



December 2016

## Embracing Innovation in State Government

*Bob Dick*

### Introduction

Conventional governing is hampering Pennsylvania's progress. Growing state budgets combined with one-time revenue transfers and targeted tax hikes are delaying the structural reforms essential to improving the quality of life for people who live and work in Pennsylvania.

Over the last five decades, state spending has risen by more than \$4,000 per person—an inflation-adjusted increase of 189 percent. In 1970, the state spent \$2,122 for every Pennsylvanian. Today, that number is \$6,132.<sup>1</sup>

Predictably, this spending binge has hurt the commonwealth's financial position. The Mercatus Center ranks Pennsylvania 46<sup>th</sup> in cash solvency, which is defined as a state's ability to pay its short-term bills on time.<sup>2</sup> Mercatus also gives the state a poor budget solvency ranking—42<sup>nd</sup> overall. This category measures the gap between a state's revenues and expenses for the fiscal year.

The rankings will come as little surprise to anyone familiar with Pennsylvania's budget process, where excessive government spending growth is the default setting. Most spending programs are rarely reviewed or debated on an annual basis.

If this budget process continues unchecked, Pennsylvanians can expect more budget deficits, higher taxes to close those deficits, and slower economic growth as a consequence. However, the alternative—reducing government spending growth and embracing innovative reforms that enhance economic freedom—can unleash economic expansion and opportunity in Pennsylvania.

Economic freedom—or individuals' ability to peacefully pursue a living without government interference—is the key to making life better for everyone.<sup>3</sup> Conversely, when government grows at an unsustainable rate, livelihoods are lost.<sup>4</sup> That's why a recent Independent Fiscal Office (IFO) report is so troubling.

---

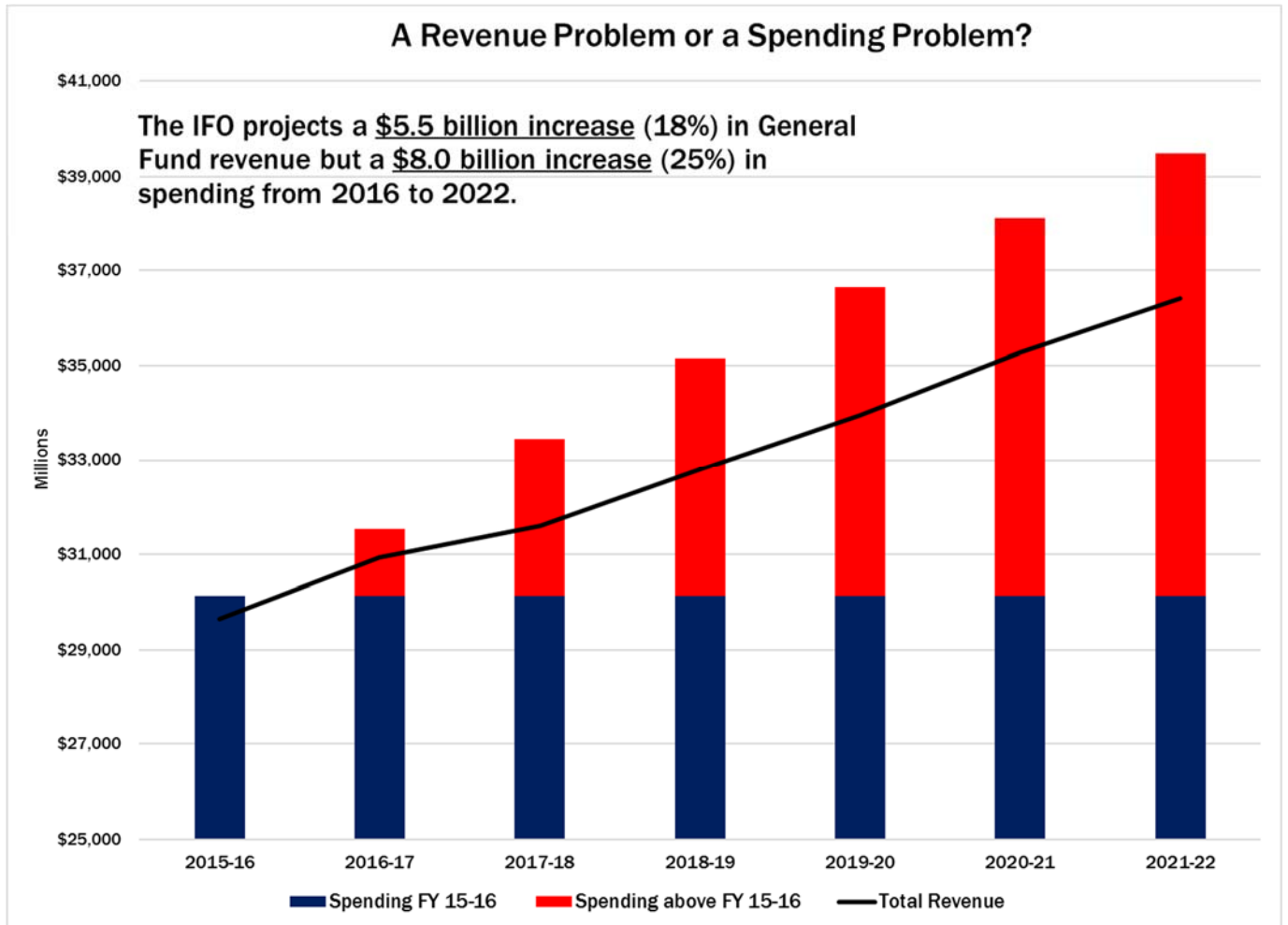
<sup>1</sup> Authors calculations based on the Governor's Executive Budget.

<sup>2</sup> Eileen Norcross and Olivia Gonzalez, "Ranking the States by Fiscal Condition" (2016 ed.), [https://www.mercatus.org/system/files/Norcross\\_2016\\_PA.pdf](https://www.mercatus.org/system/files/Norcross_2016_PA.pdf).

<sup>3</sup> Dean Stansel et al, "Economic Freedom of North America 2016," <https://www.fraserinstitute.org/studies/economic-freedom-of-north-america-2016>.

<sup>4</sup> Bob Dick, "How Tax Hikes Ruined Scottie's Dream," <http://www.commonwealthfoundation.org/policyblog/detail/how-tax-hikes-ruined-scotties-dream>.

In its annual report on Pennsylvania’s fiscal and economic outlook, the IFO projects spending will grow by approximately \$8 billion over five years, with revenue growing by just \$5.5 billion.<sup>5</sup> The gap between spending and revenue growth (\$2.5 billion) is a striking example of Pennsylvania’s spending problem.



The bulk of this projected spending growth comes from “automatic spending”—programs that will see spending increase *unless* lawmakers make changes. This represents the inflation- and population-adjusted increased costs of maintaining current policy for a new fiscal year. The IFO notes this spending is difficult but not impossible to affect.<sup>6</sup>

The projected imbalance for the current fiscal year may not occur because policymakers have many ways in which they could address the imbalance. If they enact permanent changes to revenue or spending levels, then those changes would have implications for all future years.

Managing Pennsylvania’s finances requires reducing the impact of automatic spending through long-term reforms and avoiding tax hikes, which will only exacerbate the state’s fiscal problems.

<sup>5</sup> Pennsylvania Independent Fiscal Office, “Economic and Budget Outlook Fiscal Years 2016-17 to 2021-22,” [http://www.commonwealthfoundation.org/docLib/20161116\\_Five\\_Year\\_Outlook\\_2016.pdf](http://www.commonwealthfoundation.org/docLib/20161116_Five_Year_Outlook_2016.pdf).

<sup>6</sup> Ibid, pg. 60.

Last summer, lawmakers raised taxes to (partially) pay for spending increases. Yet, the IFO projects Pennsylvania will still end the fiscal year with **more than a \$500 million deficit**. Reducing the take home pay of working people undermines our fiscal stability and economic progress. Indeed, states with the lowest tax burdens generally see faster income, job, and population growth than states with the highest tax burdens.<sup>7</sup>

By addressing cost drivers and outdated government operating practices, the following reforms will keep more resources in the hands of workers and entrepreneurs—boosting economic growth and making Pennsylvania a destination state for families and job creators.

### **Immediate Cost-Saving Reforms**

**End special subsidies.** Pennsylvania distributes approximately \$800 million in tax credits, grants, and loans annually. These programs collectively distort Pennsylvania's economy by taking spending and investment decisions out of the hands of consumers and entrepreneurs and putting them into the hands of government officials.

The politicization of economic decision-making has proven damaging in Pennsylvania and around the country. Despite leading the U.S. in “economic development” spending between 2007-2015, Pennsylvania ranked 35<sup>th</sup> in job growth, 31<sup>st</sup> in personal income growth, and 38<sup>th</sup> in population growth over roughly the same period.<sup>8</sup> Indeed, states relying on government-directed economic development have experienced slower job growth compared to states minimizing government subsidies to private interests.

This data bolsters the findings of a 2004 paper, *The Failures of Economic Development Incentives*, in which Professors Alan Peters and Peter Fisher conclude government efforts to promote economic development have largely failed.<sup>9</sup> Additionally, a 2010 Legislative Budget and Finance Committee study on Pennsylvania's tax credit programs found little hard evidence of job creation from these incentives.<sup>10</sup>

Two specific examples vividly demonstrate the failure of government subsidies. The first is the closure of Kraft's Upper Macungie operation, which received \$200,000 in subsidies from the Pennsylvania First Program.<sup>11</sup> The money was intended to help the company expand, but instead, decided to merge with Heinz and, as a result, announced the closure of its Lehigh Valley plant a year ago.

American Eagle Outfitters is the second example. It secured a \$3 million grant from the Infrastructure and Facilities Improvement Program to help open a distribution center in western Pennsylvania. But the distribution center closed in 2015.<sup>12</sup>

---

<sup>7</sup> Commonwealth Foundation analysis using data from the Bureau of Labor Statistics, Bureau of Economic Analysis, and U.S. Census Bureau.

<sup>8</sup> Bob Dick, “The Costs of Corporate Welfare,” [www.commonwealthfoundation.org/docLib/20160422\\_TheCostsofCorporateWelfare.pdf](http://www.commonwealthfoundation.org/docLib/20160422_TheCostsofCorporateWelfare.pdf).

<sup>9</sup> Alan Peters and Peter Fisher, “*The Failures of Economic Development Incentives*,” <https://www.mackinac.org/archives/2009/nr043009-petersfisher.pdf>.

<sup>10</sup> Pennsylvania Legislative Budget and Finance Committee, “Pennsylvania's Tax Credit Programs,” <http://lbf.c.state.pa.us/Resources/Documents/Reports/382.pdf>.

<sup>11</sup> Jon Harris, *Morning Call*, “State wants to prevent closure of Leigh Valley Kraft Plan,” <http://www.mcall.com/business/mc-kraft-upper-macungie-plant-folo-20151105-story.html>.

<sup>12</sup> WTAE Pittsburgh, “American Eagle closing distribution center near Pittsburgh,” <http://www.wtae.com/article/american-eagle-closing-distribution-center-near-pittsburgh/7471205>.

<b>Table 1. Corporate Welfare Grant &amp; Loan Programs</b>	<b>2016-17 Budget (Thousands)</b>
<b>Spending Programs</b>	
Agricultural Excellence	\$1,200
Agricultural Research	\$1,687
Agricultural Promotion, Education and Exports	\$275
Alternative Fuels Funding	\$591
Ben Franklin Tech Development Authority Transfer	\$14,500
City Revitalization and Improvement Fund	\$12,430
Commonwealth Financing Authority Transfer	\$95,347
Council on the Arts	\$964
Food Marketing and Research	\$494
Grants to the Arts	\$9,590
Hardwoods Research and Promotion	\$385
Industry Partnerships	\$1,813
Infrastructure and Facilities Improvement Grants	\$19,000
Keystone Communities	\$12,200
Life Sciences Greenhouses	\$3,000
Livestock Show	\$195
Machinery and Equipment Loan Fund	\$37,045
Marketing to Attract Business	\$2,005
Marketing to Attract Tourists	\$11,414
Municipalities Financial Recovery Revolving Fund Transfer	\$3,000
Neighborhood Improvement Zone Fund	\$47,100
New Choices/New Options	\$500
Open Dairy Show	\$195
Partnerships for Regional Economic Performance	\$11,880
Pennsylvania First	\$20,000
Pennsylvania Race Horse Development Fund	\$250,073
Tourism-Accredited Zoos	\$750
Transfer to the Nutrient Management Fund	\$2,714
Office of International Business Development	\$6,022
Youth Shows	\$154
<b>Total</b>	<b>\$566,523</b>
<b>Tax Credits</b>	
Film Tax Credit	\$60,000
Job Creation Tax Credit	\$10,100
Research and Development Tax Credit	\$55,000
Keystone Opportunity Zone	\$78,000
Keystone Innovation Zone	\$25,000
Resource Enhancement and Protection Tax Credit	\$10,000
Alternative Energy Production Tax Credit	\$0
<b>Total</b>	<b>\$238,100</b>
<b>Total</b>	<b>\$804,623</b>
Sources: FY 2016-17 Tracking Run & 2016-17 Governor's Executive Budget	

Given the lack of economic value and the inequality these programs create, policymakers must end the culture of special handouts. Reducing business taxes across the board is a fairer and more effective way to spur job creation. If lawmakers eliminated the \$800 million in special subsidies (identified above) and used the savings to lower Pennsylvania's corporate tax rate—the highest effective rate in the industrialized world when combined with the federal tax—they could lower the state tax rate from 9.99 percent to 7.2 percent.<sup>13</sup>

**Reduce non-General Fund spending.** Pennsylvania's General Fund budget accounts for just 40 percent of the state's total operating budget. Outside the General Fund are more than 150 special funds that are too often set on autopilot. Eliminating or reducing revenue from these funds can free up tax dollars for more important priorities.

- *The Keystone Recreation, Park and Conservation Fund:* Act 50 of 1993 directs 15 percent of the Realty Transfer Tax (RTT) to this fund for “increased acquisitions, improvements and expansions of commonwealth and community parks, recreation facilities, historic sites, zoos, public libraries, nature preserves and wildlife habitats.” According to the Governor's Executive Budget, more than \$93 million in RTT revenue will be used for these non-essential government projects in 2016-17. Past projects have included pool feasibility studies, golf course acquisitions, and sports complex rehabilitations.<sup>14</sup> The William Penn Foundation's recent announcement of its intent to commit up to \$100 million for recreation funding in Philadelphia demonstrates private alternatives to government financing do exist.<sup>15</sup>
- *Agricultural Conservation Easement Purchase Fund:* This fund, created in 1988, finances the state's Agricultural Conservation Easement Purchase Program. The program allows state and county governments to negotiate conservation easements with farmers. It is partially funded with cigarette taxes, which disproportionately affect the poor.<sup>16</sup> Essentially, the state is taxing the poor to benefit farmers, whose mean pay is one of the highest in the nation.<sup>17</sup> Private conservation efforts to create easements should replace the government's power to pick winners and losers. The fund's more than \$60 million balance can be returned to taxpayers or used to address funding shortages for critical needs.
- *Agricultural College Land Scrip Fund:* Totalling more than \$50 million, the Agricultural College Land Scrip Fund finances Penn State Extension programs. These programs provide educational information to businesses and communities on a variety of issues. However, both the private and public sector already offer many of Penn State Extension's services via groups like the Agricultural & Applied Economics Association whose members “engage in a variety of teaching, research, and extension/outreach activities.”<sup>18</sup>

With the state facing a projected \$1.7 billion budget deficit, funding for these duplicative services could be scaled back or eliminated. Penn State has other funding sources at its

---

<sup>13</sup> Commonwealth Foundation analysis using data from the Pennsylvania Department of Revenue.

<sup>14</sup> Keystone Fund Projects, [http://keystonefund.org/wp-content/uploads/sites/5/2014/06/BRCKeystoneProjects\\_byappl94-2013.pdf](http://keystonefund.org/wp-content/uploads/sites/5/2014/06/BRCKeystoneProjects_byappl94-2013.pdf).

<sup>15</sup> William Penn Foundation, “William Penn Foundation commits 100 million to Philadelphia neighborhoods through rebuild,” <http://www.williampennfoundation.org/newsroom/william-penn-foundation-commits-100-million-philadelphia-neighborhoods-through-rebuild>.

<sup>16</sup> Elizabeth Stelle, “Three reasons to avoid tobacco taxes,” <http://www.commonwealthfoundation.org/policyblog/detail/three-reasons-to-avoid-tobacco-taxes>.

<sup>17</sup> Bureau of Labor Statistics, “Occupational Employment and Wages, May 2015,” [http://www.bls.gov/oes/current/oes119013.htm#\(2\)](http://www.bls.gov/oes/current/oes119013.htm#(2)).

<sup>18</sup> Agricultural and Applied Economics Association, “About AAEEA,” <https://www.aaea.org/about-aaea>.

disposal to continue extension programs, such as its \$3.6 billion endowment—one of the largest in the country.<sup>19</sup>

- *Housing Affordability and Rehabilitation Enhancement Fund*: Act 58 of 2015 authorized the use of RTT revenue for this fund. The program’s recent expansion, which purportedly aims to make housing more affordable, demonstrates Harrisburg’s inability to control spending and protect taxpayers. Act 58 of 2015 should be repealed and RTT revenue returned to the General Fund. The loss of funds could be supplemented by the Unconventional Gas Well Fund, which has been the case in the past,<sup>20</sup> or by local governments and private organizations who focus on housing affordability issues.
- *Conservation District Fund*: More than \$3.3 million is transferred from the General Fund to the Conservation District Fund each year, with the goal of conserving soil, water, and natural resources. This is in addition to revenue distributed to conservation districts as a result of Act 13 of 2012. With a dedicated revenue source already authorized by state law, the \$3.3 million transfer could be returned to the General Fund. The existing cash balance in the Conservation District Fund can supplement any loss of funding for the 2017-18 fiscal year. Of course, this would only be a temporary measure, but would allow for time to explore the option of private funding alternatives.
- *Reprioritize transportation funds*. Pennsylvania spends more than \$1 billion a year on the operation and maintenance of mass transit systems.<sup>21</sup> Various revenue sources, including driver fees, turnpike tolls and sales taxes, finance transfers to the Public Transportation Trust Fund, Multimodal Transportation Fund, and Public Transportation Assistance Fund. This funding structure requires taxpayers to subsidize mass transit systems outside their communities. To the extent possible, people should pay for the services they use.

The revenues deposited in these funds should be reduced to reflect the proportion of state taxpayers using those services. Agencies could adjust to the reduction in state funding by implementing competitive contracting. Competitive contracting allows local agencies to bid out service management to firms willing to operate under a negotiated contract. Cities like San Diego, Denver, and London have already implemented competitive contracting, with each experiencing savings of approximately 40 percent or more.<sup>22</sup>

Severing the link between mass transit funding and Turnpike toll revenue alone will make more resources available for Turnpike improvements and even help limit toll hikes. Currently, tolls are set to increase 6 percent each year until 2044.<sup>23</sup> The legislature could also explore leasing the Turnpike as a way to raise revenue and put a lid on toll hikes. When this reform was discussed in 2008, the expected up-front savings was approximately \$12.8 billion.<sup>24</sup>

---

<sup>19</sup> Pennsylvania State University, “Long-Term Investment Pool & Similar Funds (LTIP),” <http://www.psu.edu/oim/gallery/botfiscal16.pdf>.

<sup>20</sup> Act 13 of 2012 Unconventional Gas Well Impact Fee, Annual Report of Fund Revenue and Disbursements, [http://www.puc.state.pa.us/NaturalGas/pdf/MarcellusShale/Gas\\_Well\\_PUC\\_Rpt\\_093016.pdf](http://www.puc.state.pa.us/NaturalGas/pdf/MarcellusShale/Gas_Well_PUC_Rpt_093016.pdf).

<sup>21</sup> Nathan Benefield, “Who pays for SEPTA?” <http://www.commonwealthfoundation.org/policyblog/detail/who-pays-for-septa>.

<sup>22</sup> Wendell Cox and Ronald D. Utt, “Improving Transit with Competitive Contracting,” <http://www.heritage.org/research/reports/2011/07/improving-transit-with-competitive-contracting>.

<sup>23</sup> Pennsylvania Turnpike Commission, “PA Turnpike Commission approves six percent toll increase for 2017,” <https://www.paturnpike.com/press/2016/20160719153742.htm>.

<sup>24</sup> Charles Thompson, “Spanish Firm offers 12.8 billion for 75-year turnpike lease,” [http://www.pennlive.com/midstate/index.ssf/2008/05/spanish\\_firm\\_picked\\_for\\_turnpi.html](http://www.pennlive.com/midstate/index.ssf/2008/05/spanish_firm_picked_for_turnpi.html).

The recommendations above would affect funds totaling **more than \$2.6 billion** in recurring and non-recurring revenue. If half of this spending were redirected, it would amount to an infusion of \$1.3 billion to cover costs for budget items like pension payments and debt service.

<b>Summary of Funds Available for Immediate Cost-Savings</b>	
<b>Program</b>	<b>Total Spending</b>
Public Transportation Trust Fund	\$1,221,568,000
Corporate Welfare	\$804,000,000
Public Transportation Assistance Fund	\$224,600,000
Multimodal Transportation Fund	\$138,733,000
Keystone Recreation, Park and Conservation Fund	\$93,000,000
Agricultural Conservation Easement Purchase Fund	\$60,000,000
Agricultural College Land Scrip Fund	\$50,000,000
Housing Affordability and Rehabilitation Enhancement Fund	\$13,000,000
Conservation District Fund	\$3,000,000
<b>Total</b>	<b>\$2,607,901,000</b>

### **Medium- and Long-Term Cost-Saving Reforms**

**Privatize the state-run liquor system.** With the passage of Act 39, Pennsylvania no longer has a total monopoly on wine and liquor sales, but the current system is still far from acceptable. The state continues to control the wholesale and retail side of most wine and all liquor sales. Utah is the only other state with this level of control over alcohol.

Pennsylvania’s liquor system is outdated, unpopular, and inefficient, costing the state at least \$180 million in sales annually due to border bleed.<sup>25</sup> Privatization would bring about more choice, convenience and better pricing, along with additional revenue without raising taxes. Indeed, auctioning off wholesale and retail licenses could raise between \$1.1-\$1.6 billion in up front revenue, according to a 2011 Public Financial Management Group study.<sup>26</sup>

Any revenue raised through privatization could be used to bridge the budget deficit. However, privatization is not a replacement for long-term budget reforms. Instead, it’s a way to facilitate a transition to truly balanced budgets, which are only possible if lawmakers rein in the state’s biggest cost drivers—education, human services, and corrections.

**Expand educational choice.** The state offers several educational options for families unsatisfied with the traditional public school system. These include charter schools, cyber charter schools, and two tax credit scholarship programs—the Educational Improvement Tax Credit (EITC) and the Opportunity Scholarship Tax Credit (OSTC). All of these options help families secure a better education for their children at a lower cost to taxpayers.

<sup>25</sup> Neiman Group, “2011 PLCB Border Bleed Tracking Study,” [http://www.commonwealthfoundation.org/docLib/20110912\\_PLCB\\_BorderBleed.pdf](http://www.commonwealthfoundation.org/docLib/20110912_PLCB_BorderBleed.pdf).

<sup>26</sup> Public Financial Management Group, “Liquor Privatization Analysis, Final Report,” [http://www.pabudget.com/Display/SiteFiles/154/Documents/Resources%20and%20Publications/Liquor%20Privatization/PLCB\\_Report\\_FINAL\\_10.20.11.pdf](http://www.pabudget.com/Display/SiteFiles/154/Documents/Resources%20and%20Publications/Liquor%20Privatization/PLCB_Report_FINAL_10.20.11.pdf).

As an example, in 2013-14, Philadelphia charter schools achieved a higher average School Performance Profile (SPP) score than traditional public schools—despite receiving about **20 percent less** in funding per student than public schools.<sup>27</sup> The funding difference is even greater when public school spending per student is compared to the value of the state’s two tax credit scholarship programs.

The average 2013-14 scholarship value of the EITC and OSTC was \$1,587 and \$2,312, respectively.<sup>28</sup> According to the National Center for Education Statistics, Pennsylvania’s funding per student reached \$16,013 in 2013-2014—\$3,500 more than the national average and the 9<sup>th</sup>-highest funding level in the country.<sup>29</sup>

The variation in funding is striking and highlights an opportunity to empower more families with access to a quality education while holding the line or even reducing property taxes. School choice has already saved Pennsylvania taxpayers roughly **\$1.3 billion from 2002-2014**, according to an EdChoice analysis of the EITC.<sup>30</sup> The cost-effective scholarships made savings possible by allowing students to switch from a public school to a private alternative.

Education reformers can build on Pennsylvania’s successful choice programs with Education Savings Accounts (ESAs) for students with special needs. ESAs allow parents to customize their child’s educational experience by combining services—such as cyber schools and physical therapy—for less than the cost of educating a student in a traditional public school.

The freedom to choose shouldn’t be limited to parents. School districts can benefit from more options as well. The state imposes mandates on school districts, which drive up costs for taxpayers.<sup>31</sup> By eliminating obsolete mandates, the state can clear the way for districts to prioritize spending and minimize or eliminate the need for large tax hikes and/or spending increases. The examples below highlight a few ways lawmakers could provide mandate relief to school districts.

- *Prevailing wage:* This mandate raises the costs of construction projects by requiring districts to pay contractors artificially inflated wage rates. Based on 2014 U.S. Census data—and assuming a 10 to 30 percent prevailing wage premium—both state and local governments could save between \$880 million-\$2.6 billion on construction costs if the mandate were repealed.<sup>32</sup>
- *Separate prime contracts:* School districts must enter into a separate contract for each construction project, meaning districts may be forced to hire additional staff to handle logistics, thereby raising total costs.
- *Legal advertising requirements:* School districts must provide public notices before taking certain actions. However, public notice requirements are unnecessarily cumbersome and don’t reflect how people obtain information in the digital age.

---

<sup>27</sup> James Paul, “Open Floodgates of School Choice in Philadelphia,”

[http://www.commonwealthfoundation.org/issues/research\\_detail.asp?id=3504](http://www.commonwealthfoundation.org/issues/research_detail.asp?id=3504).

<sup>28</sup> Ed Choice, “The ABCs of Ed Choice” (2016 ed.), <http://www.edchoice.org/wp-content/uploads/2016/02/2016-ABCs-WEB-2.pdf>.

<sup>29</sup> National Center for Education Statistics, “Revenues and Expenditures for Public Elementary and Secondary Education,” <http://nces.ed.gov/pubs2016/2016301.pdf>.

<sup>30</sup> Martin F. Lueken, “The Tax Credit Scholarship Audit,” [https://www.edchoice.org/wp-content/uploads/2016/11/2016-11\\_Tax-Credit-Scholarship-Audit-by-Martin-F.-Lueken-Jacob-UPDATED.pdf#page=17](https://www.edchoice.org/wp-content/uploads/2016/11/2016-11_Tax-Credit-Scholarship-Audit-by-Martin-F.-Lueken-Jacob-UPDATED.pdf#page=17).

<sup>31</sup> Pennsylvania School Board Association, “School District Mandates: Their Impact on Public Education,” <https://www.psba.org/mandates>. <https://www.psba.org/wp-content/uploads/2016/06/mandate-report-final.pdf>.

<sup>32</sup> U.S. Census Bureau - State & Local Government Finance, “2014 State and Local Government,” <https://www.census.gov/govs/local/>.



**Structure welfare to encourage self-sufficiency.** The fastest-growing agency in state government is the Department of Human Services (DHS). The agency’s budget is projected to grow by an average of 5.8 percent per year. No other major agency will match this growth. Nevertheless, the system is still failing Pennsylvanians, trapping them in poverty and discouraging independence. Large-scale reform is needed to free people from welfare and restore the dignity of work.

- *Redesign Medicaid to improve quality and ease the transition to private insurance.* Medicaid—a joint federal and state means-tested program—provides medical services to people with limited resources (income, assets, etc.). It is the largest item in the Department of Human Services’ budget and is set to grow by \$854 million in 2016-17.

About thirty percent, or \$240 million, of the increase is directly due to the Affordable Care Act, which expanded Medicaid’s service population and requires Pennsylvania to pay for 5 percent of enrollee costs in 2017 and 6 percent in 2018.<sup>33</sup>

Medicaid’s expansion came at the expense of providing quality healthcare to those who need it most.<sup>34</sup> Access to providers is often limited and evidence demonstrates those on Medicaid experience worse healthcare outcomes than the uninsured.<sup>35</sup> States need flexibility from Washington D.C. to create a system that leverages choice to protect the poor. State lawmakers can petition the incoming Congress and president for this flexibility.

Other states have reported successes after moving away from the traditional Medicaid model. Florida improved the quality of its Medicaid program through a waiver that emphasized choice counseling. The state’s reforms saved taxpayers \$161 million annually in the first five years.<sup>36</sup> Rhode Island reduced emergency room use and promoted home-care through a global waiver, resulting in savings of \$55 million over three years.<sup>37</sup>

Flexibility will allow Pennsylvania to innovate and make the changes necessary—like implementing work requirements, sliding scale premiums, and copays—to ease the transition from Medicaid to private health insurance. These reforms would also allow the state to concentrate resources on the individuals most in need.

- *Strengthen work requirements and time limits for welfare programs.* The Supplemental Nutrition Assistance Program (SNAP), or food stamps, is funded primarily by the federal government and administered by the states. As of March 1, 2016, Pennsylvania residents in 45 counties must fulfill a work requirement to receive benefits.<sup>38</sup> While this is an improvement over the previous system, more can be done to promote employment.

---

<sup>33</sup> Independent Fiscal Office email response.

<sup>34</sup> James Paul & Elizabeth Stelle, “The Trouble with Medicaid Expansion,” <http://www.commonwealthfoundation.org/policyblog/detail/the-trouble-with-medicaid-expansion>.

<sup>35</sup> Damien J. LaPar et al., “Primary Payer Status Affects Mortality for Major Surgical Operations,” <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC3071622/>.

<sup>36</sup> Tarren Bragdon, “Florida’s Medicaid Reform Shows the Way to Improve Health, Increase Satisfaction, and Control Costs,” <http://www.heritage.org/research/reports/2011/10/floridas-medicaid-reform-shows-the-way-to-improve-health-increase-satisfaction-and-control-costs>.

<sup>37</sup> The Lewin Group, “An Independent Evaluation of Rhode Island’s Global Waiver,” [http://www.ohhs.ri.gov/documents11/Lewin\\_report\\_12\\_6\\_11.pdf](http://www.ohhs.ri.gov/documents11/Lewin_report_12_6_11.pdf).

<sup>38</sup> Pennsylvania Department of Human Services, “SNAP Work Requirements (ABAWDS),” <http://www.dhs.pa.gov/citizens/supplementalnutritionassistanceprogram/snapworkrequirementsabawds/index.htm>.

To encourage independence, meaningful work requirements and time limits should be required for all able-bodied SNAP participants. Similar reforms have worked in states like Maine and Kansas. Maine saw a nearly 80 percent drop in total caseloads after implementing work requirements.<sup>39</sup> In Kansas, caseloads fell and income rose for people who found employment after leaving the SNAP program. Plus, Kansas reaped \$1.3 million in additional tax revenue per year and saved \$1.7 million in administrative costs.<sup>40</sup> If Pennsylvania were to reduce administrative costs by the same percentage, the state could save \$20 million.

- *Authorize recovery audits.* In a September 2016 report, the Auditor General revealed the state was making food stamp and cash assistance payments to more than 2,300 dead people over a 12-month period.<sup>41</sup> The cost to taxpayers? Nearly \$700,000. This type of waste must be rooted out to ensure resources are going to those who truly need them. One low-cost solution involves expanded use of recovery audits to recoup improper payments. Recovery audits should not impose any upfront costs to taxpayers because auditing firms work on a contingency basis. In other words, an auditing firm's performance—specifically its ability to recover misspent dollars—will determine compensation.
- *Reform the Child Care Works program.* According to a 2011 analysis conducted by DHS, more than 93 percent of participants in the Child Care Works Subsidy Program are single parents. Yet, parents participating in the program are not required to recover child support.<sup>42</sup> If recovery were made mandatory, lawmakers could shift part of the funding responsibility from taxpayers to absentee parents.

A stronger work requirement is also worth considering. As of now, parents must either work 20 hours a week or work 10 hours a week and engage in 10 hours of school or training.<sup>43</sup> Increasing the hours-worked threshold will help individuals more quickly transition to independence.

**Improve incarceration practices.** Pennsylvania's prison population is declining but remains 36 percent larger than in 2000. In fact, Pennsylvania has the highest incarceration rate of any state in the Northeast.<sup>44</sup>

---

<sup>39</sup> Robert Rector et al., "Maine Food Stamp Work Requirement Cuts Non-Parent Caseload by 80 Percent," <http://www.heritage.org/research/reports/2016/02/maine-food-stamp-work-requirement-cuts-non-parent-caseload-by-80-percent>.

<sup>40</sup> Foundation for Government Accountability, "The Power of Work: How Kansas' Welfare Reform Is Lifting Americans Out of Poverty," <https://thefga.org/wp-content/uploads/2016/02/PowerOfWork-KansasWelfareReform.pdf>.

<sup>41</sup> Department of Human Services, "Special Performance Audit," <https://localtvwnep.files.wordpress.com/2016/09/performance-audit-of-pa-department-of-human-services-ebt.pdf>.

<sup>42</sup> Erik Randolph, "Out of Control: How Welfare Spending is Driving the Budget Crisis," [http://www.commonwealthfoundation.org/docLib/20150521\\_DHSBudgetReport.pdf](http://www.commonwealthfoundation.org/docLib/20150521_DHSBudgetReport.pdf).

<sup>43</sup> Pennsylvania Department of Human Services, "Child Care Works Subsidized Child Care Program," <http://www.dhs.pa.gov/citizens/childcareearlylearning/childcareworkssubsidizedchildcareprogram/>.

<sup>44</sup> Justice Center - The Council of State Governments, "Justice Reinvestment in Pennsylvania: Fifth Presentation to the Working Group—December 2016," [https://csgjusticecenter.org/wp-content/uploads/2016/12/JR-in-Pennsylvania\\_fifth-presentation.pdf](https://csgjusticecenter.org/wp-content/uploads/2016/12/JR-in-Pennsylvania_fifth-presentation.pdf).

As The Council of State Governments Justice Center points out, crime is not driving high incarceration rates.<sup>45</sup> The main factor is Pennsylvania’s inefficient and ineffectual sentencing system.

The flawed sentencing system has increased corrections spending by 55 percent over the last 10 years. In 2005, General Fund corrections expenditures totaled \$1.53 billion. Today, the total exceeds \$2.3 billion—making corrections the third-largest expense in the state’s General Fund budget.<sup>46</sup>

Fortunately, Pennsylvania can build on legislation passed in 2012 that continues to reduce the prison population, recidivism rates, and costs without jeopardizing public safety. Here are four solutions:

- *Ensure inmates with short prison sentences are released when they are eligible for parole:* Prisoners are given a minimum and maximum sentence after conviction. They are eligible for parole when they reach their minimum sentence, but they are sometimes held beyond this date—by an average of about 8 months—to complete programming. This additional time costs taxpayers \$69 million a year while doing very little to reduce recidivism.<sup>47</sup> Lawmakers should consider less expensive alternatives to incarceration for low-risk offenders.
- *Base sentences on cost-effective recidivism-reducing sanctions:* In its fourth presentation to the Justice Reinvestment Initiative Working Group, the Justice Center highlights the “lack of dispositional advice” as one contributor to high recidivism.<sup>48</sup>

Stated differently, judges use costly incarceration sentences rather than sentences or programs proven to reduce recidivism because they lack pertinent information. To rectify this, lawmakers could give judges the tools necessary to evaluate sentences based on reductions in recidivism. Smart adjustments to the incarceration length will allow for increased programming in the community.

Moving less dangerous offenders out of jail or prison and increasing the intensity of community interventions will reduce costs and free institutional space for the truly dangerous.

- *Avoid lengthy prison terms for minor probation and parole violations:* Probation and parole violators account for about 30 percent of Pennsylvania’s prison population, costing taxpayers an estimated \$421 million per year to incarcerate.<sup>49</sup> According to the IFO, the Average cost of an inmate will be \$48,200 in 2016-17, compared to \$4,200 for a parolee.<sup>50</sup>

---

<sup>45</sup> Justice Center - The Council of State Governments, “Justice Reinvestment in Pennsylvania: First Presentation to the Pennsylvania Justice Reinvestment Working Group,” <https://csgjusticecenter.org/wp-content/uploads/2016/03/PA-Launch-Presentation.pdf>.

<sup>46</sup> Ibid.

<sup>47</sup> Justice Center - The Council of State Governments, “Justice Reinvestment in Pennsylvania: Fourth Presentation to the Working Group—September 2016,” [https://csgjusticecenter.org/wp-content/uploads/2016/09/JR-in-Pennsylvania\\_Fourth-Presentation.pdf](https://csgjusticecenter.org/wp-content/uploads/2016/09/JR-in-Pennsylvania_Fourth-Presentation.pdf).

<sup>48</sup> Ibid.

<sup>49</sup> Justice Center - The Council of State Governments, “Justice Reinvestment in Pennsylvania: Third Presentation to the Working Group—July 2016,” [https://csgjusticecenter.org/wp-content/uploads/2016/07/PA\\_Presentation3.pdf](https://csgjusticecenter.org/wp-content/uploads/2016/07/PA_Presentation3.pdf).

<sup>50</sup> Independent Fiscal Office, “Economic & Budget Outlook: Fiscal Years 2016-17 to 2021-22” [http://www.commonwealthfoundation.org/docLib/20161116\\_Five\\_Year\\_Outlook\\_2016.pdf](http://www.commonwealthfoundation.org/docLib/20161116_Five_Year_Outlook_2016.pdf).

By adopting better supervision practices and swift and certain confinement sanctions for minor violations of probation and parole, policymakers can reduce the prison population and save tax dollars while protecting public safety.

As part of the Justice Reinvestment process in North Carolina, the state began using swift and certain sanctions for probation violations. This helped reduce parole revocations by 50 percent.<sup>51</sup> Recent analysis indicates violators who received a short confinement sanction were less likely to abscond or be returned to prison than people who did not receive a short confinement sanction.

- *Make the best use of community correction facilities:* Community corrections facilities cost the state \$131 million annually and are filled mostly with people paroled from prison.<sup>52</sup> This inefficient use of resources limits the ability of parole officers to use these beds to sanction technical parole violators. One recommendation to improve this process includes developing admission criteria for these facilities to limit their use for low-risk people and those paroled from prison in order to maximize their use for high-risk people.

**Utilize public-private partnerships for state park management.** Leveraging the private sector to provide popular services at a lower cost is a better way to meet Pennsylvania's needs without resorting to job-killing tax hikes. A public private partnership (P3) makes this possible by bringing both sectors together to manage services, including those related to transportation, education, and recreation.

State government operates 121 parks throughout Pennsylvania, which will cost taxpayers more than \$54 million dollars in 2016-17.<sup>53</sup> Some of these costs can be shifted from taxpayers to private management companies by enacting leasing contracts established through a P3. A public body can negotiate contracts to include price ceilings, development restrictions, general operation requirements, and quality benchmarks. If a private contractor does not meet the terms of a leasing contract, the state can cancel the contract and regain park management.

The Crescent Moon/Red Rock Recreation Area in Arizona is an illuminating case study of a successful P3 model.<sup>54</sup> The park's manager—Recreation Resource Management—was able to cover the park's operating cost through fees and generate additional revenue for the U.S. Forest Service, which originally managed the park. In contrast, an adjacent park managed by a state agency failed to generate enough revenue to break even—costing taxpayers \$234,000.

Four states—Colorado, California, Oregon, and Washington—have more than 100 recreational areas operated by private concessionaries, according to a 2013 Reason Foundation study.<sup>55</sup> And while it doesn't contract park management out to private organizations, Pennsylvania does utilize concession agreements to provide certain services to park visitors.<sup>56</sup>

---

<sup>51</sup> Justice Center - The Council of State Governments, "Justice Reinvestment in North Carolina: Three Years Later," <http://jr.nc.gov/files/JRinNCThreeYearsLater.pdf>.

<sup>52</sup> Justice Center - The Council of State Governments, "Justice Reinvestment in Pennsylvania: Third Presentation to the Working Group—July 2016," [https://csgjusticecenter.org/wp-content/uploads/2016/07/PA\\_Presentation3.pdf](https://csgjusticecenter.org/wp-content/uploads/2016/07/PA_Presentation3.pdf).

<sup>53</sup> 2016-17 Enacted Budget General Fund State Appropriations, <http://www.pabudget.com/Display/SiteFiles/154/Documents/FY%202016-17%20GF%20Budget/Legislative%20Budget/2016-17%20Enacted%20-%20FINAL.pdf>.

<sup>54</sup> Warren Meyer, "A Tale of Two Parks," <http://www.perc.org/sites/default/files/pdfs/WEB-TaleofTwoParks.pdf>.

<sup>55</sup> Leonard Gilroy et al., "Parks 2.0: Operating State Parks Through Public-Private Partnerships," [http://reason.org/files/state\\_parks\\_privatization.pdf](http://reason.org/files/state_parks_privatization.pdf).

<sup>56</sup> Pennsylvania Department of Conservation and Natural Resources, "Business Opportunities," <http://www.dcnr.state.pa.us/stateparks/business-opportunities-with-state-parks/index.htm#pricing>.

Examples of concessions managed include food and refreshment sales, bicycle rentals, and golf operations. The commonwealth should build on this model and lease the management of state parks to a private operator if doing so provides a financial windfall to taxpayers. Though current concession agreements aren't aimed at saving tax dollars, they do provide a framework to follow if lawmakers decide to pursue a P3.

**Adopt a sustainable model for public employee healthcare.** Personnel is the most expensive component of government operations. While public employee pay has risen by 5.6 percent since 2006, average benefits per employee have increased by an astonishing 71.2 percent. Just last year, compensation rose by \$7,700 per worker—more than \$5,000 from benefits alone.<sup>57</sup>

Healthcare benefits are a major driver of employee costs. States like Indiana and New Hampshire have implemented reforms to reduce healthcare insurance costs without sacrificing quality care. In 2006, Indiana created a high-deductible plan paired with a Health Savings Account (or POWER account) for state employees. Every year, the state contributes to an employee's POWER account. Employees are allowed to use the account to pay their health bills, with the state covering the premium for the plan.

For the small number of employees (6% in 2010) who used their entire account balance, the state further shared health costs up to an out-of-pocket maximum of \$8,000 in 2010. This option has proven highly popular. In 2012, more than 90 percent of state workers signed up.<sup>58</sup> Plus, the state saved an estimated \$20 million in 2010.<sup>59</sup>

New Hampshire took a different approach to encourage cost-conscious healthcare use. In 2014, the state implemented a cash incentive program for state employees who shop for healthcare. Preliminary information from 2014 shows 88 percent of employees are shopping for lower cost, high quality care—saving state taxpayers about \$12 million.<sup>60</sup>

**Review government administration practices.** It's common to hear capitol insiders claim state government is cut to the bone. Yet, examples of waste—such as state agencies operating with more vehicles than actual employees—contradict this notion.<sup>61</sup> Reducing this type of waste will help ensure each tax dollar is put to the best possible use.

- *Request an analysis on streamlining government bureaucracy.* A review of state practices is long overdue, and Louisiana's approach is worth considering. In 2013, the state requested an in-depth analysis of how to deliver services more efficiently. The state tasked a business consulting firm, Alvarez & Marsal (A&M), to provide the analysis and recommendations for improvement. A&M offered more than 70 ideas to save or raise \$2.7 billion over five years.<sup>62</sup>

---

<sup>57</sup> Bob Dick, "Pennsylvania Must Control Compensation Costs,"

<http://www.commonwealthfoundation.org/policyblog/detail/pennsylvania-must-control-compensation-costs>.

<sup>58</sup> Ted Abram, "Indiana's Health Savings Account Success," <http://www.freedomworks.org/content/indianas-health-savings-account-success>.

<sup>59</sup> Mitch Daniels, "Hoosiers and Health Savings Accounts,"

<http://www.wsj.com/articles/SB10001424052748704231304575091600470293066>.

<sup>60</sup> Foundation for Government Accountability, Right to Shop, <https://thefga.org/solutions/health-care-reform/right-to-shop/>.

<sup>61</sup> John Finnerty, "Auditor general finds some state offices have more vehicles than workers," *The Tribune Democrat*, [http://www.tribdem.com/news/auditor-general-finds-some-state-offices-have-more-vehicles-than/article\\_b4f3e774-73e5-11e6-b18f-bf07ec533af9.html](http://www.tribdem.com/news/auditor-general-finds-some-state-offices-have-more-vehicles-than/article_b4f3e774-73e5-11e6-b18f-bf07ec533af9.html).

<sup>62</sup> Alvarez & Marsal, "Louisiana Government Efficiencies Management Support,"

[http://www.doa.la.gov/orm/PDF/2014\\_Louisiana\\_Government\\_Efficiencies\\_Management\\_Support\(GEMS\)Final\\_Report.pdf](http://www.doa.la.gov/orm/PDF/2014_Louisiana_Government_Efficiencies_Management_Support(GEMS)Final_Report.pdf).

Recommendations included changing the process for procuring insurance on state property, centralizing administrative functions in Louisiana's Department of Transportation, and modernizing reporting requirements. According to the report, "efficiency reviews have generally identified savings of five to six percent of the general fund budget" in other states. For Pennsylvania, this would amount to savings of \$1.5-\$1.9 billion.

- *Implement performance-based budgeting.* Too often, state government gives tax dollars to the same programs year after year without considering results. Requiring agencies to meet clearly defined outcomes would alleviate this problem. If a particular program does not meet its performance goals, it should be eliminated.

## **Conclusion**

Pennsylvania's regular budget deficits, rapid spending growth, and lackluster economic performance stem from state government operating on auto-pilot instead of actively reforming broken programs. Tackling the underlying causes of our budget problems, while embracing innovative efforts to streamline government, will strengthen Pennsylvania's communities and make the commonwealth a better place to live and work *for everyone*.

## Summary of Medium and Long-Term Cost-Saving Reforms

<b>The Problem</b>	<b>The Solution</b>	<b>Financial Impact</b>	<b>The Reform</b>
Kids trapped in violent and failing schools	Expand School Choice Options	\$1.3 billion in savings from the EITC alone from 2002-2014	Expand the EITC and OSTC. Enact Education Savings Accounts.
State and federal mandates squeezing school budgets	Reduce Education Mandates	Assuming a 10 to 30% prevailing wage premium, state and local governments could save \$1 to \$3 billion by repealing the prevailing wage.	Provide mandate relief through a waiver program and the elimination of prevailing wage for school construction projects.
Low-quality Medical Assistance with rapidly rising costs	Medicaid Flexibility	Rhode Island saved more than \$55 million through a global waiver.	Seek a block grant for Medicaid that would allow work requirements, sliding scale premiums, choice counseling and other measures to improve quality and transition individuals to private insurance.
Continued growth of welfare program enrollment	Meaningful Work Requirements	Kansas saved \$1.7 million in administrative costs and about \$1.3 million in additional income tax revenue per year. Reducing administrative costs by the same percentage could save \$20 million.	Enact meaningful work requirements and time limits for able-bodied recipients without dependents a feature of all safety net programs.
Individuals in prison beyond their minimum sentence	Release individuals when they're eligible for parole	Additional time spent in prison costs \$69 million a year.	Ensure low-risk individuals with short sentences are released when eligible to allow for alternatives to in-prison programming.
30% of inmates are probation or parole violators	Reform Probation & Parole Violation Procedures	The difference between housing an inmate and parolee is \$44,000 per year. Similar reforms in North Carolina reduced parole revocations by 50%.	Adopt better supervision practices and swift and certain confinement sanctions for minor probation and parole violations to reduce prison sentences.
The PLCB is \$238 million in debt	Privatize the State-Run Liquor System	Auctioning off licenses could raise between \$1.1-\$1.6 billion in one-time revenue, according to a 2011 PFM report.	Sell off the PLCB's wholesale and retail operations—the revenue of which can be used to help balance the budget in the short-term.
Large government bureaucracies are prone to waste	Review Government Operations for Efficiencies	An audit of Louisiana's practices revealed nearly \$2.7 billion in savings or new revenue over five years. Reviews generally save 5% of General Fund expenditures—a sum equivalent to \$1.5 billion in Pennsylvania.	Request an in-depth analysis from a business consultant firm on how to deliver government services more efficiently.
\$22 million increase in employee healthcare benefits next year	Revamp Public Employee Health Benefits	Indiana and New Hampshire were able to save \$20 million and \$12 million respectively by giving public employees more control over their healthcare.	Give public employees the incentive to shop for the best value either through HSAs or cash rebates for choosing high value care.

### **About the Author and the Commonwealth Foundation**

Bob Dick is a senior policy analyst with the Commonwealth Foundation. The author would like to thank Elizabeth Stelle—Director of Policy Analysis for the Commonwealth Foundation and Patrick Armstrong—Policy Analyst for the Council of State Governments Justice Center for their contributions to this report.

The Commonwealth Foundation is Pennsylvania’s free-market think tank. The Commonwealth Foundation transforms free-market ideas into public policies so *all* Pennsylvanians can flourish.