



May 2020

Solutions to Preventing Tax Increases in 2021

Nathan Benefield

There's no business as usual for Pennsylvania families, businesses, or state government. State revenues for **April 2020** fell \$2 billion short of estimates as an emergency shutdown order quashed economic activity.¹ An estimated \$1.7 billion of that shortfall was due to delayed tax revenue that will be shifted to later months/next year. The remaining \$400 million, is related to economic losses, and further revenue shortfalls appear likely to continue into 2021. **The IFO projects \$2.7 to \$3.9 billion** in revenue losses spread out over two years.²

Lawmakers can respect the Pennsylvania constitution's balanced budget amendment³ and act to prevent tax increases that will drive more families and businesses out of the state, further shrinking the revenue base. Here are our suggestions to balance the budget without raising taxes.

Budget savers and revenue options

1. Privatize liquor sales
2. End corporate handouts
3. Prioritize all spending and utilize fund surpluses
4. Reform higher education funding
5. Repeal prevailing wage mandates

Key reforms to protect taxpayers and revitalize Pennsylvania

1. Prevent spending overruns
2. Strengthen balanced budget requirements
3. Revive small businesses
4. Pass the Taxpayer Protection Act

Budget Savers and Revenue Options

Privatize Liquor Sales

For years, Pennsylvania residents have expressed dissatisfaction with the state liquor system, with the **vast majority** supporting privatization of alcohol sales.⁴ Gov. Wolf's unilateral, arbitrary closure of the liquor stores—and the PLCB's failed response—has exacerbated this dissatisfaction and further exposed the failure of the government-run liquor monopoly.

¹ IFO, April 2020 Revenue Update, <http://www.ifo.state.pa.us/releases/365/April-2020-Revenue-Update/>

² IFO, Projected Revenue Impact of COVID-19, <http://www.ifo.state.pa.us/releases/361/Projected-Revenue-Impact-of-COVID-19/>

³ Pennsylvania Constitution, Article VIII, Section 13a

⁴ 2013 Poll of Registered Voters by FM3, <https://www.commonwealthfoundation.org/track/trackurl.asp?q=iwfasftzcqnt>

The result has been a [massive increase in border bleed](#), which was already high, as the PLCB forced average residents to become bootleggers. Crossing state lines to buy spirits became so common, Delaware state police [stopped Pennsylvania drivers](#), [Ohio and West Virginia](#) prevented sales to Pennsylvanians because of social distancing, and [New Jersey stores were overrun](#) with Pennsylvania shoppers.

Because of this mismanagement, [PLCB is losing money](#) and dipping into reserve funds. Licensing private retailers to sell spirits would recoup some of the sales lost to other states in border bleed, and the value of licenses could more than replace the so-called “profits” of the government-run monopoly and also recover some lost tax revenue. Further, expanded private license sales could generate an estimate [\\$200 to \\$500 million](#) in additional revenue this year.⁵

End Corporate Handouts

The 2020-21 Governor’s Executive budget includes more than [\\$800 million](#) in grants and tax credits for private businesses, spread across over 30 different tax credits, grants, loan and loan guarantee programs.⁶ The state’s numerous giveaways generally fall into one of two categories: their terms are either so ambiguously defined as to call their purpose into question— Pennsylvania Capital Access Program, PENNVEST and CFA loans, Minority Business Development Loans, Ben Franklin Venture Investment Program—or so specific as to look like a targeted favor. The programs are inappropriate favors to the politically connected, and they are less effective at boosting business activity, than tax cuts or regulatory simplification.

Last year, the Independent Fiscal Office identified [\\$60 million](#) of ineffective tax credits.⁷ The true total is far higher. Fraud is also rampant. A [grand jury report](#) from last year detailed outrageous cheating pertaining to Research and Development and Keystone Innovation Zone credits.

Lawmakers should eliminate corporate giveaways in the current year, and in future years use the savings for a revenue-neutral corporate tax cut—lowering the corporate tax rate from the current 9.99% to 6.93%.⁸ This reform would provide a fairer system to all businesses, while making Pennsylvania more competitive with the rest of the nation.

Prioritize All Spending and Utilize Fund Surpluses

In this time of crisis, lawmakers need to be able to prioritize *all* state spending, not just the General Fund budget. This includes about \$24 billion⁹ in off-budget special funds that are part

⁵ Estimates calculated by combining revenue from licensing fees and wholesale revenue from wine and liquor.

⁶ Commonwealth Foundation, *Corporate Handouts in the State Budget, 2020-21*, <https://infogram.com/spending-on-corporate-welfare-2020-21-1h1749mxg1py6zj?live>

⁷ Commonwealth Foundation, *IFO Report: Pa. Wastes \$60 Million Per Year on Underperforming Programs*, Jan 27, 2020, <https://www.commonwealthfoundation.org/policyblog/detail/ifo-report-pa-wastes-60-million-per-year-on-underperforming-programs>

⁸ Independent Fiscal Office, *Initial Revenue Estimate*, May, 2020, <http://www.ifo.state.pa.us/download.cfm?file=Resources/Documents/Revenue-Estimate-2020-05.pdf>; Calculation is based on total corporate welfare spending from the 2020-21 Governor’s Executive budget

⁹ Governor’s Executive Budget, 2020-21, *Other Special Funds*, <https://www.budget.pa.gov/PublicationsAndReports/CommonwealthBudget/Documents/2020-21%20Proposed%20Budget/2020-21%20Executive%20Budget%20Book%20-%20Web%20Version.pdf>

of the “shadow budget”. The state has \$340 million¹⁰ in the rainy-day fund that can be tapped immediately, but this is only about 1% of the General Fund budget.

Lawmakers must scrutinize every dollar spent, and not leave special funds on autopilot. Dependence on the shadow budget has been growing. Since 2000, while General Fund spending has grown by 43%, “other funds” have **grown by 238%**.¹¹

The General Fund Stabilization Act (**HB 1988**, Rep. Grove), would consolidate numerous so-called special funds into the general fund. A proposed amendment to the state constitution (**HB 1991**, Rep. Keefer) would prohibit the diversion of General Fund revenue into special funds. The bills would bring money into the General Fund and increase transparency.

Additionally, many of these funds have amassed large cash reserves. In fact, the Treasurer reports **nearly \$14 billion** in fund reserves.¹² Many of these funds have been growing their reserves year after year.

Mass transit is among the one of largest recipients of special funds. SEPTA (Southeast Pennsylvania Transit Authority) and the Pittsburgh Port Authority should be funded by their riders and their local tax base, not by the state. Act 44, the funding scheme whereby the Turnpike borrows money on their behalf, has been a disaster, and **may even jeopardize the future of the Turnpike**. Ridership in the city mass transit systems is likely to be depressed for some time, which allows for an opportunity to rationalize budgets without harming riders; and state aid should be tied to support low-income riders, not failing systems.

Lawmakers should also make school districts spend down their own cash reserves. The latest annual financial reports show that school districts have more than **\$4.6 billion in total fund reserves**.¹³ They should not be permitted to hoard cash while relying on out-of-district taxpayers for their operating budget.

Aid College Students Instead of Institutions

The current state budget sends \$597 million¹⁴ to Penn State, University of Pittsburgh, Lincoln University and Temple, institutions that benefit a tiny minority of Pennsylvanians, while building up substantial endowments and outside revenue streams. Each institution is also a major recipient of federal money and federally-subsidized tuition payments.

¹⁰ Commonwealth Foundation, *Pennsylvania's Rainy Day Fund Balance*, <https://infogram.com/updated-2019-20-rainy-day-fund-balances-1hr4zzjpyo54yo?live>

¹¹ Governor's Executive Budget, 2020-21; Pa. Office of the Budget, *Past Budgets*, <https://www.budget.pa.gov/PublicationsAndReports/CommonwealthBudget/Pages/PastBudgets2015-16To2006-07.aspx>

¹² Pennsylvania Treasury, *Treasury Investment Pools*, <https://www.patreasury.gov/transparency/pools.php>

¹³ Department of Education, School Finances, *AFR Data: Detailed*, Miscellaneous, General Fund Balance: 2009-10 to 2018-19, <https://www.education.pa.gov/Teachers%20-%20Administrators/School%20Finances/Finances/AFR%20Data%20Summary/Pages/AFR-Data-Detailed-.aspx#.VZwC6mXD-Uk>

¹⁴ Governor's Executive Budget, 2020-21, *Education*, Program: Higher Education, Appropriations within this program, 2020-21 Estimated.

The State System of Higher Education (PASSHE), in contrast, has long been in financial trouble. Enrollment at these schools has declined 20% since 2010.¹⁵ The system has \$5.7 billion in debt and a \$1.6 billion gap between its assets and its liabilities, according to its most recent financial statement. It **lost** \$36 million in fiscal year 2019 and \$90 million the year before.¹⁶ The six-year graduation rate at Cheyney University is an anemic 10 percent.¹⁷

At this time, future enrollment is impossible to predict. Instead of funding these institutions—based on a formula driven by politics rather than enrollment—lawmakers should look to convert all higher-ed aid into student grants and scholarship. Such reforms would make higher education more affordable and give students more flexibility during these unprecedented times.

Repeal Prevailing Wage Mandates

Despite what its name suggests, the “prevailing wage” is an artificially-inflated wage paid to those who work on government construction projects. It is usually set at the union-inflated wage and is higher than the rate for identical work on private projects.

Not only would a repeal of the prevailing wage mandate save the state, it would also provide needed savings for municipalities and school districts. Groups like the [Pennsylvania Association of Boroughs](#) and the [Pennsylvania School Boards Association](#) both support relief from prevailing wage mandates.

According to [U.S. Census data](#), Pennsylvania state and local governments spent more than \$10.6 billion¹⁸ on construction in 2017. Assuming a 10 to 30 percent prevailing wage premium—both state and local governments could save between \$1 billion-\$3.2 billion on construction costs if the mandate were repealed.

Key Reforms to Protect Taxpayers and Revitalize Pennsylvania

Prevent Spending Overruns

Even if the legislature enacts a balanced budget, the Governor can overspend. In five of the past six fiscal years, the Wolf administration overspent what they were appropriated by the legislature, and then received a supplemental appropriation from the legislature. These overruns, including the projected result for fiscal 2019-20, total **\$1.9 billion**.

The amount is far too large to be plausibly accidental. Rather, it is strong evidence that the Wolf administration is purposefully under-budgeting up front and backfilling at year end. This is a clear work-around of the constitutional requirement for a balanced budget.

¹⁵ Shackner, Bill, “State System takes another student enrollment hit,” *Pittsburgh Post-Gazette*, Oct. 8, 2019, <https://www.post-gazette.com/news/education/2019/10/08/state-system-of-higher-education-PASSHE-state-owned-universities-enrollment-higher-education/stories/201910080172>

¹⁶ Pennsylvania’s State System of Higher Education, Financial Statements, <https://www.passhe.edu/inside/anf/accounting/Pages/Financial-Statements.aspx>

¹⁷ US Department of Education, Integrated Postsecondary Education Data System, <https://nces.ed.gov/ipeds/use-the-data>

¹⁸ United States Census Bureau, 2017 State & Local Government Finance Tables, construction, <https://www.census.gov/data/tables/2017/econ/gov-finances/summary-tables.html>

[House Bill 1861](#) (Rep. Grove) and [Senate Bill 885](#) (Sen. Phillips-Hill) propose a constitutional amendment that will require supplemental spending to be voted on in a standalone bill, not tucked into the spending bill for the next year. The amendment would make budget overruns more visible and would provide legislators with necessary oversight of appropriations.

Strengthen Balanced Budget Requirements

A balanced budget may fall out of balance due to revenue losses or overspending. Sometimes, governors respond to these deficits by freezing hiring or controlling certain categories of spending. But not always—the FY 2016 budget was never truly balanced, and the FY 2017 was out of balance until October (when the legislature voted to borrow \$1.5 billion from tobacco funds to bridge the gap).¹⁹

[House Bill 855](#) (Rep. Struzzi) would require an intra-year update to the administration's revenue projections and provides for budget reductions in the event of reduced revenue projections.

Revive Small Businesses

Given the depth of the economic crisis caused by the coronavirus pandemic and Gov. Wolf's excessive business shutdown, lawmakers should act now to revive small businesses.

This should include tax reform that will benefit businesses who endured major losses in 2020. Adjusting the tax code to permit small businesses to carry forward any losses would be a small step but would have a big impact in aiding recovery. Passing [House Bill 1603](#) (Rep. Grove) and [Senate Bill 202](#) (Sen. J. Ward) would permit small business owners to deduct net operating losses—something corporations can already do—in future tax years. Given that many businesses will see immense losses this year, this is critical to their long-term survival.

Likewise, reducing the regulatory burden and suspending occupational licensing requirements that [create barriers to employment](#) would help business and workers transition. At this time of upheaval, the state should ease the processes that impede business growth and prevent workers from taking jobs.

Pass the Taxpayer Protection Act

The Taxpayer Protection Act would limit annual General Fund budget growth to the average sum of population growth and inflation, providing for surpluses to be deposited in the rainy day fund and refunded to taxpayers.

If the Taxpayer Protection Act had been in place since 2003, taxpayers would have saved a cumulative total of nearly \$3,000 per person.²⁰ Had the Taxpayer Protection Act been in place during good economic times, Pennsylvania would have been able to support spending while also

¹⁹ Commonwealth Foundation, *What's in the Latest House Revenue Plan*, <https://www.commonwealthfoundation.org/policyblog/detail/whats-in-the-latest-house-revenue-plan> and HB 542 of 2017-18.

²⁰ Commonwealth Foundation, *State Spending Vs Taxpayer Protection Act*, <https://infogram.com/savings-per-capita-2020-21-state-spending-vs-tpa-1hzj4ozl0rxp2pw?live>

building up an ample rainy day fund. Unfortunately, a recession is now upon us, and our rainy day fund has enough reserve to cover **only 3.7 days** of state government spending.²¹

The Taxpayer Protection Act—represented by **House Bill 1316** (Rep. Warner) and **Senate Bill 116** (Sen. Bartolotta)—is popular and bipartisan. In a 2019, poll more than 2/3rds of respondents supported the Taxpayer Protection Act.²²

Conclusion

The fiscal year 2021 budget will not be easy. But, by acting now lawmakers can reduce costs, generate revenue through privatization, and adopt reforms to avoid more difficult spending decisions and a major tax hike on working families next year.

²¹ Calculations based on methodology from Pew Charitable Trusts and the enacted 2019-20 state budget, <https://infogram.com/updated-2019-20-rainy-day-fund-balances-1hxr4zzjpyo54yo?live>

²² Susquehanna Polling and Research, survey of 700 registered voters, October 2019.