



Understanding the Numbers in a Budget Crisis

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Introduction

Budget numbers are always difficult to understand, not least because they can be presented honestly from many different perspectives. Especially when political divisions are sharp, it is quite common for data on government revenues and spending to be presented, intentionally or not, in partial and one-sided ways that make it difficult for citizens to get a complete picture of the policy choices before the government.

This policy brief presents and analyzes, in as objective a way as possible and in the context of longer-term trends in state expenditures and revenues, the 2015-16 budget proposals presented by Gov. Wolf and the Republican leadership. We will focus on comparing three budget plans: Gov. Wolf's initial proposal from March 2015; the appropriations bill that aims to enact the compromise bi-partisan budget framework, SB1073, which was passed by the Senate and almost passed the House in late December; and, HB 1460, the House Republican proposal that was passed by the Senate in its last session in 2015 and line-item vetoed by Gov. Wolf on December 29th.

Our Focus: Overall Government Spending, Education and Human Services

We focus in this brief on government spending in general and in two areas of public policy: education and human services. The general question of government spending is important to address because, in this time of divided government and ideological conflict, it has become a central theme in the disputes between progressives and conservatives. Conservatives tend to see the public sector as a beast that is constantly growing at the expense of the private sector. Progressives want to see the state spend more than it has in the recent past. But do progressives seek to make the government far larger? We put the current dispute in some context in order to evaluate this dispute.

It is also important to address specific areas where there are disputes about how much to spend.

Education spending remains the critical issue in Pennsylvania politics today. Restoring the education funding that was cut during the Corbett administration is the central priority of Gov. Wolf. Even Republicans claim that their budget proposals increase education funding. So, to be fair to both sides, we need to begin any analysis of the contemporary budget debate by examining baseline education funding, going back to the last budget of the Rendell years.

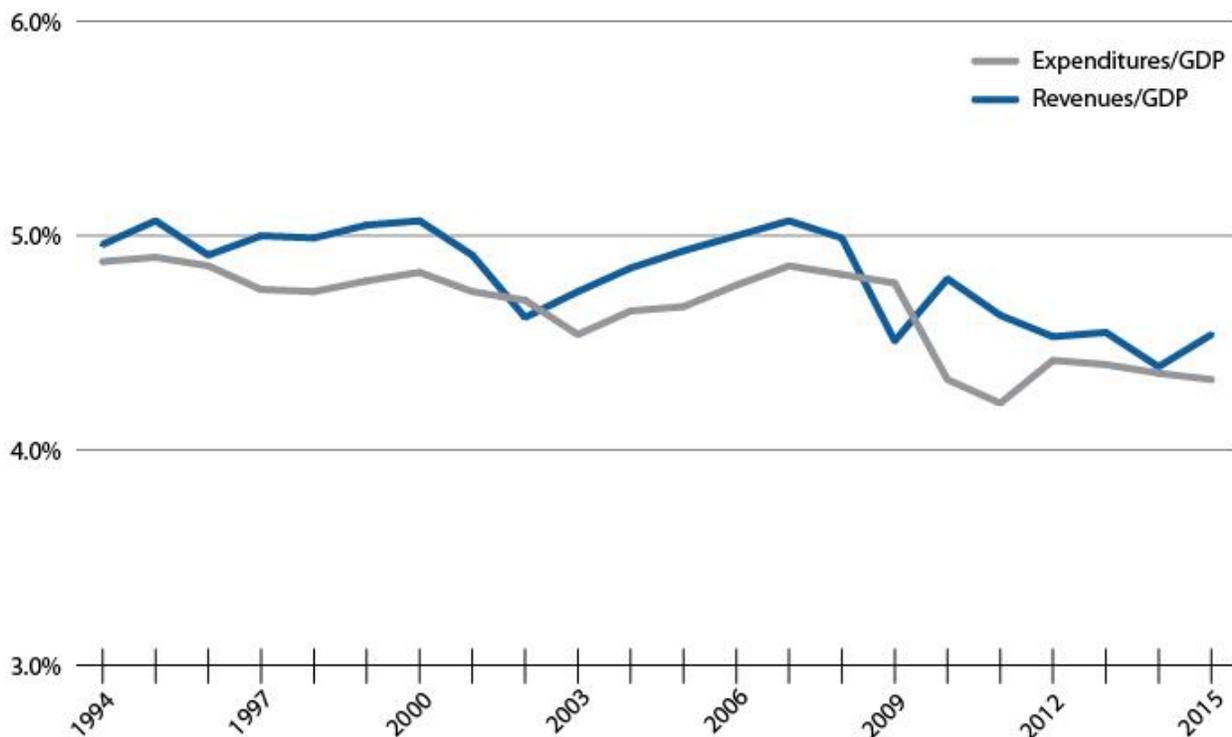
Another area that suffered cutbacks during the Corbett years is spending on human services, the programs that assist seniors, the physically or emotionally disabled or ill, and the indigent. Though almost everyone, progressive and conservative, recognizes some responsibility on the part of the commonwealth to our fellow citizens who are most vulnerable, there are critical disputes about how much to spend on these programs as well.

I. Government spending in general

When political talk turns to tax increases, the assumption is always that they are needed to support a growing government. But is government in the Commonwealth of Pennsylvania growing? There is no question that our government spends more than in the past, but, to a large extent, that is the result of inflation. Everything costs more than it did in the past, including the services provided by government from state police protection to aid to local schools. So the better question is this: is government growing as a share of Pennsylvania's economy? Or to use more technical terms, are government expenditures and revenues growing as a share of the state's gross domestic product (GDP)?

Using data and analysis from the Independent Fiscal Office, Table 1 and Figure 1 provide the answer, which is clearly "no." Indeed, the reverse is true. In the aftermath of the Great Recession of 2008-2009, the state government's share of the Commonwealth's GDP has fallen far below where it has been for almost all of the last 20 years. At its height, in 1994-95, state expenditures were 4.9 percent of Pennsylvania's GDP. Between 1994 and 2011, state expenditures averaged 4.7 percent of GDP. Since 2011, however, state expenditures have averaged just 4.38 percent. Far from growing out of control, government in Pennsylvania has in recent years represented a smaller share of all of the goods and services we produce in the state.

Figure 1.
Pennsylvania General Fund Expenditures and Revenues Are A Smaller Share of the Economy Today than in the Recent Past



Source. Pennsylvania Budget and Policy Center based on data from the Independent Fiscal Office.

Table 1

Pennsylvania General Fund Expenditures and Revenues as a Percent of GDP (nominal figures in millions)

Fiscal year ending	GDP	Expenditures	Revenue	Expenditures / GDP	Revenues / GDP
1994	305,900	14,935	15,186	4.88%	4.96%
1995	320,100	15,675	16,225	4.90%	5.07%
1996	332,800	16,163	16,339	4.86%	4.91%
1997	346,500	16,467	17,321	4.75%	5.00%
1998	363,500	17,230	18,123	4.74%	4.99%
1999	381,100	18,263	19,227	4.79%	5.05%
2000	399,600	19,295	20,257	4.83%	5.07%
2001	418,800	19,862	20,562	4.74%	4.91%
2002	434,300	20,429	20,060	4.70%	4.62%
2003	449,500	20,400	21,315	4.54%	4.74%
2004	470,200	21,885	22,828	4.65%	4.85%
2005	493,500	23,054	24,309	4.67%	4.93%
2006	517,500	24,665	25,854	4.77%	5.00%
2007	541,500	26,298	27,449	4.86%	5.07%
2008	559,600	26,968	27,928	4.82%	4.99%
2009	566,200	27,084	25,530	4.78%	4.51%
2010	576,100	24,942	27,648	4.33%	4.80%
2011	594,200	25,067	27,497	4.22%	4.63%
2012	611,100	27,031	27,678	4.42%	4.53%
2013	629,900	27,717	28,647	4.40%	4.55%
2014	651,600	28,395	28,607	4.36%	4.39%
2015	673,900	29,190	30,593	4.33%	4.54%
Average 1994 to 2011				4.71%	4.89%
Average 2012 to 2015				4.38%	4.50%

Source. Pennsylvania Budget and Policy Center based on data from the Independent Fiscal Office

Not only does state government represent a smaller share of the economy today it also employs 4,400 or 3 percent fewer people today than it did in 2010 (Table 2). Since 1990 state government employment is up by just 402 workers or 0.3 percent. In the private sector, on the other hand, employment has grown by 14.9 percent

Table 2

Employment in State and Local Government and the Private Sector

Year	State Government	Local Government ²	Local Government Education ³	Private nonfarm employment
1990	157,625	409,250		4,472,200
2000	155,950	458,717		4,965,667
2010	162,475	498,467	309,908	4,854,225
2015 ¹	158,027	453,691	271,609	5,136,500
2010 to 2015				
Change	-4,448	-44,776	-38,299	282,275
Percent Change	-3%	-9%	-12%	6%
1990 to 2015				
Change	402	44,441		664,300
Percent Change	0.3%	10.9%		14.9%

¹Through November 2015

²Includes Local Government Education

³Data series is only available since 2003

Source. Keystone Research Center based on Not Seasonally Adjusted Current Employment Statistics.

The decline in government’s share of the state GDP and employment has occurred even though government mostly provides services not goods, and productivity has historically risen much faster in goods-producing sectors than in service-producing sectors of the economy. Technological innovation makes it possible to produce goods, such as computers and cars that are both relatively cheaper and/or much more capable than they were in the past. But services are far more likely to be labor intensive. That is why we pay relatively more for haircuts and concert tickets today than 20 years ago even while our computers become cheaper and more capable. So one would expect that, to maintain the same level of service, government would have to grow as a share of GDP over time. It has not done so in Pennsylvania.

In addition, in evaluating the size of government in Pennsylvania, one should keep in mind that most state expenditures flows through our local school districts and our hospitals and doctor’s offices. In fact, more than two-thirds of what the state of Pennsylvania spends goes for education and health care services provided in our local communities. Our state government is not so much a leviathan composed of platoons of bureaucrats, but rather a small number of policy analysts, managers and clerks who collect our tax money and then send it out to local school districts controlled by local school boards and as reimbursements to the doctors and hospitals who provide our health care.

All three budget plans that have been put forward this fiscal year raise the state’s expenditures as a share of GDP above that of the post-Great Recession years. But, as Table 2 shows, none of them raise government spending beyond that of the average over the last 20 years. The Governor’s plan, for example, would raise expenditures to 4.67 percent of GDP, which is below the 1994-2011 average of 4.89 percent as well as below the pre-Great Recession average of 4.71 percent.

Table 2 also points out that, with regard to expenditures as a percent of the state’s GDP, SB1073, which embodies the bi-partisan budget framework, is a balanced compromise between the Governor’s proposal and the budget formulated solely by the Republicans. SB1073 proposes spending at a rate of 4.57 percent which is exactly midway between the Governor’s proposal and the plan formulated solely by Republicans which proposes spending equality to 4.49 percent of GDP.

Table 2

Gov. Wolf's March Proposal, SB 1073 and SB 1460 Expenditures for fiscal year 2015-16 as percent of GDP

	Expenditures	Expenditures as a % of GDP
Gov. Wolf's Budget Proposal (March)	31,323,038	4.65%
Bi-partisan Budget Framework (SB1073)	30,793,817	4.57%
Republican Budget (HB1460)	30,263,236	4.49%

Source. Pennsylvania Budget and Policy Center

Funding for Education

Three Ways to Measure Education Funding

There are three important ways to define or measure spending on elementary and secondary education.

First, we can look at *overall levels of spending on education at the PreK-12 level*. This is a useful and important way of measuring the impact of the state government investment in education, but it can also be misleading. The state spends a great deal on education that is important but does not find its way directly into the classroom. For example, while funding for public libraries and school transportation is important, money spent for these purposes does not directly affect what happens in the classroom. That is also true, in a different way, for teacher’s pensions. Good pensions help schools attract and retain excellent teachers. But the recent rise in spending on teacher’s pension does not reflect a new commitment to improving the quality of teachers in our schools. Rather, it is a response to years of underfunding of the pensions of current teachers. So it is misleading to include rising pension costs as part of spending that improves education in the current year.

To compensate for these and other vagaries in PreK-12 education funding, PBPC has developed a narrower definition of the state’s commitment to education which we call “classroom funding.” It includes the basic education subsidy for each school district plus formula enhancements, charter reimbursements, accountability block grants, and, when looking back at previous years, funding for schools that came from the American Recovery and Reinvestment Act (ARRA).¹

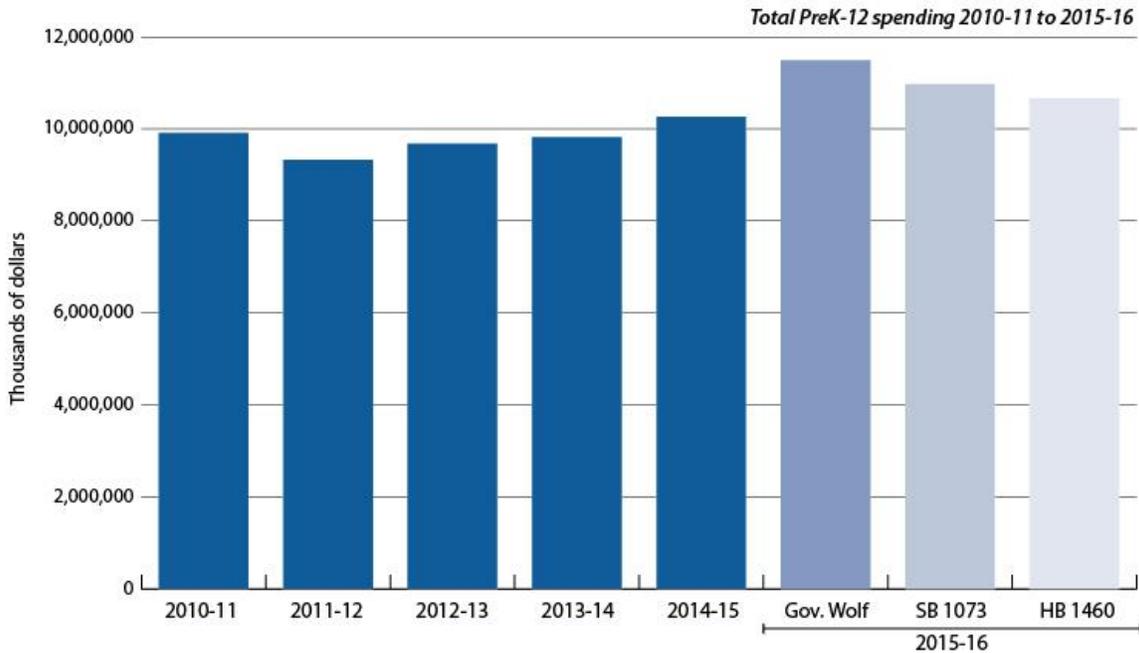
Finally, a third and critically important way to measure school funding is to look not just at overall funding levels, but at the distribution of funding in different localities. This is especially important in

¹ For more detail on classroom funding and the data sources necessary to estimate classroom funding each year, see Waslala Miranda, *Undermining Educational Opportunity: Pennsylvania’s Unequal Restoration of School Funding*, Pennsylvania Budget and Policy Center, October 21, 2015, online at <https://pennbpc.org/sites/pennbpc.org/files/finaledcutsbrief.pdf>

Pennsylvania because we have for years been among the worse states for how unequally education is funded from one school district to another.

Overall Funding for PreK-12 Education

Figure 2.
Spending on PreK-12 is Higher Than 2010-11 Under All Three Budget Proposals



Source: Pennsylvania Budget and Policy Center.

Using our first and broadest definition of school spending, Figure 2 and Table 3 show total spending on PreK-12 education in Pennsylvania since 2010-11 and as proposed for 2015-16 in the Governor’s budget, the bi-partisan budget framework as embodied in SB 1073 and the Republican proposal, HB 1460. A cut in total PreK-12 spending of almost \$600 million took place between 2010-11 and 2011-12. Even using this broad definition – which includes pension funding – it was not until 2014-15 that spending exceeded the levels attained in 2010-11 *even without taking account of inflation* (i.e., even in nominal dollar terms). This nominal dollar increase is used by some observers to highlight “historic levels” of education funding, without any acknowledgment that the increase ignores inflation and includes pension increases which have no direct impact on classroom education from one year to the next.

The three budget proposals put forward for 2015-16 all proposed (nominal dollar) increases in total PreK-12 education spending, but in widely different amounts. Gov. Wolf proposed an increase of \$1.2 billion. The Republicans proposed an increase of only \$406 million in HB 1192, which passed the General Assembly in June and in HB 1460, which passed the General Assembly at the end of December. The bi-partisan budget framework proposed an increase between that of the Governor and the Republicans of \$700 million. This amount is slightly closer to what the Republicans proposed (HB 1192) than what Gov. Wolf originally proposed.

Table 3

Trends in Total PreK-12 Funding 2010-2015 and Alternate Proposals for 2015-2016

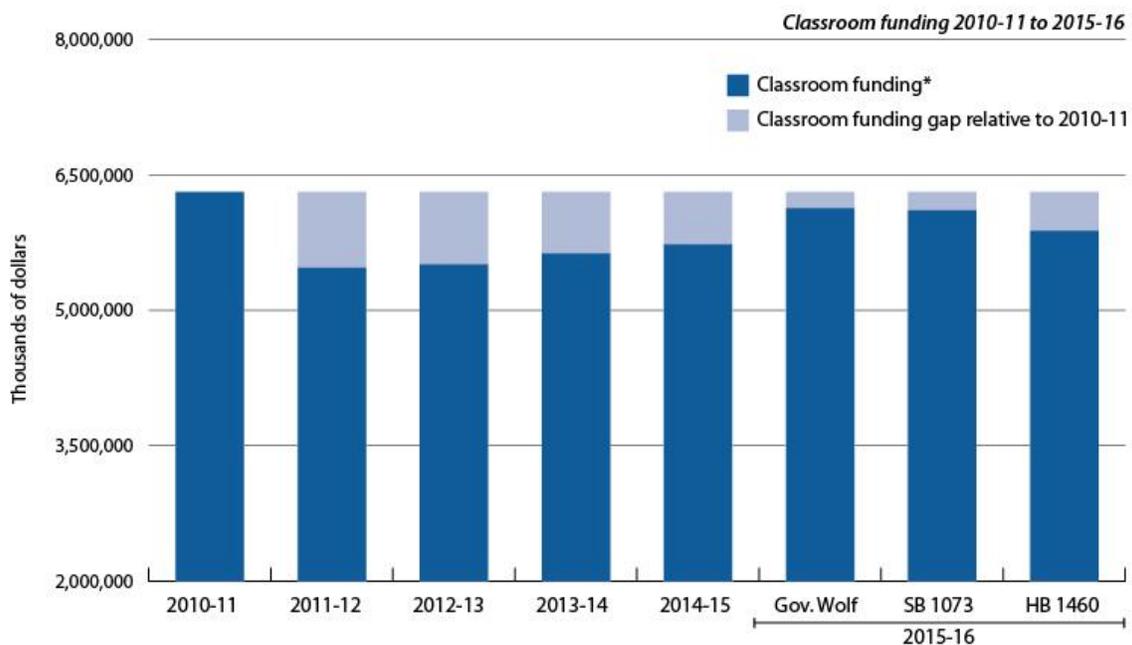
	Actual Spending					Alternative Proposals for 2015-2016		
	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16 Governor	2015-16 SB1073	2015-16 HB1460
Total PreK-12*	9,909,092	9,330,446	9,677,145	9,818,656	10,259,455	11,488,158	10,971,152	10,665,894
Increase in PreK-12 Funding from 2014-2105						1,228,703	711,697	406,439

*Includes SERS funding moved off-budget in Governor's proposal and SB 1072 in 2015-2016

Classroom Funding

While total spending on PreK-12 education suggests that the funding cut in the Corbett years has been restored, a closer look at what we call classroom spending paints a very different picture. The overall cut to classroom funding was even greater than the cut to total education funding (Figure 3 and Table 4).

Figure 3.
None of the Funding Proposals Would Fully Restore the Classroom Funding Cuts of 2011-12



*Classroom funding includes the basic education subsidy plus formula enhancements, charter reimbursements, accountability block grants, and American Recovery and Reinvestment Act (ARRA) funding.
Source: Pennsylvania Budget and Policy Center.

Pennsylvania’s classrooms lost \$841 million in state funding between 2010-11 and 2011-12. This drastic reduction in spending led to the loss of 30,000 teachers, guidance counselors, nurses and other positions in the schools.

In subsequent years, some classroom funding was restored, but progress has been slow. The last Corbett budget (in 2014-15) still had a gap of \$579 million between the amount of classroom funding in 2010-11 and the lower amount in 2014-15.

Table 4

Trends in Classroom Spending 2010-2015 and Alternate Proposals for 2015-2016

	Actual Spending					Alternative Proposals for 2015-2016		
	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16 Governor	2015-16 SB1073	2015-16 HB1460
Classroom funding*	6,309,676	5,468,629	5,506,129	5,628,629	5,730,079	6,130,079	6,106,969	5,880,079
Classroom funding gap relative to 2010-2011		841,047	803,547	681,047	579,597	179,597	202,707	429,597

*“Classroom funding” includes the basic education subsidy plus formula enhancements, charter reimbursements, accountability block grants, and American Recovery and Reinvestment Act (ARRA) funding.

All three budget proposals before the General Assembly this year recognize the need to restore state education funding. But they propose to do so at different levels. Gov. Wolf’s proposal would have wiped out all but \$179 million of the (nominal dollar) classroom funding cut compared to 2010-11 levels. The Republican budget, on the other hand, leaves a cut of \$429 million in classroom funding compared to 2010-11. The budget designed to follow the bi-partisan framework, comes close to, but does not quite reach the level of classroom funding proposed by the governor, leaving a gap of \$202 million compared to 2010-11 levels.

Equity in School Funding

A third way of analyzing Pennsylvania’s support for education is to look at how funding is distributed across Pennsylvania’s 500 school districts. This is particularly important because Pennsylvania has, for a long time, distributed school funding in a highly inequitable way.

PBPC issued a detailed study of education funding trends [in October](#).² We found that, the distribution of school funding cuts in 2011-2012 was highly inequitable and that, even after the partial restoration of funds in the years since, the inequity remained. We divided all schools into four quartiles, placing the 25 percent of schools that had seen the largest restoration of funds in the top quartile, the 25 percent that

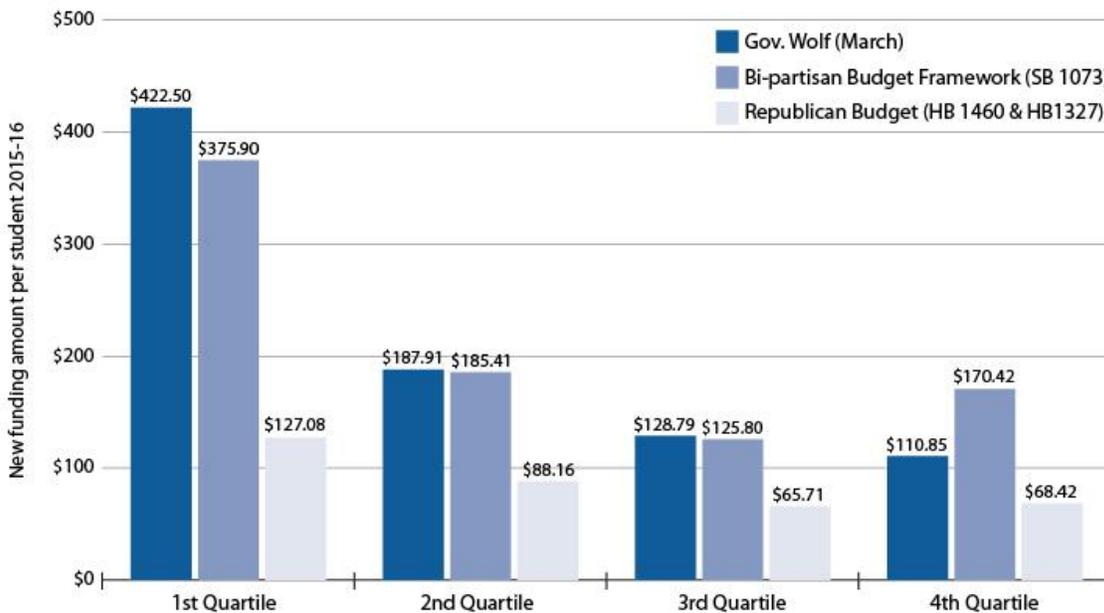
² Waslala, Miranda, “Undermining Educational Opportunity,” PBPC, October 21, 2015.

had seen the smallest restoration of funds in the bottom quartile and the others in the appropriate quartiles between them. In the top quartile of school districts only 10 percent of funding cuts were left to be restored. But in the lowest quartile of school districts, 82 percent of the funding cuts had not been restored. Moreover, the quartile of school districts with the largest remaining deficit were much more likely to serve low-income students (52 percent received free or reduced-price lunches) than those in the quartiles with the smallest remaining deficit (only 25 percent received free or reduced-priced lunches).

Gov. Wolf’s initial 2015-16 budget proposal would have increased funding for all school districts but emphasized restoring state funding cut in 2011-12 before applying the fair funding formula proposed by the Basic Education Funding Commission (<http://goo.gl/exopxi>). The distribution to school districts under the bi-partisan budget framework is a hybrid of Wolf’s proposal and the formula proposed by the Basic Education Funding Commission. The Republican budget distributes all new funding through the Basic Education Funding formula.

Figure 4.
The Republican Budget Proposal Restores Less of the Funding Cut From the Schools Hardest Hit by the 2011-12 Budget Cuts

The states 500 school districts are broken down into four groups of 125 school districts based on the size of their remaining cuts per student in 2014-15. The largest remaining cuts are in the 1st quartile and the smallest cuts are in the 4th quartile.



Source: Pennsylvania Budget and Policy Center analysis of data from the Pennsylvania Department of Education and Democratic House Appropriations Committee data.

While PBPC and education advocates have strongly supported the creation of a new funding formula we have also argued that it would be unfair to use the new formula to distribute additional state funding without first rectifying the inequities exacerbated by the 2011-12 cuts and the equally inequitable efforts to restore funding. Gov. Wolf proposed to distribute the \$1.2 billion of new funding in a way that sought to reduce that inequity. The budget designed to meet the bi-partisan budget framework proposed a hybrid plan, half based on the new funding formula and half based on the Governor’s plan.

Figure 4, looks at how the three budget proposals would distribute funds to four quartiles of schools, ranked according to how much of the 2011-2012 school funding cuts had been restored before the beginning of this budget year 2014-15.

All three budget proposals direct more funding to the schools that, as of 2014-15, had the largest remaining school funding cuts. The Republican proposal not only provides less funds for all schools but doesn't direct as much of the new funding to those schools still suffering from the deepest remaining cuts. Thus a large portion of the inequities in school funding introduced between 2010-11 and 2014-15 remain. The Wolf and the bi-partisan proposal do better in this respect.

The School Construction Issue

House Republicans claim that their proposed budget (HB 1460) increases education funding – and we have seen it does so, albeit less than either Gov. Wolf's proposal or the bi-partisan framework budget. But Gov. Wolf has recently claimed that the House Republican proposal that he line-item vetoed reduced education spending by \$95 million because that budget did not include \$305 million in reimbursements for school construction. What the Governor has done is to sum the additions in HB1460 to the Basic Education Fund, Ready to Learn, Pre-K Counts, Head Start and Special Education, which total \$210 million, and then subtract \$305 million in reimbursements for school construction, which leads to a net reduction of \$95 million in education spending.

Table 5

HB1460 Changes from 2014-15 (1000s of \$)	
Basic Education Funding	\$100,000
Ready to Learn	\$50,000
Pre-K Counts	\$25,000
Head Start	\$5,000
Special Education	\$30,000
Additions	\$210,000
Reimbursements for School Construction	-\$305,000
Total	-\$95,000

Source. Pennsylvania Budget and Policy Center

Republicans have rebutted the Governor's claim by pointing out that his own budget plan also puts the \$305 million school construction reimbursements "off budget." Both budgets plan to borrow to pay for school construction. The Governor claims, however, that because of the structural deficit exacerbated by the Republicans unwillingness to raised taxes, the state will not be able to borrow either at all or at an affordable rate.

As we point out below, in section III, there is no question that without new taxes, the state will not bring in enough revenues to pay for the spending in any of the three budget proposals for 2015-16. And the Republicans have not put forward, let alone passed, any tax proposal to fund even the spending level in HB 1460. Moreover, without new revenues, the structural deficit will be worse in 2016-17 and the state's credit rating will likely be downgraded again. Whether that means the state would not be able to borrow at all for school construction, or whether it will only be able to borrow at higher interest rates is, as we have seen, open to debate.

Whatever the answer, PBPC believes the key differences among the spending proposals for education are the total classroom spending and the distribution of state aid for education. In both respects, the bi-partisan budget, SB1073, provides more funding and directs more to the right school districts than the

Republican plan, HB1460, although it does not provide as much money as equitably as Gov. Wolf’s proposal.

II. Human Services

Analyzing spending on human services is, in many ways, more complicated than analyzing education spending because of the variety of human service programs funded by the state. While there is little question that during the Corbett years there were significant reductions in human service spending in many areas – from county services to medical assistance to spending on mental health and intellectual disabilities to general assistance cash grants to the poor – many of these programs were restructured in ways that makes it difficult, in a short brief, to compare spending over time.³

Table 6

Change from 2014-15 in Department of Human Services funding under three budget proposals. (000s of dollars)

Selected Department of Human Services Line Items	Governor's Proposed	Bi-partisan Budget Framework (SB 1073)	Republican Budget (HB 1460)
County Services ¹	\$30,876	\$28,241	\$4,049
Mental and Behavioral Health Services	\$59,825	\$63,176	\$36,473
Intellectual Disability Services ²	\$152,937	\$136,042	\$119,052
Long Term Care	\$282,672	\$335,965	\$320,315
Cash Grants	\$0	-\$20,000	-\$20,000
Supplemental Grants -Aged, Blind and Disabled	\$2,307	-\$680	-\$680
Homelessness	\$1,685	\$1,685	\$0
Children ⁴	\$42,338	-\$130,174	-\$131,474
Domestic and Rape Crisis Services	\$2,408	\$2,508	\$2,408

¹Includes County Administration -Statewide and County Assistance Offices.

²Includes Intellectual Disabilities - State Centers, Intermediate Care Facilities -Intellectual Disabilities, Intellectual Disabilities - Community Base Program, Intellectual Disabilities - Community Waiver Services, Early Intervention, Autism Intervention and Services and ID Residential Services –Lansdowne.

³Includes Child Support Enforcement, Youth Development Institutions and Forestry Camps, County Child Welfare, Community Based Family Centers, Child Care Services, Child Care Assistance

In this brief, we limit ourselves to pointing to the differences with regard to human services in the three budget proposals for this year. Table 6 shows that, in most areas, Gov. Wolf proposed more human services spending than the House Republican budget. In some areas, especially County Services, Mental and Behavioral Health Services, Intellectual Disability, and Homelessness, the bi-partisan budget framework comes closer to Gov. Wolf’s proposal. In a few areas, such as Cash Grants, Services to

³ PBPC documented many of these cuts in human service spending in a series of policy briefs. See “Health Care Funding in Final 2011-2012 Budget”; online at <http://pennbpc.org/health-care-funding-final-2011-12-budget>. See also “A Look at Health Care and Public Welfare Funding in Governor’s 2013-14 Budget”; online at <http://pennbpc.org/look-health-care-and-public-welfare-funding-governors-2013-14-budget>.

Children, and Supplemental Grants to the Aged, Blind and Disabled, the bi-partisan budget is closer to the House Republican proposal. And in one area, Long-Term Care, the bi-partisan budget proposed more spending than both Gov. Wolf and House Republicans.

III. The Structural Deficit

The Extent of the Structural Deficit

We cannot provide here a full analysis of the long-term fiscal situation of the commonwealth. Different ways of projecting the current and future costs of state government will lead to different conclusions about the extent to which they can be sustained by the revenues generated under current law. But, while there may be differences about the extent to which Pennsylvania faces a structural deficit – a situation in which spending under current public policy cannot be sustained by the revenues generated under current policy – there is no question that there is a substantial structural deficit.

The five-year outlook provided in December 2015 by the Independent Fiscal Office (IFO) provided the following projection of the state’s expenditure and revenues (Table 7):

Table 7

General Fund Balance Sheet (millions of \$)							
	2014- 15	2015- 16	2016- 17	2017- 18	2018- 19	2019- 20	2020- 21
Beginning Balance ¹	84	274					
Current Year Revenues	30,593	30,822	31,458	32,651	33,861	35,107	36,401
Less Refund Reserve	-1,340	-1,325	-1,345	-1,390	-1,430	-1,475	-1,530
Net Revenues	29,253	29,497	30,113	31,261	32,431	33,632	34,871
State Expenditures ²	-	-	-	-	-	-	-
	29,028	31,018	32,596	33,971	35,250	36,672	37,916
Current Year Balance	225	-1,521	-2,483	-2,710	-2,819	-3,040	-3,045
Lapses and Supplementals ³	-34	100	100	100	100	100	100
Ending Balance	259	-1,621	-2,583	-2,810	-2,919	-3,140	-3,145

¹ Beginning balance omitted for FY 2016-17 and thereafter

² Based on appropriations and executive authorizations

³ Current year lapses plus prior year lapses, minus supplemental appropriations. FY 2014-15

Source. Pennsylvania Budget and Policy Center based on data from the Independent Fiscal Office

The IFO’s projection of \$1.5 billion deficit in the current year, 2015-16, is based on expenditures of \$31 billion.⁴ Given that HB1460 appropriates \$800 million less, the deficit would be reduced to \$700 million which is a little bit more than Gov. Wolf’s recent projection of \$510 million. The IFO’s projections of a

⁴ We note that the IFO’s projections are highly regarded across the political spectrum. The Commonwealth Foundation has recently endorsed its conclusions about the extent of the structural deficit in this blog post:

<http://www.commonwealthfoundation.org/policyblog/detail/charting-pennsylvanias-budget-future>

deficit of \$2.4 billion in 2017-2018 is again, slightly higher than Gov. Wolf's current projection of "over \$2 billion."

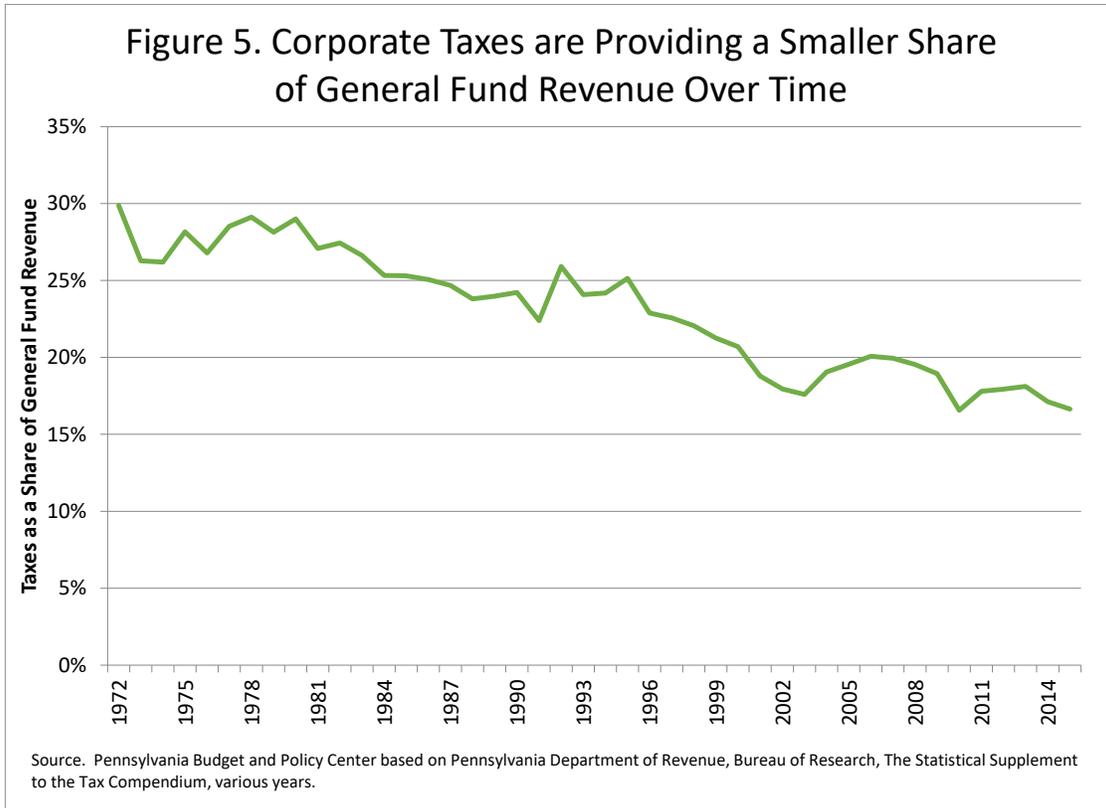
The governor's projections were recently endorsed by a report by the credit ratings agency, Standard and Poor's, that said, "The \$30.3 billion budget passed by both the house and senate is, in our view, structurally unbalanced..." They continue, "While we have not changed our rating based on the state's political gridlock, continued structural imbalance or lack of progress in funding its pensions could result in a rating action." Another downgrade of our credit rating would certainly make the structural deficit worse by increasing the state's borrowing costs. And it could eventually make it impossible for the state to engage in any borrowing that is not backed by dedicated revenues.

Gov. Wolf provided a detailed plan to generate the revenues to pay for the spending in his budget proposal. The bi-partisan budget framework called for sufficient new revenues to support the spending in SB1073, although details about which taxes were to be increased were never made public. House Republicans have not yet presented a revenue plan to close the deficit in this year or subsequent years.

A continued structural deficit created by a failure of the state to raise sufficient revenues to support its spending will ultimately lead to another series of cutbacks similar to those in education and health and human services that we saw in the Corbett administration. For example, if \$2.4 billion had be cut by 2017-18 as per Standard and Poor's, a billion or more of that might have to come from education and health and human services. The reason for that is, based on the most recent *Governor's Executive Budget*, education including higher education accounts for 40% of General Fund spending and health and human services another 40%. The final 20% includes some areas, such as debt service and corrections, that either cannot be cut or are difficult to cut. So education and health and human services are the only games in town when it comes to eliminating the structural deficit through cuts alone.

Source of the Structural Deficit

Why does the state suffer from a structural deficit? We saw above that state expenditures are not unusually high or growing relative to long-term trends in the state.



The real problem, then, is that the state is suffering from a relative decline in revenues. As we saw, all three budget proposals seek to raise state expenditures closer to the level they have been at for the last 20 years (as a share of GDP). The Governor seeks to come closer to that level, the Republican proposal does not go as far, and the bi-partisan budget framework is between them. But all three recognize that the public is demanding a higher level of services, especially, although not only, in the area of education, than it received under the Corbett administration.

Looking at historic trends in state revenues, it is clear that a key contributor to the structural budget deficit is cuts in corporate taxes (Figure 5).⁵

In the 1970s, corporate taxes accounted for 28 percent of General Fund revenue a figure that has fallen to 18 percent today. The IFO projects that this figure will fall to 14.9 percent by 2020-21.

We can estimate the impact of changes in corporate taxes in number of ways. One is to consider just the Capitol Stock and Franchise Tax (CSFT), which has been cut dramatically since 2002-03 and eliminated at the end of 2015.⁶ But for those cuts, the CSFT would have raised an additional \$2.4 billion in revenue in the 2015-16 budget year.

⁵ There are several contributors to the structural budget deficit besides the decline in corporate taxes most notably the ageing population which is both leaving less income subject to the Personal Income Tax (retirement income is not subject to the income tax in Pennsylvania) but also shifting consumer expenditures to services (like health care) which are not subject to the sales tax. This is one reason why broadening the sales tax is a good idea.

⁶ Between 2002-03 and 2015-16, the CSFT was cut from \$7.24 per thousand to \$0.45 per thousand of value of capital stock.

A second way to estimate the impact of corporate tax reductions is to project what general fund revenues would be today if corporate taxes were the same percentage of all tax revenues that they were in the past. From 1988-1989 to 2002-2003, taxes on corporations were, on average, 22.25 percent of all general fund revenues. If taxes on corporations provided the same share of general revenues in 2015-16, total general revenue would be \$2.39 billion higher than projected this year.

The structural deficit is not something that just happened to Pennsylvania. It was created by an effort, begun under Gov.'s Ridge and Rendell and then heightened under Gov. Corbett, to reduce taxes on the corporate sector. Not only were these tax cuts fiscally irresponsible in that they were not paid for with new revenues, but there is no evidence that job growth in Pennsylvania relative to the rest of the country has improved.⁷

Conclusion

Gov. Wolf and House Republicans presented starkly different budget plans this fiscal year. That is the main reason we are entering February without a complete budget. The House budget proposal passed by Republicans in both legislative chambers at the end of December, which Gov. Wolf line-item vetoed, will not provide for critical needs this fiscal year. Many school districts will start running out of money in March or April. Not enough money has been appropriated to run the state's prisons. No state money has been appropriated for the state-affiliated universities. And, as we pointed out above, without new revenues, the state will not have enough money to pay for those programs.

Yet despite the stark differences between the Governor's proposed budget and the budget put forward by the Republicans, the Governor and the leaders of the Democrats and Republicans in the House and Senate did manage to reach a "framework agreement" that splits the differences between them on overall spending and education spending and also reaches agreement on human service spending. But for various reasons we have discussed elsewhere, they have not been able to complete work on this framework budget.

A main sticking point seems to be raising taxes to pay for the spending levels in all three budget proposals. This is not just a problem this year but is likely to remain a difficulty for the commonwealth for some time. As we have seen, the structural deficit was not caused by growing state spending. On the contrary, state spending has been on the decline. Rather it was caused by large corporate tax reductions.

If Pennsylvania is to have adequate and honest budgets this year and in the future, even by the standards of the Republicans who prefer less government spending, new sources of general fund revenues must be found.

⁷ Ellis Wazeter and Mark Price, "The Final Verdict: A Cuts-Only Approach to the Budget Doesn't Work", Pennsylvania Budget and Policy Center, June 23 2015. Available online at <http://keystoneresearch.org/finalverdict>. See also Mark Price "Pennsylvania at Another Crossroads", Pennsylvania Budget and Policy Center, October 6 2015. Available online at <https://pennbpc.org/pacrossrds>