

# Virginia Budget Brings Fiscal Fitness But Not Reform

BY BETTY JOYCE NASH

Virginia legislators passed a \$60 billion two-year budget after more than 100 days of haggling. The work paid off: The new budget restored the state's AAA bond rating from Moody's Investor Service, which should save the state money when it issues bonds.

The budget is noteworthy because it raises taxes. And as this issue goes to press, tax revenue is rolling in above predictions, growing at an annual 9.3 percent, nearly 3 percent above state forecasts.

While legislators shied away from raising any motor fuel taxes for transportation funding, given uncertainty over gasoline prices, they approved amendments affecting transportation proposed by Gov. Mark Warner. Those changes will move about \$19 million from the general fund to the transportation fund and allow the governor to designate \$50 million more for transportation projects.

The spending plan aims to restructure the tax code and invest in services. Legislators intended to reduce reliance on personal income taxes. In the past the state has received some 20 percent of revenue through sales taxes and about 55 percent through individual income taxes.

The budget deal will increase the state's sales tax by a half cent for most products. The plan eventually adds 30 cents (up from 2.5 cents) to the cost of a pack of cigarettes. (The deal also gradually lowers sales taxes on food, a move that many people say is equitable, since poor people spend a disproportionate amount of income on food.)

Increased revenues will put new funding worth \$1.5 billion into public education to pay for rising enrollments, teacher pay, health insurance, and retirement costs. The budget also adds \$27 million to expand funds to teach English as a second language. Higher education will benefit. Faculty members will get raises and Virginia students at private institutions will get more tuition assistance.

The plan brought tax breaks for some — like Philip Morris. The cigarette company, which moved its corporate home to Richmond in 2003, will get a \$6 million credit on state taxes against income on sales of cigarettes produced for export, a break that expires in 2016.

Ordinary taxpayers got a little something, too. "Widely ignored was some modest reduction in income taxes by slightly raising the personal exemption," says John Knapp, director of the Weldon Cooper Center for Public Policy at the University of Virginia. The exemption went from \$800 to \$900.

The filing threshold was increased, too, from \$7,000 to \$14,000. That removes 141,000 poor people from the tax rolls.

The car tax was also frozen. The tax is imposed on car owners by local governments, and was cut in 1998 by Gov. Jim Gilmore. The tax ultimately would have eliminated tax on the first \$20,000 of a car's value. In its current phase, local governments reimburse citizens for 70 percent of the the tax they pay, and the state reimburses localities for the lost revenue. The budget agreement caps the reimbursement at its current level, about \$950 million annually.

Overall, states are digging out of the hole they found themselves in when revenues during the most recent recession dribbled in rather than deluged state treasuries. "At least we're past the shortfall period and we can kind of now look forward," says Scott Pattison, executive director of the National Association of State Budget Officers. For example, state tax collections, adjusted for inflation, fell 7 percent in second quarter 2002 compared to the same quarter of 2001. Coming on the heels of a decade of rising revenue, the shrinking portions put most state budgets on a diet and used up rainy-day funds.

It's easy to see why. Revenues fade when economic activity slows while demand for public services tends to grow. States can fix the problem in two ways — reduce the cyclical variability of the revenue stream or build savings by creating and properly using rainy-day funds.

Sobel and Wagner found that for states with individual income taxes and retail sales taxes that include food, "shifting the reliance more heavily toward one and away from the other will not have a significant impact on overall revenue variability."

Virginia's tax and spending plan did raise eyebrows with its tax hike, but analysts don't see it as reform. Scott Moody of the Tax Foundation, an advocacy group based in Washington, D.C., says that he prefers a flatter tax system without special exemptions. "Anytime you riddle the tax code with special exemptions ... those are social policy programs that don't belong in the tax code," he says.

"To a large extent it [reform] is in the eye of the beholder," adds Knapp.

On the spending side, more money for K-12 and higher education might help boost human capital and ultimately economic growth. But whether "that extra dollar is going to be efficiently spent, that's beyond my analytical ability," says Knapp. **RF**

**Virginia's Budget 2004-2006**

- Raises state sales tax by a half cent
- Raises cigarette tax from 2.5 cents to 30 cents
- Freezes car tax phaseout
- Adds \$450 million to rainy-day fund
- Adds \$1.5 billion for public schools
- Adds \$1 billion for nursing homes, hospitals