



November 2020

## How to Balance the State Budget without Raising Taxes in a Pandemic

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*There is no business as usual for Pennsylvania families, businesses, or state government. The 2019-20 fiscal year ended with an \$2.7 billion deficit, leading to a current budget that funds state government for approximately five months. [The Independent Fiscal Office \(IFO\) projects approximately \\$3 billion](#) in revenue losses due to COVID-19.<sup>1</sup> This analysis presents a menu of identified spending reductions and transfers—collectively, they provide more than double the revenue needed to close the balance the budget.*

### **Key Points**

- As COVID-19 revenue losses materialize and entitlement spending increases, Pennsylvania must prioritize spending.
- This analysis presents a range of spending reductions and reforms totaling \$10 billion, or more than double the revenue losses facing lawmakers in November.
- Spending reductions include:
  - Transferring excess cash from hundreds of segregated special funds (the shadow budget) totaling \$345 million.
  - Twelve line-item reductions totaling at least \$1.6 billion.
  - Eliminating underperforming tax credits, freeing up \$145 million.
  - Turning the turnpike into a revenue stream by leasing the toll road, for a net return of \$6.8 billion.
  - Privatizing the retail and wholesale sale of liquor, reaping \$1 billion in up-front revenue.

### **Shadow Budget Transfers**

The operating budget contains more than a hundred special funds outside of the General Fund. These funds operate in the background, apart from yearly budget discussions, and are labeled the shadow budget. As of November 2, these funds total \$10.6 billion.

This analysis highlights 14 funds with significant reserves, plus three major mass transportation funds. Together, these funds have a reserve that totals 147% of their planned spending.

Government officials could transfer \$345 million from these reserves to balance the budget without impacting spending commitments.

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<sup>1</sup> Independent Fiscal Office: <http://www.ifo.state.pa.us/releases/378/Official-Revenue-Estimate-FY-2020-21/>;  
[http://www.ifo.state.pa.us/download.cfm?file=Resources/Documents/Economic\\_and\\_Revenue\\_Update\\_2020\\_10.pdf](http://www.ifo.state.pa.us/download.cfm?file=Resources/Documents/Economic_and_Revenue_Update_2020_10.pdf).

# 2020 Shadow Budget Reserves

*Pennsylvania has billions of surplus dollars in off-budget funds*

Selected Funds	Reserves 9/18	Annual Spending	Reserves as % of Spending
Agricultural Conservation	\$67,693,369	\$40,000,000	169%
Ben Franklin Technology Development Authority Fund	\$24,556,408	\$35,000,000	70%
Compulsive and Problem Gambling Treatment Fund	\$10,784,080	\$9,797,000	110%
Conservation District Fund	\$6,066,428	\$7,585,000	80%
Energy Development Fund	\$3,488,726	\$135,000	2584%
Environmental Education Fund	\$4,429,647	\$904,000	490%
Environmental Stewardship Fund	\$166,367,337	\$108,872,000	153%
Historical Preservation Fund	\$6,729,599	\$3,967,000	170%
Justice Reinvestment Fund	\$633,325	\$566,000	112%
Keystone Recreation, Park and Conservation Fund	\$168,165,689	\$114,368,000	147%
Minority Business Development Fund	\$1,749,091	\$1,340,000	131%
Pa Infrastructure Bank	\$40,922,393	\$25,000,000	164%
Recycling Fund	\$99,455,724	\$62,581,000	159%
Highway Beautification Fund	\$386,244	\$300,000	129%
<b>Subtotal</b>	<b>\$601,428,060</b>	<b>\$410,415,000</b>	<b>147%</b>
<b>Mass Transit Funds</b>			
Multimodal Transportation Fund	\$294,906,574	\$152,320,000	194%
Public Transport Trust Fund	\$942,529,652	\$1,634,488,000	-58%
Public Transport	\$10,581,999	\$297,500,000	-4%
<b>Subtotal</b>	<b>\$1,248,018,225</b>	<b>\$2,084,308,000</b>	<b>60%</b>
<b>Other</b>			
Rainy Day	\$343,272,058	\$0	
<b>Grand Total</b>	<b>\$2,192,718,343</b>	<b>\$2,494,723,000</b>	

Source: <https://www.patreasury.gov/tabs/>;

<https://www.budget.pa.gov/PublicationsAndReports/CommonwealthBudget/Pages/default.aspx>

## **12 Line-Item Reductions**

1. **Personnel:** About 8.4% of Pennsylvania private-sector jobs have been lost.<sup>2</sup> In contrast, Governor Tom Wolf enacted a 1.5% reduction in state workers under his jurisdiction. Further, the benefit costs of state workers far exceed those in the private sector. Total benefits represent 79% of salary—compared to a norm of 30% in the private sector.<sup>3</sup> If the governor enacted layoffs on the scale of the private sector, agencies would see a savings of *\$688 million*. The legislature should seek additional rightsizing for staff and overtime and benefits.

# Public and Private Employee Trends

*Public employee job loss is far less than private sector job loss*

Number of Employees		
	Public	Private
3/15/2020	103,059	5,331,400
5/15/2020	102,272	4,520,800
8/15/2020	101,475	4,878,800
Change Since March	-1,584	-452,600
Percentage Change Since March	-1.5%	-8.4%

Employee Compensation		
	Cost Per Public Employee	Total Cost
Overtime	\$4,006	\$313,437,452
Employee Health Care	\$12,675	\$991,717,350
Retiree Health Care	\$7,824	\$612,165,408
Total Employee Benefits	\$46,249	\$3,618,614,258
<b>Total Employee Costs</b>	<b>\$104,606</b>	<b>\$8,184,582,652</b>

Sources: PennWatch, State Government Workforce Statistics for 78,242 employees under the governor's jurisdiction, and data from the Bureau of Labor Statistics.

<sup>2</sup> Bureau of Labor Statistics: <https://www.bls.gov/sae/data/home.htm>. See also: <https://infogram.com/payroll-job-losses-by-sector-1h0r6r7x88k72ek?live>.

<sup>3</sup> Office of Administration workforce statistics: <https://www.hrm.oa.pa.gov/Workforce/Pages/default.aspx>; Bureau of Labor Statistics: <https://www.bls.gov/news.release/ecec.t01.htm>.

2. **Office Space:** [According to PennWatch](#), state government spent **\$255.5 million** on real estate, **\$32.6 million** on heating fuel, and **\$56.7 million** on electricity during 2019-20. As state staff continues to work remotely, these costs should decline and be reflected in agency budgets. Reducing heating and electricity costs by half would save *\$44.65 million*.
3. **Travel Costs:** [According to PennWatch](#), state government spent **\$5.7 million** during 2019-20 on travel. Suspension of in-home visits, conferences, and other traveling should be reflected in agency budgets. If travel costs were distributed equally across the year, and all traveling was suspended from mid-March until July (when the last counties went green), taxpayers would realize *over \$1 million in savings*.
4. **Grants to the Arts:** Suspend this line item under the executive office for one year. *\$9.590 million in savings*
5. **Nutrient Management and Conservation District Fund:** Suspend transfers to these funds for one year. *\$6.369 million in savings*
6. **Pa. Assessment:** Funding for school districts to administer testing could be significantly reduced, upwards of 75%, as PSSA and Keystone Exam testing was suspended in the spring. *\$36.742 million in savings*
7. **Historical and Museum Commission:** To reflect a reduction in tourism, keep this line item at the June appropriation level of \$23.5 million. *\$13.741 million in savings*
8. **Judiciary:** Most courts were closed for two and a half months, [reopening in limited capacity on June 1](#). Operating expenses should be reduced from the \$356 million appropriated last year. A prorated reduction based on consistent costs throughout the year amounts to *\$75 million in savings*.
9. **Reduce Legislative Reserves:** In past recessions or budget holes, the legislature has considered spending down reserves or reducing reserve fund appropriations. Reserve funds total \$172 million as of June 30, 2019.<sup>4</sup> A 10% reduction would result in *\$17.2 million in savings*.
10. **Mass Transit:** Largely through special funds, Pa. transit agencies received nearly **\$2.4 billion in state funds in 2019-20**. On top of that, Pa. transit agencies received approximately **\$1.1 billion in direct federal aid** through the CARES Act. Transit ridership has dropped dramatically, for instance, SEPTA's ridership dropped from about one million riders per day to about **300,000 per day**. A 30% reduction in spending to reflect that lower ridership would *save \$720 million*.
11. **Incorporate School District Reserves:** School districts report \$4.6 billion in reserve funds as of June 30, 2019.<sup>5</sup> These resources should be considered before considering any increases to basic education funding or supplemental education funding line items.

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<sup>4</sup> Legislative Audit Advisory Report: [https://www.legis.state.pa.us/WU01/LI/LAAC/2019\\_Report.pdf](https://www.legis.state.pa.us/WU01/LI/LAAC/2019_Report.pdf)

<sup>5</sup> Pennsylvania Department of Education, Detailed Annual Financial Reports, "General Fund Balance 2018-19." <https://www.education.pa.gov/Teachers%20-%20Administrators/School%20Finances/Finances/AFR%20Data%20Summary/Pages/AFR-Data-Detailed-.aspx#.VZwC6mXD-Uk>

12. **Higher Education:** Institutions of higher education received **\$1.38 billion in state funding** (including \$597 million for state-related universities, \$477 million for PASSHE, and \$302 million for community colleges), while \$369 million was appropriated to PHEAA for grants. On top of this, Pa. colleges and universities received approximately **\$500 million in direct federal relief** through the CARES Act and an **extra \$100 million of CARES Act funds** through the state.

With PASSHE enrollment declining, university consolidation under consideration, and many colleges switching to online-only models, institutional funding no longer makes sense. Lawmakers should look to convert all higher-education aid into student grants and scholarships. Such reforms would make higher education more affordable and give students more flexibility during these unprecedented times.

## Line Item Reductions

*Selected line item reductions for the 2020-21 state budget, resulting in \$1.7 billion in savings*

Line Items	Savings (millions)
Personnel	\$794
Office Space	\$44.65
Travel Costs	\$1
Grants to the Arts	\$9.59
Nutrient Management and Conservation District Fund	\$6.37
PA Assessment	\$36.74
Historical and Museum Commission	\$13.74
Judiciary	\$75
Legislative Reserve	\$17.20
Mass Transit	\$720
<b>Total</b>	<b>\$1,718.292</b>

Sources: State Government Workforce Statistics for 78,242 employees under the Governor's jurisdiction, PennWatch, Governor's Budget Office: 2020-21 Interim Budget Line Items

### **Corporate Handout Reductions**

In 2020-21, Pennsylvania will spend roughly \$958 million on corporate welfare, or grants, loans, and tax credits to politically connected businesses.<sup>6</sup> More than half of this spending is allocated to just four programs. If the state eliminated all corporate welfare, we could reduce the CNIT by more than two percentage points, bringing the rate down to 7.22% while remaining revenue neutral.<sup>7</sup>

<sup>6</sup> Competition Not Corporate Welfare: 3 Ways to Help All Businesses Flourish: <https://www.commonwealthfoundation.org/policyblog/detail/competition-not-corporate-welfare-3-ways-to-help-all-businesses-flourish>.

<sup>7</sup> Ibid.

Pennsylvania has five underperforming tax credit programs that cost over \$120 million a year in expected return investment, according to recent IFO evaluations.<sup>8</sup> Completely eliminating these programs would reap \$145 million in savings. Lawmakers could build on mandatory IFO tax credit evaluations by automatically sunseting underperforming programs with less than a dollar-for-dollar return.

The underperforming tax credits that should be immediately eliminated include:

1. **Film Production Tax Credit:** The program has a **ROI of 13.1 cents** on the dollar and represents a waste of almost \$61 million.
2. **Research and Development Tax Credit:** The program has a net **ROI of 12 cents** on the dollar and represents a waste of over \$48 million.
3. **Keystone Innovation Zone Tax Credit:** The program has a net **ROI of 27 cents** on the dollar and represents a waste of almost \$11 million.
4. **Mobile Telecommunications Broadband Investment Tax Credit:** The program has a net **ROI of 9 cents** on the dollar and represents a waste of over \$4 million.
5. **Organ and Bone Marrow Donation Tax Credit:** While well-intentioned, no firm has used this program since its re-enactment in 2014.

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<sup>8</sup> IFO Tax Credit Review Reports: <http://www.ifo.state.pa.us/releases/type/11/Tax-Credit-Review/>.

## Corporate Handouts in the State Budget, 2020-21

Program	Amount, thousands
Agricultural Excellence	\$ 2,800.00
Alternative Fuels Funding	\$ 8,795.00
Ben Franklin Tech Development Authority Transfer	\$ 19,500.00
City Revitalization and Improvement Fund	\$ 9,000.00
Commonwealth Financing Authority Transfer**	\$ 25,081.00
Computer Data Center Equipment Incentive Program	\$ 7,000.00
Council on the Arts	\$ 971.00
Grants to the Arts	\$ 11,090.00
Industry Partnerships	\$ 2,813.00
Infrastructure and Facilities Improvement Grants	\$ 10,000.00
Keystone Communities	\$ 6,365.00
Life Sciences Greenhouses	\$ 3,000.00
Machinery and Equipment Loan Fund	\$ 11,778.00
Marketing to Attract Business	\$ 2,027.00
Marketing to Attract Tourists	\$ 4,071.00
Municipalities Financial Recovery Revolving Fund Transfer	\$ 4,500.00
Neighborhood Improvement Zone Fund	\$ 63,520.00
New Choices/New Options	\$ 750.00
Partnerships for Regional Economic Performance	\$ 9,880.00
Pennsylvania First	\$ 12,000.00
Pennsylvania Race Horse Development Fund	\$ 234,759.00
Transfer to the Nutrient Management Fund	\$ 6,200.00
Office of International Business Development	\$ 5,936.00
Youth Shows	\$ 169.00
WEDnetPA	\$ 10,000.00
Brewer's Tax Credit	\$ 5,000.00
Entertainment Production Tax Credit*	\$ 79,000.00
Innovate in PA Tax Credit	\$ 20,000.00
Keystone Opportunity Zone	\$ 95,200.00
Keystone Innovation Zone	\$ 15,000.00
Manufacturing and Investment Tax Credit*	\$ 10,000.00
Mobile Telecommunications Broadband Investment Tax Credit	\$ 5,000.00
Neighborhood assistance Tax Credit	\$ 36,000.00
Pennsylvania Resource Manufacturing Tax Credit	\$ 17,100.00
Research and Development Tax Credit	\$ 55,000.00
Resource Enhancement and Protection Tax Credit	\$ 13,000.00
Tax Credits for Beginning Farmers	\$ 5,000.00
<b>Total</b>	<b>\$ 827,305.00</b>

Source: Office of the Budget, Commonwealth Budget, 2020-21, [Governor's Executive Budget](#).

\*total of different components \*\*Commonwealth Financing Authority Transfer calculated by combining transfers from the Department of Community and Economic Development and the State Gaming Fund and revenue from the PlanCon Bond Project Fund.

### **Cutting Spending through a Turnpike Lease and Liquor Privatization**

Leasing the Pennsylvania Turnpike to a private operator and privatizing the wholesale and retail side of the Pennsylvania Liquor Control Board (PLCB) could provide upfront revenue *and* reduce debt or liabilities resulting in a net financial gain for the commonwealth.

Ending the PLCB monopoly would create revenue gains from the initial privatization as well as from increased tax revenue if Pennsylvania achieves a level of liquor store density comparable to other states.

A 2011 study conducted by Public Financial Management estimated the sale of licenses would raise \$1 billion to \$1.5 billion in one-time revenue. Adjusting those figures for today, lawmakers could anticipate *\$1 billion in one-time revenue*, with approximately \$30 million in additional yearly tax revenue.

PLCB privatization has been introduced as [House Bill 2547](#) (Rep. Tim O'Neal). Incremental liquor reforms that could increase alcohol revenue but fall short of full privatization include [Senate Bill 548](#) (Sen. Gene Yaw), which would allow private wine and liquor stores.

Leasing the Pennsylvania Turnpike to a private operator could yield billions. A recent [study by the Reason Foundation](#) suggests a valuation for the turnpike of \$16 billion to \$25 billion. After paying off debt, the study estimates net proceeds of \$6.8 billion.

In 2006, the Pennsylvania Funding and Reform Commission proposed leasing the turnpike to a private operator. At least one bid came in at \$13 billion for a 75-year lease with a limit on toll hikes.

### **Conclusion**

Reducing spending to reflect how the pandemic impacted state agencies and balance the budget without tax hikes or borrowing is **the first step**. Without additional structural spending changes laid out in our backgrounder [Reforms Beyond the Current Budget](#), future tax hikes will occur.