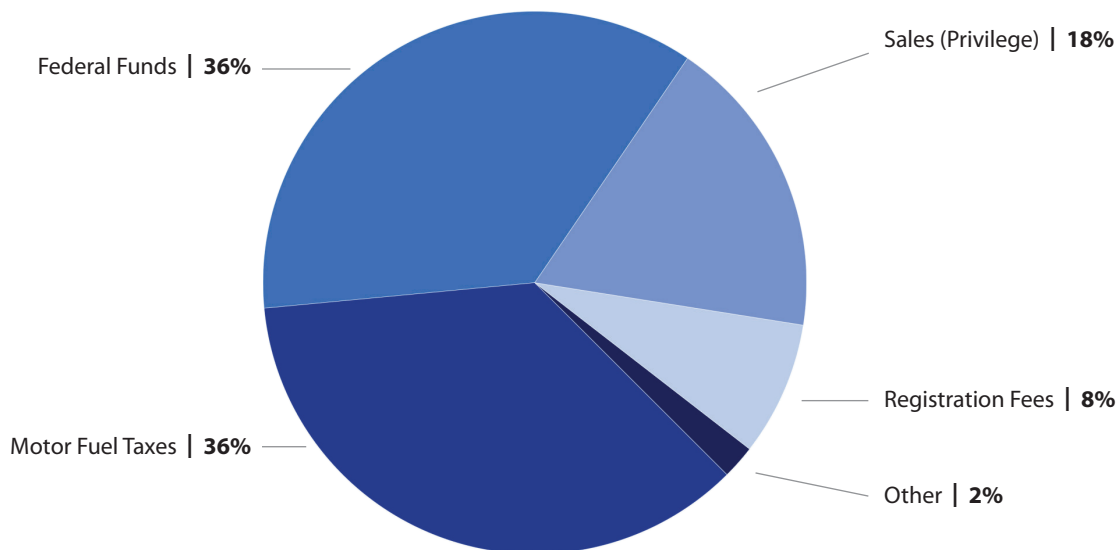
West Virginia's Road Fund

West Virginia's Road Fund is not part of the state's base budget, instead is made up of four central revenue sources, including federal matching funds, motor fuel taxes, registration fees, and a five percent sales (privilege) tax. Altogether, this amounted to \$1.12 billion in FY 2016. Federal funds and motor fuel taxes made up \$396.4 million, sales taxes contributed \$206.2 million, vehicle registration fees were \$88.9 million, and \$20.1 million came from other funds (**Figure 16**).

These funds are used to match federal funds for interstate construction and maintenance and for other state road and bridge construction. The state also pays for roads through general obligation debt such as road bonds. As of June 30, 2016, the total outstanding debt on road bonds was \$166.4 million. (The state also collects toll fees on the West Virginia Turnpike operated by the West Virginia Parkways Authority, but this money is solely used for the I-64 Turnpike and does not receive federal matching funds.)

FIGURE 16

FY 2016 State Road Funding Revenue Sources

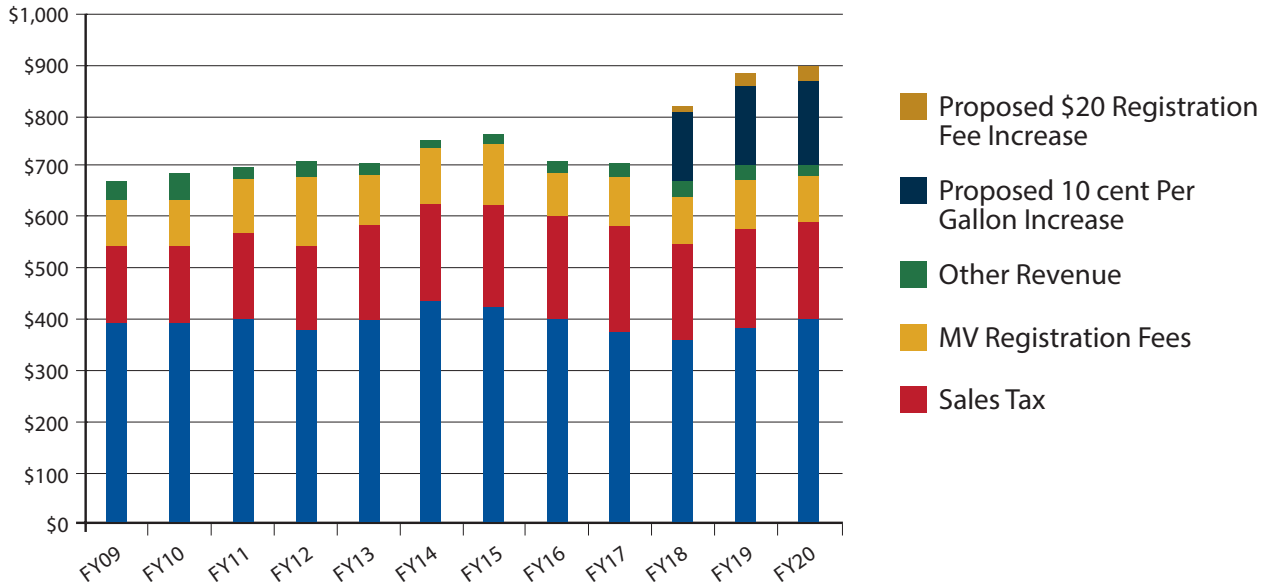


Source: WV State Budget Office.

Governor Justice's proposed revenue enhancements – including the 10-cent hike in the gasoline tax and \$20 increase in registration fees - boosts revenue into the State Road Fund by an estimated \$177 million in FY 2018 and \$191 million in FY 2019 and FY 2020 (**Figure 17**).

FIGURE 17

State-Source Road Fund Revenues and Proposed Revenue Increases (in Millions)

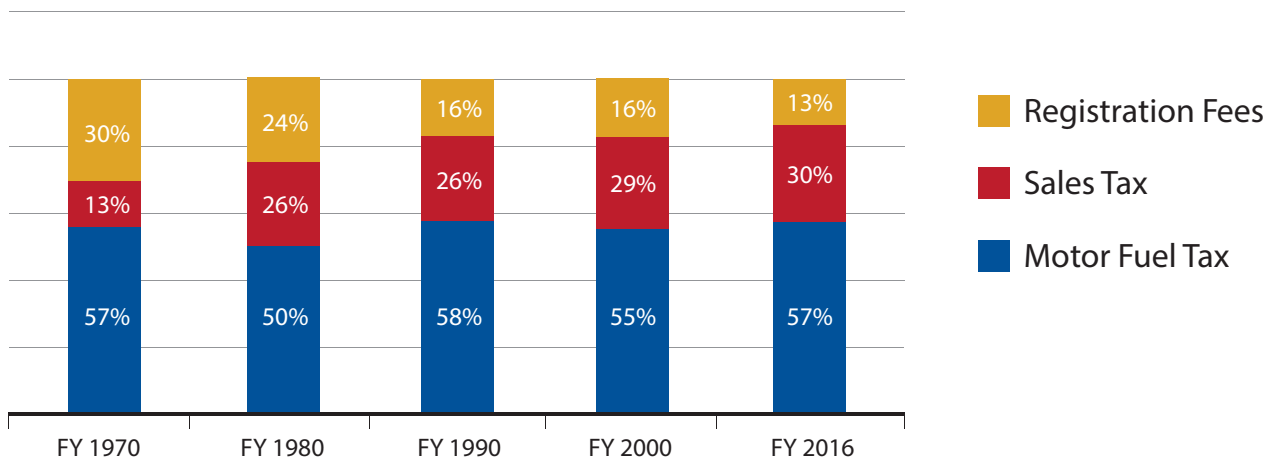


Source: WV State Budget Office.

Over the last several decades, sources of tax revenue to the State Road Fund have shifted away from registration fees and more toward the motor fuel taxes and the sales tax (5 percent). From 1980 to 2015, fuel taxes grew by 286 percent, sales taxes by 291 percent, and registration fees by 79 percent. In 1970, registration fees made up 30 percent of revenue and today they comprise just 13 percent (Figure 18).

FIGURE 18

State-Source Road Fund Revenues and Proposed Revenue Increases (in Millions)



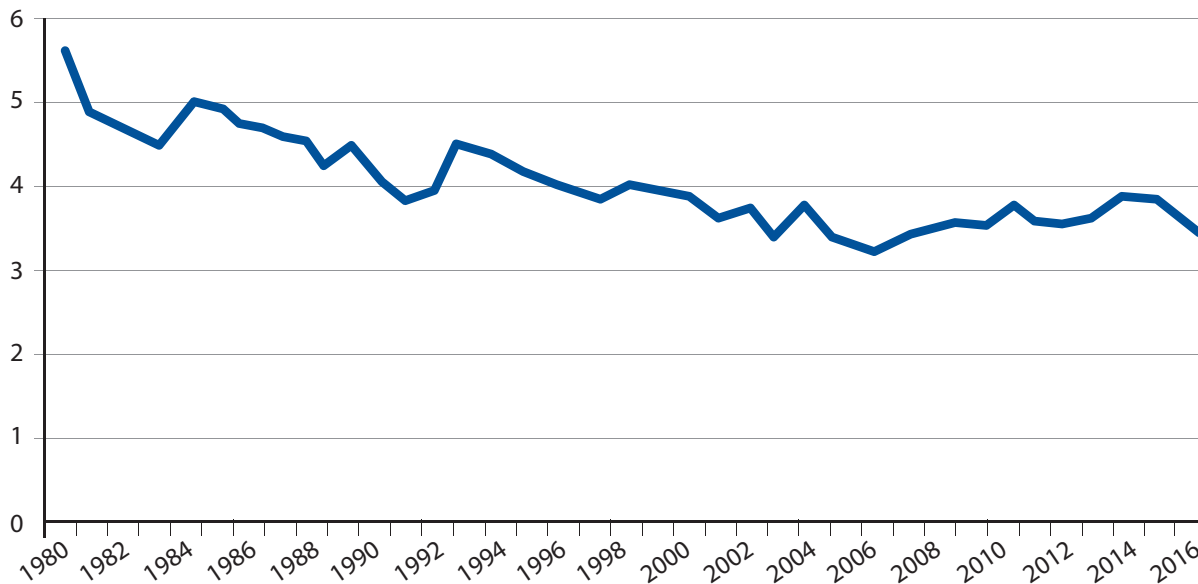
Source: WV State Budget Office.

Over the last several decades, the state has found that its central revenue source, the motor fuel tax (which contains a flat rate of 20.5 cents per gallon and a variable rate of 5 percent based on the wholesale price of gasoline), cannot catch up to the increasing fuel efficiency of cars and trucks in the state. But as fuel efficiency has increased, so has the number of miles driven in the state, putting more stress on maintaining roads and bridges. According to the Federal Highway Administration (FHA), from 1980 to 2013, the number of miles driven per vehicle in West Virginia has grown from 8,142 to 13,233. Meanwhile, fuel use over this period remains about the same, meaning people are driving farther on less gas, which means less revenue for the state.

Over this same time, the state has also seen a large growth in the number of trucks on its roads, growing from 387,313 in 1980 to 848,948 in 2013. Meanwhile, the total number of automobiles in the state has shrunk from 929,000 in 1980 to 541,900. With more trucks on our state roads creating more stress and deterioration, it is not surprising the state is having trouble keeping up with road repairs and maintenance.

One way to look at the declining power of State Road Fund revenue to meet the increased use of roads is by looking at vehicle miles traveled (VMT) in the state. According to FHA, in 1980 the total VMT was 10.7 billion miles. By 2016, this number almost doubled reaching 19.6 billion. Figure 18 shows State Road Fund Revenue per VMT in West Virginia from 1980 to 2016.

FIGURE 19
State-Source Road Fund Revenues Per Vehicle Mile Traveled in West Virginia, 1980-2016 (adjusted for inflation, 2016\$)



Source: Federal Highway Administration and Bureau of Labor Statistics.

The state is receiving less revenue per mile driven after adjusting for inflation. In 1980, the state received about 5.5 cents per vehicle mile driven compared to just 3.5 cents per vehicle mile driven in 2016 (**Figure 19**).

With low gasoline prices, policymakers need to consider increasing the state’s motor fuel tax and other various taxes and fees to help pay for maintenance on the state’s highways and other roads. West Virginia’s current motor fuel tax is 33.2 cents per gallon (flat + variable rate). West Virginia could raise this rate by five cents per gallon and tie it to both construction-cost inflation and fuel-efficiency growth, which would increase revenues by an estimated \$129 million annually by 2020. The state could also look at increasing toll rates on the West Virginia Turnpike or creating an additional toll road on I-81 in the state’s Eastern Panhandle. Raising the sales tax rate on motor vehicles from five percent to six percent to align it with the state’s sales and use tax would yield an additional \$37.2 million annually.

Conclusions and Recommendations

West Virginia is facing a budget crisis unlike anything since the late 1980s. This crisis comes on top of years of large budget cuts to many of our state's most important public investments, including higher education. Unfazed by the projected \$500 million budget gap in FY 2018, some lawmakers are considering drastic tax reforms that will not only lead to more future budget cuts but shift more of the tax load onto working families that can afford it the least.

Instead of exacerbating the state's already upside down tax system with more special interests tax breaks for the wealthy, policymakers need to pursue common sense reforms that rebalance the state's tax system by asking the wealthy to carry their share of the load while providing enough revenue to put the state on a sustainable path that invests in the building blocks of our state's economy. Below are several revenue options that take a balanced approach for how we end the state's budget crisis and get it back on track without further damage to the state's economy.

- **Reinstate Business Tax Cuts.** Over the last 10 years, West Virginia gave corporations more than a half a billion dollars in special tax breaks. Reinstate the Business Franchise Tax at 0.70 percent and the Corporate Net Income Tax at 9 percent. West Virginia could also close offshore tax havens. **[Revenue \$219M + \$10M]**
- **Apply Sales Tax to cell phones.** Former Governor Earl Ray Tomblin proposed applying the sales tax to cell phones and other ancillary telecommunications. West Virginia has the 44th lowest tax rate on cell phones in the nation. **[Revenue \$60M]**
- **Access High-Income Surcharge.** West Virginia could access a 3 percent surcharge on households with excess income over \$200,000. A person earning \$201,000 would pay an additional 3 percent on the last \$1,000 of income, or \$30 more per year. **[Revenue \$96M]**
- **Scale Back Personal Income Tax Exemptions.** Phase out \$2,000 personal income tax exemption for taxpayers between \$150,000-\$200,000 and eliminate it for those over \$200,000. **[Revenue \$10M]**
- **Low-Wage Employer Fee.** Many big box retailers force families to rely on public assistance to make ends meet. The Low-Wage Employer fee will require companies with 500 or more employees to pay a reasonable hourly-based fee for every worker earning \$15 or less per hour. **[Revenue \$45M]**
- **Sugary-Sweetened Beverage Tax.** A 1-penny per-ounce tax on sugary-sweetened beverages would help the state address its unhealthy workforce while generating much-needed revenue. **[Revenue \$88M]**
- **Raise Tobacco Taxes.** West Virginia taxes tobacco products at a lower rate than most states. Legislators can raise the tobacco taxes to \$1.55 per pack (from \$1.20 per pack) and 50 percent (from 12%) of the wholesale price on other tobacco products. **[Revenue \$60M]**
- **Increase Alcohol Taxes:** Increase beer barrel tax to \$11 from \$5.50 and require ABCA to set higher wholesale prices on wine and liquor to yield additional \$6.5 million. **[Revenue \$13.6M]**
- **Modernize Sales Tax.** West Virginia could expand its sales tax base to include digital downloads from the Internet and more personal services (tattoo parlors, beauty salons, private fitness center, etc.) **[Revenue \$9.8M]**

- **Reinstate Estate Tax.** West Virginia, which had an estate tax from 1904 to 2005, could reinstate the estate tax. Today, 21 states collect over \$4.5 billion per year from their estate tax. **[Revenue \$15M-20M]**
- **Raise Natural Gas & Oil Severance Tax Rate to 6.5% from 5%.** Ohio Governor John Kasich and Pennsylvania Governor Tom Wolf have recently proposed a 6.5% natural gas and oil severance tax. **[Revenue \$35M]**
- **Raise Sales Tax.** West Virginia's sales tax is relatively low in comparison to its neighbors. Legislators could look at raising the state's sales tax from 6 percent to 6.5 percent or 7 percent. This measure should be coupled with a refundable WV Earned Income Tax Credit of at least 20 percent to help offset its impact on low-and moderate-income families (-\$69M). **[Revenue \$98M, \$196M]**
- **Apply Sales Tax to Professional Services.** West Virginia could expand its sales tax base to include more professional services – including accounting, legal, advertising, engineering, architects, investment counseling, and land surveying. **[Revenue \$172M]**