

# Virginia's Budget Options



Virginia First Cities Coalition



Fiscal Analytics, LTD

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# Economic Outlook for the 2022-24 Biennium



*Who knows the answer to these questions: Where is inflation headed? Will there be a recession and if so, how bad? How will the war in Ukraine end? What is going to happen in Taiwan? What policies will be enacted by the new Congress and President?*

*“There are two kinds of forecasters: those who don’t know and those who don’t know they don’t know.” -- John Kenneth Galbraith*

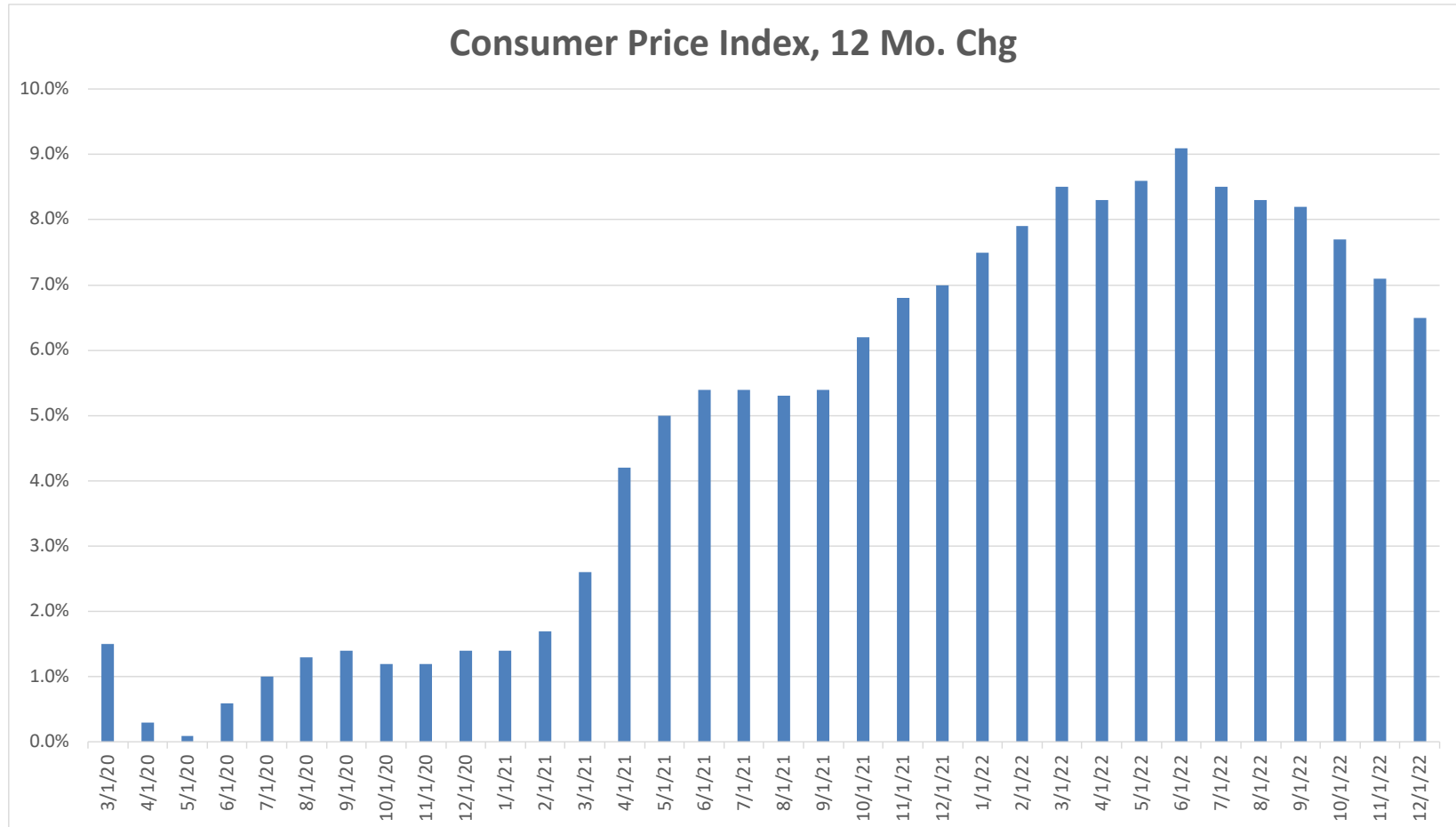
- Federal Reserve is tightening monetary policy and raising the risk of a recession in the 2022-24 biennium. Fed only has the blunt tools of raising interest rates and removing liquidity from the financial system to balance supply and demand. Which will...
  - Reduce aggregate demand for durable goods, such as autos and homes purchases.
  - Lower asset values for stocks, bonds, and homes, and reduce the “wealth effect”.
  - Increase the exchange rate for the dollar, which increases purchasing power to reduce inflation.
- Will Federal Reserve actions to reduce inflation result in a “soft landing” or recession? Soft landings very hard to achieve...
- Rising interest rates, volatility in stock market, war in Ukraine, etc. will keep economic/revenue forecasts conservative in a **‘show us the money’** mode.
  - Massive deglobalization of ‘just in time’ supply chains is beginning with consequences for economies (e.g. higher prices) around the world.

# Nine Month Recession Forecast Underpins the GF Revenue Forecast



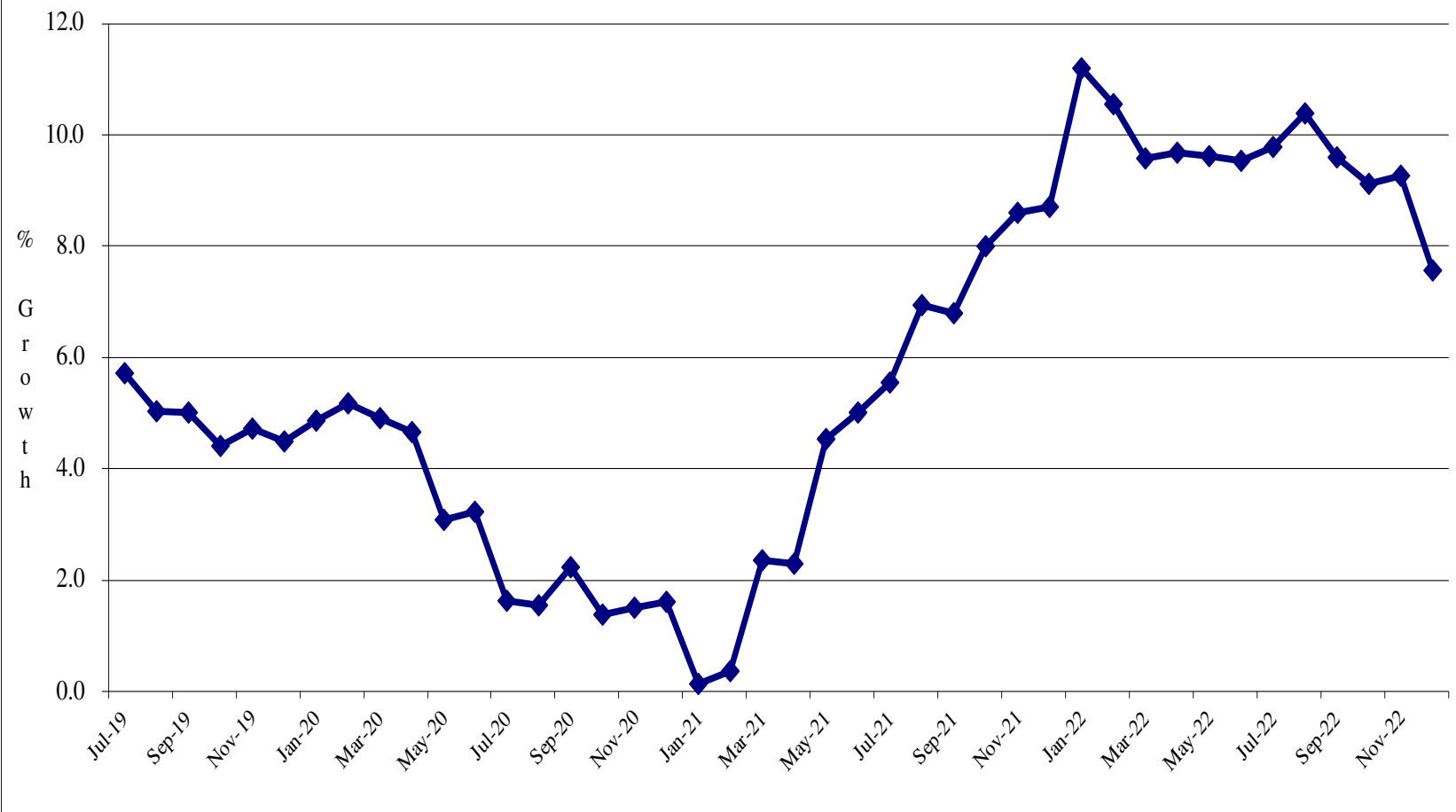
	<b>Actual</b>	<b>Forecast</b>	
	<b><u>FY 2022</u></b>	<b><u>FY 2023</u></b>	<b><u>FY 2024</u></b>
Real U.S. GDP	4.0	0.4	(0.5)
CPI	7.2	6.5	2.9
VA Non-Ag Employment	3.2	2.5	(1.2)
VA Personal Income	3.0	5.7	3.2
VA Wages and Salaries (53%)	8.0	8.3	2.6

# Consumer Prices are Slowly Declining



Source: <https://www.bls.gov/charts/consumer-price-index/consumer-price-index-by-category-line-chart.htm>

# 12 Mo. Moving Avg Income Tax Withholding Growth Remains Strong Thru December



# Expect Significantly Higher Revenues Than Ch. 2



- GF revenues through December 2022 are running slightly above the introduced budget forecast of \$2.16 billion above Ch. 2 adopted budget revenues.
- Inflation should keep *nominal* growth in withholding and sales taxes higher than otherwise for the next year or so. For example, higher cost-of-living increases for social security; raises for federal, state and local workers, and higher pay increases in the private sector.
- As usual, Virginia should fare better than the nation in an economic downturn due to its higher federal government and military economic footprint.
- Expect nonwithholding income tax revenues to decline sharply (forecast is for -25% in FY 23 and -10% in FY 24). However, note that official FY 2022 revenue forecast capped FY 2022 nonwithholding collections and did not adjust for lower refunds and thus did not include those revenues in the adopted spending budget.
- The Commonwealth also has very healthy reserves and other financial levers it can pull in the event of an unexpected revenue downturn.
  - Rainy day fund and voluntary reserves total \$4.3 bil.
  - 2022-24 budget has \$2.8 billion in GF cash for capital outlay that could be delayed or converted to debt in the event of a revenue crisis.
  - \$1.0 bil. recent GF VRS deposit in 2022-24 budget helps provides a pension cushion.

# Introduced Budget Uses a Conservative Revenue Forecast



## Comparison of 2022-24 General Fund Revenue Estimates

	<b><u>Actual</u></b> <b><u>FY 2022</u></b>	<b><u>FY 2023</u></b>	<b><u>FY 2024</u></b>	<b><u>Biennium</u></b>	<b><u>Difference</u></b> <b><u>From CH. 2</u></b>
<i>FY 2022 Actual, Chapter 2 GF Revenues</i>	\$28,935.0	\$24,871.3	\$27,263.0	\$52,134.3	
<i>SFAC Est. General Fund Revenues</i>		\$27,007.3	\$27,912.4	\$54,919.7	\$2,785.4
<i>HAC Est. General Fund Revenues</i>		\$26,835.6	\$28,193.0	\$55,028.6	\$2,894.3
<b>Introduced Budget GF Revenues</b>		<b>\$26,459.9</b>	<b>\$27,830.1</b>	<b>\$54,290.0</b>	<b>\$2,155.7</b>

# \$3.6 Bil. in New GF Resources Available for Appropriation in the Introduced Budget



- Higher projected revenues of \$2.16 billion
- Reserves released from the FY 2022 year–end balance sheet (super deposit and taxpayer reserve - \$849 mil)
- Expired appropriations the Governor is reverting to the General Fund (\$233 million)
- Additional Medicaid savings from the continuation of the federal public health emergency law (\$354 mil.)
- *70 percent of new spending proposals net of tax proposals are one-time.*



# Proposed Tax Policy Changes Reduce 2022-24 GF Revenues by \$1.0 Bil., Significantly More in Future Years



	<u>FY 2023</u>	<u>FY 2024</u>	<u>2022-24 Biennium</u>	<u>2024-26 Biennium</u>
Decrease Corporate Tax Rate from 6% to 5% (TY 23)	\$71.9	\$290.2	\$362.1	
10% QBI Deduction (TY 23)		\$162.1	\$162.1	
Reduced Individual Income Tax Top Rate from 5.75% to 5.5% (TY 24)		\$333.3	\$333.3	
Increase Standard Deduction to \$9k/\$18k (TY 24)		\$94.9	\$94.9	
Remove Age Limit on Military Retirement Subtraction (TY 24)		\$37.8	\$37.8	
All Other	<u>\$0.2</u>	<u>\$10.6</u>	<u>\$10.8</u>	
	\$72.1	\$928.9	\$1,001.0	\$2,893.0

# Adopted Vs. Introduced GF Budget by Secretarial Area (Incl. Ch. 2 Contingent Appropriations and FY 24 RDF Deposit)



	<b>Final</b>	<b>Ch. 2</b>	<b>Intro</b>		<b>Ch. 2</b>	<b>Intro</b>		<b>Biennium</b>
	<b><u>FY 2022</u></b>	<b><u>FY 2023</u></b>	<b><u>FY 2023</u></b>	<b><u>\$ Change</u></b>	<b><u>FY 2024</u></b>	<b><u>FY 2024</u></b>	<b><u>\$ Change</u></b>	<b><u>\$ Change</u></b>
Legislative and Executive	\$156.4	\$173.8	\$173.8	\$0.0	\$173.2	\$178.6	\$5.4	\$5.4
Judicial Dept.	\$547.6	\$582.0	\$582.0	\$0.0	\$582.6	\$595.9	\$13.3	\$13.3
Administration/Comp Bd	\$789.2	\$886.3	\$886.0	(\$0.3)	\$892.3	\$914.4	\$22.1	\$21.8
Treasury Board Debt Service	\$853.5	\$954.2	\$947.5	(\$6.7)	\$994.6	\$991.4	(\$3.2)	(\$9.9)
Other Finance /VRS Deposit	\$918.5	\$180.0	\$430.7	\$250.7	\$170.7	\$171.6	\$0.9	\$251.6
Rainy Day Fund Deposit	\$498.7	\$1,127.7	\$1,127.7	\$0.0	\$0.0	\$406.0	\$406.0	\$406.0
Car Tax Reimbursement	\$950.0	\$950.0	\$950.0	\$0.0	\$950.0	\$950.0	\$0.0	\$0.0
Commerce and Trade/Labor	\$488.6	\$590.1	\$976.3	\$386.2	\$549.6	\$861.0	\$311.4	\$697.6
Agriculture / Nat. Resources	\$323.0	\$636.1	\$852.0	\$215.9	\$257.8	\$657.3	\$399.5	\$615.4
K-12 Education/DOE	\$7,252.7	\$9,091.4	\$9,258.3	\$166.9	\$8,611.7	\$8,887.1	\$275.4	\$442.3
Higher & Other Education	\$2,582.1	\$2,960.3	\$2,960.7	\$0.4	\$3,082.1	\$3,129.0	\$46.9	\$47.3
DMAS Medicaid	\$4,409.1	\$5,540.8	\$5,057.9	(\$482.9)	\$5,948.4	\$6,140.6	\$192.2	(\$290.7)
Other Health & HS	\$2,408.4	\$2,606.2	\$2,581.4	(\$24.8)	\$2,710.8	\$2,912.8	\$202.0	\$177.2
Public Safety & Veterans/HS	\$2,292.3	\$2,504.3	\$2,504.3	\$0.0	\$2,504.2	\$2,611.2	\$107.0	\$107.0
Transportation	\$342.5	\$51.5	\$201.5	\$150.0	\$110.0	\$110.5	\$0.5	\$150.5
Central Appropriations	\$336.2	\$451.1	\$441.5	(\$9.6)	\$732.5	\$959.1	\$226.6	\$217.0
Cash Reserve	\$650.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Independent Agencies/Capital	<u>\$621.1</u>	<u>\$1,964.6</u>	<u>\$2,240.1</u>	<u>\$275.5</u>	<u>\$218.2</u>	<u>\$547.2</u>	<u>\$329.0</u>	<u>\$604.5</u>
<b>Total GF Appropriations</b>	<b>\$26,419.9</b>	<b>\$31,250.4</b>	<b>\$32,171.7</b>	<b>\$921.3</b>	<b>\$28,488.7</b>	<b>\$31,023.7</b>	<b>\$2,535.0</b>	<b>\$3,456.3</b>

# FY 24 Appropriations Contingent (in order below) on Meeting FY 2023 Revenue Forecast



1. \$333.3 mil. - Reduction in the top marginal individual income tax rate to 5.5%
2. \$250 mil. - Additional funding for site development
3. \$100 mil. - Additional funding for the Resilient Virginia Revolving Loan Fund
4. \$100 mi. - State employee performance bonus
5. \$300 mil. - Additional Capital Outlay Supplement

# Major GF Spending Additions to Ch. 2 in the Introduced Budget



- Capital Outlay - \$604 mil.
- **Natural Resources - \$457.1 mil.** (Resilient Virginia Revolving Loan Fund, Enhanced Nutrient Removal Certainty Program, Richmond combined sewer overflow project, agriculture best management practices)
- Site Development Investments - \$450 million
- **K-12 Education Additions - \$442 mil.**
- State Employee Bonus - \$200 mil.
- Nursing and Other Health and Welfare - \$160 mil.
- Behavioral Health Initiatives- \$149.1 mil.
- Unemployment Trust Fund Deposit - \$100 mil.
- Public Safety/Law Enforcement - \$98.4 mil.
- Invest in Workforce Development - \$61.8 million
- Higher Education - \$47 mil.

# \$442 Mil. Budget Additions to 2022-24 K-12 Spending Largely Technical



- **\$168 mil. growth in higher sales tax distribution forecast**
- **\$71.2 mil. for ADM student projection increase**
- \$50 mil. additional Lab school support
- \$50 mil. for \$5,000 bonuses for teachers identified by DOE as top performers based on student academic growth.
- \$45.2 mil. for a 1% bonus on 9/1/23 for SOQ positions.
- \$20 mil. for a public-private pilot program of a mixed delivery preschool programs in Southwest and Petersburg school districts.
- \$16.9 mil. to expand reading specialist staffing standard to 4th and 5th grades
- \$10 mil. for teacher incentive bonuses in hard-to-staff schools
- \$7.2 mil. for math specialists at underperforming schools

# Major Gaps in State K-12 Funding

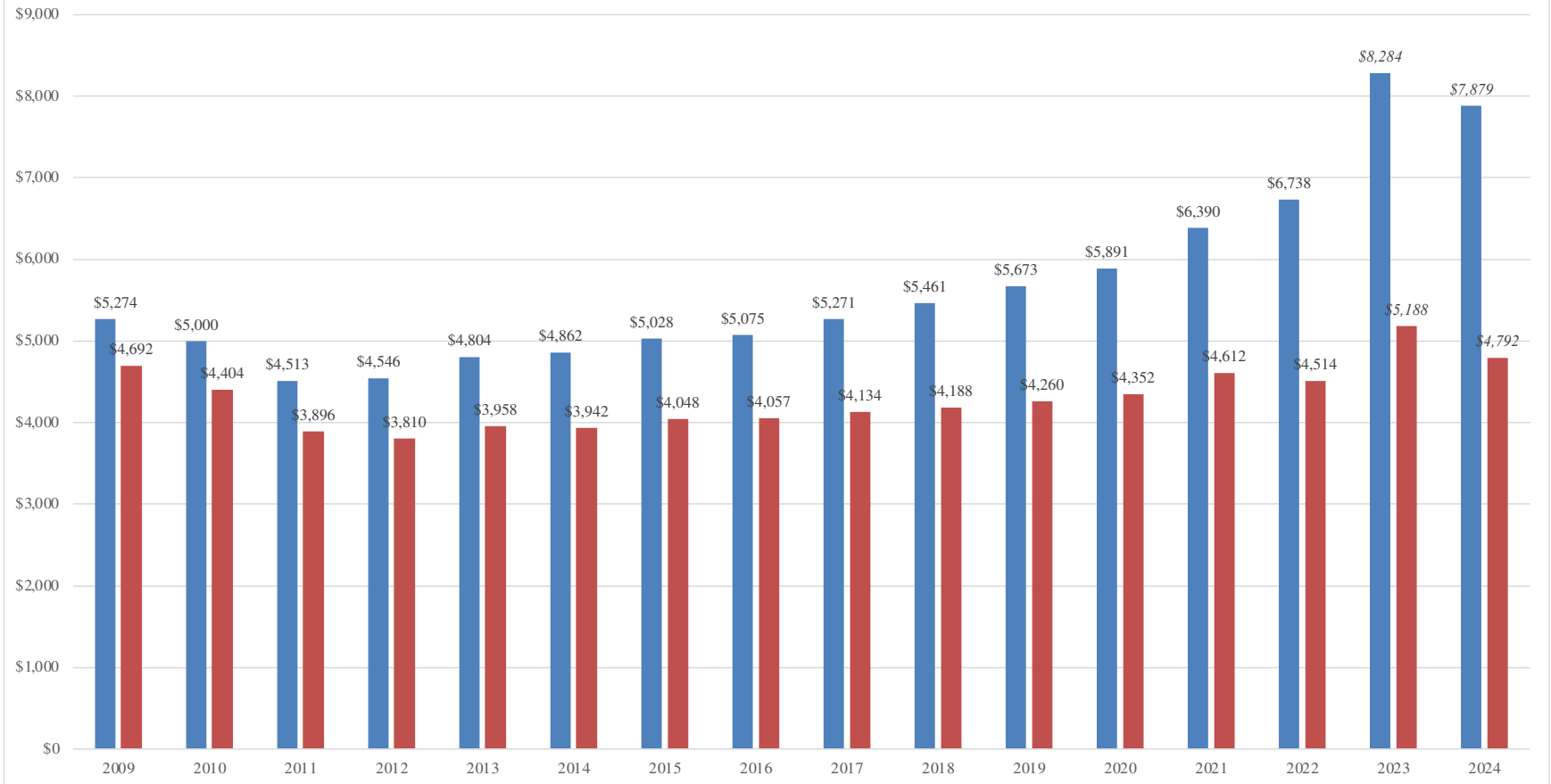


- Full elimination of the support cost cap would cost \$267 mil./yr. or an additional increase of 5.34 positions per 1,000 students.
- State funding for instructional aides
  - Out of 21,300 employed, only 2,837 aides were state funded in the SOQ in FY 2022. SOQ: If the average daily membership in any **kindergarten** class exceeds 24 pupils, a full-time teacher's aide shall be assigned.
  - Gap in SOQ funding is over \$400 million for local school divisions.
- Only 920 assistant principals are funded by the state SOQ out of over 2,800 employed by school divisions.
- Resolving the gap in teacher supply
  - Adequate salaries to attract/keep teachers (at a minimum keeping pace with inflation)
  - Declining enrollment in teacher preparation programs - remove financial barriers to encourage potential teachers to enroll in teacher preparation programs
  - Find ways to provide teachers with the support they need to minimize burnout
- Additional school renovation and construction support
  - At least \$25 bil. In documented needs.

# K-12 State Per Pupil Funding Just Now Exceeding Inflation-Adjusted 2009 Levels



**2022-24 Introduced Budget State Per Pupil K-12 Direct Aid Funding  
Nominal and Inflation-Adjusted (CPI \$2005)**



# Appendix of Chapter 2 Education Changes





# 2022-24 Major New One-Time K-12 Education GF Spending (Chapter 2)



- **\$450 mil. School Construction Assistance Program**
  - Grants would cover 10% to 30% of reasonable project costs up to \$100 mil. , depending on a locality's local composite index and fiscal stress score.
- **\$400 mil. School Construction Grants**
  - Each school division receives \$1 mil. with the remainder distributed by share of ADM modified by their respective LCI.
- Use GF rather than **Literary Fund** for school employee retirement costs (\$166 mil.)
- **Laboratory schools** deposit (\$100 mil.)
- **Hold harmless rebenchmarking** using pre-covid data (\$354 mil.)
- \$146 mil. to **Maintain FY 2022 VRS rates** instead of lowering based on usual methodology. (Higher VRS local match too)
- \$1,000 bonus with \$124.7 mil. in **ARPA** funds distributed based on SOQ funded teacher and support positions with no local match.

## 2022-24 Major New Ongoing GF K-12 Spending ( Chapter 2 Biennial Amounts)



- **5% salary increases each year** for state funded SOQ teacher and support positions (\$730 mil.)
- **Offset loss of state sales tax on food** with \$361 mil. in GF
- Partial removal of **support position cap** – increased from 17 to 21 positions per 1000 ADM (\$272 mil.)
- Increase **at-risk add-on** from maximum 26% to 36% basic aid boost per free lunch each year. (\$145 mil.)
- Fund **reading specialists** at 1 per 550 K-3 students (\$63 mil.)
- Fund **principals** in each elementary school (\$20 mil.)
- Increase **VPI per pupil** from \$7,655 to \$8,359 (\$27 mil.)
- Expand **VPI access to three-year-olds** with additional slots: 1,138 FY 2023 and 1,374 FY 2024. (\$19 mil.)