Does the GVI have a Revenue Problem or Spending Problem?

Former OMB Director Nellon L. Bowry discusses the long-standing fiscal issues and potential solutions for the Government of the Virgin Islands. He examines the unsustainable fiscal imbalance and argues for a balanced approach to resolving it

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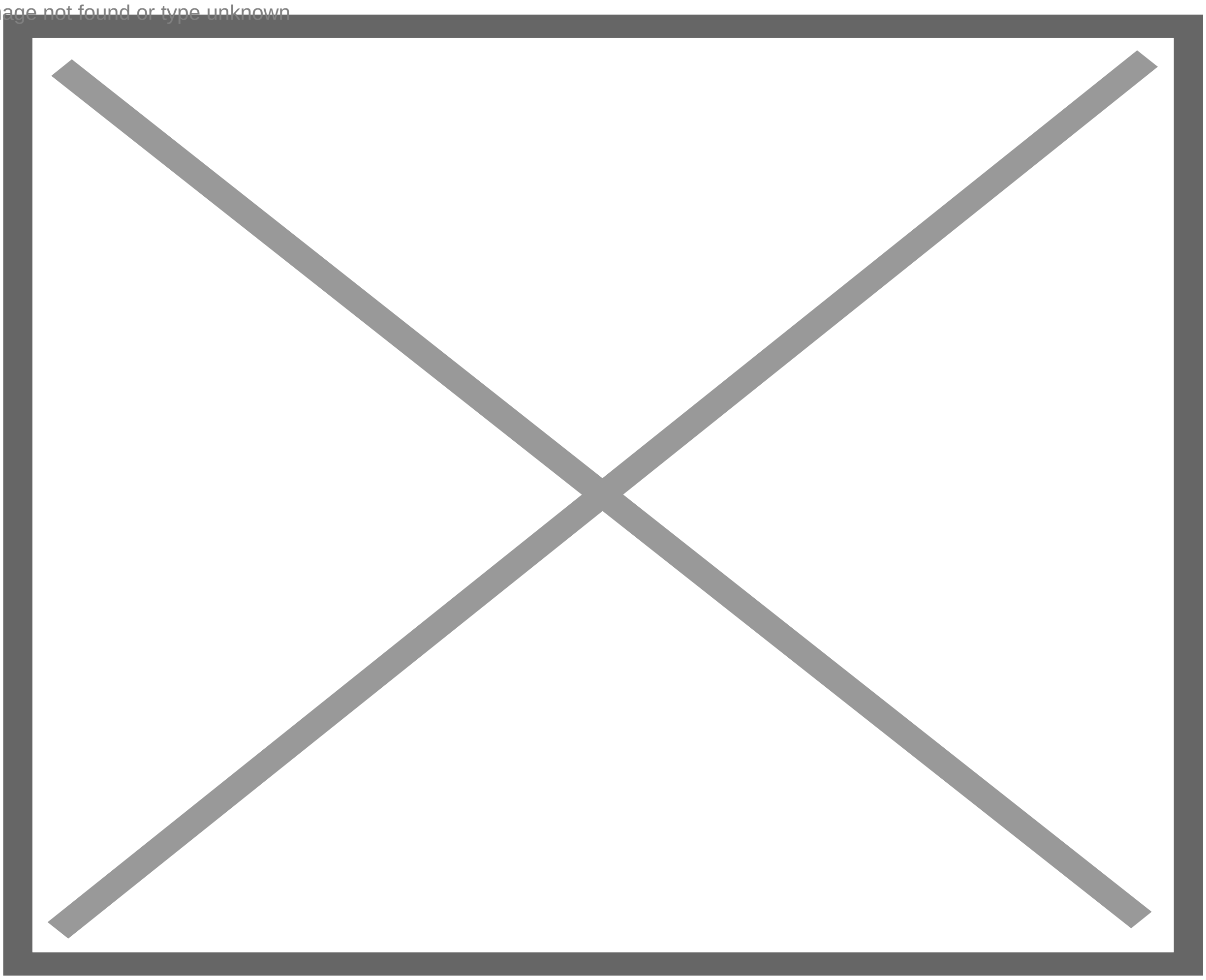

Fiscal cliff concept. **By. GETTY IMAGES**

Here is some context to help you decide.

There is no disputing the problem. For many years, there has been a fiscal imbalance between GVI operating revenues and expenditures. Every year for at least 15 fiscal years – very likely longer – General Fund revenues have been less than expenditures; or if you prefer, expenditures have exceeded revenues by hundreds of millions of dollars per year. This has resulted in chronic cash shortages, credit rating downgrade, loss of access to credit, and overall deterioration in GVI's fiscal condition and outlook. All agree that it is unsustainable and needs to be fixed.

The dispute is about the messaging. Framing it as a revenue problem implies that the solution is to increase revenues – instinctively interpreted as "more burden on taxpayers". Framing it as a spending problem implies that the solution is to reduce expenditures – instinctively assumed to be doable by "cutting out government waste and mismanagement". Which explains the popularity of the claim, particularly by campaigning politicians, that "the GVI has a spending problem, not a revenue problem".

It helps to restate the question: Is the GVI better able to cure its cash shortage problem by reducing expenditures or by increasing revenues? Reframing the question shifts the focus of the debate toward an evidence-based response.

First, the expenditure reduction option. The GVI's ability to control expenditures is constrained by two factors largely beyond its control: the level and quality of services demanded by the public, and the increasing cost to provide those services, due to inflation.

The primary purpose of government is to provide public services – the type, quantity and quality determined by citizens. The GVI cannot choose to provide public safety and health services 16 out of 24 hours a day, to reduce expenditures. It cannot cut costs by reducing the school week to three days. Rather, it is about to increase expenditures, by building an additional school in a district where enrollment has declined 34% in the past ten years, because its public service mandate demands it.

The inflation effect is even more intractable. Inflation erodes the purchasing power of money; requiring more money to provide equivalent services. A 2.9% annual inflation rate – very conservative for the VI -- would require $1.29 today, to provide

the same services that cost $1.00 ten years ago. For perspective, that's $248 million more in 2024 for services that cost $846 million General Fund operating expenditures in 2014. This increase is largely unavoidable, except by endangering government services.

GVI General Fund expenditures grew 2.0% per year between 2007 and 2021; below the rate required to make up for inflation during that period. This indicates that there is very little room for significant expenditure reduction; without negatively impacting public services. Given acknowledged gaps in public services – education, health care and public safety – efficiency savings are more likely to be applied to improving services than to reducing expenditure levels; better bang for the buck.

These realities probably explain why VI elected officials routinely propose and approve annual expenditure increases, not long after condemning "excessive government spending" on the campaign trail.

What about the revenue increase option? To achieve fiscal balance, revenues should at a minimum grow at the annual inflation rate. Instead, General Fund tax revenues grew less than one percent (0.85%) per year – between 2007 and 2021; less than one-half the expenditure growth rate, and of greater concern, less than one-third the inflation rate. There are two opportunities to increase revenues without "further burdening" taxpayers: improve tax collection efficiency; and expand the tax base by growing the economy.

In 14 of the 15 fiscal years (2007-2021), taxes owed to the GVI exceeded tax refunds owed to taxpayers; by about $100 million on average. This represents unrealized tax revenues sufficient to cut the average annual General Fund deficit in half.

The second opportunity shows even more potential. The VI economy is the source of GVI revenues. Specifically, General Fund tax revenues average 16.5% of USVI GDP. But the economy has declined such that GDP for 2021 ($4.44B) was lower than for 2007 ($4.8B) – 15 years prior. So, there is clearly potential for economic expansion, which will spur revenue growth -- to expand the tax base rather than "further burdening" the existing one.

"A problem well-stated is a problem half-solved." Charles F. Kettering

Submitted on Thursday, June 20, 2024 by Nellon L. Bowry, former Office of Management & Budget director.