



## **Overspending Claims Overheated Pennsylvania Spending Increases Trail U.S. Average Two Years Running Spending Below Average of all States**

### *Summary*

During the past two years, states have begun to restore funding for programs and services that were cut or squeezed during the economic recession, thanks to better than anticipated revenues. Consistent with this trend, General Fund spending in Pennsylvania has risen, as funds have become available to bring services up to pre-recession levels and to make up lost ground on education, higher education, and corrections costs. Still, in 2006 spending growth and total spending in the Commonwealth are lower than the national average.

- Throughout the 2005–07 period, spending growth has been more restrained in Pennsylvania than in most states and in the nation as a whole.<sup>1</sup>
- Lower than average spending was the rule both in total General Fund spending and in key program areas.
- Pennsylvania remains below the national average in spending in 2007 as a percent of personal income.<sup>2</sup>

Modest increases in spending have allowed Pennsylvania to restore program funding and make key investments in Pennsylvania's future, but the gains may be short-lived. Pennsylvania, like most states, projects revenue growth to slow from 6.4% in 2005–06 to 3.7% in 2006–07.<sup>3</sup> If revenues fall short of these expectations, gains made in education, higher education, library funding, and child care may be jeopardized. New challenges, including a minimum \$500 million shortfall in mass transit funding, will place additional pressure on the state budget.

In response to this slightly higher spending growth, efforts to put restrictive limits on state spending growth, known as TABOR, have been promoted by some candidates and state legislators. Analysis of spending trends suggests that, in addition to being arbitrary and unwise, spending limits are unnecessary. State spending as a share of personal income has remained steady, averaging 5.4% over the last 20 years. Furthermore, new research finds that private-sector economies of states with larger public sectors outperform those with smaller public sectors and that high spending is not associated with slower private-sector growth.<sup>4</sup>

Claims about overspending in Pennsylvania don't square with the facts. State spending has been restrained—relative to other states and the nation—over the past two years, even with substantially higher than predicted revenues. General Fund spending as a share of the economy hasn't changed over two decades. Moving forward, Pennsylvania is in a good position to invest more to meet economic challenges and pressing educational and social needs. Whether it is roads and bridges, health care and prescription drug benefits, or education and community colleges, Pennsylvania has room to invest in the future.

## *Pennsylvania spending growth for FY 2006-07 falls behind average of all states*

A survey of state General Fund spending conducted by the National Conference of State Legislatures, which assessed budget action in 49 states, determined that on average spending for fiscal year 2006–07 will increase by 7.6%. In contrast, Pennsylvania General Fund spending for this same period will increase by only 5.8%.

<b>Table 1. Pennsylvania vs. U.S. General Fund Spending</b>		
<b>FY 2006-07</b>	<b>U.S.</b>	<b>Pennsylvania</b>
Total Increase	7.6%	5.8%
K-12 Education	7.9%	7.5%
Corrections	5.7%	4.2%
Higher Education	6.3%	5.1%
Medicaid	4.9%	-7.1%
Source: National Conference of State Legislatures, Pennsylvania Budget and Policy Center (PBPC) analysis of Pennsylvania Budget Office Data.		

Pennsylvania trails average state increases in basic education, higher education, and corrections (see Table 1). K-12 education will increase by 7.5% in Pennsylvania, compared to 7.9% projected across all states. The average increase across all states for higher education is 6.3%, compared to 5.7% in Pennsylvania. States will increase spending on corrections by an average of 5.7% in FY 2007, while Pennsylvania's increase is projected at 4.2%.<sup>5</sup>

Many states plan to spend significantly more to restore programs that were cut during and after the 2001 downturn, or to make investments delayed by a slow recovery. Twelve states project double-digit spending in K-12 education, 11 states have double-digit increases in higher education funds, and 11 states also have double-digit increases in prison spending.

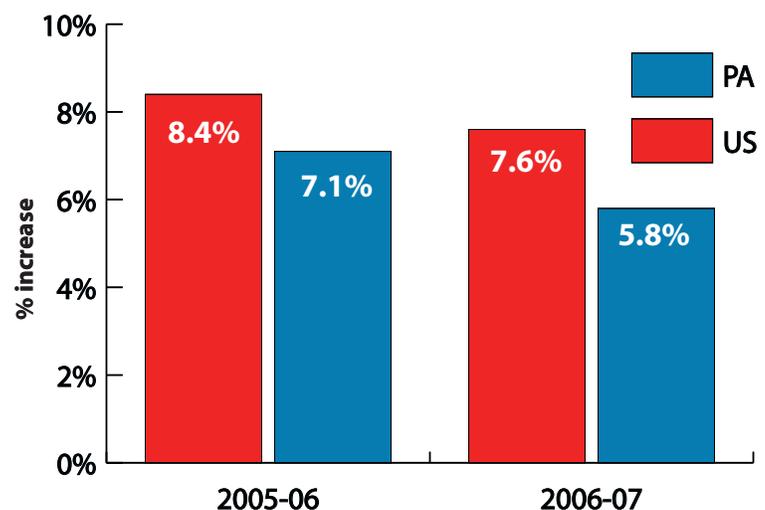
Unlike Pennsylvania, many states also are planning to use unanticipated revenues to shore up pension funds and make previously unplanned improvements to state employee compensation packages. Using these revenues, 14 states plan to increase state employee salaries or benefits, and eight will increase contributions to pension funds. Medical Assistance (MA) spending, which grew rapidly during the economic downturn, slowed in most states this year. Still, 11 states report increasing Medical Assistance spending by more than 10%. Pennsylvania is one of 7 states that plan to *reduce* MA spending in 2007.

While the restoration of spending has been a priority in a number of states, so has replenishing or even increasing reserves. Pennsylvania, along with 17 other states, plans to make deposits to a rainy-day fund in FY 2007.

### *Pennsylvania spending lower for second year*

The economic recovery that started in 2002 improved revenue across most states, and began to replenish state coffers during the 2004–05 fiscal year. Across the country, state budgets grew faster than projected in 2005–06. Still, Pennsylvania's spending grew more slowly than that of most states during 2005–06, even with more than \$340 million in supplemental appropriations. Across all states, spending increased an average of 8.4% in 2005–06, while spending increased by only 7.1% in Pennsylvania (see Figure 1).

**Figure 1.**  
Increase in General Fund Spending in Pennsylvania Lower Than in the United States



This lower spending growth occurred despite continued high growth in medical assistance costs of 18% in 2006. Rising MA costs have been a factor the state has had to address since the recession, when Medical Assistance enrollments began to grow in Pennsylvania and across the nation—growth that occurred during a period of substantially declining state revenues. In 2003–2006, states including Pennsylvania adopted cost-containment methods to address this dilemma. In fiscal year 2006–07, Medical Assistance spending will decline by 7.1% in Pennsylvania.

*Pennsylvania spending recovers but lags national average*

When they make comparisons over time and across states,

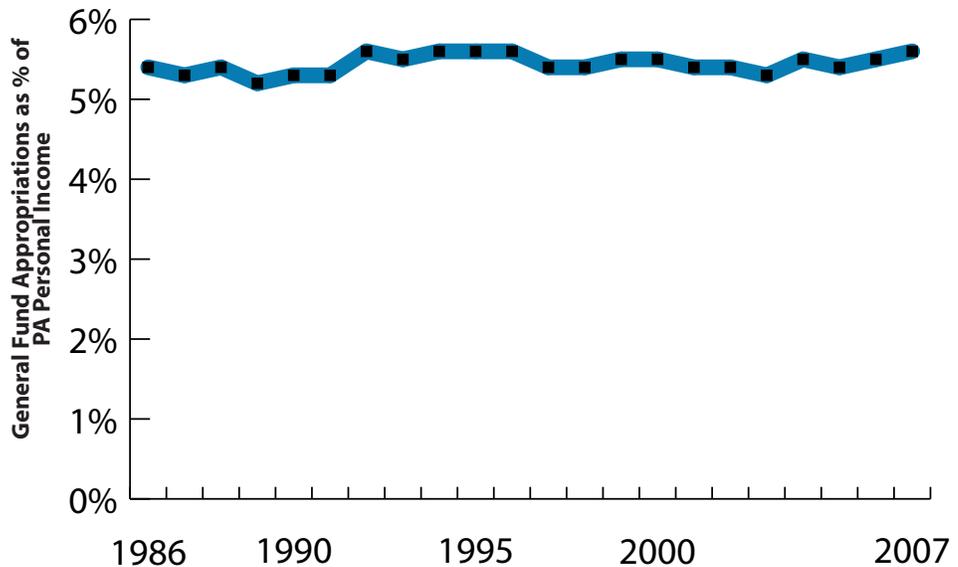
analysts frequently examine spending as a share of total personal income. Personal income data, published by the U.S. Bureau of Economic Analysis, is one measure of the overall size of an economy. It adds together the income of wage earners (including wages and salaries), with that of investors and retirees (dividends, interests, capital gains, and pensions). If spending as a share of personal income remains roughly constant, then state expenditures are growing at roughly the same rate as the overall income levels.<sup>6</sup>

In Pennsylvania, what stands out most from a 20-year examination of trends in spending as a share of personal income is how stable this ratio is. Spending as a share of state personal income was 5.4% in 1986 and 5.6% in 2007. The average across all 20 years is 5.4%, indicating that state spending has mirrored the expansion of the overall economy (see Figure 2).

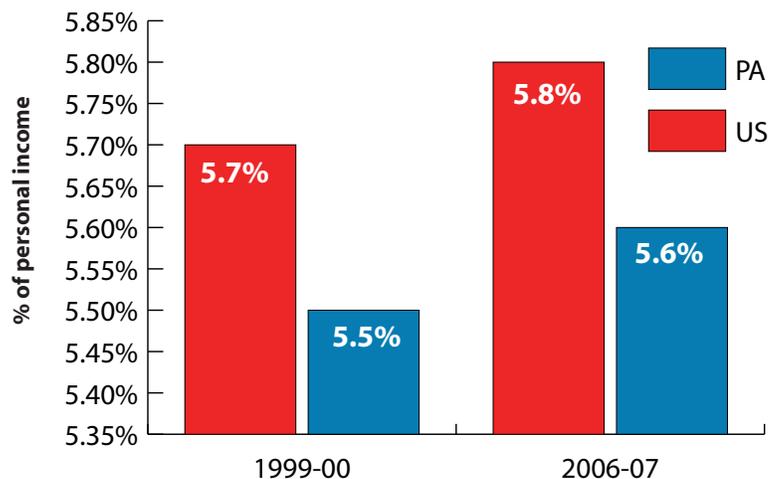
Thus, the declines and increases in state spending in recent years have been small fluctuations around a flat general trend. These fluctuations include a fall in General Fund spending as a share of personal income in 2001 and again in 2003, and increases in 2004 and 2006 to bring the share back to pre-recession levels. In Fiscal Year 2006-07, General Fund spending as a share of personal income will increase to 5.6%, comparable to FY 1994–95 and 1995–96.

Despite this increase, state spending as a share of personal income is lower in Pennsylvania than the national average. Figure 3 compares

**Figure 2.**  
**State Spending Has Remained Constant the Last 20 Years**



**Figure 3.**  
**State Spending as Share of Personal Income is Lower in Pennsylvania Than U.S. Average**



spending as a share of personal income in Pennsylvania and the US, in the last fiscal year before the recession, and for 2006–07. In both years, before the economic downturn and today, spending as a share of the economy is lower in Pennsylvania than the U.S. average. State General Fund spending would be \$835 million higher if the Commonwealth's spending were at the national average.

### *State spending in perspective*

Much of the dialogue throughout the past year, in the General Assembly, in state house races, and in the Governor's race, has centered on the claim that state spending in Pennsylvania is too high. This claim has spread across the country, with a small number of national groups promoting, and many times funding, ballot and legislative initiatives to enact constitutional amendments to impose tax and expenditure limits (TEL) modeled after Colorado's TABOR (Taxpayer Bill of Rights). The same principles have made their way to the U.S. Congress in the form of S.O.S. (Stop Overspending) legislation.<sup>7</sup>

The analysis in the previous sections allows us to examine the need for such spending caps. Is there a case to be made that drastic spending caps are necessary to rein in state government spending in Pennsylvania? The simple answer is no. Even in the context of an aging population, rapidly rising health care costs, pockets of concentrated poverty, a national government that continues to push funding responsibility onto state governments, and an increasing need to invest in education in the knowledge-based global economy, Pennsylvania state spending has been remarkably stable relative to the size of the economy. In addition, the state continues to fall in the middle (or lower) of most rankings of state General Fund spending.

In this context, drastically shrinking state government relative to the size of the economy, as TABOR would do, could have a potentially devastating impact on services and quality of life in the state. An earlier PBPC analysis showed that

- a TABOR enacted in 1986 would have shrunk state spending by a quarter today;
- to implement cuts of this size, if the state maintained current spending on three critical areas—pre-K through grade 12 education, Medicaid and public health, and corrections—there would be virtually nothing left for other budget items such as higher education, community and economic development, the environment, and state police;
- if, instead, there were proportional cuts of 25% in virtually every program, the effects would be devastating across the board.

### *An investment economy*

Recent research suggests that state spending in the face of long-term economic challenges may, in fact, have been too stable. A new study of public- and private-sector growth from 1990 to 2004 shows that the economies of states that have higher levels of public spending actually perform better than those that do not.

Policy Matters Ohio compared trends in inflation-adjusted per capita gross state product (GSP) in all 50 states over two time periods to determine the impact of public-sector size and growth on private-sector performance.<sup>8</sup>

The study found that, across all states, increases in per capita state and local government spending were positively associated with private-sector economic growth from 1990 to 1997. Such increases had no association during the 1997–2004 periods. In neither period did a growing public sector impede private-sector growth.

Over the entire 1990 to 2004 period, private-sector economic growth was 37% higher in states with expanding public sectors. Across all states, increases in state and local government GSP were associated with increases in private-sector output during both periods.

These findings are consistent with evidence that public-sector investments support private-sector growth. Rather than “crowding out” private-sector investment, spending on education and infrastructure have significant long-term economic returns that improve state and local economic fortunes.<sup>9</sup>

### *Services Pennsylvanians Need*

Discussions about the level of state spending, divorced from a discussion of what the state buys, are not very useful. Tax dollars are spent to purchase services for individuals and communities. These range from elementary schools to Penn State University, from rural health clinics to nursing homes, from state troopers to state prisons. State General Fund spending supports critical services, K-12 education, health care, and public safety and prevention programs for children that touch the lives of Commonwealth citizens across the state and across the years.

Support for needed services for Pennsylvanians runs across party and geographic lines. In 2006–2007, additional funding for growing school districts, K-12 education, libraries, health care services, and economic development topped the priority list for House Republicans, for example.<sup>10</sup> Expanding health insurance to all children and K-12 education funding topped the list for House Democrats this year.

Legislators make choices about the level of spending and the mix of services to Pennsylvanians that the state can afford each year. The evidence shows that, so far, they have done so with a mixture of compassion and fiscal responsibility.

### *Endnotes*

<sup>1</sup> Corina Eckl and Bert Waisanen, *State Budget and Tax Actions 2006, Preliminary Report* (Denver: National Conference of State Legislatures, August 2006).

<sup>2</sup> Elizabeth C. McNichol, Iris J. Lav, and Ifie Okwuje, *States Still Playing Catch-Up in New Budgets*, (August 2006), at <http://www.cbpp.org/8-2-06sfp.htm>.

<sup>3</sup> PBPC analysis of Pennsylvania Office of the Budget and Department of Revenue data.

<sup>4</sup> John Honeck, *State Economic Growth and the Public Sector* (Cleveland: Policy Matters Ohio, August 2006) at [http://www.policymattersohio.org/state\\_economic\\_growth\\_2006.htm](http://www.policymattersohio.org/state_economic_growth_2006.htm)

<sup>5</sup> PBPC analysis of Enacted Budget Highlights, [http://www.budget.state.pa.us/budget/lib/budget/2006-2007/2006\\_07enacted\\_budget\\_highlights.pdf](http://www.budget.state.pa.us/budget/lib/budget/2006-2007/2006_07enacted_budget_highlights.pdf).

<sup>6</sup> There are, however, times when it is appropriate for state spending to rise as a share of the economy. For instance, state spending as a share of the economy may increase if the state assumes a rising share of education costs traditionally borne by local governments, or of health care costs as the population ages.

<sup>7</sup><http://www.cbpp.org/6-1-05tabor.pdf>

<sup>8</sup> Jon Honeck, *State Economic Growth and the Public Sector*. See footnote iv.

<sup>9</sup> Robert Lynch, *Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development* (Washington, DC: Economic Policy Institute, 2004).

<sup>10</sup> 2006-07 Pennsylvania State Budget Overview. House Appropriations Committee at <http://appropriations.pahousegop.com/uploads/2006-07%20Budget%20-%20Multi-Page%20Summary.pdf>