POLICY MEMO
FROM THE COMMONWEALTH FOUNDATION

June 2017

Principles for State Budget

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Reject Gov. Wolf's Billion-Dollar Tax Hike

Gov. Wolf's 2017 proposed budget shifts towards identifying cost savings and reinventing government. He includes several notable reforms aimed at consolidating programs and making services more efficient.

Unfortunately, he doesn't take this reinventing government far enough. In total, Wolf calls for $1 billion in additional taxes, amounting to $315 more per family of four.

State Tax Rate Changes	Total Revenue	Per Family of Four
Severance Tax of 6.5% - July 1, 2017 (existing impact fee payments deducted)	$293,800	$92
Sales Tax (6% rate) imposed on custom programming, design and data processing - July 1, 2017	$330,300	$103
Sales Tax (6% rate) imposed on commercial storage - July 1, 2017	$153,600	$48
Sales Tax (6% rate) imposed on airline food - July 1, 2017	$800	$0
Sales Tax (6% rate) imposed on aircraft sales - July 1, 2017	$5,100	$2
Insurance Premiums Tax expanded to most previously exempt insurance entities - January 1, 2018	$141,500	$44
Corporate Net Income Tax: Mandatory Combined Reporting; Cap of Net Operating Loss Carry Forward. Future reductions in 2019-2022 to get rate to 6.49%	$81,200	$25
TOTAL STATE TAX INCREASES	$1,006,300	$315

Source: Governor's Executive Budget. Total Revenue in Thousands

His budget includes imposing the sales tax on several business services that are currently untaxed, including technology services. He also proposes expanding the tax on insurance premiums.

For the third time, Gov. Wolf proposes a natural gas severance tax. This 6.5% proposal is unlikely to get traction in the legislature. The severance tax, targeting one industry, ignores that gas drillers already pay an onerous impact fee, which functions like a 5% tax, plus all the high taxes every other Pennsylvania business pays. With gas prices still depressed, this tax wouldn't generate much revenue and would only hinder job growth when the gas industry is already laying off workers.

Focus Tax Policy on Growing the Economy

The state budget deficit isn't the result of taxes being too low, but because of slow economic growth. To borrow from former president Bill Clinton's campaign, "it's the economy, stupid."

Pennsylvania's overall state and local tax burden already ranks 15th highest in the country, according to the Tax Foundation. WalletHub estimates that for a family with the median household income, Pennsylvania's tax system imposes the 11th highest tax burden.

As a result of these high taxes, Pennsylvania continues to lose residents to other states and lag behind the nation in economic growth. From 1991-2015, Pennsylvania ranked 46th in job growth, 45th in personal income growth, and 46th in population growth. Last year, Pennsylvania lost population for the first time in 31 years. Losses in state-to-state migration drive this population loss: Pennsylvania lost 45,000 residents in net domestic migration last year.

This migration is especially pronounced among college-educated millennials. Pennsylvania lost a net 12,981 millennials to other states in 2015—that's 36 college graduates leaving every day to find jobs elsewhere.

Lawmakers need to address tax reform to grow our state economy, generate job growth, attract new residents, and make the Keystone State a land of opportunity. Only such long-term thinking will fix our fiscal woes.

Avoid Last Year's Mistakes

The 2016-17 state budget was never truly balanced, and instead included rosy forecasts of revenue growth, imposed job-killing new taxes, and avoided necessary spending reforms.

Lawmakers should be quick to reject any more tax increases, following the $650 million tax increase enacted last year. Instead of solving the structural deficit, these tax hikes only further hindered the state economy, resulting in a more severe budget deficit.

The onerous 40% wholesale tax on e-cigarette products is a clear example of misguided policy. Less than one year after implementation, nearly one-third of the state's vape shops—about 100—have shut their doors. Legislation to address the harms of this tax advanced in the State Senate in April.

Likewise, efforts to "modernize" the state liquor stores—a Liquor Control Board-crafted initiative to avoid real privatization—haven't delivered. The modernization that let the government monopoly "act more like a business" by offering coupons, extended hours, and imposing higher prices on consumers is on track to generate only 29% of the projected revenue.

Enact Real Structural Reforms

1. *Privatize Liquor Sales*

   In April, the Pennsylvania House passed multiple bills that would seek to end the government monopoly over liquor sales. These bills would allow restaurant licensees to sell spirits, allow retail stores to sell wine and spirits, and allow private wholesalers to distribute wine and spirits across the state. In total, these reforms would offer consumers better selection and more convenience, would generate the competition necessary to see lower prices, and would end the rampant corruption and conflict of interest at the Pennsylvania Liquor Control Board.

Additionally, these proposals would generate new revenue to help balance the budget without raising taxes—both in terms of upfront revenues, and in annual license fees and tax revenues from reducing border bleed.

2. *Reduce Corporate Welfare*

   Pennsylvania leads the nation in economic development subsidies. In reality, picking winners and losers—while keeping the overall tax burden exorbitantly high—is a recipe for economic stagnation. States that spend the most on corporate subsidies have *slower* job growth than those that spend less, who can consequently offer lower taxes on all job creators and working families.

   The current budget includes more than $800 million in grants, loans, tax breaks, and other incentives targeting specific businesses and industries. Before asking taxpayers to give more, lawmakers should reduce these corporate welfare programs that benefit a select few special interests. In particular, the $250 million used every year to subsidize horse racing prizes—money that benefits out-of-state billionaires—should be a target for reduction.

3. *Reform Welfare Programs*

   The Independent Fiscal Office projects spending in the Department of Human Services—where welfare programs are housed—to outpace, by several times, the growth rate of the overall economy in the coming years. This sort of growth, in the largest department in state government, is unsustainable, threatening both taxpayers and the truly needy who rely on human services.

   Medicaid is a prime example. Despite projections that spending will grow 6.7% annually, the program provides sub-quality care and few options for our population's diverse health needs. One solution is to seek flexibility from the federal government, through a waiver or future block grant, to create a program that expands patient control and provides a smooth transition to private insurance.

   Several lawmakers are discussing meaningful work requirements for welfare programs. When enacted in other states, these requirements reduced welfare rolls because more individuals found jobs—both saving money and helping families transition from poverty to prosperity.

4. *Adopt Criminal Justice Reforms*

   "Smart on crime" reforms adopted in Pennsylvania and across the nation have shown to both reduce corrections costs and help reduce crime.

   Pennsylvania's prison population declined by almost 2,000 inmates since the end of 2012, following unanimously adopted reforms. This includes a decline of 850 inmates in 2015—the largest one-year decline in 40 years. Pennsylvania's recidivism rate—the percentage of paroled inmates who return to prison—has dropped to some of the lowest rates in recent history. And simultaneously, Pennsylvania's crime rate declined since the enactment of these reforms.

A second round of Justice Reinvestment Initiative reforms, a proposal approved by a bi-partisan commission representing a broad swath of interest groups, would save an estimated $108 million over four years. Further, merging the Department of Correction and Probation and Parole, legislation which advanced in the Senate this year as well as last session, would help implement critical reforms while reducing the costs for taxpayers.

5. *Enact the Taxpayer Protection Act*

   The Taxpayer Protection Act (TPA) is simple legislation that would limit the *growth* of state spending to inflation and population growth, and can only be exceeded with the support of a super-majority of lawmakers. The TPA would prevent the boom and bust cycles of overspending when the economy is performing well.

   Had the TPA been in place since 2003, taxpayers would have saved a cumulative **$29.4 billion or $2,222 per family of four**. And Pennsylvania would be ending the fiscal year with a $2 billion surplus. Instead, lawmakers are contemplating how to close a multi-billion-dollar budget deficit.

   Both House and Senate committees have moved versions of the TPA.

6. *Expand School Choice*

   The state House has passed legislation to increase the Educational Improvement Tax Credit (EITC) and the Opportunity Scholarship Tax Credit (OSTC) by a combined $75 million. These tax credit scholarship programs serve approximate 50,000 students, but many more families await opportunities. For example, the Children's Scholarship Fund Philadelphia has nearly 8,000 applicants each year they can't serve—students who literally lose a lottery for a scholarship.

   Scholarship programs have a strong record of success. Of 18 studies of educational choice scholarship programs, 14 found they improve academic performance. Moreover, tax credit scholarships save money. The EITC alone saved Pennsylvania taxpayers an estimated $1.3 billion between 2002 and 2014, according to an EdChoice study. The average EITC scholarship is $1,684—approximately one-tenth the $16,425 public schools spend per student.

Lawmakers have an opportunity to double down on the idea of reinventing government and adopt meaningful reforms that will save taxpayers money and avoid job-killing tax hikes—while simultaneously stimulating economic growth and improving services for the residents of Pennsylvania.