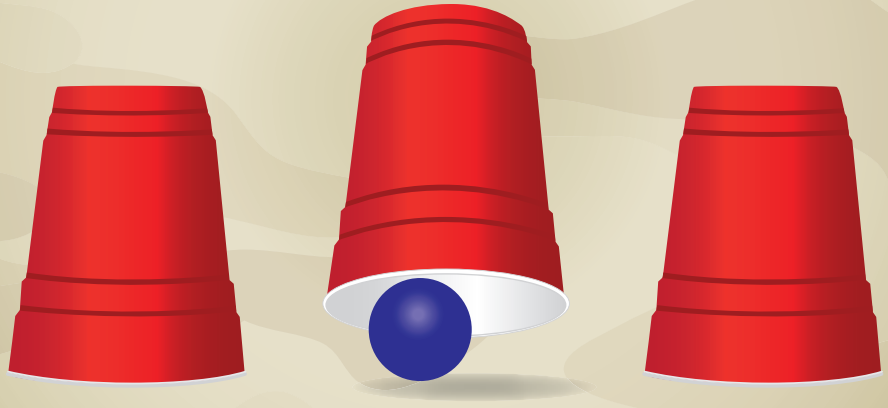
SHELL GAME

Virginia Balances its Budget with Cuts and Accounting Sleights of Hand



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Shell Game

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For 10 of the last 12 years, legislators have addressed budget shortfalls through an array of tactics including deep spending cuts to public services, drawing down the "rainy day fund," and using federal Recovery Act money.

But Virginia lawmakers also relied heavily on an array of budget gimmicks, accounting sleights of hand, and one-time deals in order to make the budget gap vanish. On top of that, for every gimmick actually enacted, still more were attempted in an effort to avoid dealing with the real underlying problem facing Virginia: there isn't enough revenue to invest adequately in education, transportation and other public services that underpin our prosperity.

But the problem has not gone away. This paper exposes the great lengths policymakers have gone to avoid addressing Virginia's revenue problem at great risk to our economic future. In addition to cutting programs, spending down the "rainy day fund," and using one-time Recovery Act money, Virginia lawmakers have resorted to:

Going Further Into Debt – Though many legislators decry the amount of borrowing done by the federal government, Virginia uses public debt to balance its own budget at significant cost.

Changing the Calendar – For most of us there are only 12 months in a year, but the General Assembly found a way to conjure up a 13-month year in 2010.

Robbing Peter to Pay Paul – In addition to using one-time funds for ongoing expenses, Virginia has taken money intended for one purpose and used the bulk of it for something totally different.

Grasping at Straws – The state needs a dedicated source of funding for transportation, yet proposals to fund this core public service avoid the only real solution: new revenue.

Changing the Calendar

For years Virginia has manipulated budget timetables and the flow of resources between different parts of the budget in an effort to make the budget numbers come out right. This has allowed Virginia to rely on next year's resources to pay this year's bills, according to a new national evaluation of state budget practices.[1] The problem with these approaches is that at some point, the state will have to pay the piper. When we do, unwinding the gimmicks will be a big blow to state finances.

During the 2010 session, for example, the General Assembly changed the way certain retailers remit sales taxes that customers pay at the register. Before the change, those retailers sent the taxes to the state at the end of each month. Lawmakers changed the rules to require retailers with annual sales of over $1 million to estimate their future sales for one month and send in that estimated tax a month early. They called it the Accelerated Sales Tax. With this trick, the legislature created 13 months of tax receipts in a 12-month year and booked an estimated $227.7 million. But that trick came at the expense of following years.

At the time they made the change, legislators said they intended to phase out the policy slowly from 2013 through 2021. But they started phasing it out early, and while phasing it out will gradually eliminate the 13-months-in-a year fiction, it will cost the Commonwealth over $100 million in reduced revenue. In other words, despite the one-time budget boost, we're back to where we started.

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Going Further Into Debt

In addition to short-term gimmicks, Virginia has used public debt to balance the budget. But funding today's public investments with dollars that have to be paid back with interest is expensive. Debt service has grown to be the 6th largest expense in the general fund. Moreover, going further into debt to balance the budget does not address Virginia's underlying fiscal challenges. It only guarantees that the problems will continue.

In 2011, the General Assembly approved a transportation funding package that relied heavily on borrowing. To fund current projects, legislators borrowed against future federal transportation funds, essentially deferring the costs to a later date. While this scheme provides a much-needed infusion of funding for current projects, it reduces the state's capacity and flexibility to meet future needs by obligating more of Virginia's future federal transportation funds to paying off the debt.

Virginia has also mortgaged the future of our public employees by deliberately underfunding the Virginia Retirement System (VRS). In 2010, the General Assembly reduced the state's funding of the state employee retirement and benefits system below levels recommended by the system actuaries. This included delaying or suspending a whole fiscal quarter of contributions for state employees and teachers; reducing the state's retirement and benefit contributions below the actuary-recommended levels for two years.

[1] Report of the State Budget Crisis Task Force, released July 17th, 2012, Pg. 57-60:
http://www.statebudgetcrisis.org/wpcms/wp-content/images/Report-of-the-State-Budget-Crisis-Task-Force-Full.pdf

While these actions resulted in savings of over $150 million in the 2008-2010 two-year budget, and over $700 million in the 2010-2012 budget, bringing those budgets to balance, they also significantly underfunded the retirement system and increased the system's unfunded future liability which the state still has to pay. Underfunding the retirement system isn't a new tactic; Virginia has been deliberately paying less than the recommended rate for years, resulting in underfunding of $3.2 billion between 2001 and 2011.

All this borrowing is expensive to repay. In 2011, for example, Virginia paid $42 million to make up for the 4th quarter VRS payments it previously skipped, and another $34.2 million to restore 4th quarter payments to the recommended level. Virginia also spent $31 million to increase its contribution rate for teachers to 6.33 percent, still significantly under VRS board certified level of 12.91 percent.

On top of all this, Virginia maxed out its debt capacity in 2009 for the first time ever, due to the recession and several years of significant borrowing. As a result, Virginia raised its debt ceiling, a sign of lawmakers' desperation to manufacture additional resources without increasing revenues. This change is the equivalent of a family upping the borrowing limit on their credit cards to make ends meet.

Since the inability to borrow more money or raise more revenue could be viewed as a weakness by credit rating agencies, legislators changed Virginia's debt capacity model in 2010 to allow the state to borrow more. In essence, instead of dealing with the problem of insufficient revenue, Virginia approved itself for another credit card.

As a result, Virginia increased its ability to borrow by approximately $466 million this year and beyond.

Robbing Peter to Pay Paul

In addition to changing the calendar, shortchanging retirees and going further into debt just to balance the budget, Virginia has taken one-time federal money intended for one purpose and used the bulk of it for something totally different.

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The $25 billion national mortgage settlement reached last winter between the federal government and five of the largest loan servicers resulted in a $65.9 million payment to Virginia While the money was intended to be used for housing-related programs, the state's Housing Trust Fund received only $7 million. The bulk of the one-time settlement – roughly $58.9 million – will be used to meet education costs related to inflation, retirement, and the Virginia Preschool Initiative. These are ongoing needs being funded with one-time money.

Diverting sales tax revenue – revenue normally used for schools, public safety, and health care for seniors and low-income Virginians – to fund transportation projects is another example of this type of gimmick. The governor's transportation proposal has relied on this tactic for the past two years in an effort to support critical transportation maintenance and construction without bringing in new revenue. The governor's most recent plan would have diverted about $94.6 million over the next two years, rising to $240 million a year by 2020, when the plan would have been fully implemented.

Although the proposal has failed twice, the reluctance of legislators and the governor to generate new revenue for transportation makes it highly likely that the diversion scheme will resurface. If it is ever enacted, transportation would compete with K-12 education, Medicaid, public safety and all other programs and services funded through the general fund, reducing the resources available for those programs, rather than getting transportation funding on a sound, forward-looking footing.

Virginia needs an effective long-term plan for balancing our state budget.

Grasping at Straws

Of all the funding needs that legislators face each year, transportation has been a perennial problem that showcases the extent of the gimmicks lawmakers will use to avoid dealing with the real problem. The transportation package passed in 2007 and the "abusive driver" fees it contained – since repealed – are prime examples.

As part of the 2007 package, the General Assembly approved new fees for crimes like reckless driving or driving under the influence. Because the money was intended to fund road maintenance, they were enacted as "civil remedial fees" rather than fines, which are designated for education. Ranging from $750 to $3,000 per offense, these fees were expected to yield about $65 million a year for transportation. The fees sparked public outrage because of their high cost and a legal technicality that prevented them from being collected from out-of-state drivers. Their unpopularity, combined with legal challenges over their constitutionality, prompted lawmakers to repeal the fees in 2008, with full refunds available for any fees paid up to that point.

Governor McDonnell's plan to sell off the state's liquor stores is another example of the great lengths lawmakers will go to avoid addressing ongoing funding challenges. In 2010, Governor

McDonnell proposed privatizing Virginia's highly profitable Alcoholic Beverage Control stores to generate a one-time infusion of cash for transportation projects. Beyond the revenue from the sale, a cocktail of new excise taxes and fees were estimated to replace 94 percent of the general fund revenues from the ABC store system. The proposal faced substantial criticism from both parties on financial and ideological grounds, but it may resurface as the state continues to struggle with funding transportation.

Finally, the recently passed measure allowing the state to sell naming rights for roads and bridges does little for Virginia's transportation funding problem. The state is expected to charge $5,000 to $200,000 for the right to name a road or bridge, bringing in an estimated $5 million to slightly over $100 million annually (if all eligible roads and bridges are named). Yet, we face a funding crisis well beyond $860 million for 2012-2014 just for maintenance and operation.

Conclusion

Virginia needs an effective long-term plan for balancing our state budget – without gimmicks, without turning to costly borrowing, and without risking our future.

The gap between the resources we need to support our modern and growing state with a booming population and growing demands for roads, sewers and other infrastructure has created annual budget shortfalls for more than a decade. Yet the state has ignored the problem, imagining we can cut, borrow and contrive our way to prosperity. Lawmakers have played games with existing resources in a desperate move to avoid talking about real solutions to our revenue problem. That kind of shell game is unsustainable.

The recent recession isn't to blame for the problems, but it has exposed the flaws in balancing our budget by focusing only on the short-term. When the economy turns around, we'll still be faced with the same problems that we've ignored for decades. It's time for legislators to put all the cards on the table and get serious about long-term solutions.

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