

State Finishes FY 2004 with \$61 Million Surplus; Financial Picture Still Bleak for Future

West Virginia finished the fiscal year that concluded on June 30, 2004 (FY 2004), with a general fund surplus of about \$61 million out of its \$3.04 billion budget.

That good financial news comes as a result of two circumstances. First, the state collected some \$41 million more in revenues than forecast because the economy had improved. Second, the midyear budget cuts imposed in December 2003 saved roughly \$20 million.

Half of the surplus was moved into the state's "rainy day fund," bringing its balance to \$84.5 million. The Legislature appropriated more than \$21 million of the extra monies during a special session in June.

Similarly, West Virginia Lottery revenues exceeded estimates by more than \$67 million. The revenue estimate was not increased over the previous year in anticipation that at least one neighboring state would legalize video slot machines. However, that did not occur during the fiscal year. The Legislature appropriated more than \$24 million of the extra lottery receipts during a special session in June.

Finally, a 3 percent increase in federal matching funds over the 3-to-1 match ratio previously used resulted in a surplus in that fund as well.

Current unappropriated surpluses total \$84.5 million. They include more than \$9 million in general funds, \$43 million in lottery funds, and \$33 million in Medicaid monies.

These extra funds should help the state avoid any tax increases or budget cuts during the fiscal year that runs from July 1, 2004, to June 30, 2005 (FY2005). A \$1 million surplus is predicted for the \$3.07 billion general funds budget.

However, this appears to be the only bright spot in an otherwise bleak picture.

Deficits are still projected for future years because revenue growth is not expected to keep pace with increased costs, particularly those for health care, insurance, and retirement funds. Current projections call for a deficit of \$127 million for the fiscal year that runs from July 1, 2005, to June 30, 2006 (FY2006), and \$258 million for the fiscal year that runs from July 1, 2006, to June 30, 2007 (FY2007). Furthermore, Gov. Bob Wise ordered state agencies to trim their initial

budget requests for FY2006 by 5.5 percent in areas funded by general revenue and traditional lottery monies.

These anticipated budget deficits are somewhat less than what was placed before the Legislature in February – \$111 million for FY2005, \$174 million for FY2006, and \$259 million for FY2007. However, the general trend of continuing and increasing state budget deficits remains unchanged.

In addition, Pennsylvania legalized video slot machines as part of its budget package in early July. That could lead to a decrease in West Virginia Lottery revenues by April 2005. Meanwhile, Maryland continues to debate the issue.

Nationally, most states experienced better times in FY2004. The size of the deficits that had to be made up was smaller than in the previous two years. And more states ended the year "in the black."

The past several years have been difficult for state governments. According to data from the Center on Budget and Policy Priorities, the 50 states have had a combined \$195 billion in budget gaps for the fiscal years ending in 2002, 2003, and 2004. Similarly, according to the National Council on State Legislatures, the cumulative four-year budget deficit for all states exceeds \$235 billion.

The recent improvement in this situation requires some additional explanation. Some of the improved fiscal situation could be attributed to improved economic conditions nationally. Some of it also resulted after special federal allocations to the states helped balance the budgets in May 2003, near the end of that fiscal year for most states, and provided additional funding for FY2004.

The Center on Budget and Policy Priorities estimated that federal fiscal relief has been used to close \$20 billion of the states' deficits.

That same study found that the most common action to balance state budgets was cutting spending. Spending cuts totaled almost \$81 billion over the three years. Conversely, tax and fee increases provided only \$26 billion over the same period.

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State Finishes FY 2004 with \$61 Million Surplus (*continued*)

Meanwhile, the use of rainy day funds and general fund balances closed another \$20 billion of the state budget gaps. The remaining \$48 billion of combined state budget deficits was closed by a variety of means, mostly one-time actions ranging from short-term borrowing to shifts in payment dates.

Overall, because of the severity of the revenue downturn during the 2001 recession and the means used to balance state budgets, most states are expected to face tight budgets or worse for the next several years.

For more information on the state budget situation at the national level, visit the Center for Budget and Policy Priorities (www.cbpp.org), the National Association of State Budget Officers (www.nasbo.org) or the National Conference of State Legislatures (www.ncsl.org).

What Issues Do You Want *PIE* to Examine?

This is the third issue of the *PIE Update* newsletter. I will refrain from the joke that I have made in the previous two issues about pie. Nevertheless, how do you like *PIE Update* so far?

This issue examines budget- and finance-related matters in the Mountain State. We focus on the ongoing state budget shortfalls, which West Virginia is not alone in experiencing. There is also information on a new revenue option for municipal governments that goes into effect next year.

Previously, the newsletter introduced the concept of Public Issues Education (Spring issue) and discussed important legislation that came out of the 2004 regular session of the West Virginia Legislature (Summer). The Winter issue of *PIE Update* will review the November election results and what they might mean. It will also include information from the National Public Policy Education Conference.

Current plans call for this quarterly newsletter to become a Web-based tool in 2005. That schedule may change, depending upon the planned upgrading of the Extension Web site. Until then, the newsletter will be sent to each WVU Extension Service county office and to each program unit director. If electronic copies of the newsletter are wanted and are not available on the Web, please contact me directly.

Once the *PIE Update* is converted to a Web-based tool, we will be able to include additional topics and articles. Furthermore, the newsletter will not necessarily be bound by the quarterly publication schedule, allowing for more timely discussion of major issues as they arise.

Finally, to make *PIE Update* as useful as it can be, please let me know about any topic or concern that you would like to see examined in an upcoming issue.

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SB701 Law enacted

Municipalities to Have More Tax Options Next Year

The tax options for municipalities will be greater beginning July 1, 2005, because of a law enacted this year. SB 701 was signed by Gov. Bob Wise on March 13. The law creates Chapter 8, Article 13C of the State Code – “Municipal Tax In Lieu of Business and Occupation Tax; And Municipal Taxes Applicable to Pension Funds.”

Cities and towns will have the option of imposing a local sales tax, starting in FY2006. However, the sales tax would be allowed only in those municipalities that do not collect or that cease collecting a B&O (business and occupation) tax. The maximum rate is 1 percent – which would bring the combined sales tax rate up to 7 percent in places with the maximum local rate. The existing exemptions to the sales and use tax would also apply to the local tax. Also, the local sales tax would not apply to gasoline and special fuel sales. The state would administer the program as part of its sales tax collections and distribute the funds back to the localities.

Whether a local sales tax would be beneficial for a city or town would depend on its current tax structure and the volume of retail sales. For example, a city that imposes several different B&O taxes currently but does not have many stores and service providers may generate less revenue with a sales tax. Conversely, a place that has a healthy retail sector and that does not currently impose B&O taxes (or imposes very few of them) could very well benefit by imposing a local sales tax. Only a detailed study of each individual case will determine whether this course of action is appropriate for a particular municipality.

Also part of the new law is a provision that permits municipalities having a police/fire pension fund that is less than 3 percent funded to impose Pension Relief municipal taxes. These include sales and service taxes, use taxes, and occupational taxes. The new taxes must be part of a plan to reduce the unfunded liability of the pensions. Authority to collect these taxes ceases when the unfunded liability is eliminated. Currently, only Huntington qualifies to impose this set of taxes.

Finally, there is some speculation that this law marks the beginning of giving local governments additional taxing authority. However, the granting of any such power would require the Legislature to enact additional laws. Thus, it is unknown whether this is a one-time occurrence or the beginning of a subtle shift in the governmental structure in the Mountain State.