An Opportunity for Progress

Some Available Revenue, but Bigger Needs

By Laura Goren and Michael Cassidy

Virginia is likely to take in about $750 million more in revenue over the next two years than the cost of continuing Virginia’s current inadequate level of public investment during those same two years.

However, that is far less money than is needed to get Virginia back on the track to solid economic growth and broad prosperity.

Optimistic talk in Richmond about improving budget conditions needs to be tempered by the understanding that having a little more money than the prior year isn’t the same as having more than – or even as much as – we need.

Even including the $750 million, Virginia will not have enough money to fix its schools, bring class sizes back down to reasonable levels, rein in the shift of college costs onto students, provide a reasonable level of care for seriously disabled adults, and fully unwind recession-era gimmicks.

Fully meeting the state’s longtime commitments in the area of K12 education would, alone, cost more than the projected available revenue. With all these important priorities competing over a small pot of money, the growing calls to cut taxes are unwarranted at this time, and if anything a need for a serious look at new revenues is needed.

A Positive Technical Forecast for Virginia’s Budget

Due to Virginia’s slowly growing economy, general fund revenue is expected to grow about 3.1 percent this year, 2.8 percent in the budget year that starts July 1, 2016, and 3.7 percent in the year after that. That would give the state almost $3.4 billion in additional general fund revenue over the course of the two-year budget than is included in the current budget.

Some of that revenue will be needed to make up for the fact that Virginia will no longer be pulling resource from the rainy day fund, but on the plus side Virginia may end the current year with some surplus money that can be carried over into the next year’s budget.

For years when the economy was depressed, people’s incomes and their spending failed to grow as much as usual. This meant less revenue to meet important state needs, low levels of public spending on schools, communities, and families, and, therefore, a low baseline for projecting the state’s future spending needs.

Methodology Note

The Commonwealth Institute updated the state’s FY2015-2020 six-year financial plan (published Jan 2014) with actual FY2016 budget appropriations from Chapter 665, Acts of Assembly 2015. TCI then applied to the new base the spending growth estimates from the six-year financial plan (with adjustments where more up-to-date estimates were available). These estimates are then compared to expected general fund revenue, which is based on estimated actual FY2015 revenue collections and the growth rates assumed in the current state budget for FY2016 and the Secretary of Finance’s December 2014 projections for FY2017 and FY2018.

IN BRIEF

The Forecast

Virginia is expected to take in about $750 million more in revenue over the next two budget years than it will cost to maintain the status quo for K-12 schools, higher education, health care, and the other services for which state revenues are used.

The Problem

The status quo is well short of what Virginians need. The positive forecast is not enough money to:

- Stop ignoring the real costs of providing a quality education and restore support for K-12 schools, fix the buildings, and reduce class size, among other things. Cost: At least $1.1 billion over the next two years.
- Restore support for public colleges and universities so that students and their families are not paying an unfair share of the cost. Cost: $1.2 billion to meet pre-recession levels; fully meeting the state’s commitment to supporting Virginia students at public colleges would cost more.
- Unwind the accelerated sales tax gimmick that makes retailers pay some of the next year’s sales tax revenue during the current fiscal year. Cost: about $195 million.
- Keep up with ongoing inflation and population growth in other budget areas. Cost: About $650 million.

Taken together, the cost of meeting these important needs dwarfs the forecasted $750 million in available revenue.

The Solution

It is important that policymakers take this opportunity to start moving the state back toward meeting its longtime commitments to our state’s families and communities. This will require the wise investment of existing revenue. Avoiding significant tax cuts is important for preserving this opportunity to make some progress on these critical issues.
Using the current yet insufficient budget as the baseline, meeting the state’s basic requirements in education and health care while maintaining current spending in other areas will cost the state $2.67 billion more over the course of the next budget than the state is spending in the current budget.

Including all the factors – estimated leftover balances from a strong end to the current budget year, reasonable revenue growth over the next two years, and cautious estimates that only increase costs where required to meet Virginia’s basic obligations – budget writers should have about $750 million more than it will take to meet Virginia’s obligations in 2017 and 20181 – if those obligations are viewed in a way that ignores the fact that the budget is not currently meeting the state’s needs.

But Virginia Faces Many Challenges
What’s not included in that forecast is the cost to undo recession-era budgeting gimmicks and bring state support for education and health care back to what it takes to meet today’s needs. Taken together, the cost of meeting these important needs is far higher than $750 million.

It is important that budget writers take the opportunity of this expected financial breathing room to move the state back toward meeting its longtime commitments to education and the state’s families and communities.

Restoring state support for public education alone would take all of the forecasted available revenue. Since the state won’t release estimates on the money needed to meet growing school enrollment and inflation – a process called SOQ rebenchmarking – until September, the K-12 forecast in this paper assumes the predicted annual percent increases that were estimated in the state’s January 2014 budget forecast. Based on this, state direct aid for K-12 schools is expected to increase by $372 million in the budget year that ends June 30 2017 and $453 million the following year, for a combined increase of $825 million over this year’s funding.

To restore per-student direct aid funding to the 2009 level – a level just before policymakers engaged in a round of changes to the school funding formula in order to ignore many types of school costs and artificially drive the cost down – would require an additional $1.9 billion across the two upcoming budget years. That’s an extra $1.1 billion that’s needed during this budget period, above the $825 million already included in the forecast, just to restore per pupil direct aid support to prior levels.

Similarly, the state’s six-year budget forecast, which is the basis of this paper’s forecast, assumes increases in funding for higher education of about $50 million in the budget year that ends June 30, 2017 and $100 million the following year over this year’s levels.

But to get Virginia back to where we were before the recession in terms of public support for in-state students at our public colleges and universities would require more significant investments.

Virginia is providing 28 percent less this year in per in-state student public support for Virginia’s colleges and universities than was provided in 2007, after adjusting for inflation. This has resulted in the colleges looking to tuition increases to maintain services, and Virginia’s students and their families are shouldering a far higher share of the costs of a public college education than in the past.

The Outlook: A Little Available Revenue
Virginia should have slightly more in revenue than the cost to continue current low budget levels

Forecasted general fund revenue and costs, fiscal years 2015 to 2018, Billions of dollars

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Note: Carryover balances are shown in revenue for FY2015 but not future years, but some FY2015 surplus revenue is set aside to meet rainy day fund deposits due FY2017, and a similar set-aside may occur at the end of FY2016.

Assuming college enrollment stays at 2014-2015 levels, getting back to the pre-recession level of per pupil public support for higher education would require $685 million per year—almost $1.4 billion over two years. That’s $1.2 billion more for the upcoming two-year budget period than the $150 million assumed in the forecast.

The situation is similar with regard to Virginia’s investments in a healthy population. Necessary changes to Virginia’s Medicaid waiver program for individuals with intellectual and developmental disabilities—critical changes that are needed to help seriously disabled adults live with dignity in the community and to help meet the terms of a settlement with the Department of Justice over the violation of their rights—is expected to cost an additional $40 million over the next two budget years.

And outside of these major budget areas, making sure the state’s support in many other areas that help the public—like state parks, public health, and social services—keeps up with inflation and population growth over the next two years would cost about $650 million more than what is included in the budget forecast used for this paper.

And still there are gimmicks to unwind and reserves to restore. Policymakers were working to unwind the accelerated sales tax—a gimmick that requires some retailers to send to the state 13 months of sales tax revenue during a single 12-month period—but then expanded it instead. Completely unwinding it at this point is likely to cost about $195 million.

Similarly, the recent draw-down of money from the state’s “rainy day fund” means it’s far from poised to help Virginia get through the next economic downturn. There’s a formula that governs when deposits into that fund must be made, and Virginia policymakers have generally set aside money in advance to meet them in a responsible fashion. If the state’s revenue growth ends up being significantly better than expected, a major chunk of that increased revenue will be required to be deposited into the rainy day fund. But if revenue doesn’t bounce back at a strong pace, policymakers will need to make hard choices to make sure the rainy day fund has enough money in it to supplement the state’s budget in an economic crisis.

**Looking Forward**

A positive budget forecast is a nice change from the years of predicted shortfalls, but we’re not out of the woods yet.

Even with this $750 million, Virginia will not have enough revenue to meet the state’s real needs. And various proposals to cut taxes could once again put Virginia deep into the red.

Virginia is a relatively well-off state with an economy that is finally growing again. We have the capacity to make sure every community in the state has the top-quality schools and services that our families and economy need. It will require a commitment to K-12 schools, public colleges, and everything else that builds a strong economy. We can’t afford to do anything less.