FIRST SLOW SPENDING

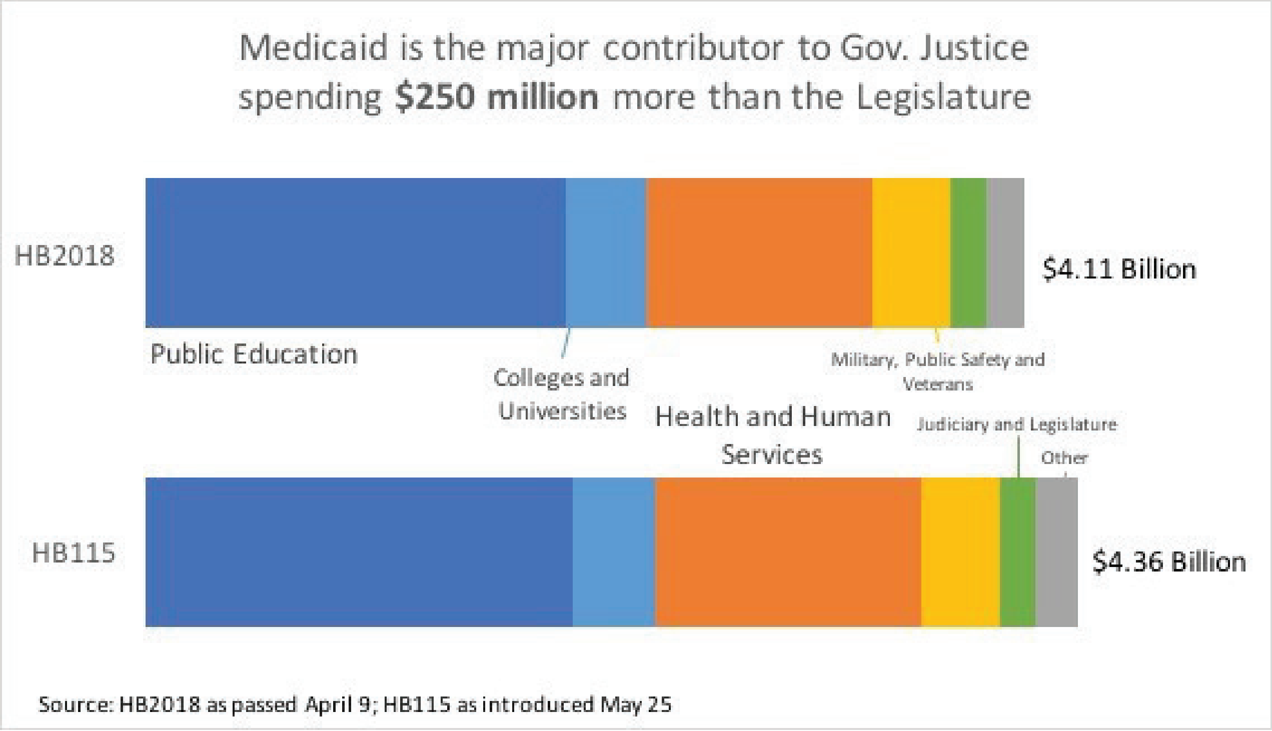
As lawmakers prepare for the special session, they should recognize the long-term trends West Virginia faces, avoid one-time fixes, and restrain spending. With slower spending, they will have greater flexibility to identify and pursue needed structural reforms that can make the economy more competitive over time.

BACKGROUND

Gov. Justice looks to spend $4.35 billion in General Revenue, an increase of $160 million from the current fiscal year that ends June 30. This would be $247 million more than the bill he vetoed in April, but $150 million less than his original budget proposal in February. The governor's biggest concession is a reduction in the Save Our State initiative from $105 million to $10 million.

To pay for this spending, the governor and legislators will increase the sales tax and apply it to more goods and services. From January 2018, a larger exemption from personal income taxes will offset some of this. An earlier attempt by the Senate to reduce tax rates has been set aside.

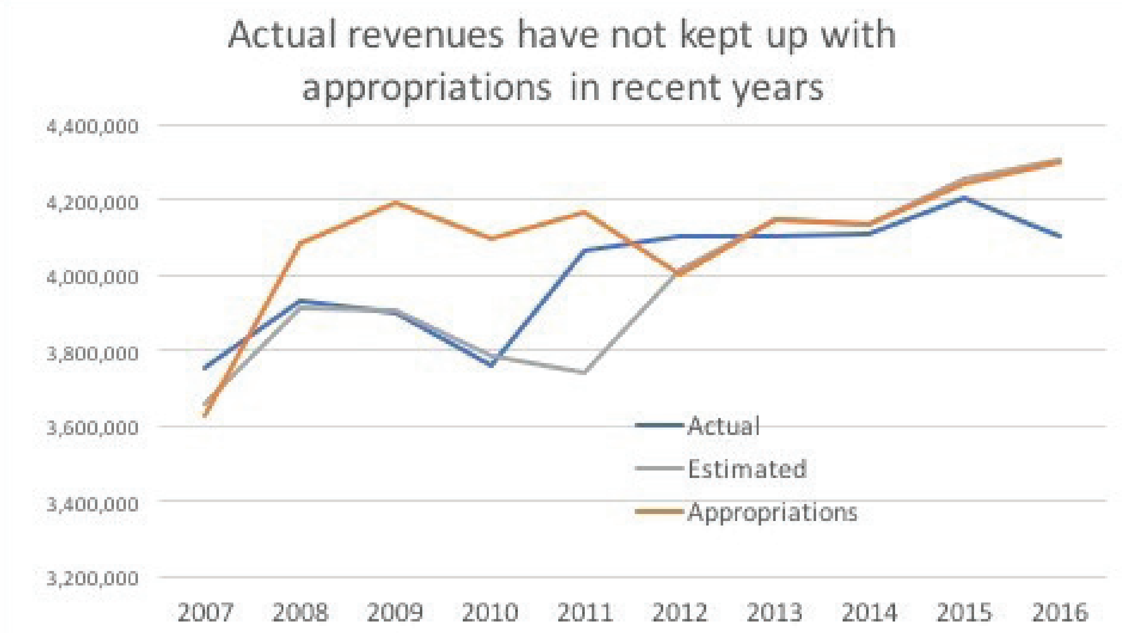
A new tax on business revenue, called a Commercial Activity Tax (CAT), would raise $16 million for roads at a rate of 0.015 percent, or $150 per million dollars in revenue. The nonpartisan Tax Foundation warns that "Gross receipts taxes lead to higher consumer prices, lower wages, and fewer job opportunities, as the tax pyramids throughout the production cycle."[1] In an examination of the theory and experience with the tax, it noted, "Countries aspire through reform to avoid resorting to gross receipts taxes because of their hindrance to growth and development."[2] The House and Senate had previously dropped the CAT.



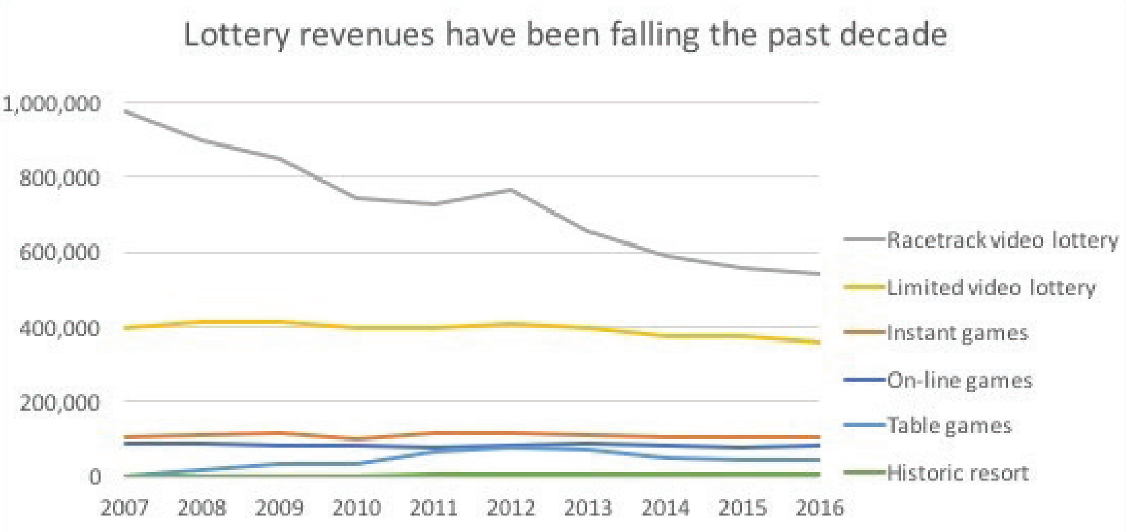
ANALYSIS

Spending is the best place to act to close the remaining fiscal gap. Without spending reform, cutting taxes like Kansas or raising taxes like Illinois only changes the timing of the next crisis. Nearly all sources of tax and lottery revenues have been flat or falling since 2011. Appropriations have tracked with estimated revenues even as actuals have fallen short, which has compounded the problem.

Although the gross receipts tax is misguided, the desire to have a stable funding source is a worthy goal. The severance tax on mining has been a volatile source of income and proposals to increase the tax when prices rise and decrease the tax when prices fall would exacerbate the ups and downs. Policymakers should reduce state government's dependence on the severance tax. They do look likely to take small steps to shift the burden on individuals from a tax on productive income to the sales tax on consumption, which is a better method of taxation.



Source: State Budget Office



Source: West Virginia Lottery Annual Reports

The attempt to "Save Our State" with a one-time injection of money for roads and other projects was from its inception, at a proposed $105 million, the equivalent of trying to save a marriage with a weekend trip to The Greenbrier. At the latest proposal for $10 million, it is like trying to save a marriage at Motel 6. Better to set it aside and focus on the underlying issues. This would also reduce the pressure for the gross receipts tax, which is projected to raise an equivalent amount.

In addition to leaving behind the Save Our State spending push, budget negotiators should make sustainable spending their top priority and avoid quick hits like withdrawals from the rainy day fund to supplement regular revenue.

FUTURE REFORMS

West Virginia's fiscal straits over the past decade highlight the challenges of an economy in transition. Sen. Robert Byrd tried for decades to help the state with federal spending. Policymakers in Charleston have tried their own solutions. Once they have a restrained spending plan with reasonable taxes for the 2017-18 fiscal year, legislators will need to turn their attention again to long-term reforms.

The budgeting process gives them a good place to start with performance measures for each program and agency that can begin strategic discussions of the best use of state dollars. What problems does the state face in education, health care, the environment, community development? Are agencies focused on the right problems? What is the right unit of service to measure? What is the cost to deliver a unit of service?

Until revenues recover with an improving economy, policymakers will need to be vigilant with spending and consider steps beyond small reductions in the cost of programs. In education, each college and university should consider the best method of teaching each class and the value of the classes and programs of study available to students. Those with oversight may be forced to consider how many public colleges and universities taxpayers can afford to support.

In the meantime, legislators may want to consider capping the number of state employees and the amount spent on compensation. This can provide more flexibility than a straight hiring freeze without as much opportunity to game the system with consultants. Some agencies may also benefit from voluntary separations to reorganize their work at lower cost. North Carolina achieved cost savings and efficiency improvements in this way with a program called Reorganization through Reduction, or RTR, in some cabinet agencies.

Focusing government resources in fewer places can make it more effective where it does operate. Without a chronic crisis of funding, citizens and businesses can turn their attention to productive endeavors instead of worrying whether they will have enough to cover the next tax increase. Slower spending is the first step.

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[1]Kaeding, Nicole. "The Return of Gross Receipts Taxes." Tax Foundation. March 2017.
[2]Ross, Justin. "Gross Receipts Taxes: Theory and Recent Evidence." Tax Foundation. October 2016.