



Gov. Wolf's Budget Plan & Working Families

Pennsylvania House Majority Policy Committee

February 24, 2021

Chairman Causer and members of the House Majority Policy Committee, thank you for inviting the Commonwealth Foundation to testify on the impact of Governor Wolf's budget proposal. My name is Elizabeth Stelle, and I am the Director of Policy Analysis for the foundation.

In short, this budget proposal favors bureaucrats and tax hikes over kids and communities. It targets the same small businesses that bore the brunt of rolling shutdown orders and continues to ignore the needs of parents and kids struggling with virtual learning. The budget proposal includes a total tax hike of \$2.96 billion, or \$232 per Pennsylvania resident.¹

SAME FAILED POLICIES

The budget proposal contains the same policy prescriptions as previous budgets proposals, ignoring the very different economic environment Pennsylvanians now face. As in previous years, the budget includes a natural gas severance tax on top of the impact fee, making our tax rate on natural gas the highest in the nation.² As in previous years, it also calls for a minimum wage hike while ignoring systematic failures of our assistance programs, and it includes a supplemental request of nearly \$1 billion, indicating the governor's unwillingness to keep spending within the confines of the agreed-to budget.³ And finally, also as in previous years, it calls for a spending hike far outside of the Taxpayer Protection Act index of inflation plus population growth: an astronomical increase of nearly \$4 billion versus the TPA-index increase of \$654 million.

After nearly a decade of consistently growing state spending, we know this path is not the way to prosperity.

Pennsylvania's recovery is tepid at best. Unemployment reached a high of 16.1% last spring and sits at 6.7% as of December, well above the 4.6% rate of December 2019.⁴ The Independent Fiscal Office (IFO) projects it will take our state six years to recover lost jobs.⁵ That is not acceptable.

Even more concerning than stalling unemployment rates is the drop in labor force participation. During the pandemic, almost 250,000 Pennsylvanians dropped out of the labor force, giving us the lowest labor force participation rate in 10 years.⁶ Growing our labor force is critical. As the IFO notes, the ratio between working-age adults and retirees is already projected to decline through

¹ Calculated by dividing new costs by the population of Pennsylvania.

² The Marcellus Shale Coalition estimates the severance tax and impact fee would levy a 12% tax on producers, by far the highest in the nation.

³ The Executive Budget Book lists state supplemental requests for FY 2020-21 at \$903,416.

⁴ U.S. Bureau of Labor Statistics, Local Area Unemployment Statistics: <https://www.bls.gov/lau/>

⁵ Independent Fiscal Office, Five Year Economic and Budget Outlook Fiscal Years 2020-21 to 2025-26: http://www.ifo.state.pa.us/download.cfm?file=Resources/Documents/Economic_and_Revenue_Update_2021.pdf

⁶ U.S. Bureau of Labor Statistics, Local Area Unemployment Statistics: <https://www.bls.gov/lau/>

2030.⁷ Pennsylvania was facing headwinds before the pandemic, now the situation is critical.

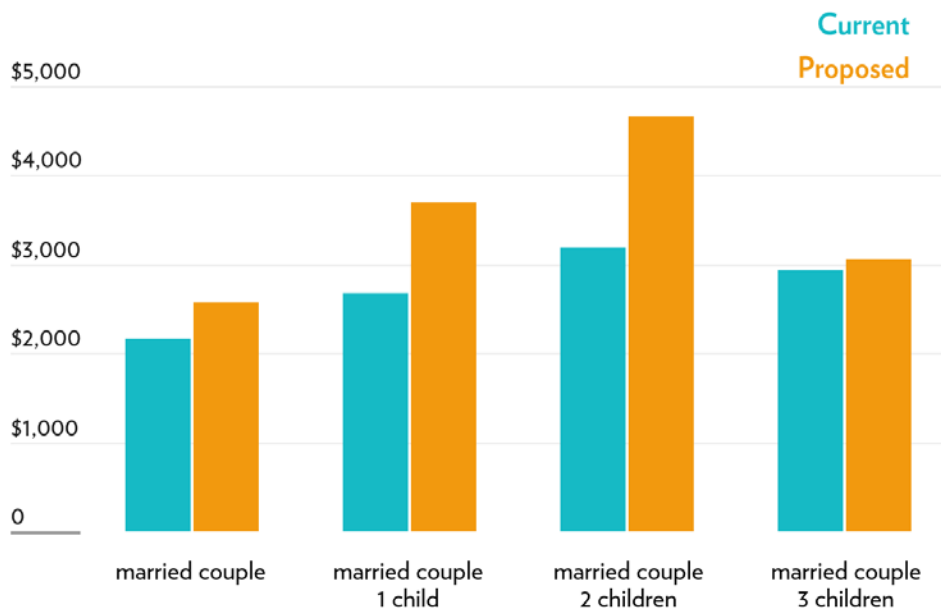
PERSONAL INCOME TAX HIKE

In this bleak environment, the governor has introduced a 46% increase in the personal income tax with significantly expanded tax forgiveness to create a progressive income tax system. This is a higher rate than his 2015 proposal, which included raising the personal income tax to 3.7%.⁸ This back-door approach has the insidious intent of raising taxes on median earners. This is not “investing” in Pennsylvania, it is simply taking from residents.

Increasing the income tax from 3.07% to 4.49% would result in a \$1,500 tax hike for a family of four making the median family income. It would also hammer small businesses just starting to recover, as the increase would affect roughly 855,000 small business owners that pay the personal income tax.⁹

Gov. Wolf’s Proposed Personal Income Tax Increase

Under Wolf’s plan, taxes would increase for most median households.



Source: United States Census Bureau, *American Community Survey*, ACSST1Y2019, Retrieved from: <https://data.census.gov/cedsci/table?q=Pennsylvania%20Income%20and%20Poverty&tid=ACSST1Y2019.S1903&hidePreview=true>.

The governor has attempted to defend his proposal by noting Pennsylvania’s low personal income tax rate in comparison to other states. It is true we have one of the lowest flat personal income tax

⁷ Independent Fiscal Office, Five Year Economic and Budget Outlook Fiscal Years 2020-21 to 2025-26: http://www.ifo.state.pa.us/download.cfm?file=Resources/Documents/Economic_and_Revenue_Update_2021.pdf

⁸ Commonwealth Foundation, Summary of Governor Wolf’s 2015-16 Budget Proposal: <https://www.commonwealthfoundation.org/issues/detail/summary-of-governor-wolfs-2015-2016-budget-proposal>

⁹ Department of Revenue, personal income tax statistics: https://www.revenue.pa.gov/GeneralTaxInformation/News%20and%20Statistics/ReportsStats/PIT/Documents/2018_pit_stats.pdf

rates in the nation, second only to North Dakota and Indiana (though Pennsylvania has few deductions). However, eight states levy no personal income tax.¹⁰ These are the same states seeing the highest levels of personal income growth and welcoming large numbers of Pennsylvania residents each year.¹¹ One could argue the personal income tax is the only competitive tax rate in Pennsylvania.

TAX HIKES & BUDGET DEFICITS

The governor is continuing a disturbing pattern of calling for tax hikes in a time of economic retraction and large projected budget deficits. The IFO projects a \$2.5 billion budget deficit next year following a surplus this year. While legislators have rejected most of Gov. Wolf's 14 proposed tax hikes, Pennsylvania has raised taxes twice in the last five years. Taxes were hiked on streaming services like Netflix, cigarettes, vape shops, gambling, online retailers like Etsy, and fireworks.¹²

This increasing tax burden has led to regular outmigration of jobs and residents. Every year, Pennsylvania loses residents to other states in a trend known as "brain drain." This past year, we actually lost population; and the commonwealth will lose another seat in Congress as a result of people voting with their feet.

Limiting spending through the Taxpayer Protection Act is the best way to prevent tax hikes now and long after the pandemic ends. More one-time revenues or additional targeted tax hikes will not solve our fundamental problems, including a structural deficit of about \$2 billion, declining population, and an uncompetitive business environment.

To rebuild a better Pennsylvania, we must prioritize our kids and communities, specifically revitalizing our kids' education and fostering entrepreneurship.

CARING FOR KIDS & COMMUNITIES

Only 40% of school districts are open for in-person instruction, regardless of parents' wishes and CDC guidance.¹³ Now more than ever, families need educational options. There are numerous ways to empower parents.

Expand the Educational Improvement Tax Credit and Opportunity Scholarship Tax Credit. Last year, nearly 43,000 students who applied for K-12 scholarships to attend their school of choice were waitlisted due to arbitrary tax credit caps.¹⁴ Ideally, the program should be able to grow with the demand for scholarships.

Establish Education Opportunity Accounts. In November, we had a chance to set aside millions in CARES funding to help parents get their kids back on track, instead all \$1.3 billion of the remaining funds went to plugging budget holes. Every month we choose not to send resources directly to families is a month that will put our most vulnerable students further behind.

¹⁰ Tax Foundation, State Income Tax Rates 2021: <https://taxfoundation.org/state-income-tax-rates-2021/>

¹¹ Commonwealth Foundation, Impact of Taxes on State Economic Performance: <https://infoqram.com/copy-impact-of-taxes-on-states-economic-performance-1h7j4dn1d1od6nr> and Independent Fiscal Office, Five Year Economic and Budget Outlook Fiscal Years 2020-21 to 2025-26:

http://www.ifo.state.pa.us/download.cfm?file=Resources/Documents/Economic_and_Revenue_Update_2021.pdf

¹² Department of Revenue, Online Retailers Information:

<https://www.revenue.pa.gov/GeneralTaxInformation/Tax%20Types%20and%20Information/SUT/OnlineRetailers/Pages/default.aspx> and Commonwealth Foundation, Progress and Setbacks in the 2017-18 Budget:

<https://www.commonwealthfoundation.org/policyblog/detail/progress-and-setbacks-in-the-2017-18-budget>

¹³ PennLive, Teachers Struggle Amid Ongoing COVID-19 Crisis: <https://www.pennlive.com/coronavirus/2021/01/im-on-my-own-teachers-schools-struggle-amid-ongoing-covid-19-crisis.html>

¹⁴ Information provided by the Department for Economic and Community Development via Right-to-Know Request.

Communities need help too. Commonwealth Foundation has outlined a Race to Rebuild agenda to bolster employers and make Pennsylvania more competitive in the future. This agenda includes:

Passing the Taxpayer Protection Act. House Bill 71, introduced by Rep. Ryan Warner, limits the growth of state spending to population and inflation. Government should grow with, not faster, than the economy. Following a similar spending growth limit in Colorado, their tax burden fell from 10.1% of state residents' income in 1992 to 8.9% of total income.¹⁵

Provide tax reform to permit small businesses to carry forward losses. Small businesses that take losses in 2020 should be permitted to carry forward and deduct them in future years, something that corporations can already do. This reform is included in House Bill 198, sponsored by Rep. George Dunbar.¹⁶

Ease Pennsylvanians' tax burden. Pennsylvania business owners paying the Corporate Net Income Tax (CNIT) shoulder the second largest tax rate in the nation, impeding businesses from coming to and thriving in the commonwealth. Officials should lower the CNIT rate from 9.99% to approximately 7% without adding additional reporting requirements. Reducing the rate is shown to spur investment, jobs, and economic growth.¹⁷

- Sen. Michele Brooks intends to reintroduce legislation reducing the CNIT rate by 0.5% annually over a six year period until it reaches 6.99%.

Cut the red tape facing job creators. Lawmakers should use this opportunity to ease the barriers faced by entrepreneurs. Small businesses that manage to survive will still have to face almost 163,000 individual regulations. Pennsylvania ranks the 11th in total restrictions, according to the Mercatus Center database.¹⁸

- Specifically, lawmakers can require legislative approval for regulations that will cost more than \$1 million a year as introduced in House Bill 72 by Rep. Dawn Keefer.

Protect small businesses, schools, and health care providers from opportunistic lawsuits. Unfortunately, businesses are susceptible to lawsuits in their attempts to survive the impacts of COVID-19. Many states have passed legislation to protect companies that make good faith efforts to keep their workplaces and related operations safe.

- In 2020, the legislature passed, and Wolf vetoed, House Bill 1737 to provide COVID-19 liability protections. Lawmakers should continue efforts to grant businesses broad liability protection, especially as in-person activities increase.

Reassess occupational licensing restrictions to help workers find jobs. Over 250 Pennsylvania professions require a license to work, many of them low- and mid-income jobs. Unfortunately, occupational licensing requirements create barriers to employment.¹⁹

We can be the envy of the east if we turn from backfilling bureaucracies and enriching already well-funded agencies to creating pathways to prosperity.

¹⁵ Tax Foundation, State and Local Tax Burden Rankings: <https://taxfoundation.org/colorados-state-and-local-tax-burden/>

¹⁶ Senator Judy Ward and Senator Ryan Aument have memos for small business reform packages that include permitting small-business owners to deduct net operating losses in future tax years.

¹⁷ American Enterprise Institute, Economic Effects of the Corporate Tax Rate Reduction: <https://www.aei.org/wp-content/uploads/2018/04/Economic-Effects-of-the-Corporate-Tax-Rate-Reduction.pdf>

¹⁸ Mercatus Center, RegCensus Explorer: <https://www.quantgov.org/regcensus-explorer>

¹⁹ Department of State, Executive Report on Occupational Licensing: <https://www.dos.pa.gov/ProfessionalLicensing/Documents/EO2017-03-Executive-Report-Occupational-Licensing.pdf> and Institute for Justice, State and National Estimates of the Economic Cost of Occupational Licensing: <https://ij.org/report/at-what-cost>