Not Measuring Up

Virginia Continues Budget Cuts Despite Growing Needs in the State

The Commonwealth Institute

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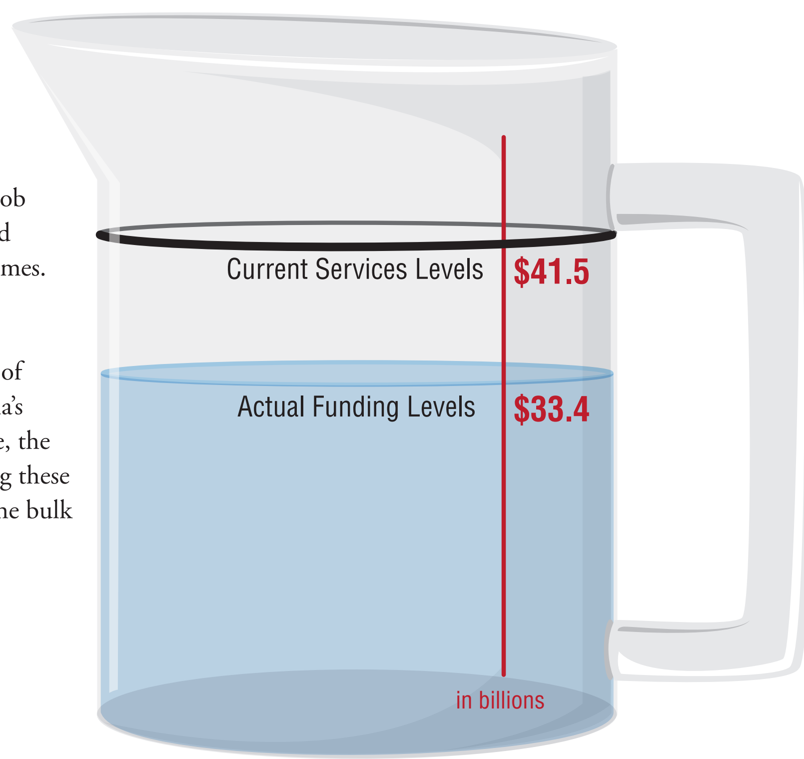
Executive Summary

Although Virginia's economy has slowly begun to see some returning revenue from the fragile economic recovery, a great chasm remains between the needs of the Commonwealth and the funding available to meet those needs. The budget passed by the General Assembly on April 6, 2011, reveals funding levels for core services that are far below pre-recession levels when adjusted for population growth and inflation. This report, *Not Measuring Up*, analyzes this budget and the challenges ahead. Among the report's key findings:

- Virginia's investment in its citizens and future is $8 billion below pre-recession levels, once spending levels are adjusted for the rising cost of providing services to a growing population (see Figure 1). Even without that adjustment, the state's general fund investment levels are $657 million below pre-recession levels.
- Vulnerable populations throughout Virginia are impacted by the continuing cuts to services included in the budget passed by the General Assembly this year.
  - Compared to pre-recession investment levels, the Commonwealth has reduced state support for K-12 education by $2.6 billion across this year and next year.
  - Despite a significant increase in Medicaid enrollment — as more and more people have lost health insurance when they have lost their job as result of the recession — the state has reduced Medicaid payments to hospitals and nursing homes.
- While state revenues are beginning to rise, these increases fall far short of replacing the $3 billion of Recovery Act funding that supplemented Virginia's general fund for the last three years. Furthermore, the General Assembly and Governor are not targeting these state revenues for education and health care, as the bulk of the Recovery Act did.

[Virginia has made little progress in restoring the cuts made to critical public services during the Recession.]

Figure 1: Total Funding



Budget Overview

Despite all the headlines surrounding Virginia's recent revenue uptick, the Commonwealth has made little progress in restoring the cuts made to critical public services during the recession. While the recent growth in revenues comes as welcome news, vast challenges still face the Commonwealth as it attempts to dig out of a deep economic hole.

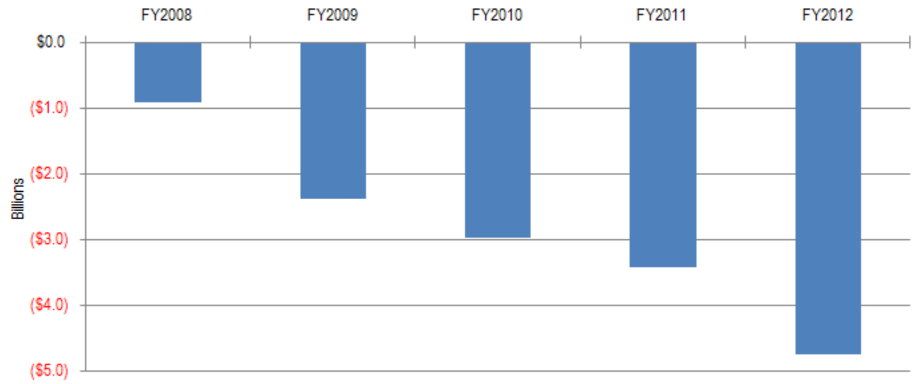
When we look at the public investments included in the current version of the budget and compare where we are today to where we were before the recession, we see that we have lost substantial ground. In comparison to fiscal year (FY) 2007, the last budget year before the significant revenue declines of the recession, the recently passed budget contains general fund[1] appropriations that are $657 million below 2007 levels. This reduction in general fund investment reveals the state's declining support for key public services at a time of increased need.

The General Assembly has the most discretion over the budget's general fund, which typically represents about half of Virginia's total budget. Given the flexibility associated with the general fund, how Virginia spends these dollars provides a window into the state's priorities. Once we analyze the growing cost of providing the same services due to Virginia's growing population and the rising price of goods and services, the budget passed this session includes spending levels for the current year that are $3.4 billion below the pre-recession levels.

Across the two-year biennial budget (the current year and next year), Virginia's general fund is $8 billion below adjusted pre-recession levels (see Figure 2). Without the federal Recovery Act funds, this gap would have been even larger.

Underwater: Current Budgets Are Below Pre-Recession Levels

Figure 2: Virginia's General Fund Operating Budgets Compared to FY2007, Adjusted for Inflation and Population Growth



Source: TCI Analysis of 2008-2010 & 2010-2012 Biennial Budgets, presentations by the Sec of Finance, & letters from the Governor.

The sharp cuts in education, health care and other services have shifted the budget burden onto Virginia's families, businesses, and localities. Nearly 40 percent of the growth in Virginia's non-general fund can be attributed to the transfer of higher education costs onto Virginia's students and their parents. Similarly, a variety of fee increases have moved part of the cost of certain services from taxpayers as a whole to selected individuals and businesses. At the same time, the state has passed down other budget shortfalls to localities through cuts to state support for a wide array of locally delivered services such as education, social services, and public safety. Thus, local governments, which are facing revenue crises of their own due to sharp declines in housing values, have been forced to choose between cutting important services or raising local taxes.

It is worth noting that the budget passed by this year's General Assembly, however, is better than the original biennial budget passed during the 2010 General Assembly session. Because of an uptick in revenues and some key policy decisions, this version of the budget includes about $625 million more in general fund resources than the budget previously approved. Unfortunately, Virginia still has far to go in terms of bringing public investment levels back in the range of pre-recession levels.

This report also examines the impact of these cuts in two key areas of Virginia's budget: K-12 education and health and human resources. Together, these areas account for close to 60 percent of Virginia's general fund in the current biennium. These budget areas serve a large number of Virginia's residents and our investments in them are key to maintaining the state's reputation for providing a healthy, well-educated workforce.

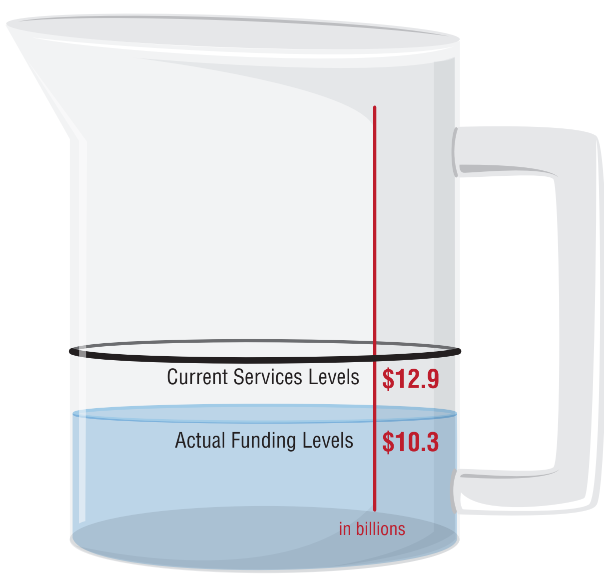
[1] Throughout this analysis, Recovery Act funding is counted as "general fund" resources.

Investment in Public Education (K-12 Education)

Even as revenues are ticking up, the state budget as approved by this year's General Assembly constitutes a continuation of Virginia's disinvestment in public education. Compared to pre-recession levels, the Commonwealth has cut K-12 education by nearly $2.6 billion dollars over the current biennium, adjusted for inflation and enrollment (see Figure 3). Adequate state support is vital in this area as it primarily funds pre-K through 12th grade education across the state.

The federal Recovery Act provided more than $741 million dollars in additional support for local school districts, colleges, and universities this year. These funds offered needed state fiscal relief in the midst of historic recessionary declines in state revenues and prevented cuts from being even worse. Yet, even with the extra help, K-12 funding levels in Virginia are still 16 percent below pre-recession levels.

Figure 3: K-12 Education



Cuts of this magnitude are resulting in increased class sizes, reductions of services and educational programs, and layoffs of teachers and support personnel throughout the state.

Unfortunately, the fiscal relief provided by the Recovery Act is coming to an end. And rather than using recent increases in state revenue to restore some of these cuts, Virginia's lawmakers chose to reduce funding for K-12 education this year by $25 million dollars compared to the budget the General Assembly passed last year.

The state has cut K-12 education by nearly $2.6 billion dollars over the current biennium.

Among the many amendments to this area of the budget are reductions in state support for several key programs and services including:

- Textbooks for students: $5.9 million cut. The budget reduces the amount allocated per pupil from $48.38 to $40.56.
- State Operated Educational Programs: $1.2 million cut. This budget reduces funding for local and regional detention facilities to provide educational services for kids in custody.
- Project Discovery: $68,580 cut. Project Discovery is a local guidance counselor program that serves more than 29,000 low-income students. Over 85 percent of the kids they serve attend local colleges and universities.

By cutting state support, the budget shifts costs to local school divisions at a time when they have already endured several recessionary cuts. With a tepid recovery and declining property values, it will be hard for localities to make up for losses in state support.

Additionally, the General Assembly redirected some education funds. In 1999, Virginia legislators made a commitment to use state lottery funds to supplement ongoing general fund support for education. But this year, with high lottery proceeds expected, lawmakers decided to replace some general fund education money with the supplemental lottery money.

The budget passed this year makes it clear that investing in our children's schools was not a priority of the General Assembly. With Recovery Act money no longer available next year and the inability of local school divisions to fully shoulder more of the costs, there likely will be additional future cuts.

Investment in Health and Human Resources

Virginia's current level of investment in Health and Human Resources (HHR) has fallen significantly below where it was before the recession. In other words, when you adjust for the rising cost of health care and increasing enrollment in Medicaid due to the recession, Virginia faces a gap in current spending compared with pre-recession spending. Figure 4 shows that in order to provide the same amount of services as prior to the recession, Virginia's HHR spending should have been at least $400 million more in this and next year than is actually funded in the budget.

Virginia's Medicaid program and other HHR programs have been under significant pressure during the recession as repeated attempts have been made to cut services at a time of increased demand. Before adjusting for rising health care costs and enrollment, general fund spending in HHR has actually increased by about $1 billion since 2007. Yet this increase is primarily driven by Medicaid enrollment increases as more Virginians qualify for the program, not by increased reimbursements or services. Medicaid is a counter-cyclical program; as the economy worsens, enrollment increases. When economic conditions improve, program enrollment and spending stabilize or even decline.

Increased general fund spending on Medicaid is matched by at least 50 percent in federal matching dollars, which brings billions of additional dollars into the state economy. With the increased federal Medicaid money included in the Recovery Act, the federal portion of Virginia's Medicaid funding increased from 50 percent to over 60 percent during the past two budget years.

Even though overall spending increased in recent years due to upticks in enrollment in Medicaid, Virginia has cut parts of the Medicaid program in order to reduce overall spending growth. Impacts include:

- **Cuts in Payments to Hospitals**, Nursing Homes and other Providers: The budget passed this year maintains the 4 percent cut to payments for hospital outpatient care and hospital/nursing home capital costs. These cuts could have an impact on access to care. According to hospital-provided data, Virginia Medicaid payments cover less than 65 percent of hospital costs for treating Medicaid patients, down from 75 percent pre-recession. Further cuts could reduce access to care for some Medicaid recipients.

  The 4 percent reduction in payments for in-patient hospital care, nursing home operating costs, and for doctors and dentists, however, were reversed.

- **Reducing Respite Care Hours:** The current annual limit for Medicaid waiver respite care hours per person will be reduced from 720 to 480 hours beginning in July 2011, an almost $8 million general fund cut. This reduction will increase the burden on Virginians caring for people with disabilities. These Virginians rely on respite services to cope with the tremendous needs associated with caring for loved ones with disabilities.

- **Cuts to Local Department of Social Services (DSS) Offices:** The budget passed this year maintains $2.9 million in general fund cuts to local DSS offices in Virginia. Local DSS offices are essential in managing caseloads in Medicaid, TANF, Supplemental Nutrition Assistance Program and other safety net programs. Reduced funding could cause a delay in Virginians being able to access these services, especially given the increased enrollment in these counter-cyclical programs.

The Recovery Act has provided the state with more than $1.5 billion — about $650 million in this year alone — in additional Medicaid funding since 2009 to help Virginia and other states maintain their programs without restricting eligibility, reducing benefits, or cutting provider and physician payment rates. Without this funding, the cuts to Medicaid would have been far deeper. No additional federal Medicaid assistance is expected going forward, which will present the state with additional challenges in even meeting the current needs of Virginians in the program.

Figure 4: Investment in Health and Human Resources

Recovery Act Softened the Blow, But Legislators Fail to Fill Hole Left by its Expiration

An infusion of federal fiscal relief funds through the Recovery Act bolstered Virginia's general fund in the last three years, protecting the state from much worse cuts. Virginia received $3 billion in Recovery Act funding to help meet rising demands on state services, as the recession battered state revenues. This dedicated funding for health care, education, and public safety freed up general fund resources to fill holes in other critical state services.

In FY2011 alone, Virginia received $1.4 billion in flexible fiscal relief through the Recovery Act and its extensions (see Figure 5). When the Recovery Act and its extensions were passed, it was hoped that states' economies would have recovered enough by the end of 2011 that federal fiscal relief would no longer be needed. However, with the recession far deeper and longer than predicted, this is not the case.

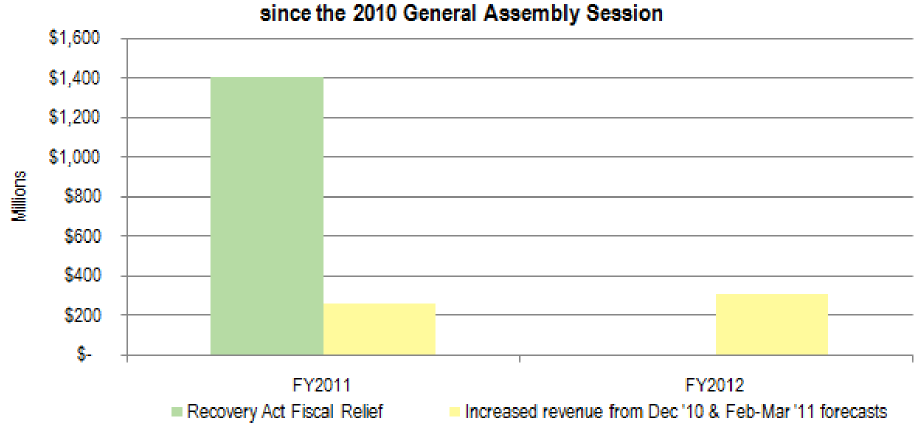
When last year's General Assembly passed the FY2011 and FY2012 budgets, general fund revenue in FY2012 was expected to be just $1 billion above FY2011 levels (not counting FY2011 Recovery Act funds), significantly less than the $1.4 billion in expiring Recovery Act funds. Furthermore, last year's General Assembly decided to dedicate the $1 billion increase to a variety of uses, rather than to the areas of the budget losing the $1.4 billion in Recovery Act funding. In the budget passed by last year's General Assembly, K-12 education faced a $450 million budget cut in FY2012 compared to the prior year, even before considering continued enrollment increases. In addition, not only is Recovery Act funding for public safety and higher education disappearing in FY2012, the General Assembly also chose to make further cuts in those key areas, resulting in $55 million and $286 million in cuts, respectively, compared to the prior year.

The General Assembly and Governor are not targeting new state revenues for education and health care, as the bulk of the Recovery Act did.

With revenues returning to Virginia at a slightly faster than expected rate, this year's General Assembly had the opportunity to restore some of last year's cuts to K-12 education, public safety, and higher education. However, Virginia's lawmakers chose to use just a fraction of the small amount of returning revenue to backfill these key areas, while funding tax policy changes, business incentives, and other purposes. K-12 education, public safety, and higher education received just $49 million, $35 million, and $87 million of the returning revenue, respectively, leaving deep holes in these key areas of Virginia's FY2012 budget. Only in the area of Medicaid, where recession-related enrollment increases continue driving sharp increases in costs, does the returning revenue in the budget fill in the hole left by the expiration of Recovery Act funds.

Disappearing Act: Returning Revenue No Match for Recovery Act

Figure 5: Recovery Act fiscal stabilization funding and adjustments to revenue since the 2010 General Assembly Session



Source: TCI Analysis of the 2008-2010 Biennial Budget, presentations by the Sec of Finance, & letters from the Governor.

Conclusion

The level of state investment in key public services such as education and health care remains billions below pre-recession levels. Between a slow economic recovery and the expiration of federal Recovery Act funds, the situation looks grim. The continued revenue hole in the state budget means costs are being passed down to Virginia's families, localities, and businesses through policies such as increased tuition, decreased road maintenance, and cuts in aid to localities. To make matters worse, as revenues have begun to rise, Virginia's legislators have dedicated the returning revenue to a variety of different purposes, rather than restoring funding in the key areas for which the Recovery Act provided support.

The Commonwealth Institute

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