Virginia’s Fiscal Crisis

Fairy tales often begin, “Once upon a time . . .” and end with the expected “and they lived happily ever after.” The story of the commonwealth’s fiscal crisis begins in typical fairy tale fashion.

Once upon a time, a Virginia candidate for governor, campaigning in the heady atmosphere of a robust economy, believed that happy experience would last forever. So the campaign created a popular villain—the car tax—and to complement the emerging drama, a likely hero was devised, a hero who would slay the villain, and as the revenues continued to pour into state coffers, we would all live happily ever after.

The plot, however, was conceived with grievous mistakes and miscalculations.

First, the car tax, as estimated by the amateurs in administration, would cost in the neighborhood of $600 million annually. No state services, no vital state responsibilities such as education would suffer loss, they said. Now that the truth is known, even though the phase-out stalled at 70 percent of total elimination, the loss is upwards of twice the original erroneous estimate. Second, the dilemma deepens; the cost of reimbursing localities for the elimination of the car tax actually grows as greater numbers of expensive cars are bought each year.

Part of the fallacious recipe for election was the state’s upwardly spiraling tax from revenue from 1996 to fiscal year 1999-2000. However, state general-fund revenues for FY 2002 amounted to $10.6 billion, more than $400 million below the previous year’s collection of $11.1 million. This is the “worst case” accurately predicted in 1998 in a report to the Virginia Business Council: the loss of car taxes and diminishing tax revenues. Had the Senate of Virginia acquiesced to then Governor Gilmore’s demand that the car tax be fully phased in for FY 2002, the budget shortfall would have been an additional $350 million.

The car tax bill for 2002-04, at the 70 percent rate, is now projected to be $1.727 billion. In August 2002 Governor Warner reduced the general-fund revenue projection for the 2002-04 biennium by $1.5 billion, calling for even deeper cuts in state spending than those already imposed by the 2002 General Assembly.

The sad part of this disaster is that warnings were raised that this plan, built upon uninformed projections, was reckless public policy and if actually implemented could result in unbelievable strains on education, transportation, and health care, to name just a few. Local governments would suffer as well.

As the cost of the car tax became apparent, groups such as Virginia Forward, the Virginia Business Higher Education Council, and the Virginia Business Council became alarmed at the implications for such state responsibilities as education, health care, and transportation. In 1997 the Virginia Business Council assumed a leadership role by hiring seasoned budget professionals to conduct an independent study of the state’s fiscal prospects over the next 10 years.

The study report, entitled “Virginia’s Fiscal Future: A Long-Term Perspective,” sought to determine whether the growth in state revenues, projected at historical levels, would be sufficient to meet the demand for state services such as education, transportation, and health care. A major conclusion of the study, published in early fall of 1998, is as follows:

While the budget is balanced for the 1998-2000 biennium, forecasts suggest that there could be pressures on the state budget in future years. In fact, the commonwealth could face a significant shortfall each year beginning with 2001 . . . Needless to say, continued economic growth beyond the official forecast would ease the situation somewhat, while lower-than-expected growth, or worse yet, an economic downturn, would present difficult challenges.

Given the abundance of evidence that this situation was accurately foreseen in 1998, why, one might ask, was the Virginia Business Council’s farsighted study not given more credence by the General Assembly and the public at large? The answer is simple: it was suppressed by Governor Gilmore.

According to the Richmond Times-Dispatch, on November 6, 1998, Governor Gilmore addressed the Virginia Business Council, attacking the study for its assumptions, facts, and conclusions. An administration official was quoted as saying, “The consultants’ report is just plain wrong. It reads more like a comic book.”

The next day, the Times-Dispatch headline read “Council Suppresses Disputed Report, Gilmore Attacked Economic Forecast.” According to the story, the council decided by one vote not to release the report.

The Times-Dispatch noted that the report predicted as much as a $1-billion shortfall as early as 2001 “if the revenue forecast holds, expenditure levels grow at historical rates, the car-tax relief program is implemented as planned, and policymakers attempt to address unmet needs [such as school construction].”

“An inaccurate report is an inaccurate report, no matter what kind of cover you put on it,” the governor’s official spokesperson commented to the newspaper. Today, we know that the only possible inaccuracy in the report may have been underestimating the magnitude of the problem.

Undeterred by the comments of the Gilmore administration, a few business leaders resolved to pursue the truth of the situation insofar as it could be determined. Because the

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Virginia Business Council report was conducted by former state employees who had worked in a number of previous administrations, those leaders decided to reach outside the state for another professional analysis of the commonwealth’s fiscal future.

Virginia Forward, a newly formed group of business leaders in Northern Virginia and around the state, contracted with the Barents Group LLC, a Washington, D. C., professional consulting firm and a subsidiary of the Big-Six accounting firm KPMG. Over the next year Barents published two studies: “Projection of Virginia’s State and Local Expenditures and Revenues” (September 1999) and “Virginia’s State and Local Tax Structure: Recent Performance and Restructuring Options” (December 1999). Copies of the reports are available through Virginia Forward.

The study of expenditures and revenues, while employing a different methodology than the Business Council’s consultants, arrived at substantially the same conclusions. Of course, as both reports note, opinions will differ about what level of services is considered adequate. By any measure, however, Virginia ranks low among the states in its support for education at all levels, health care, state parks and recreation, the arts, and virtually every other sector of state expenditure with the possible exception of prisons.

The Barents Group’s analysis of state and local tax structure added a new dimension to the ongoing discussion that Virginia Forward was seeking to keep alive. Comparing Virginia to national norms and regional competitors*, the study revealed that in terms of tax burden, Virginia ranks quite low:

With $56 of state taxes per $1,000 of personal income, Virginia falls far below the national average of $69 and the comparison states’ average of $71. . . . Within the region, Virginia’s taxes are less than all states except Tennessee.

In support of the Barents Group’s analysis, an independent study by the Joint Legislative Audit and Review Commission recently analyzed Virginia’s total state spending versus other states and found that, on a per capita basis, Virginia ranked as high as 37th and as low as 46th between 1991 and 1999. Since Virginia is the 13th wealthiest state on a personal income basis, it ranks even lower in state spending as a percentage of personal income.

Armed with newly validated information, a small group of business leaders traveled around the state in the fall of 1999, meeting with local business and community leaders. They presented the results of the Barents Group’s study and sought to create awareness of the fiscal shoals toward which the ship of state was drifting. However, their campaign coincided with the height of the high-tech fever in the economy, and the state was in its third straight year of double-digit revenue growth. Even seasoned observers were wondering whether, with the new technology-based economy, the traditional laws of economics had been repealed.

Today, the painful lessons of economics have been learned all over again. Government cannot and should not try to do everything. Past leaders have wisely determined the proper role of government. Now, however, we stand at the beginning of a new century. This generation is again faced with the question of government’s proper role. What are its indispensable functions? What current functions could be downscaled or eliminated?

Institutions of higher education are particularly reluctant to publicize the extent of damage to their ongoing programs due to continued budget reductions for fear of upsetting legislators and driving away prospective students and talented faculty. Many of Virginia’s institutions rank high nationally, but reputation always lags behind reality. As the next round of budget reductions is implemented, the long-term quality and reputation of many of our institutions is put at risk.

In the end, many of the questions that need to be asked are the same as those posed by the Virginia Business Council Study in 1998:

- What is the long-term vision for Virginia? What kind of state do business- ers, community leaders, and citizens want in the future?
- What options are available to the commonwealth should future revenues fall short of desired expenditure levels? What course of action should the commonwealth pursue?
- Does the current tax structure “fit” today’s economy and appropriately distribute the burden for funding government services?
- How should the discrepancy between transportation revenues and transportation needs be reconciled?

On May 8, 1997, John T. “Til” Hazel, chair of the Virginia Business Higher Education Council, had this to say:

Without investment and reinvestment, we cannot expect to be competitive as we enter the next century. No business leader can fail to invest in the future. Why should our great state be denied investment in the future? We cannot allow Virginia to be weakened at this time of intense global competition by denial of problems and refusal to debate the issues…. The citizens of Virginia are entitled to be informed and to decide whether we should settle for mediocrity in job growth, in education, in transportation, and in our financial base…. Our goals
must be a system of higher education among the best in the country. Not a quibble over 43rd or 44th [in funding]. A K-12 system which prepares graduates for accelerated learning and successful participation in the workplace, a first-class system of transportation, and a financial structure with bi-partisan support that addresses with political honesty funding requirements.

Again, the voters of Virginia must make the tough but necessary decisions regarding the future. The ensuing debate will decide what is important, if not critical, to Virginia’s future. Many thoughtful observers of the commonwealth’s finances have concluded that proper funding to ensure that this commonwealth has schools, roads, and all other necessary infrastructure to excel in an increasingly competitive global economy cannot be achieved through the current tax structure. The current scene of finger pointing by some of Virginia’s elected members to the General Assembly, seeking political advantage from this train wreck, should not receive approval from Virginia’s citizens.

The resolution to the current fiscal situation is not apparent. What is apparent, however, is that refusal to engage in meaningful public debate that will consider all options will result in further damage to the future. The current politically correct posture of bashing all who dare address the dreaded “T” word is unacceptable. Only an open, honest debate wherein the participants vigorously contend in a healthy exchange of competing views can lead us to the fairy tale ending: “… and they continued the story tale life of old in the commonwealth of Virginia and lived happily ever after.”

* Florida, Georgia, Kentucky, Maryland, North Carolina, South Carolina, Tennessee, and West Virginia

* Spending for Medicaid, higher education, and transportation.

** Amount needed to provide same level of services that were provided in base year (FY 2002), adjusted for projected inflation and other anticipated changes.

Source: The Barents Group LLC, Projection of Virginia’s State and Local Expenditures and Revenues, September 10, 1999.