Virginia's Budget Growth

FY 1996 to FY 2006:

A Decade of Change

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Economic cycle and policy choices

- Virginia's budget picture at any point is influenced by the portion of a business cycle that it covers, along with policy choices.
  - The decade between FY 1996 and FY 2006 reflects a peak-to-peak business cycle.
    - FY 96 was the beginning of the "dot-com" run-up that produced double-digit revenue growth in late 1990's;
    - Slowed growth and recession followed in the middle of ten-year period;
    - Back to double-digit revenue growth in post-recession expansion.
  - The decade also reflects a number of policy changes:
    - "Rainy Day Fund" deposits
    - Parole reform
    - Welfare reform
    - Car Tax relief
    - K-3 education reform
    - Lottery profits shared with localities
    - 2004 tax reform

Budget Growth – All Funds

- Between FY 1996 and FY 2006, Virginia's population increased by almost a million people, or roughly 15 percent.
  - In recent years, Virginia has been the 11th fastest-growing state in the nation.
- Between FY 1996 and FY 2006, overall inflation was 33 percent.
- Over this ten-year period, Virginia's operating budget (all funds) grew 96 percent.
  - The inflation and population-adjusted growth was 28.8 percent, an average annual growth rate of 2.6 percent.
- When tracking Virginia's budget growth, it is more meaningful to focus on the general fund (GF) alone.

Growth in NGF can be misleading . . .

- Nongeneral funds (NGF) are fees or dedicated revenues collected for a specific purpose; they provide little budget flexibility because they can't be shifted to something else.

- Two thirds of NGFs come from:
  - Federal grants;
  - Research contracts;
  - College tuition;
  - Hospital fees.

- About 80 percent of NGFs are accounted for when unemployment payroll taxes and transportation taxes are added.

- Motivation is different with NGFs; in some cases, bigger is better:
  - Increased federal grants/reimbursements allow Virginians to benefit from the federal taxes they pay.
  - "Growing" research dollars has a positive impact on the economic health of the Commonwealth.

Growth in NGF can be misleading . . .

- Often, changes in the NGF budget are technical in nature:

  - State budget serves as a “pass-through” or “convenience” account.
    - Child support collections for non-welfare children - welfare reform increased collections from $162 million in FY 96 to $593 million in FY 06; state does not use the funds but acts as collection agent for custodial parent.
    - Tobacco Master Settlement agreement – 60 percent of the funds are collected by state and passed through to the TICR and Tobacco Settlement Foundation.
    - Unemployment compensation funds which rise and fall with the economic climate are held in trust for payments to the unemployed.

  - NGF accounting rules change, thereby creating artificial impression of growth.
    - VCCS federal financial aid payments were accounted for as “local” funds until recently and were not appropriated by the General Assembly; now, they are reflected in the state budget with a FY 06 amount of $103.6 million.
    - Virginia Prepaid Education Program – Previously, the state budget has not reflected “savings account” payments made to colleges on behalf of participants; current budget includes almost $100 million per year.
    - The MCV Hospital was included in the NGF budget in FY 96; today, it is an “off-books” independent authority.

Focus on the GF Budget

- Since growth in the NGF budget can be misleading and offers little budget flexibility, a budget growth analysis should focus on the GF budget.
  - GF is comprised of broad-based taxes, such as personal income, corporate income and sales tax (88 percent of GF).
  - Governor and General Assembly decide how funds are spent.

GF Budget Growth

- Between FY 1996 and FY 2006, Virginia's GF budget increased by 30.6 percent (adjusted for inflation and population), an average annual growth rate of 2.7 percent.
  - This translates to $3.5 billion in "real" budget growth over the ten-year period.
  - This is the amount that needs to be analyzed to explain Virginia's budget growth.

What comprises the $3.5 billion in "real" GF budget growth (FY 1996 vs. FY 2006)?

- **Specific policy choices (See Appendix) = $2.9 billion**
  - Rainy Day Fund deposit - $584.2 million
  - Parole abolition & sentencing reform - $117.2 million: State responsible offender growth was twice the rate of overall population growth; therefore, a portion of the Corrections growth related to policy changes.
  - HB 599 funding for police departments: Removed the funding freeze - $124.4 million
  - Car tax relief - $737.2 million
  - K-12 Educational Opportunity Initiatives - $95.2 million (K-3 reduced class size; At-risk 4's; Early Intervention Reading; school construction)
  - Lottery profits shared with localities - $160.4 million
  - K-12 SOQ revisions (w/JLARC technical adj.) - $336.7 million
  - Higher education – $61.4 million: Financial aid & TAG increases to help offset rising tuition
  - Higher education - $122.1 million: First step toward base adequacy
  - Chesapeake Bay "clean-up" - $153.9 million
  - Higher debt service from increased use of bonded debt during recession - $191.2 million
  - HHR initiatives - $132.5 million (FAMIS child health care; Medicaid provider rate increases; MR waiver slots to reduce waiting lists)
  - Increased GFs for transportation - $143.4 million
  - Miscellaneous – ($72 million) – Net budget reduction from end of Harper retiree settlement payments, transfer of tobacco tax to Va. Health Care Fund and increase in sheriff deputy staffing standard to 1:1,500.

What comprises the $3.5 billion in "real" GF budget growth (FY 1996 vs. FY 2006)?

- Beyond the $2.9 billion for specific policy choices, inflation in two of the largest GF programs exceeded the "market basket" rate of overall inflation (CPI):
  - **Medical care inflation was over 50 percent higher than overall inflation = $204 million**
    - Medical care inflation was 51 percent versus 33 percent for overall inflation; therefore, a portion of Medicaid costs were uncontrollable costs that exceeded the general inflation-adjusted numbers.
    - Virginia was under a federal court order to increase staffing and funding of its mental hospitals during the period.
  - **SOQ re-benchmarking increase above inflation and population-adjusted growth = $471.2 million**
    - Re-benchmarking cost is heavily influenced by teacher salaries/fringe benefits.
    - Bureau of Labor Statistics reports that Employment Cost Index was 3.1 percent during the ten-year period, about ½ percentage point higher than CPI.
    - Teacher salaries in Virginia grew by an average of 3.0 percent per year, raising Virginia's national rank from 27th to 20th.
    - This annual ½ percent increment in salary inflation above CPI explains part of the "real" re-benchmarking cost.

Summary

- After adjusting for inflation and population growth, Virginia's GF budget increased by $3.5 billion over the ten-year period 1996 to 2006, an overall growth rate of 30.6 percent, or average annual growth rate of 2.7 percent.

- $2.9 billion, or 82 percent of this "real" budget increase, is explained by specific policy changes primarily in education, health care, public safety and tax relief (See Appendix for details).

- Much of the remaining $600 million is explained by inflation increases that were higher than the CPI.
  - Health care inflation was 55 percent higher than CPI;
  - Teacher salary increases reflected the Employment Price Index, which was ½ percentage point higher than CPI over the ten-year period.

Appendix - Details of Major Policy Changes

- Rainy Day Fund Deposits
  - Constitutionally-required deposit is made to the Rainy Day Fund for fiscal years that have revenue growth above a six-year average.
    - Half of the above-trend growth is deposited to the Fund in the second fiscal year after it is collected.
  - RDF provides a revenue cushion for economic downturns; half of a budget problem can be addressed through a RDF withdrawal.
    - $715.2 million was withdrawn during the last recession.
  - Annual deposits are highly variable, with the largest deposit of $584.2 million being made in FY 2006.
    - Large deposits in recent years have placed the Fund at its Constitutional maximum.
    - The RDF is projected to reach $1.3 billion by the end of current biennium.

Appendix - Details of Major Policy Changes

- Parole Reform
  - In 1994 Special Session, the General Assembly abolished parole for certain crimes and enacted sentencing reform.
    - The Virginia Sentencing Commission developed guidelines for uniform sentencing.
    - Additional prison capacity was authorized.
      - $273.0 million was spent under the 1994 plan to add 6,398 beds.
      - FY 2006 operating cost for these additional beds was $117.2 million.

Appendix - Details of Major Policy Changes

- Welfare Reform
  - The 1995 General Assembly adopted welfare reform placing emphasis on work-related activities to foster independence.
    - 1st phase of welfare reform was implemented in FY 1996.
    - Over the 10-year period 1996 to 2006, TANF cash assistance payments declined to about half the 1996 level.
    - Conversely, employment-related costs increased, i.e., job training, transportation and day care.
    - Overall, the GF cost for direct welfare-related assistance decreased 23 percent.
    - Budget growth occurred on the NGF side as emphasis was placed on collecting support enforcement payments for non-welfare children.
      - Support collections increased from $162 million to $593 million.
      - State became collection agent for custodial parent, serving as "pass-through" for funds.

Appendix - Details of Major Policy Changes

- Car Tax Relief
  - The 1998 General Assembly approved a phased assumption of local car tax bills on behalf of local taxpayers.
    - First $20,000 in vehicle value for personal use vehicles
  - Initial state appropriation was $164.9 million in FY 99
    - Phased reimbursement was to move from 12.5 percent to 100 percent in five increments.
    - Reimbursement was frozen at 70 percent of bill in early 90's due to economic recession.
    - Appropriation was capped at $950 million per year in 2004 session, as part of tax reform package.
      - FY 2006 appropriation of $737.2 million reflected a shift in payment dates and was the transition year between the original and new capped program.

Appendix - Details of Major Policy Changes

- K-3 Education Reform
  - Several efforts were undertaken in mid-to late 90's to address perceived disparity in educational opportunity:
    - Virginia Preschool Initiative for At-Risk Four-Year-Olds: State funding for at-risk children not served by Head Start or other pre-school programs.
    - Early Intervention Reading: Early diagnosis and remedial help for students with reading problems.
    - School construction: Per pupil grants for capital improvements.
    - K-3 Class Size Reduction: Reduced class size in the early years, with special emphasis on schools with high concentrations of low-income students.
    - SOL Algebra Readiness: Math intervention in grades 6 through 8, based on diagnostic test results.

Appendix - Details of Major Policy Changes

- Lottery profits shared with localities
  - Lottery profits were specifically allocated to public education in 1999 session (applied toward state match of SOQ).
    - Constitutional amendment ratified November 2000, to be effective July 1, 2001.
  - Subsequent action by General Assembly sent 40 percent of lottery profits directly to localities for public education, with at least half to be used for capital purposes.
    - FY 2006 amount of $160.4 million was distributed to localities based on the school division's proportion of enrollment, weighted by composite index.
    - Resulted in GF increase to replace this amount that previously had been applied toward the state share of SOQ cost.

Appendix - Details of Major Policy Changes

- 2004 Tax Reform
  - Tax relief for Virginia families
    - Raised personal exemption
    - Eliminated “marriage penalty” in standard deduction
    - Raised filing threshold
    - Removed “cliff effect” of low-income tax credit
    - Reduced sales tax on food by 1 ½ percent
  - Tax equity
    - Applied means test to age deduction
    - Eliminated corporate tax loopholes and public service sales tax exemption.

Appendix - Details of Major Policy Changes

- 2004 Tax Reform
  - ½ percent increase in non-food sales tax
    - Half dedicated to K-12 Local Real Estate Tax Relief Fund to reduce pressure on local property taxes
  - Increased recordation tax 10 cents/$100 value
  - Tobacco products user tax increase dedicated to Virginia Health Care Fund for Medicaid match

Appendix - Details of Major Policy Changes

- 2004 Tax Reform
  - Produced roughly $500 million/year GF (FY 2006)
    - SOQ revisions: Funded four of eight SOQ revisions proposed by Board of Education ($220.3 million);
    - JLARC recommendations: Corrected K-12 funding formula error and ended one-month rollover of fringe benefit costs ($44.3 million)
    - Expand funding for At-Risk 4's Preschool from 60 percent of those not served by Head Start to 100 percent ($30.3 million)
    - First step of Higher Education base adequacy ($122.1 million)
    - Reduce MR waiting list for community services: 700 waiver slots ($35.0 million)
    - Chesapeake Bay wastewater construction initiative ($50.0 million)
    - State Police radio system debt service ($10.1 million)
  - Produced roughly $200 million/year NGF from tobacco tax increases for Virginia Health Care Fund