



RESTORING CONFIDENCE IN GOVERNMENT: An Overview of the Governor's Proposed 2017-18 Budget

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Designed by Stephanie Frank

Acknowledgments

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Executive Summary

Last year at our budget summit, we said that Pennsylvania is at a crossroads and that there are two paths forward. We are still there. Pennsylvanians—and their government—are divided about which of two paths they believe our state government should follow.

One view is that the public sector—both the work of government and the work of non-profits that rely on state government funding—is essential to creating broadly shared prosperity in Pennsylvania. The other view downplays the positive role of government and public investments, and sees the taxes that pay for them as an impediment to economic growth.

The voters of Pennsylvania have elected a Democratic Governor, who tends to favor the first view of political and economic life, and a Republican-dominated General Assembly, whose leaders have tended toward increasingly extreme versions of the second view. Voters, in other words, have not chosen between these two visions of government; instead, they have set up a conflict between them, one that, together with the large structural deficit the state faces, could lead this year to another long budget impasse.^[1]

These political circumstances clearly have shaped the budget Governor Wolf presented this year. While his name is on the budget book, his budget reflects both the necessity of eliminating the structural deficit and the political divisions in Harrisburg.

In response to these circumstances, the Governor has proposed a different kind of budget. At its center is a plan to close a \$3 billion structural deficit in part through an ambitious and mostly well-designed, and plausible \$2 billion program to reform and restructure government operations and in part through \$1 billion in new revenues that mostly come from corporations and the business community, not working people and the middle class.

The necessity of closing a large deficit at a time when the General Assembly is likely to chaff at enacting \$1 billion in new taxes means that the Governor has presented an austere budget that calls for little new spending beyond what is necessary to meet mandatory increases. The only exceptions are in critical areas—Pre-K and K-12 education and human services—where the Governor continues to meet his commitment to seek new funding. The budget also includes an increase in the minimum wage to \$12 an hour, which will benefit nearly 1.5 million Pennsylvanians, lead to higher state income and sales tax revenues and shift more of the cost of Medicaid to the federal government. And Governor Wolf calls for other new initiatives to create middle-class jobs, in manufacturing a via a Middle Class Task Force.

From our perspective, however, the Governor's budget invests too little in public goods and asks the wealthiest citizens and corporations to contribute too little to our commonwealth.

But we understand the political circumstances that limit the Governor's choices. And we hope that his plan to restructure and reform government, and to close the deficit without burdening working people and the middle class with new taxes, can help convince our fellow citizens to embrace a more active vision of government in the future.

[1] Gerrymandering of legislative districts enhances this conflict both because it helps Republicans win more seats and because it creates legislative districts that are overwhelmingly dominated by one party or another. When representatives and senators fear defeat by those to their left or right in a primary more than they fear defeat in a general election, they become more inclined to represent the extremes of their own party than voters who stand in the middle in their constituencies.

Introduction

Last year at our budget summit, we said that Pennsylvania is at a crossroads and that there are two paths forward. We are still there. Pennsylvanians—and their government—are divided about which of two paths they believe our state government should follow.

One view is that the public sector—both the work of government and the work of non-profits that rely on state government funding—is essential to creating broadly shared prosperity in Pennsylvania. That view holds that public sector investment in things like infrastructure and education—from pre-K to K-12 to college to worker training programs—encourages the private sector investment that creates new, well-paid jobs. That view holds that everyone who works should receive a family-sustaining wage and that good jobs fuel a growing, innovative economy. It holds that communities won't thrive if we don't invest in public amenities such as first responders, clean, well-paved streets, parks, and recreation centers, and protection of clean air and water. And it holds that everyone, including those who need a helping hand, should have an opportunity to take advantage of all that riches of contemporary life.

The other view downplays the positive role of government and public investments, and sees the taxes that pay for them as an impediment to economic growth. That view seeks to increase the profits of businesses by adopting policies that undermine unions, lower wages, and eliminate regulations.

Few Pennsylvanians hold entirely to one view or another. And while each of our two political parties tend to favor one or the other, there are many exceptions and many political officials who stand somewhere in the middle.

We at the Pennsylvania Budget and Policy Center mostly embrace the first view, but understand that even it can be taken to an extreme.

The voters of Pennsylvania have elected a Democratic Governor, who tends to favor the first view of political and economic life, and a Republican-dominated General Assembly, whose leaders have tended toward increasingly extreme versions of the second view. Voters, in other words, have not chosen between these two visions of government; instead, they have set up a conflict between them, one that, together with the large structural deficit the state faces, could lead this year to another long budget impasse. [1]

These political circumstances clearly have shaped the budget Governor Wolf presented this year. While his name is on the budget book, his budget reflects both the necessity of eliminating the structural deficit and the political divisions in Harrisburg.

His budget proposal recognizes, first, that if those of us who believe in active government are to convince our fellow citizens to trust our vision, we must work to ensure that government is as efficient and as responsive to the most important concerns of citizens as possible.

The budget proposal recognizes, second, that if we are to ask for new revenues to invest in thriving communities as well as close the structural deficit, we cannot ask citizens with stagnant incomes to pay much more of the bill. We must, instead, fix our broken tax system by asking those who earn the most, but have the lowest tax rates, to pay their share.

And it recognizes, third, that long, drawn out budget dramas undermine confidence in government. The result is an austere budget that calls for little new spending beyond what is necessary to meet mandatory increases. The only exceptions are in critical areas—Pre-K and K-12 education and human services—where the public clearly supports new investments.

As we point out in this analysis, in many areas, the Governor has not called for sufficient investments in public goods. We urge legislators to do more than he has asked. But we understand that attaining our goals for public investment is politically difficult this year.

We also think that a major effort to restructure and reform Pennsylvania's government—which promises to reduce spending dramatically as well as to make government more efficient and responsive to citizens—makes sense, especially this year. Those reforms will help restore confidence in government and, by doing so, build long-term support for a budget that embraces a more active, effective public sector.

Government reforms proposed by the Governor generate \$2 billion of the \$3 billion necessary to close the structural deficit.

The last \$1 billion is generated by tax reforms that do not fall on the vast majority of Pennsylvanians but, instead, ask corporations and other businesses, who have seen their taxes cut in recent years, to pay more.

We would prefer a budget that goes farther in raising revenue by more aggressively fixing our broken tax system and by investing more in education, infrastructure, protecting clean air and water, and human services. But even the Governor's modest proposals may still face opposition. Yet it is hard to see reasonable alternatives to the spending reductions and tax increases in this proposed budget.

Government spending in Pennsylvania is at historically low levels, and any further reduction in spending will come from drastic cuts in education and human services at a time when state spending in those areas has not fully recovered from the cuts of the Corbett years—cuts that voters clearly rejected in 2014.

Given the hesitancy of the legislature to embrace taxes and spending as a way to reduce on economic inequality, state government could and should take other steps to encourage the creation of more middle-class jobs. The governor proposes three steps in that direction. He calls, first, for an increase in minimum wage to \$12 per hour. As well as benefitting nearly 1.5 million Pennsylvanians this would help balance the state's budget by increasing state income and sales taxes and also by shifting more of the costs of Medicaid to the federal government. Second, the governor proposes a state manufacturing strategy, "PA Manufacturing." And third, he will create a "Middle Class Task Force" that will make further recommendations for effective government action to strengthen the middle class.

As in the past, we begin with a discussion of the structural deficit, followed by an overview of the Governor's overall proposals on the expenditure and revenue side of the budget. But before turning to details on the expenditure side, we look in more detail at the Governor's proposals for government reform and restructuring, which apply to many department and across departmental lines.

The Challenge of the Structural Deficit

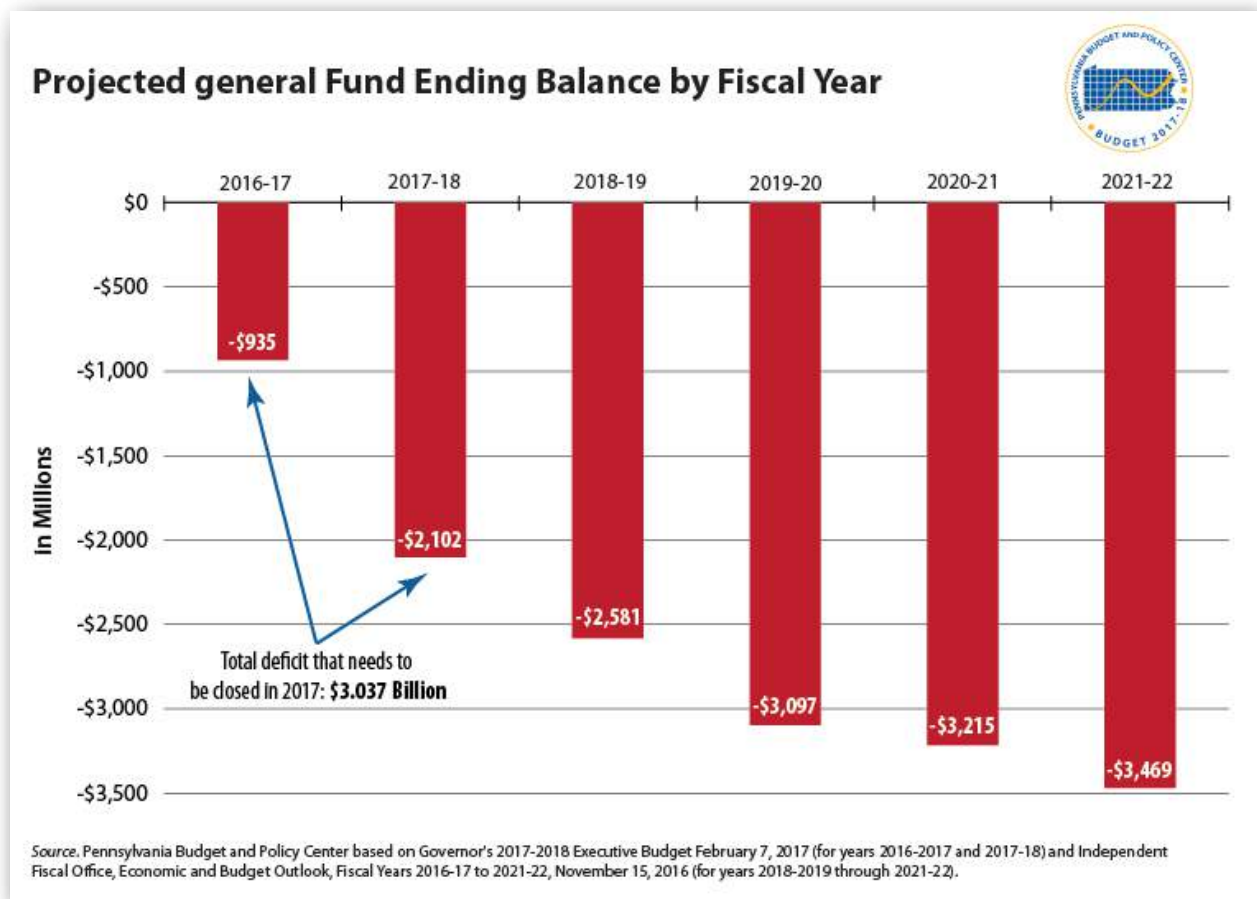
The Extent of the Structural Deficit

A structural deficit exists when the expenditures necessary to maintain the current level of government service is greater than the revenues expected under current law.

Figure 1 shows that, under current law, the state is projected to run a deficit of \$935 million in the current fiscal year, 2016-2017, and a \$2.1 billion deficit in the 2017-2018 fiscal year, which begins on July 1, 2017. Furthermore, the Independent Fiscal Office predicts that under current law, yearly deficits are projected to increase, reaching almost \$3.5 billion in the 2021-2022 fiscal year.

Under the Pennsylvania Constitution, the state cannot run a deficit. Thus, the General Assembly must take action this year to eliminate the deficit in the current year and in 2017-2018. That is, the structural deficit that must be closed this year is a little over \$3 billion.

Figure 1.



The expenditures necessary to maintain the current level of government services include not only the current level of spending, but increases necessary to meet inflation in the costs of goods and services and what are known as mandatory spending increases.

As Table 1 shows, mandatory increases account for \$1.6 billion in additional spending in the 2017-2018 budget. They include spending for services to which individuals are entitled under federal programs such as Medical Assistance (Medicaid's name in Pennsylvania), to fund pensions and pay interest on the

state debt, to meet contractual obligations to state employees, and to pay the growing costs of housing inmates in state correctional institutions. On the revenue side, calculations of the structural deficit include not only the revenues raised in the current year, but revenues expected under current law, which may increase (or in some cases decrease) given changes in the economy.

Table 1.

Mandatory Spending Increases In 2017-2018 Budget		
Spending Category	Increase in Spending (in Millions)	Explanation
Department of Human Services	\$900	Increases required to draw down federal matching funds
Pensions	\$300	Act 120 of 2010 requires state pension contribution
Department of Corrections	\$200	Costs expected to grow this year. Savings are possible through criminal justice reform in the long term
Debt Obligations	\$100	The state cannot default on its debt payments
Contracts	\$100	
Total	\$1,600	
<i>Source. Pennsylvania Budget and Policy Center based on Governor's 2017-18 Executive Budget, Feb. 7, 2017</i>		

Growing Expenditures Do Not Account for the Structural Deficit

In order to understand the Pennsylvania budget, we need to understand why we have a structural deficit. That means looking at both the short-term and long term-sources of the deficit.

The problem is not increased state spending. As a percentage of the state's Gross Domestic Product (GDP), expenditures and revenues (Table 2 and Figure 2) since 2011-2012 are below the historical average of the previous 18 years, illustrating clearly that out-of-control spending is not the source of the current structural deficit.

State government expenditures dropped during the Governor Corbett years (2011-2015) to 4.37% of GDP, substantially below the 4.71% average between 1994 and 2011. Expenditures have dropped slightly during Governor Wolf's first two years in office to 4.32%, and his proposed budget for this year would reduce state expenditures to 4.29% of GDP.

Of course, while state spending is declining as a percent of GDP, it has grown in absolute terms. But an increase in spending is necessary to maintain the same level of government services. The population of the state grows in most years, and inflation requires higher levels of spending to maintain the same level of services. And that is especially true in government because inflation in services—which is mainly what government provides—and especially in health care services, tends to be higher than inflation in goods. Technological innovation makes it possible to produce goods, such as computers and cars that are both 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. To maintain the same level of service, government has to slowly grow as a share of GDP over time. It has not done so in Pennsylvania.

Table 2.

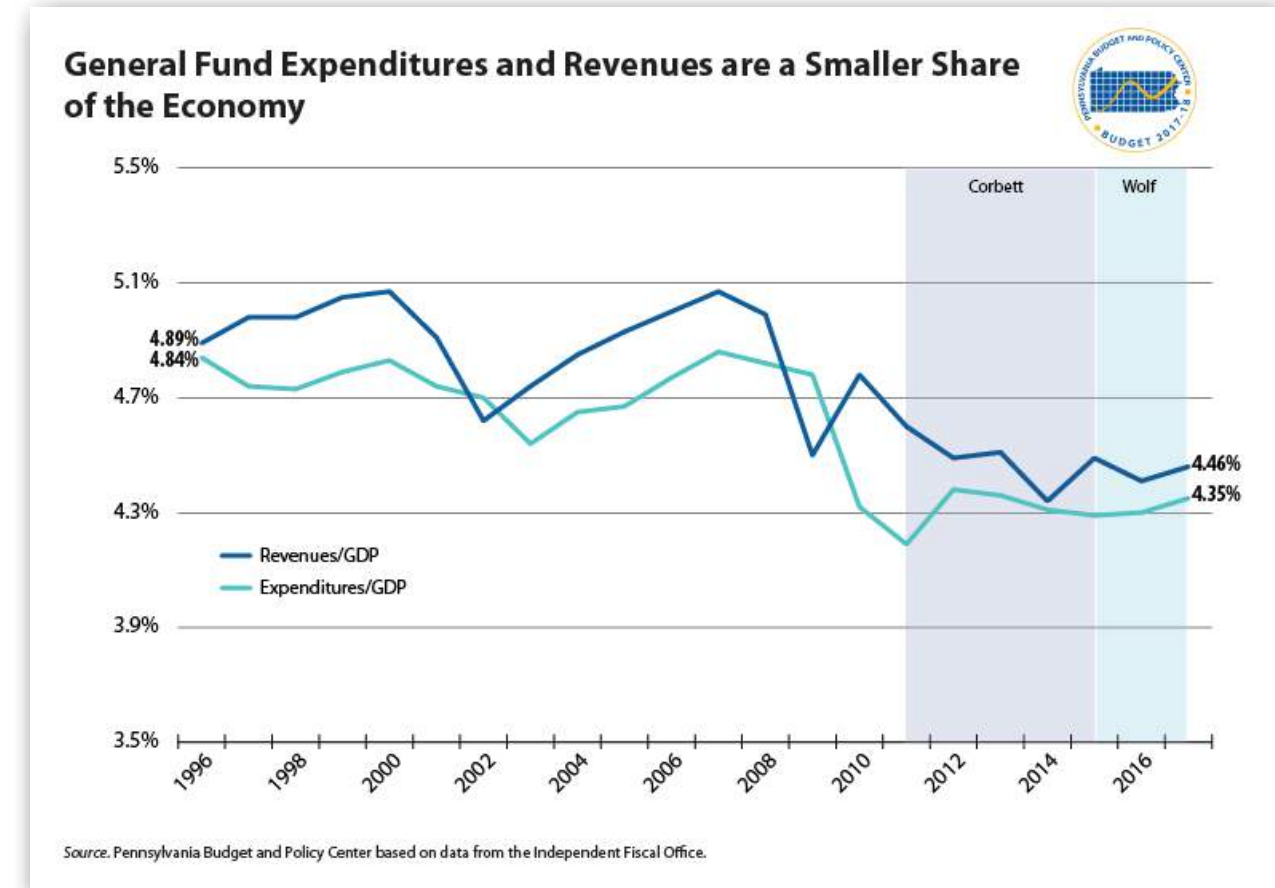
Pennsylvania General Fund Expenditures and Revenues as a Percent of GDP (nominal figures in millions)		
Fiscal year ending	Expenditures / GDP	Revenues / GDP
Average 1994 to 2011	4.71%	4.89%
Average 2012 to 2015	4.37%	4.49%
Average 2016 to 2017	4.32%	4.33%
Proposed 2018	4.29%	4.47%

Source. Pennsylvania Budget and Policy Center based on Governor's 2017-18 Executive Budget, Feb. 7, 2017 (for years 2016-17 and 2017-18) and Independent Fiscal Office, Economic and Budget Outlook.

So, the structural deficits the state faces this year and into the future cannot be blamed on increased expenditures. Rather, they are largely the result of declining tax revenues. From 1994 to 2011, revenues averaged 4.89% of the state's GDP. During the Corbett years, they dropped to 4.49% of GDP, and they dropped again to 4.33% of GDP during Governor Wolf's first two years in office.¹

The decline of both revenues and expenditures as a percent of GDP can be seen in the Figure 2.

Figure 2.



¹ Careful readers will note that in all three periods under consideration, revenues exceed expenditures as a percent of GDP. So why has the state not been accumulating surpluses? The answer is that revenues each year must exceed expenditures to provide a reserve for tax refunds to those whose withheld tax payments exceed their tax obligation. The refund reserve is typically 4% of expenditures or .18% of state GDP.

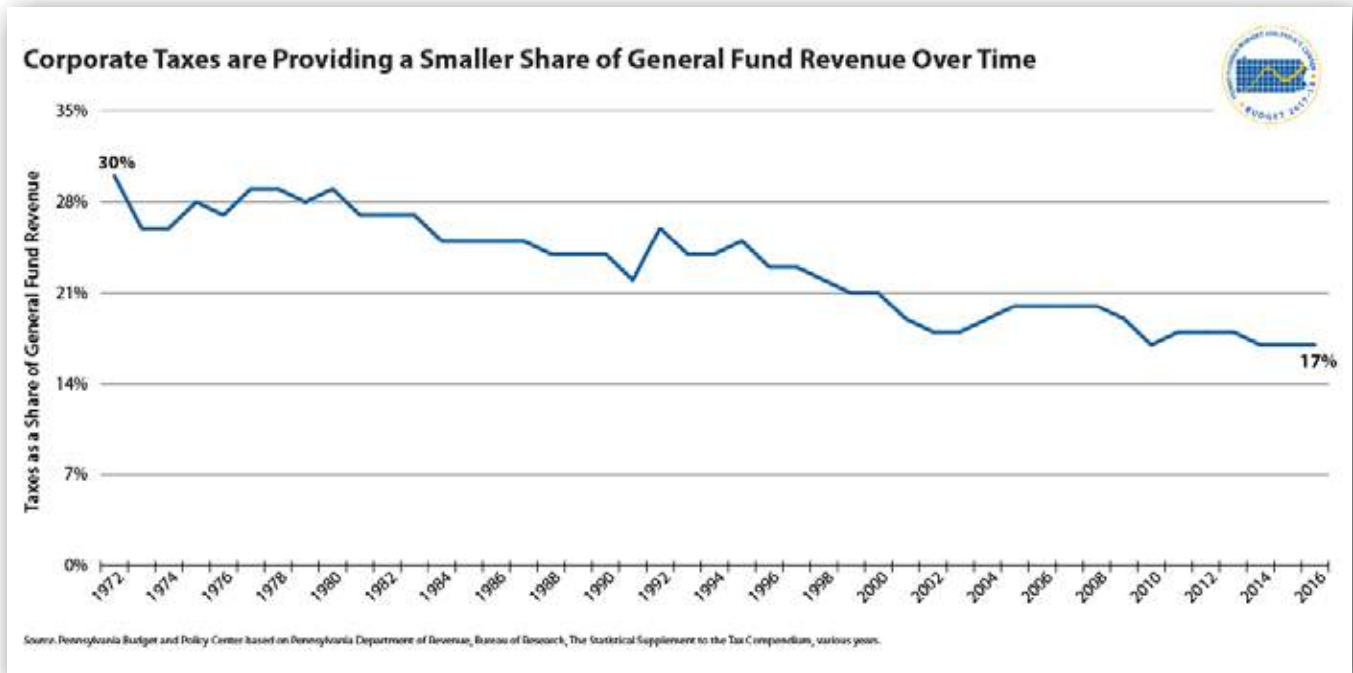
Long-term Sources of the Structural Deficit: Corporate Tax Cuts

We can divide the revenue issue into long-term and short-term components.

The long-term problem is the decision, supported by members of both political parties, to cut corporate taxes over a number of years. One corporate tax, the Capital Stock Franchise Tax, has been entirely phased out. Meanwhile, changes in the Corporate Net Income Tax have reduced revenues as well.

The dramatic decline in the contribution of corporate taxes to general fund revenues can be seen in Figure 3.

Figure 3.



If corporate taxes brought in the same percentage of General Fund revenues that they did between 1988-89 and 2002-03, total general revenue would be \$2.39 billion higher than projected in 2016-2017 and a bit more than that in 2017-2018. Not only would there be no structural deficit problem, but there would be additional funds available to invest in education, human services, infrastructure, and protecting our air and water.

Corporate tax cuts were made on the assumption that they would lead to increased economic growth and the creation of new jobs. As we have shown elsewhere² that did not happen. State and local taxes are only a small fraction of business costs. While tax reductions for businesses have large impacts on the state budget and public employment they are a small share of business costs and do little to change the market forces that shape employment growth in the commonwealth over the long term.³ Labor is by far the largest cost of most businesses. Since one of the primary roles of public spending is investment in education and training, which makes workers more productive, our failure to invest adequately in our children now will undercut future prosperity.

² 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://keystonerresearch.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>

³ Deep budget cuts like those of 2011-12 can impact employment growth in the short run by leading to large scale layoffs in the public sector which ripple through the economy as spending reductions which in turn sap the growth of employment over several years.

Short-term Sources of the Deficit: One-time Revenues in the 2015-2016 Budget

The reduction in corporate taxes (and the broader failure to tax those with the highest incomes in Pennsylvania) has created the long-term revenue problem that governors and legislators must deal with as they balance the budget year after year. The only true solution to the problem is to generate new recurring revenues. But recently, legislators have been unwilling to secure recurring revenues sufficient to close the structural deficit permanently. Instead, they have relied on one-time sources of revenue, including borrowing from other funds to close the deficit in one year, thereby increasing deficits in future years.

The 2016-2017 budget year was no exception. Table 3 lists the \$1.3 billion in new revenues enacted to fund the budget in the current fiscal year. Of that \$1.3 billion, less than half, or \$627 million, came from recurring revenues. Most of those revenues came from taxes on tobacco, which will no doubt decline as those taxes reduce consumption. Reduced consumption of tobacco products is good for people's health, but it also means that, over time, the state will bring in less revenue.

On the other side of the ledger are several one-time revenues, such as sales of licenses to sell liquor in new locations and to expand gaming. Whether one favors or opposes these policies, the sale of licenses only brings in revenue for one year.⁴ The same can be said for the use of tobacco settlement and Volkswagen settlement funds to balance the budget. Some of the non-recurring revenues are also costly in the long-term. The second tax amnesty in a decade does bring in new revenues, although less than what is owed the Commonwealth. But it also undermines future revenues by encouraging Pennsylvanians to not pay their taxes with the expectation of another amnesty in a few years. And while borrowing from other funds—in this case, the Medicare Liability Fund—to support the General Fund does help balance the budget in one year, the loan must be repaid with interest.

Table 3.

New Revenue in 2016-17 (in millions of dollars)			
Recurring Revenue		Non-recurring revenue	
Cigarette Tax	431	Tax amnesty	100
E-Cigarettes	13	Internet gaming*	100
Smokeless Tobacco	48	Liquor licenses	149
Roll you own	3	Casino license fee-Philadelphia*	50
Cap sales tax vendor discount	56	Table games license fee	25
Sales tax on digital downloads	47	Tobacco settlement transfer	29
Personal income tax on lottery winnings	16	Volkswagen settlement	20
Bank shares tax	24	Balance transfers	37
Table games tax 2% increase	17	Loans from other funds	200
Minor tax changes	-2		
Education Improvement tax credit	-25		
Subtotal recurring revenue	627	Subtotal non-recurring revenue	709
Total new revenue			1337
*Revenues not realized as of March 2017			
Source. Pennsylvania Budget and Policy Center analysis of 2016-2017 budget			

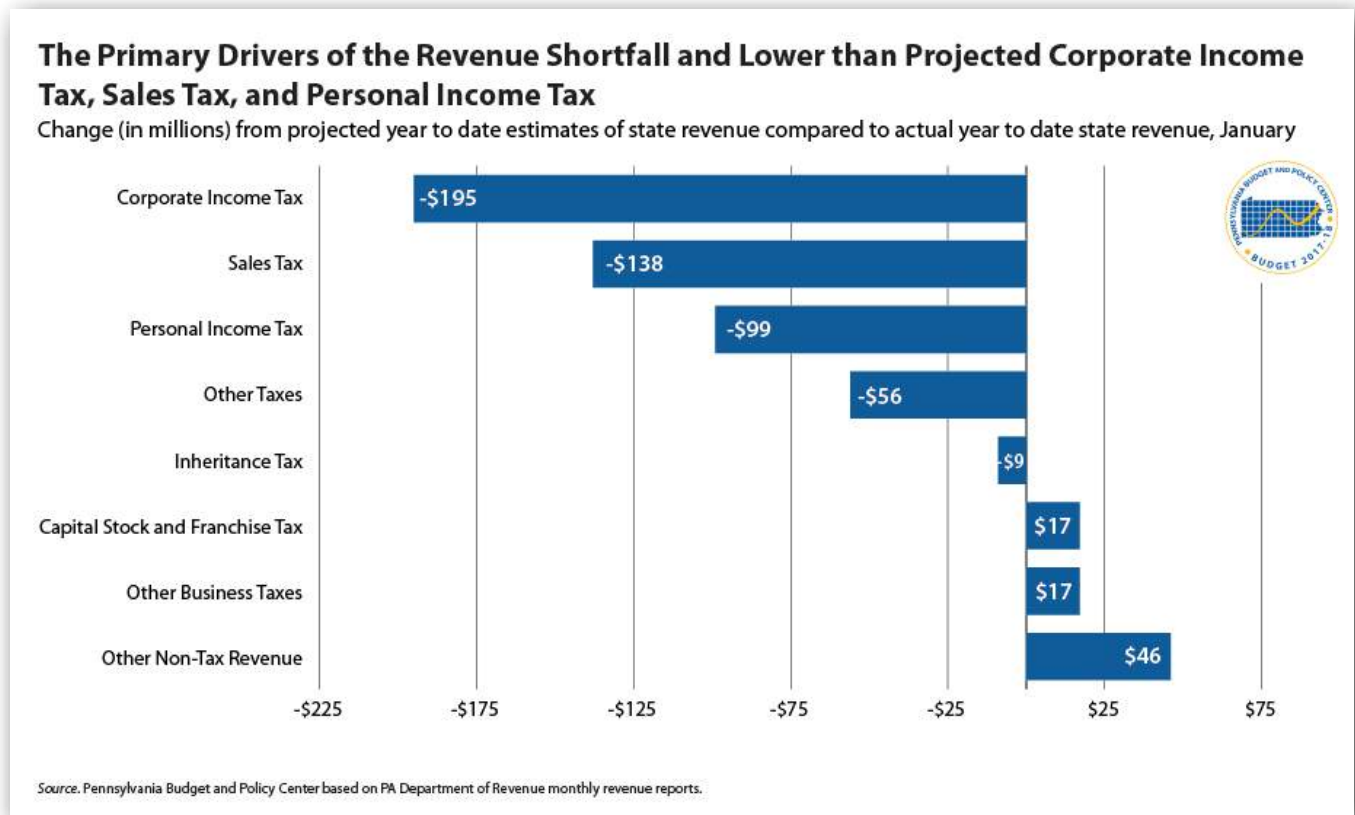
⁴ At this point, it seems unlikely that a second Philadelphia casino license will be sold in the current fiscal year and the General Assembly has yet to pass legislation enabling internet gaming. There is also a history of new gaming licenses bringing in far less revenue than initially projected.

Short-term Sources of the Deficit: Revenue Shortfall

The long-term problem of insufficient recurring revenues to balance the budget creates another problem for Pennsylvania—it makes our fiscal house extremely vulnerable to short-term fluctuations in state revenues. The state suffered greatly from the devastating impact of the Great Recession on revenues. We are seeing a similar problem this year, as economic growth has underperformed projections and thus led to a revenue shortfall in the current fiscal year.

Figure 4 shows that the current projection for tax revenues for the current fiscal year, 2016-2017 is \$400 million less than the July 2016 projection. And that, of course, means that the base for projecting tax revenues for 2017-2018 is lower as well.

Figure 4.



One reason it is important to close the structural deficit is that the state should fully fund its “rainy day fund” so that unexpected revenue shortfalls in the future do not create budget crises.

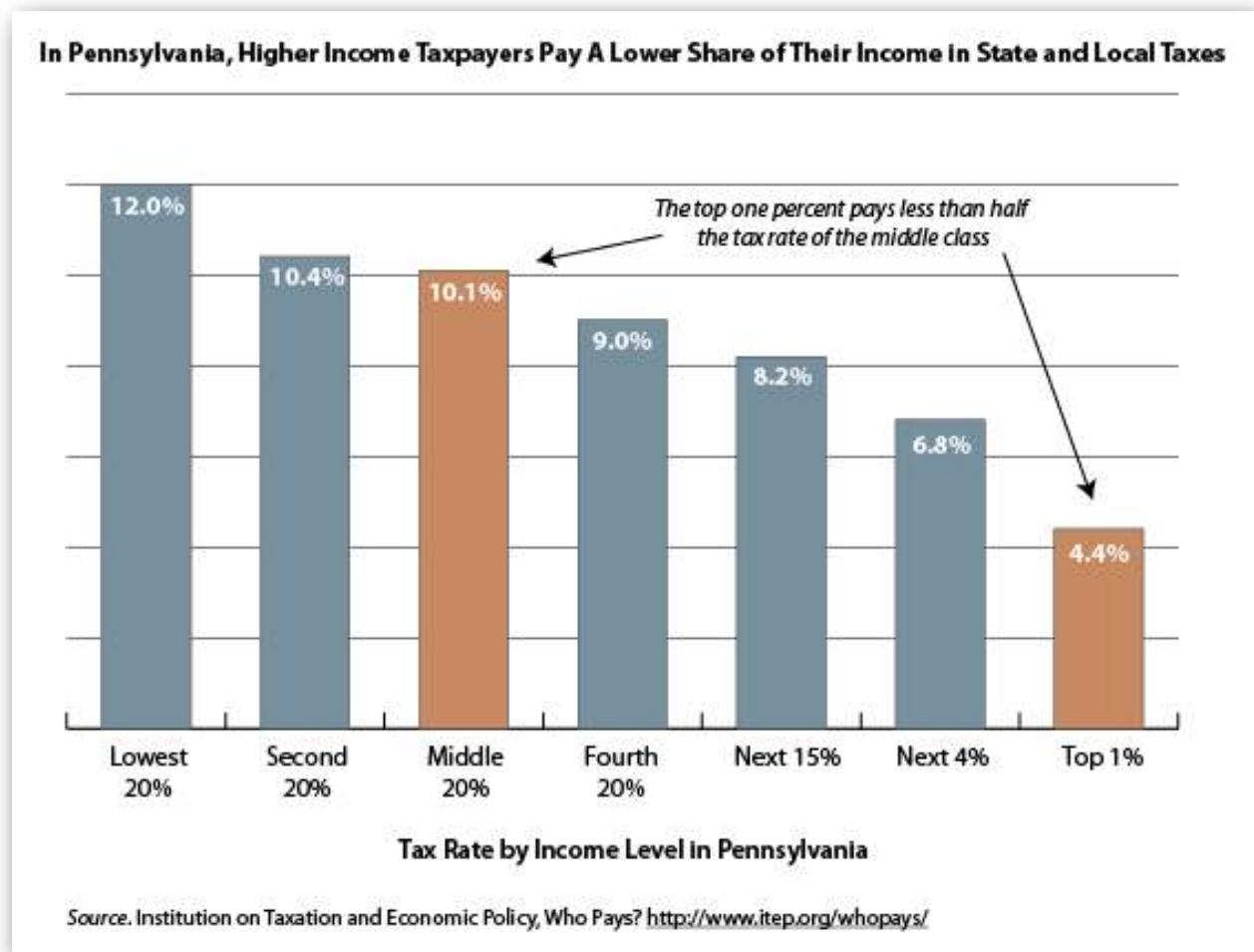
Overview of General Fund Revenues

The budget put forward by Governor Wolf proposes to close the current \$3 billion structural deficit by raising \$1 billion in new recurring revenues and by saving \$2 billion through government reform and restructuring. We look first at his revenue plan.

Sources of New Revenues

Governor Wolf proposes no new broad-based tax increases this year. As Figure 5 shows, the 20% of Pennsylvania families with the lowest incomes pay 12% of their income in state and local taxes, while those in the middle 20% pay 10.3%. But the top 1% of families pay only 4.2% of their income in state and local taxes. Not only is this upside-down tax system unfair, but it makes it impossible for the state to raise the revenues needed to pay for vital public services. We will never balance our budgets if the rich and corporations can use their political influence to avoid paying their fair share of taxes.

Figure 5.



Governor Wolf's proposals for new tax revenues are a step in the right direction. All four of his tax proposals raise new revenue from businesses.

Nearly half (49%) of new revenue will come from expansion of the Sales and Use Tax base to include business services that are currently not taxed, even though consumers are taxed for similar services. For example, consumers are taxed if they purchase software, but businesses that purchase custom

programming are not presently taxed. Consumers that rent storage units are taxed but businesses that do so are not. Catering is taxed except on airlines. The Governor’s budget calls for that anomaly to be fixed as well. It also proposes that aircraft sales and repair be subject to the sales tax, just as the cars purchased by or repaired by consumers now come under the sales tax. All of these proposals to expand the sales tax base will raise income mostly from business and the wealthy, rather than the average Pennsylvanian.

The governor has also proposed a 6.5% severance tax (with a credit for the impact fee credit natural gas drillers currently pay). Every other major gas-producing state has a severance tax to ensure that the state’s natural resources aren’t extracted with no benefit to its citizens. A severance tax would bring in almost \$300 million more than the impact fee currently in place. And revenues from the severance tax will grow as natural gas prices increase. Some part of the severance tax will be paid by the owners of natural gas fields and drillers. Another part may be passed on to consumers. But because pipelines from our Marcellus Shale fields take 80% of the natural gas produced in Pennsylvania outside the state, it is consumers in other states who will pay the tax. Pennsylvania consumers of natural gas already pay the severance tax put in place by the states which produce the natural gas they consume.

Table 4.

Governor’s Proposed New Tax Revenues		
Tax Changes	Revenue (in millions)	Explanation
	2017-18	
Corporate Net Income Tax	\$81.20	Net Operating Loss (NOL) capped at 30% for tax year 2018 and after; combined reporting beginning in 2019. Rates: 8.99% for 2019; 7.99% for 2020; 6.99% for 2021; 6.49% for 2022 and thereafter.
Severance Tax	\$293.90	6.5% tax with credit for impact fee payments
Insurance Premiums Tax	\$141.50	Base expansion to include entities that are currently exempt, such as nonprofits and HMOs. Effective Jan.1, 2018.
Sales and Use Tax	\$489.80	
Custom programming, design and data	\$330.30	Canned software purchased off the shelf is currently taxable. Effective July 1, 2017.
Commercial storage	\$153.60	Excludes farm product, warehousing storage and transportation services. Self storage is currently taxable. Effective July 1, 2017.
Aircraft sales, use, and repair	\$5.10	Vehicles and repair are currently taxable. Effective July 1, 2017.
Airline catering	\$0.80	All other catering is currently taxable. Effective July 1, 2017.
Total New Tax Revenues	\$1,006.40	
<i>Source. Pennsylvania Budget and Policy Center based on Governor’s 2017-18 Executive Budget, Feb. 7, 2017</i>		

The budget calls for the Insurance Premium tax to be extended to non-profit insurance companies and HMOs. The difference between for-profit and non-profit insurance companies has, for the most part, ceased to be meaningful and many non-profit insurance companies do much of their business in for-profit subsidiaries. Thus, this proposal will create a level playing field for all insurance companies, no matter how they are organized.

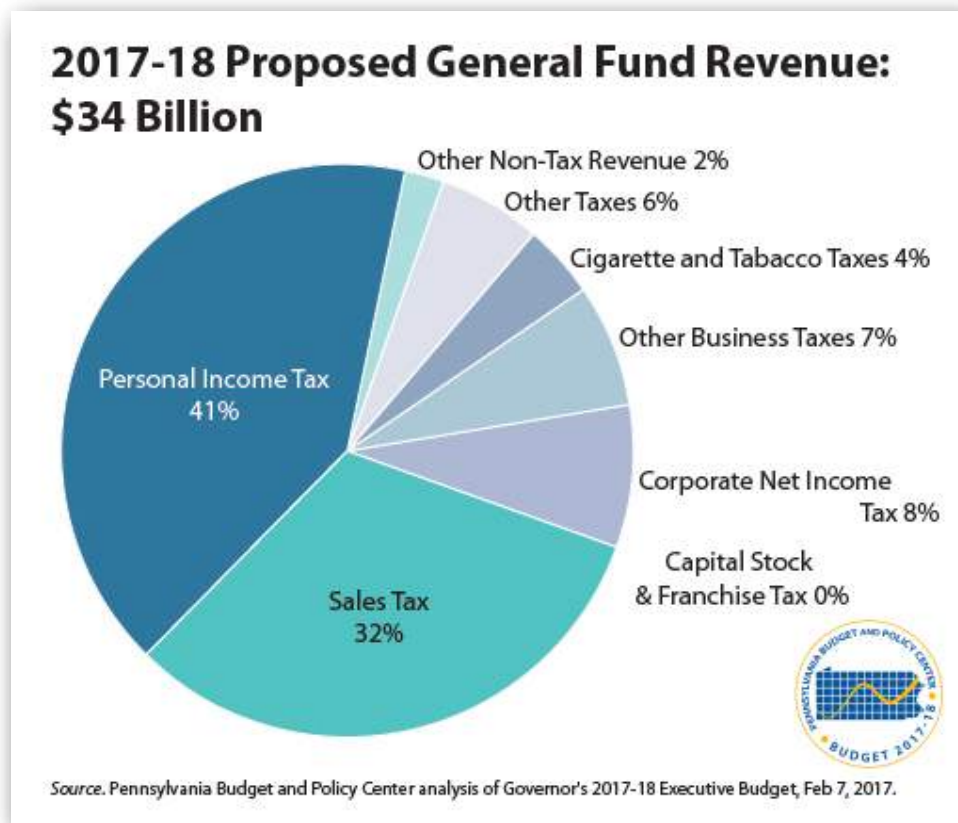
Finally, the Governor proposes to institute combined corporate tax reporting, which would close the notorious “Delaware “Loophole,” which has allowed 71% of corporations that operate in Pennsylvania to avoid paying corporate taxes. Corporations like Wal-Mart and Toys-R-Us take advantage of the loophole by arranging their books to show no profit in Pennsylvania. They charge their Pennsylvania affiliates for goods sold here or for national advertising or for intangibles like the “good will” associated with their national brand at rates that allow them to show that they make no profit in Pennsylvania.

Combined reporting closes the “Delaware Loophole” by requiring corporations to attribute to Pennsylvania the proportion of their total profit that matches the proportion of their total sales made in our state. Closing the loophole would enable the state to generate more revenues from corporate taxation at lower rates. Indeed, the Governor wants the tax rate to eventually drop from the current 9.9% to 6.49%. We believe that proposal goes too far, and would recommend reducing the rate to a level that brings in at least an additional \$200 million per year over what the corporate tax brings in this year.⁵

Revenues in the 2017-2018 Budget

An overview of all revenue sources in the 2017-2018 budget can be found in Figure 7. Over 73% of the \$34 billion total comes from Personal Income Tax and Sales and Use Tax, as has been the case in recent years. Revenue raised from businesses via the Corporate Net Income Tax and other business taxes is 15%. Thus, even though Governor Wolf proposes to raise new revenue from corporations, the corporate share of tax revenue continues at its historically low level.

Figure 6.



⁵ Given that so many corporations have avoided the tax until now, we can't be sure what level that is until combined reporting is instituted.

While the Governor's tax proposals make sense, we believe he could have proposed other new initiatives that would do have done more to fix our upside-down tax system. He might, for example, have called for an idea we have championed: raising the tax rate on what we call income from wealth (dividends, capital gains, non-corporate business profits, estates, royalties and gaming winnings) while not changing, or even slightly reducing the rate on wages and interest. As we have shown elsewhere,⁶ raising the tax rate on income from wealth can generate a lot of new revenue mostly from those in the top 5% of families.

Among non-tax revenues, a notable contributor to the General Fund revenues are a transfer from the State Stores Fund of \$185 billion. (Liquor and Malt Liquor taxes account for another \$413 million and, as we have pointed out elsewhere, the state's very high alcohol taxes could not be sustained if not for the state-owned Pennsylvania Liquor Control Board.⁷)

Two questionable items are also included among non-tax revenues. The budget again assumes that gaming expansion will bring in new one-time revenues from internet gaming and the sale of a license for a second Philadelphia casino. So far the General Assembly has not reached agreement on a plan for internet gaming, and plans for the second Philadelphia casino have not moved forward this year.

An additional \$324 million in new revenues are included in the Governor's plan to reform and restructure Pennsylvania government and will be discussed in more detail below. We note here first that one of those plans, to borrow \$165 million from Workers Security Fund, continues the unfortunate trend, criticized above, of borrowing from other funds to supplement General Fund Revenues. This loan, like others made in recent years, will need to be paid back. Second, we believe the budget understates the additional revenue and/or savings that will result from raising the minimum wage to \$12 an hour. The budget assumes that this will generate an additional \$95 million in new Sales and Personal Income Tax Revenue.⁸ However, raising the income of 1.5 million workers making the minimum wage will enable many of them to move from traditional Medicaid/Medical Assistance to expanded Medicaid. Because the federal government reimburses expanded Medicaid at a much higher level than traditional Medicaid, the state should save roughly \$125 million in Medical Assistance/Medicaid spending as a result of raising the minimum wage.

6 See, Marc Stier and Stephen Herzenberg A Fair Share Tax Proposal for Pennsylvania: How to Raise Revenues While Sparing Most Pennsylvanians, Pennsylvania Budget and Policy Center, December 20, 2016.

7 Marc Stier, More on Why Privatizing PLCB Privatization is a Bad Idea.

8 We believe that the additional revenues may be a little higher.

Overview of General Fund Expenditures

The Governor has proposed a 1.8% increase in General Fund Spending in 2017-18. His budget takes another step towards restoring the cuts of the Corbett years, especially with regard to education. There are increases in human services in the areas of opioid addiction and intellectual disabilities, which have been underfunded in past years considering the need.

Figure 7.

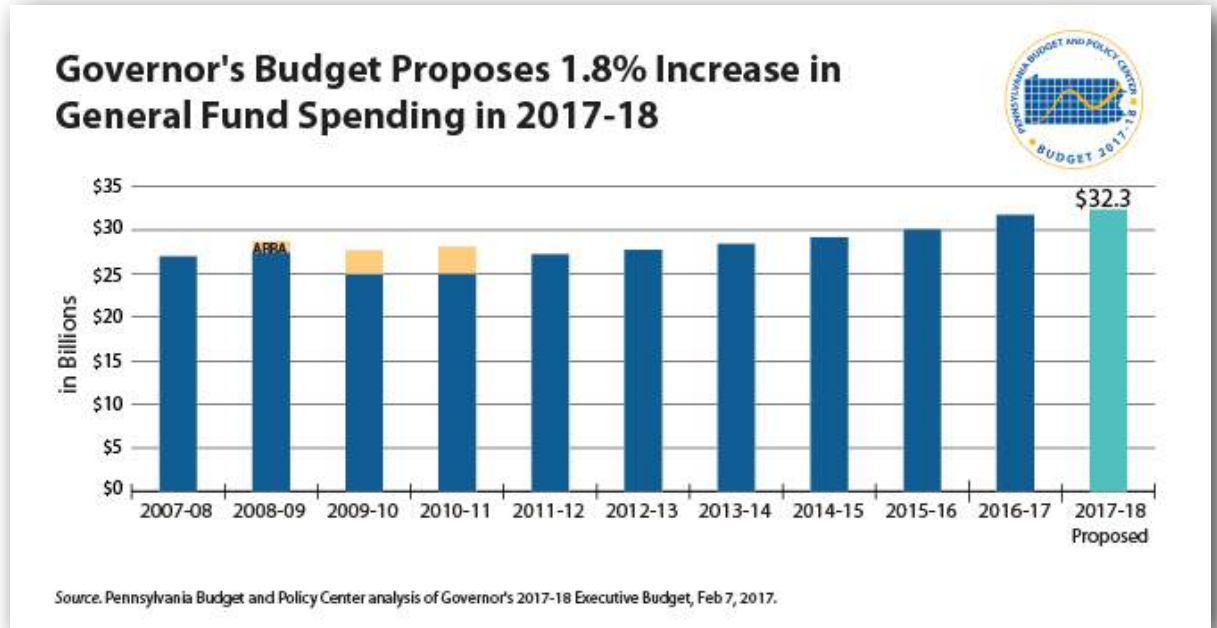
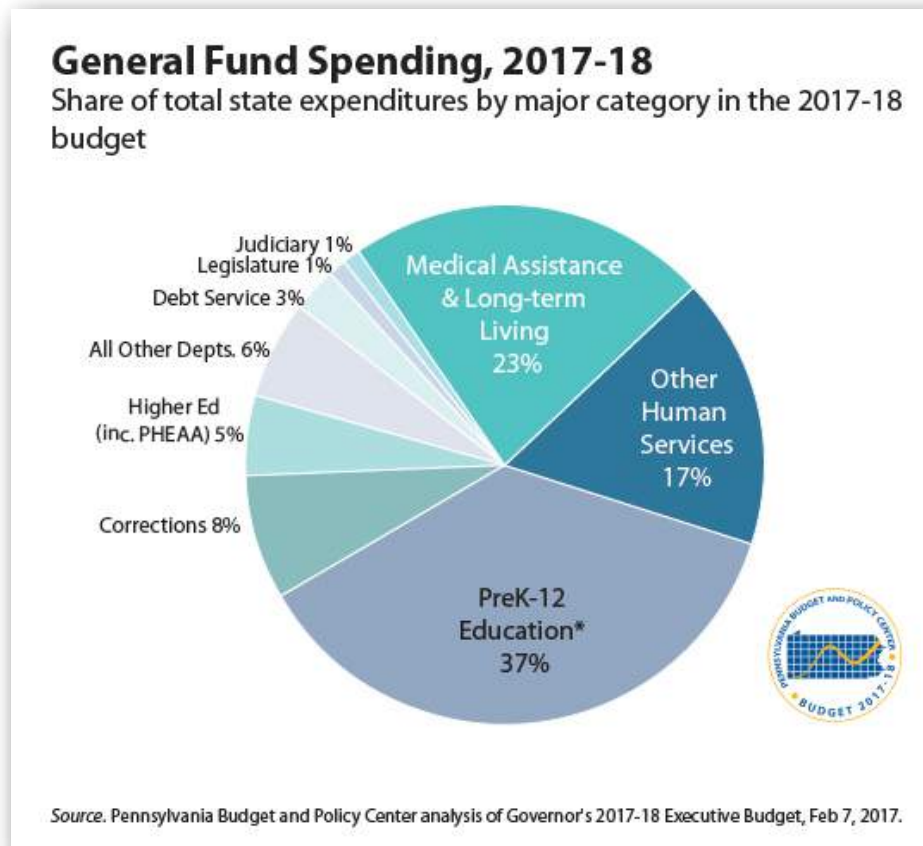


Figure 8 shows the Governor's proposed General Fund spending for 2017-18, which totals \$32.3 billion. The largest government spending is in Human Services, which includes Medical Assistance and Long-Term Living and Other Human Services (40%) followed by PreK-12 education (37%) and Corrections (8%).

Figure 8.



Government Reform and Restructuring

At this point in our review of the budget we would normally turn to the details of the proposed expenditures in the 2017-2018 budget in different policy areas and departments. But before we look at those details, we want to step back and examine the Governor's proposal for government reform and restructuring. For while many of the Governor's proposals for reform are applied within particular departments, there are a number of general approaches that are applied to many departments and, indeed, aim at consolidating not only particular departments but functional operations in more than one department.

The overall aim of the Governor's plan is something everyone, from any point on the political spectrum, should support: government efficiency and transparency. We all believe that government should be as efficient as possible, making the best possible use of our tax dollars. And we also all believe government services should be as easy to use as possible. Any effort to save money and make Pennsylvania's government more responsive to the citizens of the state is worth undertaking.

But while the overall goal is commendable, we also need to evaluate how the Governor intends to reach that goal. In a report of this length, we can't discuss, let alone evaluate, every initiative proposed by the governor. Instead, we will point to some of the major initiatives in each of the seven categories in which the governor has grouped his proposals. Even with regard to these major proposals, we can't provide a complete evaluation. We respond in general terms to those proposals and say where we think they make sense—which is in most cases—and where they seem problematic—which is in a few cases. But, as politicians, staffers, advocates, and analysts have frequently said in the last two weeks, "the devil is in the details." Whether the Governor's plan ultimately makes government more effective, responsive to citizens, and less expensive depends on how it is carried out. As we will see below, many of the Governor's proposals, such as reducing personnel costs and replacing tax credits with block grants, could go wrong if they are not carried out well. It will be some time before we can provide a full evaluation of an initiative that is both ambitious, and worth pursuing.

An overview of the key elements in each of seven categories of reform identified by the Governor can be found in Table 5. We will consider some of them below. But two general points should be made before we do so.

First, efficiency means doing the same or more with less. The state should not save money by reducing services that are important to the health and safety of Pennsylvanians and the economic well-being of the state. That doesn't mean that we should not reconsider whether some state programs are less important than others or whether there are alternatives to direct state provision of some public goods. But government reform and restructuring does not, and should not, cut back on what we expect of the state.

Second, we believe that the workforce of the Commonwealth should play a role in helping make government more efficient. Research on both public and private sector enterprises has consistently shown that people who work in large organizations care about working efficiently and that they have a great deal of knowledge about how to improve the work they do. The public sector and teacher unions in the Commonwealth have long been committed to making government work better. The leaders and members of these unions should be fully enlisted in efforts to reform and restructure government.

Table 5.

Savings from Government Reform 2016-2017 and 2017-2018 Budget (in millions of dollars)			
Categories	Totals in Major Categories*	Totals in sub- categories	Notes and Comments
Complement Controls / Workforce Reduction	143.0		Eliminate funding for vacant positions, early retirement incentive, and adjustments to span of control.
Consolidation of Departments	104.0		
Health and Human Services (from Human Service, Health, Aging and Drug and Alcohol Programs)		90.0	\$45 million for consolidating prescription drug programs; \$15 million for State Health Care Center program relocation; \$7 million for County Assistance Office reorganization; \$9 million from back office / administrative positions; \$5 million increased fees for child abuse clearance and death certificates, \$5 million from Act 534 reforms and reductions in some small health programs..
Department of Criminal Justice (from Corrections and the Board of Probation and Parole)		10.4	Reduction in administrative; costs
Reducing our Footprint / Facilities management	104.0		
Pittsburgh State Correction Institution closure		65.0	
Reduction in beds in Hollidaysburg Veterans Home		10.0	Reduction in beds from 506 to 367
Non-core Program Reductions	171.0		
Tax credits converted to block grant		100.0	Tax credits under DCED and the Department of Revenue that are be converted to block grants or eliminated not yet been identified. Saving will come from reducing expenditures that contribute least to economic development
End subsidy to UPENN Veterinary School		30.1	
Institutional assistance grants		12.9	Private colleges will be required to match state funds, thus reducing state spending
Attorney General		8.5	Increased fees for delinquent accounts and broaden allowable use and expand funds in restricted accounts
Revenue Enhancements	314.0		
Minimum wage increase		95.0	
Workers Compensation Security Fund Loan		165.0	
Other revenue maximization		64.0	

Fiscal Management	493.0		
Farm Show Lease-back		200.0	
Shift of grants from General Fund to bond funding		109.5	
—CURE Grants		45.9	
—Cultural and historical support grants		2.0	
—Grants to the arts		9.6	
—Environmental stewardship grants		52.0	
Prior Year Lapses		145.0	
Debt restructuring		28.0	
Efficiencies	767.0		
State Police reimbursement		47.0	Municipalities that have no local police and rely on the state police will pay \$25 per capita. The new fee generates \$63 million of which \$16 must, according to the fiscal code, go to the Motor License Fund
Pupil transportation reimbursement formula revision		50.0	
Increased inspections fees		7.0	Fees paid to the Department of Labor and Industry and other departments for state services
Oil and Gas Fund		8.0	Increase in funding from the Oil and Gas Fund will offset General Fund spending for the Department of Conservation and Natural Resources
DHHS Cost reductions		556.0	\$330 million due to updated calculations in capitation models with regard to expected enrollment increases and reimbursement levels; \$128 million increase in assessment on Managed Care \$98 million due to delay in launch of CommunityHealthChoices.
Administrative efficiencies and savings		98.0	Includes procurement efficiencies, consolidation of Human Resource and Information Technology services, new and scaled up GO-TIME Projects
*Savings in major categories does not equal total of detailed savings because smaller initiatives are not presented			
Source. Pennsylvania Budget and Policy Center based on Commonwealth of Pennsylvania 2017-18 Budget and Budget Presentation			

Complement Controls / Workforce Reductions

The first category of reform, which is projected to save \$143 million, involves reduction in the state's workforce, which in budget jargon is called complement controls. The Governor's budget calls for small reductions in the workforce complement in most departments and agencies. The budget proposes to reduce the state's workforce by not filling vacant positions and by encouraging some early retirements. The administration also intends to adjust the span of control of supervisors to ensure that they are not managing too few (or too many) subordinates.

The administration has promised that there will be minimal layoffs. Keeping this promise is critical to enlisting the knowledge and commitment of state workers to the administration's plans.

Many vacancies have existed for several years in state government. And early retirement is a good way to reduce costs as senior workers are replaced by new ones with far lower salaries. This part of the Governor's plan thus makes a great deal of sense. But it can go wrong, as well. We urge administration officials and the General Assembly to insure that key positions do not go unfilled and that adequate plans are made to ensure that workers with critical knowledge train their replacements before they retire.

Consolidation of Departments

The Governor proposes to consolidate four departments, Human Service, Health, Aging and Drug and Alcohol Programs into a new Department of Health and Human Services and also to create a Department of Criminal Justice by consolidating the Department of Corrections and the Board of Probation and Parole. Of the \$104 million savings resulting from these consolidations, \$90 million results from the consolidation of four departments into the Department of Health and Human Services. Of that amount, \$45 million comes from consolidating prescription drug programs; \$15 million from by providing State Health Center services in other locations besides independent offices including County Assistance Offices, local health departments, and non-profit agencies. (Some of the services now provided by State Health Centers may be able to secure federal reimbursement in these other settings.) County Assistance Office reorganization, which will combine some back-office operations in different centers, will save \$7 million. Savings of \$9 million come from the reduction of administrative overlap, such as eliminating duplication in the department leadership and consolidation of the offices that provide services currently provided by the different departments. Placing a three year cap on Act 534 program benefits, requiring beneficiaries to shift to worker compensation afterwards, saves \$5 million. Increase feeds for child abuse clearance and death certificates brings in \$5 million. (Other savings from consolidating departments, such as workforce reduction, facility reduction, and other program changes are counted in one of the other seven categories of government reform.)

The consolidation of the four departments that will make up the new Health and Human Services Department is the part of the Governor's plan most likely to improve the delivery of services to citizens and thus accounts for most of the expected savings in this category. The four departments serve an overlapping clientele. Consolidation of the departments is likely to make it easier for citizens to secure all the services to which they are entitled without talking to officials at or submitting information to different office locations or websites. It will be easier to automate and digitize services that are not currently provided through the internet if the departments are consolidated as well. Similar savings can be found by bringing overlapping services together in a Department of Criminal Justice.

Reducing the Footprint of the State / Facilities Management

The budget proposes to save \$104 million through improved facilities management, which means closing or reducing the size of facilities no longer needed and consolidating programs in one location. A large part of the savings in this category comes from closing the Pittsburgh State Correction Institution. Other savings come from reducing the size of one veteran's home.

The administration may find further savings in this category office space in the future by consolidating State Police stations and by using computer technology to keep more inspectors from The Department of Labor and Industry and Department of Environmental Protection in the field.

Revenue Enhancements

The administration plans to institute specific reforms that will generate \$314 million in new revenues. One of them, raising the minimum wage, was discussed above. The administration also expects to generate \$64 million by taking various steps to ensure that taxpayers meet their obligations to the Commonwealth. This is surely a good use of resources, as it will not only bring in more money but generate more confidence in the equity of the state's tax system.

One proposal in this area, to secure a \$165 million loan to the General Fund from the Workers Compensation Security Fund, troubles us. It appears to be one more attempt to balance the books by borrowing from the future.

Non-core Program Reductions

Non-core program reductions, which is supposed to generate \$171 billion in savings, include a number of elements that may be controversial.

One is a proposal to review state tax credits and replace some of them with block grants, while eliminating others, saving \$100 billion. Questions have long been raised about the many tax credits that largely benefit particular businesses rather than whole economic sectors and about using tax credits rather than direct grants to attain the goals of the state. Our view has always been that tax credits are less transparent than direct appropriations, at least as currently managed. Where they are used, they should be focused not on helping individual businesses, but on creating the conditions under which multiple businesses in an economic sector can thrive, for example, by training workers (e.g., at firms in a multi-employer apprenticeship or an Industry Partnership) or improving infrastructure. When tax credits go directly to a business, the benefit to the public may be lost if the business moves or closes. But when workers are trained and infrastructure is improved, the benefit to the public is likely to be more long lasting and different companies can take advantage of those programs.

Because the administration has not yet identified which tax credits will be eliminated and/or converted to block grants, it is impossible to fully evaluate this proposal.

The administration proposes to end a \$31 million subsidy to the University of Pennsylvania Veterinary school, arguing that this is a less essential task for the state, that other states do not provide similar subsidies, and that the University of Pennsylvania has the financial means to provide other support for the school.

The administration also proposes to require private colleges and universities to match state funds, thus reducing state support to them by \$12.9 million. In general, we believe that the state provides too little, not too much, support for higher education. But while more funding is necessary, we also think it should be directed to public, four-year colleges and community colleges, not private institutions that have the means to replace state support.

Finally, the state proposes a reduction of \$8.5 million for the Attorney General's office. Much of this funding will be replaced by increased fees.

Fiscal Management

There are two major items in the fiscal management category, the lease of the Farm Show complex and the shift of a number of state grant programs from the General Fund budget to Commonwealth Financing Authority Bonds.

The lease of the Farm Show Complex to a private entity for twenty-nine years and the lease-back to the state for the same term will enable the state to reduce General Fund Debt Service by \$200 million (\$151.4 billion net).

Proceeds from \$387.4 billion in Commonwealth Financing Authority Bonds will go to support a Smart Cities Initiative (\$11 billion); Water Protection Efforts to manage erosion on Pennsylvania Farms, address local water quality issues near farms, and to expand the Chesapeake Bay Riparian Forest Buffer program (\$45 billion); as well as the four programs listed in the chart: Commonwealth Universal Research

Enhancement or CURE grants for health care research (\$45.9 million) Cultural and Historical Support Grants (\$2 million); Grants to the Arts (\$9.6 million) and Environmental Stewardship Fund Grants (\$52 million.)

There is sometimes a fine line between operating expenses for goods and services consumed in one year, which should be funded by revenues raised during that year, and capital expenses for goods and services that benefit Pennsylvanians over a number of years, which it is reasonable to fund through the issuance of bonds. As the benefits of some of the grants issued under these four programs extend beyond one year, it is not unreasonable for the administration to fund them with the proceeds of bonds. Using bonds to support the Environmental Stewardship Fund grants and the transfer from that Fund to the Oil and Gas Lease Fund to the Department of Conservation and Natural Resources (described below in the section on the Department of Conservation and Natural Resources) makes sense if those transfers ultimately support projects with benefits that extend beyond one year.

Debt restructuring is also proposed with the expectation that it will save \$28 million in 2017-2018.

Efficiencies

The large efficiencies category generates \$767 million in savings from several initiatives.

One will require communities that rely on the state police rather than local police forces to pay a \$25 per capita fee. This fee will generate \$63.1 million for the Motor License Fund, of which \$47 million will go to the state police, reducing General Fund support for the State Police by the same amount. Over 2.6 million people, or 20% of Pennsylvanians, live in one of the 1,294, or 50% of municipalities that rely on the State Police for full-time police coverage. The cost to the state is about \$540 million. Given that 80% of Pennsylvanians live in the other half of communities that spend local tax dollars—at rates far higher than \$25 per person—to provide local police coverage, this reform seems fair.

The administration has put forward a sensible proposal to revise the formula by which school districts receive reimbursements for transportation expenses to encourage more efficient use of resources. This is projected to save \$50 million.

Increased inspection fees for the Department of Labor and Industry and other departments are meant to generate \$7 million. This proposal, like others in the plan, ask those who particularly benefit from state policies that also serve the common good to pay for their share of the benefit.

The administration proposes to reduce General Fund spending by \$8 million by taking advantage of a larger balance in the Oil and Gas Fund to pay for Department of Conservation and Natural Resources spending.

The administration calls for saving \$98 million by means of consolidating human resource and information technology services in and between departments, saving money through more effective procurement of goods and services, and through new and scaled up GO-TIME projects, which create innovative means of carrying out the business of the state.

The largest saving in this category is \$556 million in savings in the Department of Health and Human Services. Savings of \$330 are an updated calculation of capitation models with regard to expected enrollment increases and reimbursement levels. An increase in the assessment on managed care organizations will create a savings of \$128 million. A six-month delay in the launch of CommunityHealthChoices in Southwest Pennsylvania will save \$98 million.

All told, the Governor's plan to reform and restructure government in Pennsylvania for the most part

seems sensible and honest. We have raised doubts about a few items, such as the Workers Compensation Security Fund which, at least on its face, seems to be a continuation of the bad practices of the past. The transfer of funds from a bond issue to the Environmental Stewardship Fund to the Oil and Gas Lease Fund to DCNR could, if DCNR spends those funds on short term projects, be a way of using capital funds to pay operating expense (and we will be looking carefully at the use of funds here.)

One could also raise some doubts about how the Administration has chosen to categorize some of the savings that are part of its program to reform and restructure government. When the Administration's recalculation of how much human service spending will increase shows a lower increase, is that really a "saving" let alone a more "efficient" use of resources. The Administration has good political reason to claim that it is closing 2/3rds of the deficit with reforms and savings not tax increases. But when some of the savings come from new revenues (e.g., from raising the minimum wage or better enforcing tax laws or from increasing fees), are we really talking about revenues or reform? The Administration's position on these matters is not indefensible. When new revenues do come from policy changes that are justifiable in themselves (e.g., an increase in the minimum wage, better enforcement of tax laws, or asking those who use government services, such as the state police, to pay part of the cost), then it is certainly justifiable to say that those new revenues are a product of government reforms. If projected costs decline because the administration gets better at predicting those costs, that's also an improvement in the functioning of state government.

What is hard to deny after a close examination of the plan to restructure and reform government is that the Governor and his team have conducted a serious, well-intentioned, and thorough examination of how the government functions. And the result is a number of real reforms in the proposed budget—and possibly more of them in future budgets—that are likely to make government far more efficient and responsive to citizens in the future. That's an impressive achievement, and especially so for our state, given our long history of questionable budget practices.

Strengthening the Middle Class

One further theme of the Governor's budget address deserves mention before we discuss proposed state expenditures for next fiscal year by program area: rebuilding the middle class. Since his inaugural address, Governor Wolf has emphasized "jobs that pay" as one of his three themes. In the wake of an election that underscored that Pennsylvanians and Americans are tired of an economy that fails to deliver for most people, the Governor's 2017 budget proposal highlights three new initiatives to increase the number of Pennsylvania jobs that pay decently. First, as noted, the Governor proposes raising the minimum wage to \$12 per hour, lifting the pay of almost a quarter of Pennsylvania workers. Second, the Governor outlined a "Manufacturing PA" initiative. (This initiative is described in more detail below in the section on economic development.) In many rural and smaller metropolitan areas, manufacturing remains a source of many of the best-paid jobs for non-college Pennsylvanians. Third, the Governor's budget (p. A1-11) acknowledges that, even with his proposed budget initiatives, "...more work must be done. To that end, the Governor will call for the creation of a Middle Class Task Force, composed of industry and policy experts as well as residents, to make future policy recommendations to improve the lives of our hard working, middle class families." We look forward to engaging with the Wolf Administration and Pennsylvanians across the state and political spectrum on how to create an "economy that works for all."

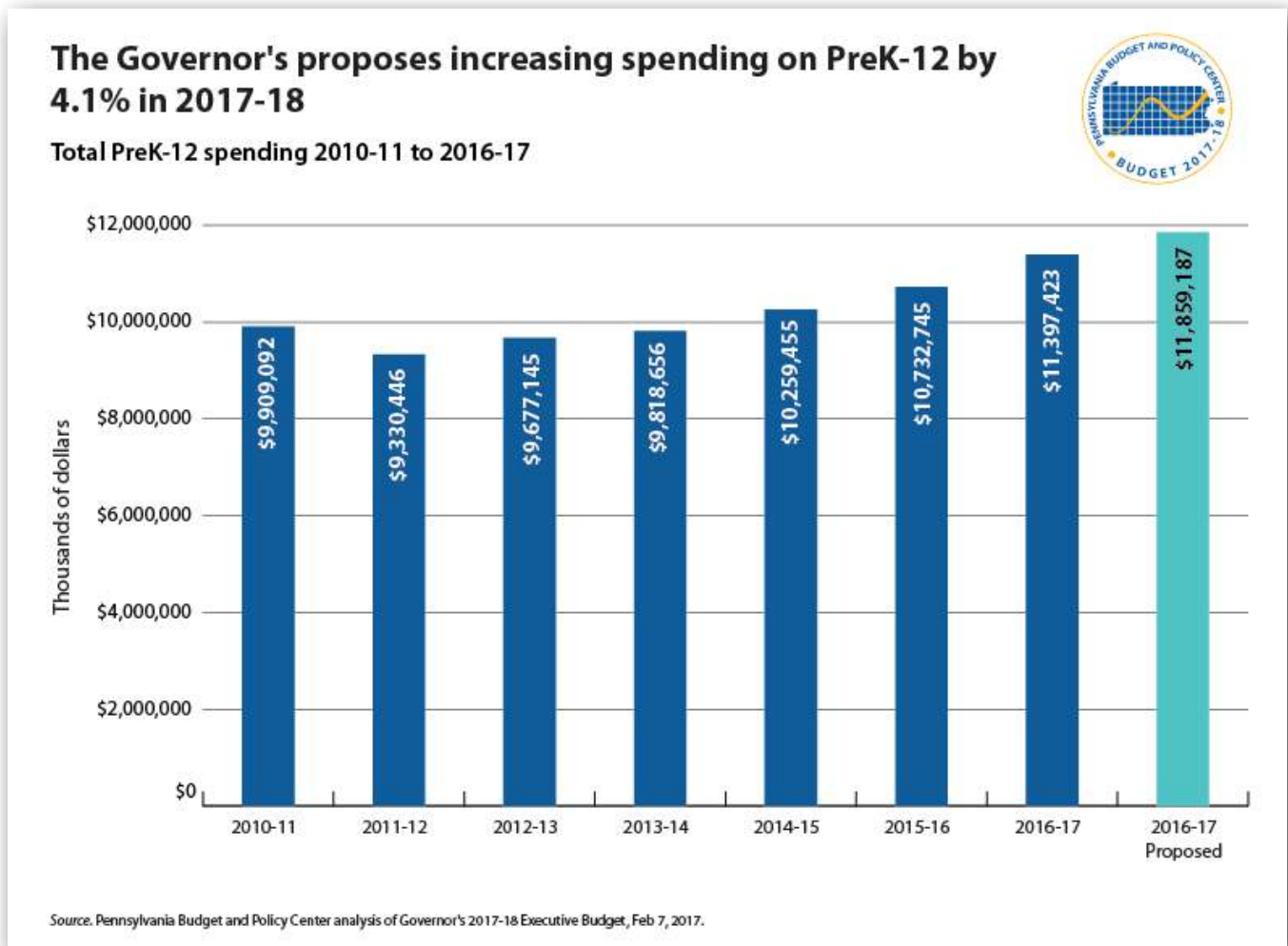
Education

Governor Wolf has made the state's education system a key pillar of his budget proposal for 2017-18. It is one of two areas where the governor calls for substantial new spending.

Overall PreK-12 Spending

PBPC analyzes education spending in two ways, overall spending on PreK-12⁹ education and what we call "classroom funding," which for the most part is the general purpose state subsidy provided to local school districts to fund education.¹⁰ Governor Wolf proposes to increase overall spending on PreK-12 by 4.1% in 2017-18 (Figure 9).

Figure 9.

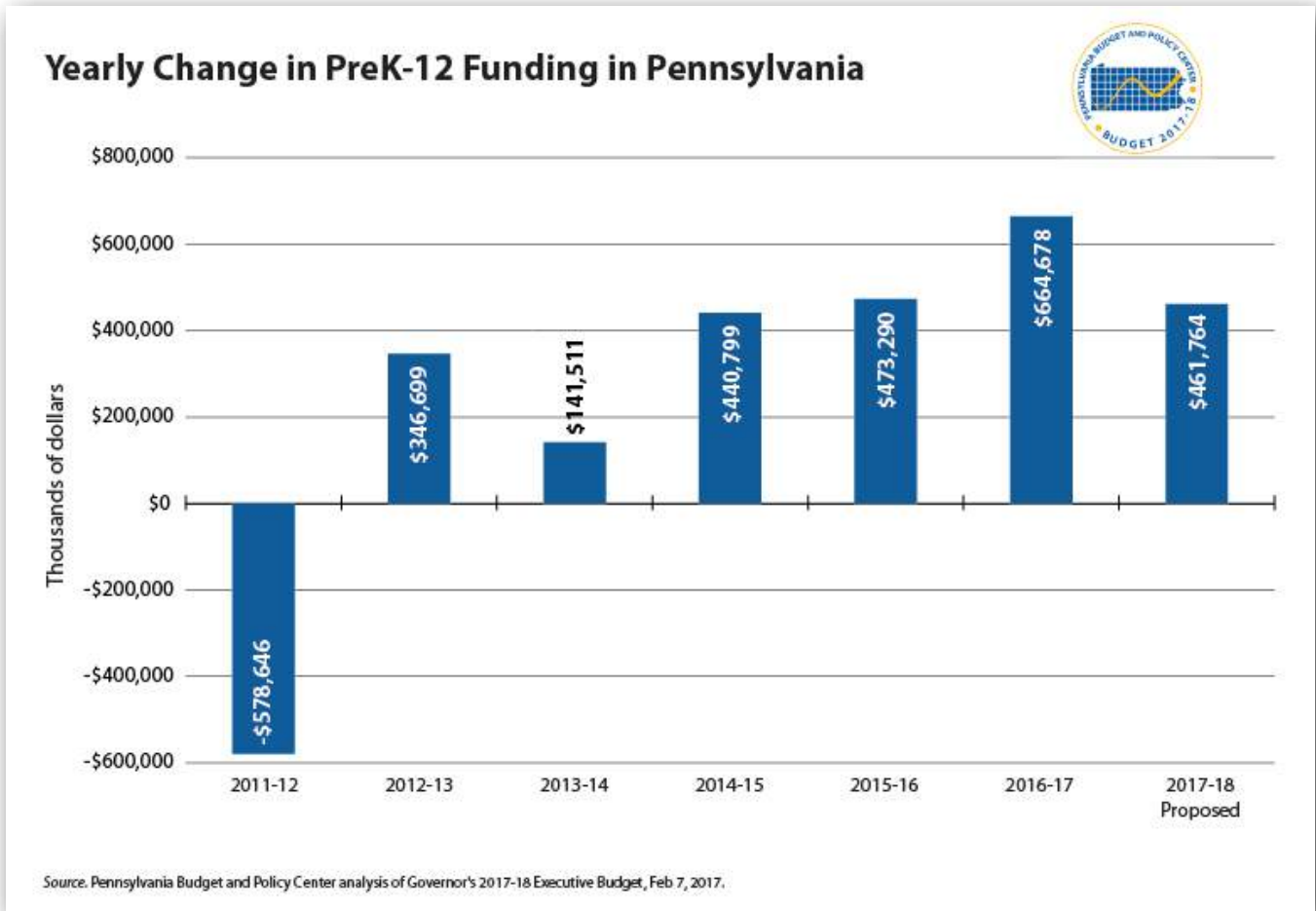


9 Our figures for total PreK-12 spending are slightly different (and higher) than those presented in the Governor's summary of his budget proposal.

10 Classroom funding is the primary vehicle (through the education funding formula) for closing the gaps that have emerged in a system of education finance that because of a heavy reliance on local property taxes has generated wide gaps in spending per student between school districts. It also excludes spending that does not directly affect what goes on in the classroom as well as spending on pensions which do not affect the quality of education in solely one year. For our methodology and data sources see Waslala Miranda, Undermining Educational Opportunity: Pennsylvania's Unequal Restoration of School Funding, Pennsylvania Budget and Policy Center, October 21, 2015, especially Box 1 and "Methodology and Data Sources" (at the end of the brief); online at <https://pennbpc.org/sites/pennbpc.org/files/finaledcutsbrief.pdf>.

Figure 10 below shows the yearly change in PreK-12 funding since the 2011-12 cuts by Corbett. The increase in funding of \$461 million following increases in the last two fiscal years, would bring the total increase in spending on PreK-12 education during Governor Wolf’s term to \$1.7 billion.

Figure 10.



Basic education is increased in the budget proposal by \$100 billion to \$6.25 billion, which is just \$64.6 million below the peak funding of 2010-2011. New basic education funding for 2017-2018, like the basic education funding added in 2015-2016 and 2016-2017, will be distributed using the new fair funding formula, which was enacted in June of 2016. This formula ensures that the distribution of new basic funding for education takes into account each district’s unique needs, including factors such as number of children living in poverty, number of English language learners, and the wealth of the district.

However, the fair funding formula is not applied to the existing basic education funding appropriated as of 2014-2015, only to the “new” money added since then. Thus, under the Governor’s proposal, the total amount of basic education funding distributed through the fair funding formula will increase to \$452 million which is only 7.5% of the entire \$6.25 billion basic education funding appropriation.

Special Education

Under the Governor’s proposal, special education funding would increase by \$25 million or 2.5%. The total increase in special education funding since 2013-2014 comes to \$95 million.

PlanCon

PlanCon funding, which reimburses school districts for construction cost, is now mostly raised through bonds issued by the Commonwealth Financing Authority. In 2016-2017, \$735 million was made available to schools from school construction bond proceeds. A second round of school construction bonds are expected in 2017-2018. The Governor’s budget includes a \$29.7 million line item for reducing the backlog of school projects awaiting reimbursement, as well as for paying charter school leases.

Classroom Spending

Figure 11 looks at trends in classroom spending, and Figure 12 tracks the yearly change in classroom spending. Classroom spending excludes funding for, among other things, pensions and transportation. As Figure 11 shows, classroom spending was drastically cut in 2011-12 under Governor Corbett. This had a devastating impact on the public education system in the state. Tens of thousands of teachers, guidance counselors and school nurses were laid off and students suffered due to declining staff and funding.

Despite the increases in overall PreK-12 spending proposed by Governor Wolf and enacted by the General Assembly, classroom spending is still below the 2010-2011 level. The gap between overall spending and classroom spending is largely the result of increased state spending on pensions for teachers. After years of failure to meet required pension contributions, the state, under Act 120 (the pension reform act of 2010) finally committed the state to fully funding pensions. Pension spending at the state and school district levels has increased as a result. Those increases will begin to level off in the next two years.

If enacted, Governor Wolf’s proposal for 2017-2018 will almost close the gap between current classroom funding and classroom funding levels of 2010-2011.

Figure 11.

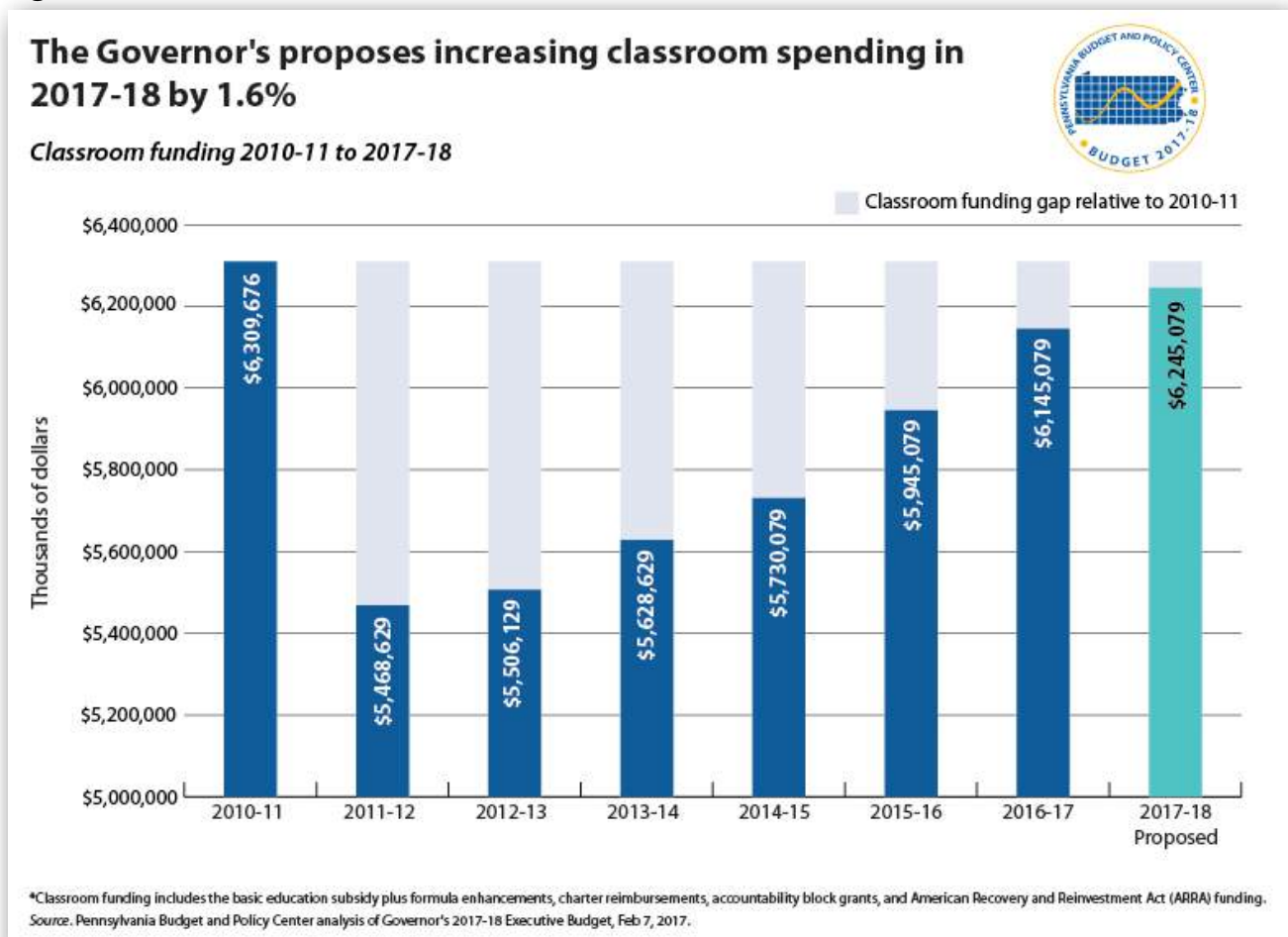
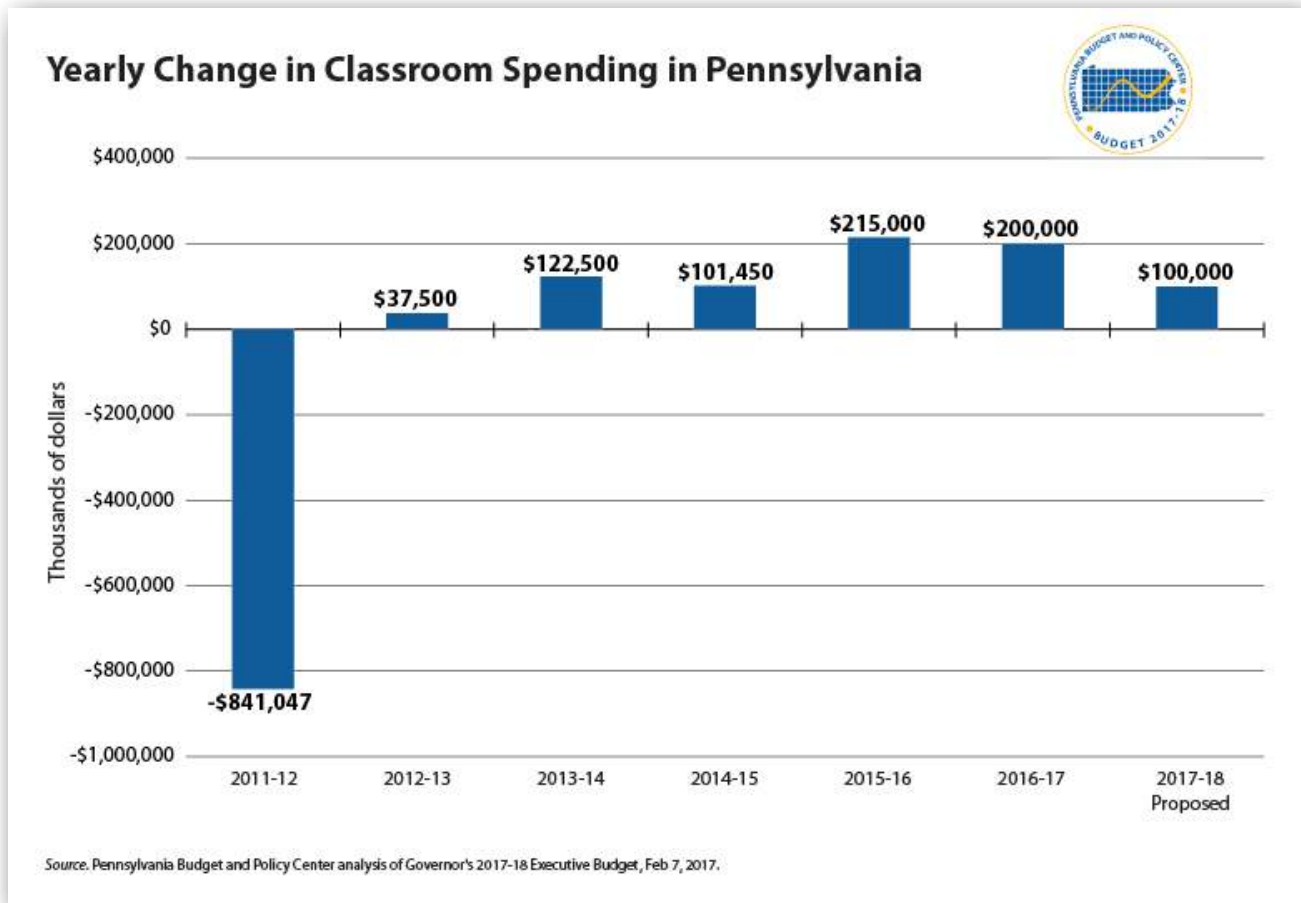


Figure 12.



School Funding Inequality Remains

While most of overall classroom spending cuts of the Corbett years will be restored if Governor Wolf's proposals for 2017-2108 are enacted, a substantial part of the inequity created by the Corbett cuts, which were far deeper for districts in low-income than high-income communities, will remain.

Figures 13 and 14 show per-pupil funding for Pennsylvania's 500 school districts arranged into four groups of 125, based on the percent of children under 18 living below the poverty line. The 1st quartile is made up of the highest poverty districts and the 4th quartile is of the lowest poverty districts.

As we pointed out above, new basic education funding is distributed through the fair funding formula. Thus, as figure 13 shows, new funding for 2017-2018 would add classroom funding for all school districts but provide more new funding to the high poverty school districts that suffered the greatest reductions from the Corbett budget cuts of 2011-2012.

Figure 13.

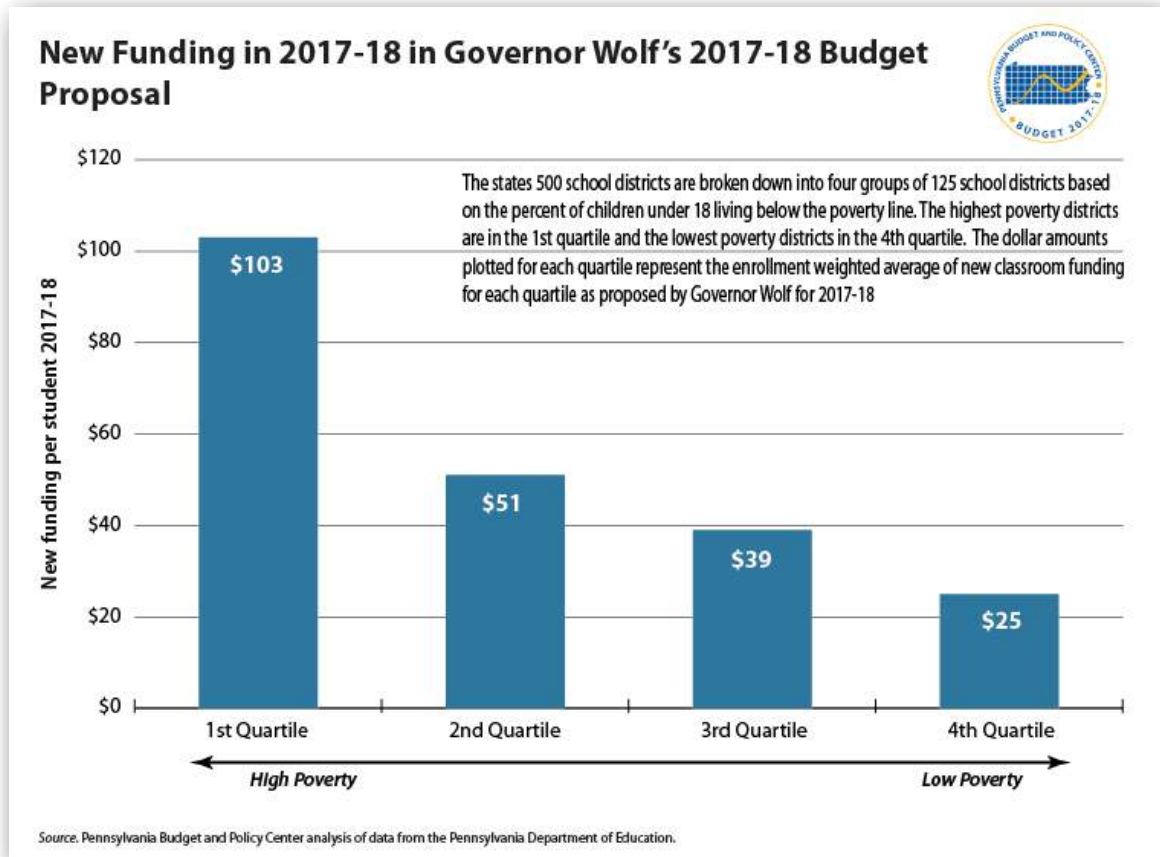
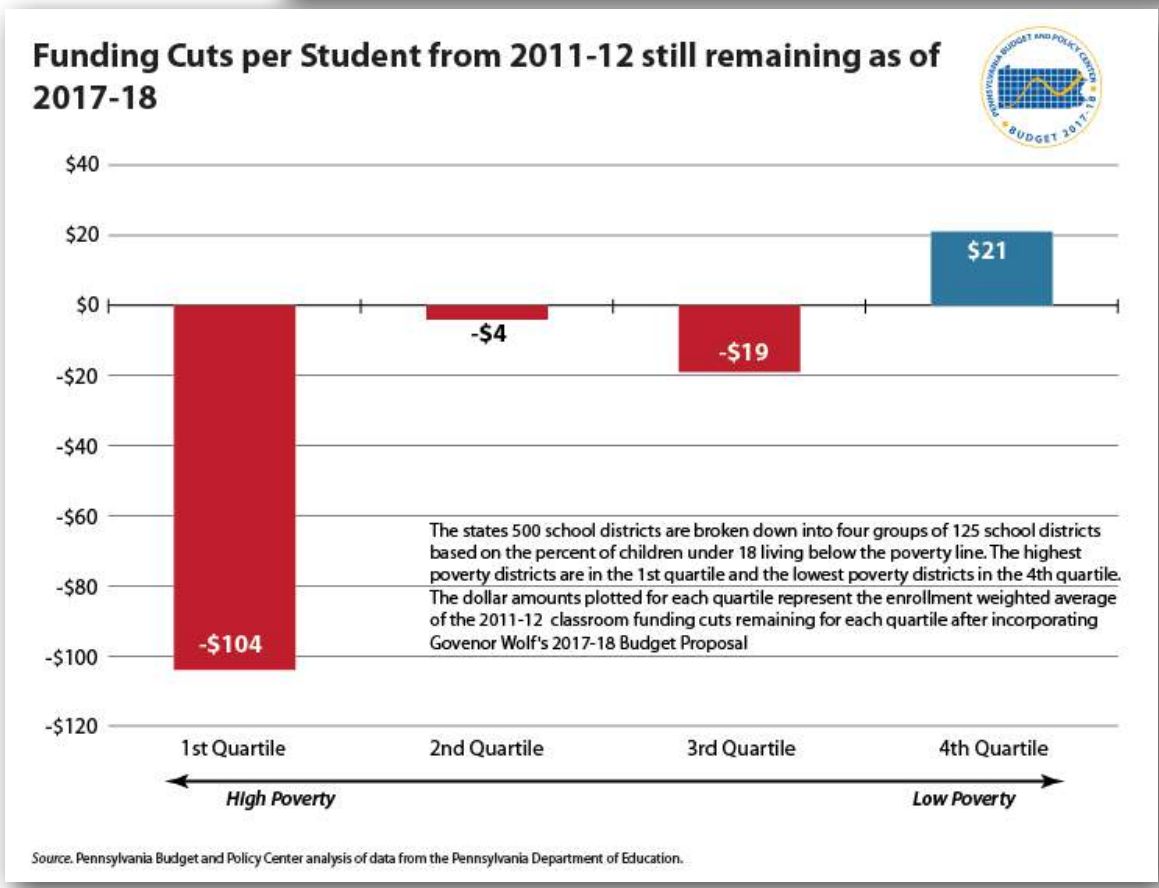


Figure 14.



But as Figure 14 shows, disparities in per student funding will remain even with the new basic education funding. The 125 school districts in the 1st quartile will still receive \$104 less in classroom funding per student than they did in 2010-2011. So long as the fair funding formula only applies to new basic education funding, it will take at least another \$100

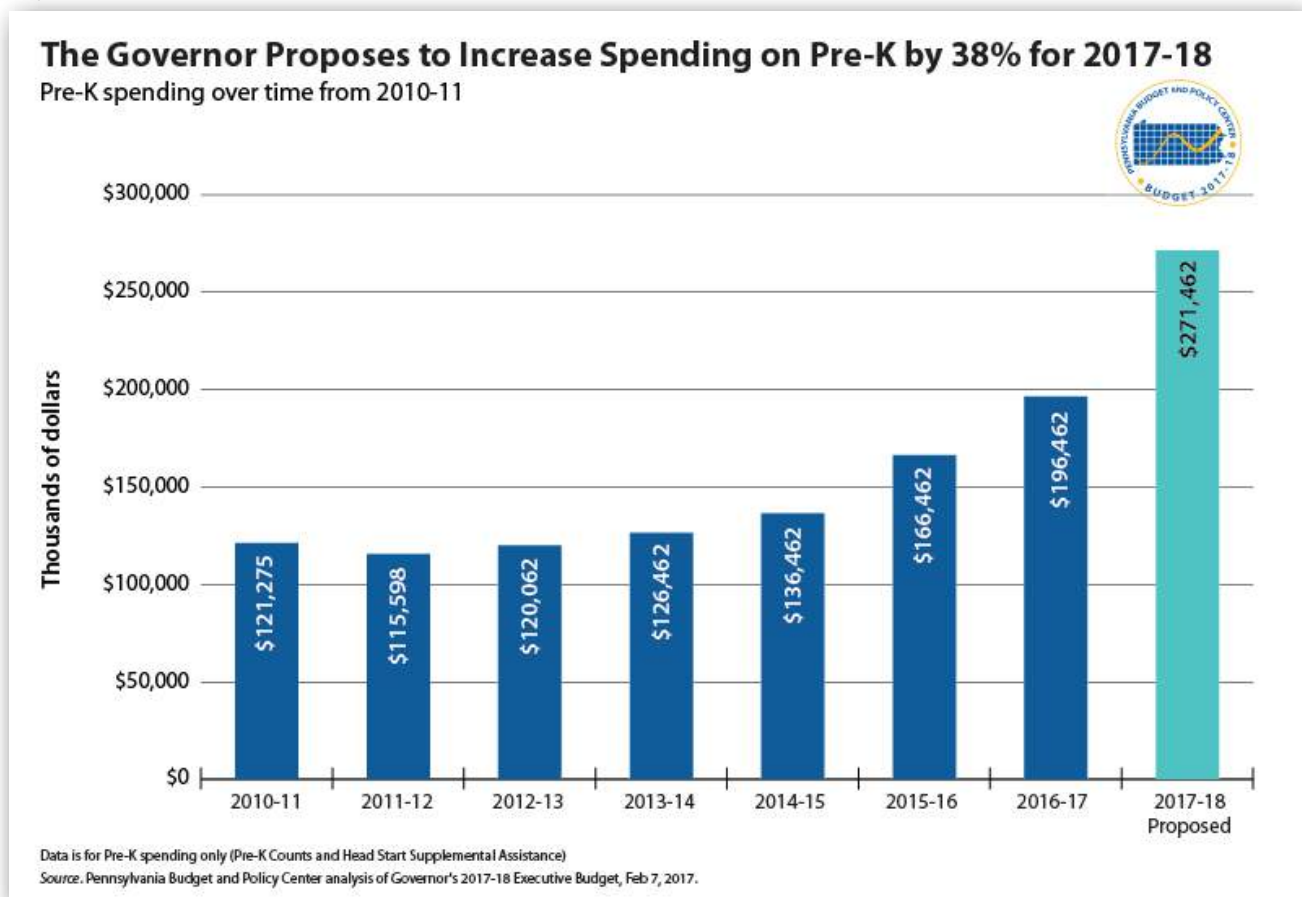
million in new basic education funding to fully restore the cuts in the low-income school districts.

While the Governor’s proposed education funding increases combined with the fair funding formula take a step towards addressing the great inequities faced by our state’s schools, it is not enough. Pennsylvania currently ranks 46th in the nation in terms of our state share of K-12 education funding.¹¹ The low state share of education spending shifts the burden of financing local schools onto local taxpayers. This, combined with large differences in income between school districts, leads to large funding inequities. Pennsylvania has the largest gap in the U.S. between the state’s wealthiest and poorest school districts with the highest income districts spending 33% more than the lowest income ones.¹² To address these inequities and to fully support all of Pennsylvania’s youth, the Public Interest Law Center has estimated that the state needs to invest another \$3 to \$4 billion in public education over the next six to eight years.¹³

Increased Spending to Early Childhood Education

The governor proposes a significant increase of \$75 million in early childhood education for 2017-18, up 38% from last year (Figure 15). This increased investment in Pennsylvania Pre-K Counts and the Head Start Supplemental Assistance Program will make it possible for an additional 8,400 children to be served by these programs. Given the extensive evidence that effective Pre-K education helps children do better not only in school but in life, this is an investment well worth making.¹⁴

Figure 15.



11 See <http://sanatogapost.com/2017/02/10/school-funding-advocate-praises-budget-proposal/>

12 <http://www.mcall.com/news/nationworld/pennsylvania/mc-pennsylvania-budget-public-school-funding-20150314-story.html>

13 <http://fairfundingpa.org/2016/07/campaign-fair-education-funding-statement-final-passage-2016-17-state-budget/>

14 Henry, G., Ponder, B., Rickman, D., Mashburn, A., Henderson, L., and Gordon, C., 2004. An Evaluation of the Implementation of Georgia’s Pre-K Program: Report of the Findings from the Georgia Early Childhood Study. Atlanta: Georgia State University, Applied Research Center; William Gormley, Jr., Deborah Phillips, and Ted Gayer, “Preschool Programs Can Boost School Readiness,” *Science* 320 (June 27, 2008), pp.1723-24; and L. J. Schweinhart et al., *Lifetime Effects: The High/Scope Perry Preschool Study Through Age 40* (2005)

Higher Education

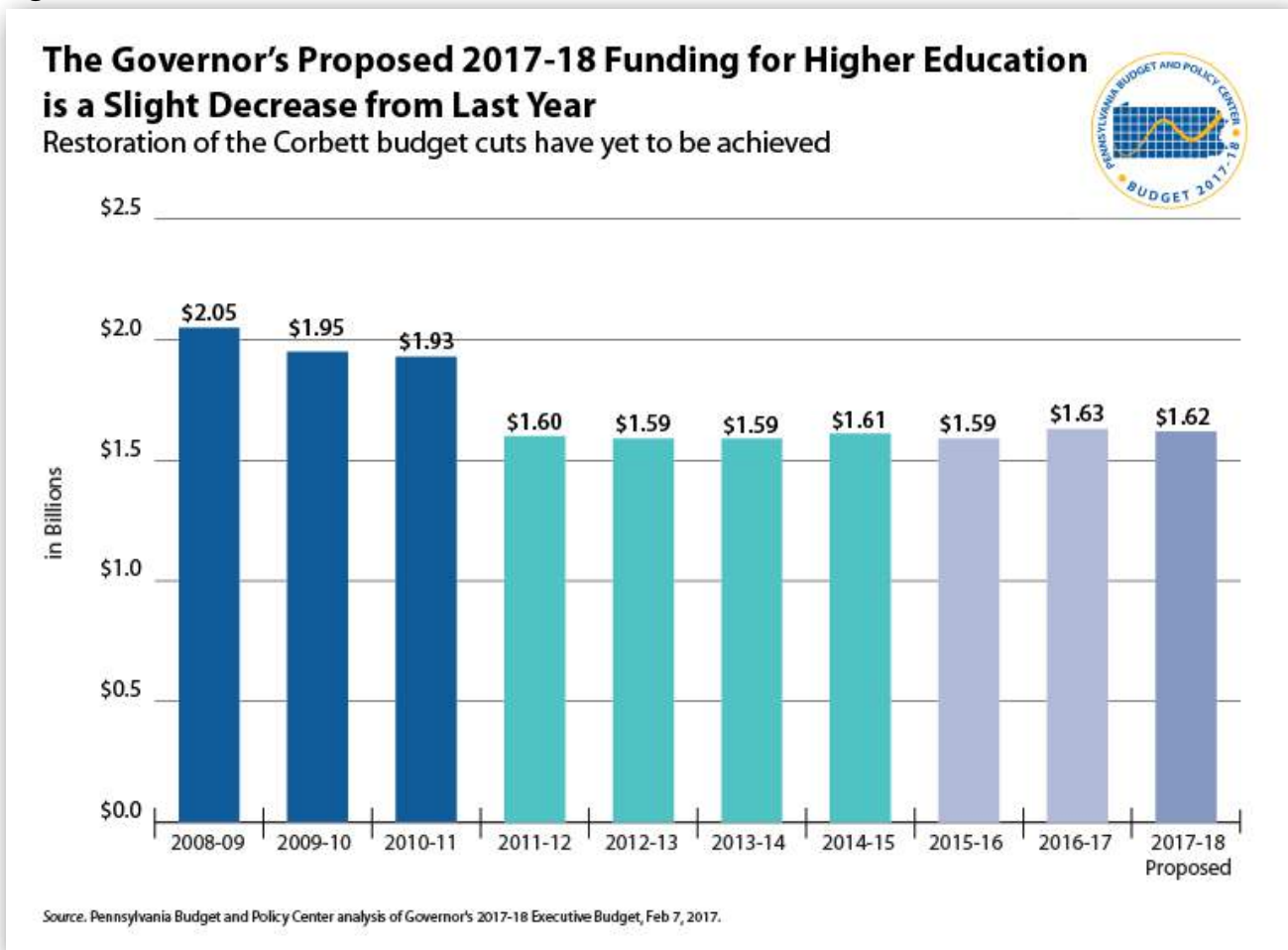
As of 2014-15, Pennsylvania funding for higher education as a share of state personal income ranked 49th out of the 50 states in the country—less than half the national average.¹⁵ In his original 2015-16 budget proposal, Governor Wolf proposed a \$140 million increase in funding for two-year and four-year colleges, the community colleges, the 14 PA State System of Higher Education (PASSHE) colleges, and the four state-related universities, Penn State University, University of Pittsburgh, Temple University, and Lincoln University. This proposal was intended as the first of a two-part full restoration of the higher education funding cuts in the 2011-12 budget. But it was mostly rejected by the General Assembly.

In his 2016-17 budget proposal, by contrast, Governor Wolf proposed only a \$72 million increase in funding for core higher education, a bit less than a 10% increase over 2014-15 spending.

In the face of continued resistance on the part of the General Assembly to increase funding for higher education, Governor Wolf’s 2017-2018 budget proposes only a \$9.8 million, or 2%, increase for PASSHE, calls for flat-funding of both community colleges and the four state-related universities.

As Figure 16, shows, funding for all higher education spending in 2017-2018 would still be far below the level of 2010-2011.

Figure 16.



15 Illinois State University College of Education, Grapevine Survey 2014-15, Table 4, http://education.illinoisstate.edu/grapevine/tables/Table4_GPV15.xlsx.

The continued failure of the state to invest in higher education is deeply problematic. Economic research indicates that reduced higher education funding in Pennsylvania would compromise the state's future economic growth and undercut economic opportunity for individuals, particularly in rural areas where educational attainment is especially low.¹⁶

Underfunding higher education also saddles Pennsylvania college students with among the highest tuition and debt levels in the nation. And it created a self-fulfilling prophecy of higher educational failure. The less the state spends on higher education, the greater the burden on college students to pay for tuition, room and board. And as that burden increases, fewer young Pennsylvanians choose to go to college and enrollment at the PASSHE and other schools decline. That decline has recently led some members of the General Assembly, as well as the leadership of PASSHE, to call for closing some of the PASSHE schools. That would be a catastrophic path for Pennsylvania to take. Instead, the state should be providing more funds for PASSHE, reducing tuition, room and board, educating more of our young people, and reaping the economic and other benefits of a more highly educated citizenry.

Human Services

Much of the Human Services budget consists of mandated Medical Assistance/Medicaid spending, both for health care and long-term care. Table 3 focuses on critical areas of non-mandated Human Service spending where the Governor and General Assembly can increase or decrease spending.

The Governor's budget proposes substantial increases in Human Services spending, especially for areas in which the previous administration had reduced spending. Mental and Behavior Health Services, Intellectual Disability Services, and Children's Services receive substantial increases. Long Term Care, parts of which are mandated under the Medical Assistance program, receives major increases as well, reflecting the aging of our population and the increasing costs of providing care for our seniors.

Cash grants remains unchanged from last year, when funding for aid to indigent adult Pennsylvanians was reduced by 44%. We continue to be troubled by the failure of our state to provide sufficient protection for adults who are down on their luck. And, with other advocates, we are concerned that the state is re-programming federal TANF funds in ways that may not be appropriate. That is a topic we hope to investigate in the future.

Everyone who cares about human services should be concerned about the possible impact of changes in federal law. We have recently pointed to the terrible consequences for the state of repealing the Affordable Care Act. Not only will 1.1 million Pennsylvanians lose health insurance and over 3000 of them die prematurely as a result, but the state's economy will be harmed and tax revenues will thus decline. In addition, state spending for health care programs that have been largely replaced by the Medicaid Expansion will increase by over \$1 billion. Other possible changes in federal policy, such as a block granting of traditional Medicaid or of the food stamp program will increase the demand for human service from the state, especially at moments of economic distress. Political officials in a state with a persistent structural deficit and a reluctance to raise taxes should be discouraging the federal government from changing federal program in a way that would create these and other problems.

¹⁶ Stephen Herzenberg et al., A Must Have for Pennsylvania, Part II: Investment in Higher Education for Growth and Opportunity, Keystone Research Center and Pennsylvania Budget and Policy Center, October 2014; online at <https://pennbpc.org/must-have-pennsylvania-part-2-investment-higher-education-growth-and-opportunity>

Table 6.

Human Services Funding					
	2014-15	2016-17	2017-18		
	Available	Available	Governor's Proposal	Change from 2014-15	Percentage Increase from 2014-15
County Services ¹	\$345,946	\$384,797	\$343,924	-\$2,022	-0.58%
Mental and Behavioral Health Services	\$774,701	\$842,144	\$831,578	\$56,877	7.34%
Intellectual Disability Services ²	\$1,657,333	\$1,901,386	\$2,103,419	\$446,086	26.92%
Long Term Care ³	\$1,454,131	\$2,153,571	\$2,339,612	\$885,481	60.89%
Cash Grants	\$45,457	\$25,457	\$25,457	-\$20,000	-44.00%
Supplemental Grants -Aged, Blind and Disabled	\$137,656	\$132,284	\$131,487	-\$6,169	-4.48%
Homelessness	\$18,496	\$18,496	\$18,496	\$0	0.00%
Children ⁴	\$1,470,193	\$1,516,575	\$1,605,536	\$135,343	9.21%
Domestic and Rape Crisis Services	\$24,082	\$27,285	\$27,285	\$3,203	13.30%
Total State Funds Department of Health and Human Services	\$11,279,922	\$12,206,832	\$12,897,192	\$1,617,270	14.34%
¹ Includes funding for County Administration -Statewide and County Assistance Offices.					
² 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.					
³ Includes Long-Term Care, Home and Community Based Services, Long-Term Care-Managed Care, Services to Persons with Disabilities, and Attendant Care					
⁴ Child support enforcement, Youth Development Institutions and Forestry Camps, County Welfare, Community Based Family Centers, Child Care Services, Child Care Assistance					
Source. Pennsylvania Budget and Policy Center based on Governor's 2017-18 Executive Budget, Feb. 7, 2017					

Within these broad categories, the budget proposal for Health and Human Services includes some notable program and funding initiatives. Many of them seek to provide more support for Pennsylvanians in community and home based settings.¹⁷

Community Services for Seniors and Adults with Physical Disabilities

The Governor is seeking \$56.2 million to provide home and community based services to an additional 4,338 seniors and adults with physical disabilities. This includes:

- \$12.9 million for the Medicaid Aging Waiver to serve an additional 1,428 seniors;
- \$14.1 million for the LIFE managed care program to serve an additional 600 seniors;
- \$21.2 million for services to persons with disabilities to enable an additional 1,470 adults to participate in Medicaid waiver programs; and
- \$8 million for attendant care services for an additional 840 adults with disabilities.

¹⁷ Our analysis of these programs owes a huge debt to the work of the staff of the House Democratic Appropriations Committee.

Community Services for Individuals with Intellectual Disabilities and Adults with Autism.

The budget includes \$25.2 million to provide home and community based services to individuals with intellectual disabilities and adults with autism. This funding would support Medicaid waiver services for 1,910 Pennsylvanians including:

- \$15.4 million for 1,000 individuals on the waiting list for intellectual disability services;
- \$8.6 million to serve 820 graduates from special education;
- \$564,000 to serve 50 individuals with intellectual disabilities currently residing in state centers; and
- \$642,000 to serve 50 adults with autism spectrum disorder.

Another \$1 million is proposed to provide targeted case management services to 2,000 Pennsylvanians with intellectual disabilities or autism spectrum disorder who are transitioning to a community setting.

Mental Health Services

The budget seeks \$4.7 million to provide community services for 90 individuals who currently reside in state mental health hospitals.

Community HealthChoices

In his 2015-2016 budget, the Governor proposed a managed long-term care program to be called CommunityHealthChoices as a new way of providing comprehensive, community-based, physical health and long-term care services for seniors and adults with physical disabilities. The Governor's 2017-2018 budget calls for \$44 million to enable the program to begin operation in Southwest Pennsylvania on January 1, 2018. When fully operational, the program will serve around 450,000 adults statewide and is expected to help control the growth in long-term care spending.

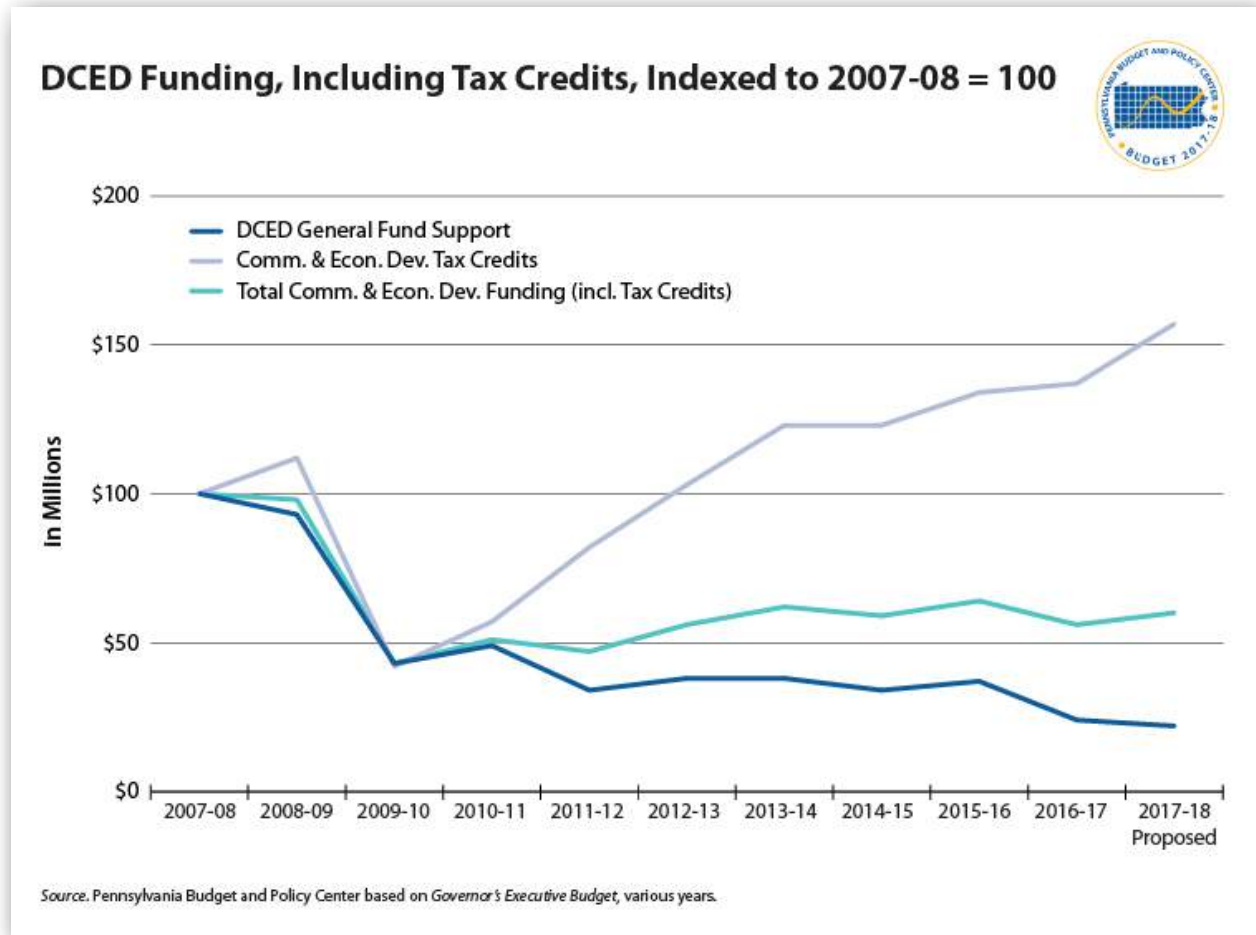
Economic and Community Development

Governor Wolf proposes General Fund support of \$134.1 million for the Department of Community and Economic Development (DCED) in 2017-18, down from \$145.5 million in 2016-17. After taking into account \$13 million in one-time expenditures in the 2016-17 budget, the 2017-18 budget proposal is roughly flat General Fund support for DCED (adjusted for inflation).¹⁸ Understanding changes in state support over time is complicated by the fact that some community and economic development programs receive support for DCED from "special funds" (such as the tobacco settlement fund) or are financed with gaming monies or tipping fees. It is further complicated by the fact that the state has increased its use of tax credits to promote economic and community development (e.g., to encourage companies to invest more in research and development or in certain neighborhoods). Figure 17 and Table A1 show the "big picture" since roughly the peak of state support for economic and community development going into the Great Recession. General Fund support for DCED has plunged to about one fifth (22%) of its 2007-08 level.¹⁹ General Fund support dropped by more than 50% in Governor Rendell's last two budgets and has dropped another 50% plus since then. Taking into account the growth of tax credits, however, the cut in DCED support has been much smaller—about 40 percent—with a modest increase since 2010-11. (This chart does not take into consideration the possibility that tax credits will be reduced by up to \$100 million, as proposed by Governor Wolf.)

¹⁸ The \$13 million includes \$10 million in "Regional Event Security and Support" last year because Pope Francis and the Democratic Convention came to Philadelphia and \$3 million in short-term disaster relief.

¹⁹ The drop is smaller, a decline to 28% instead of 22% of the 2007-08 level, if you consider all other state funds that support DCED not just the General Fund (see Table A1). In addition, If significant funding for Commonwealth Financing Authority (CFA) for 2017-18 is added for 2017-08 to Table A1, DCED's budget would likely rise to about one third of the 2007-08 level (or to nearly 40% considering state support from all funds). Note 3 to Table A1 explains our uncertainty regarding CFA funding in the past two years.

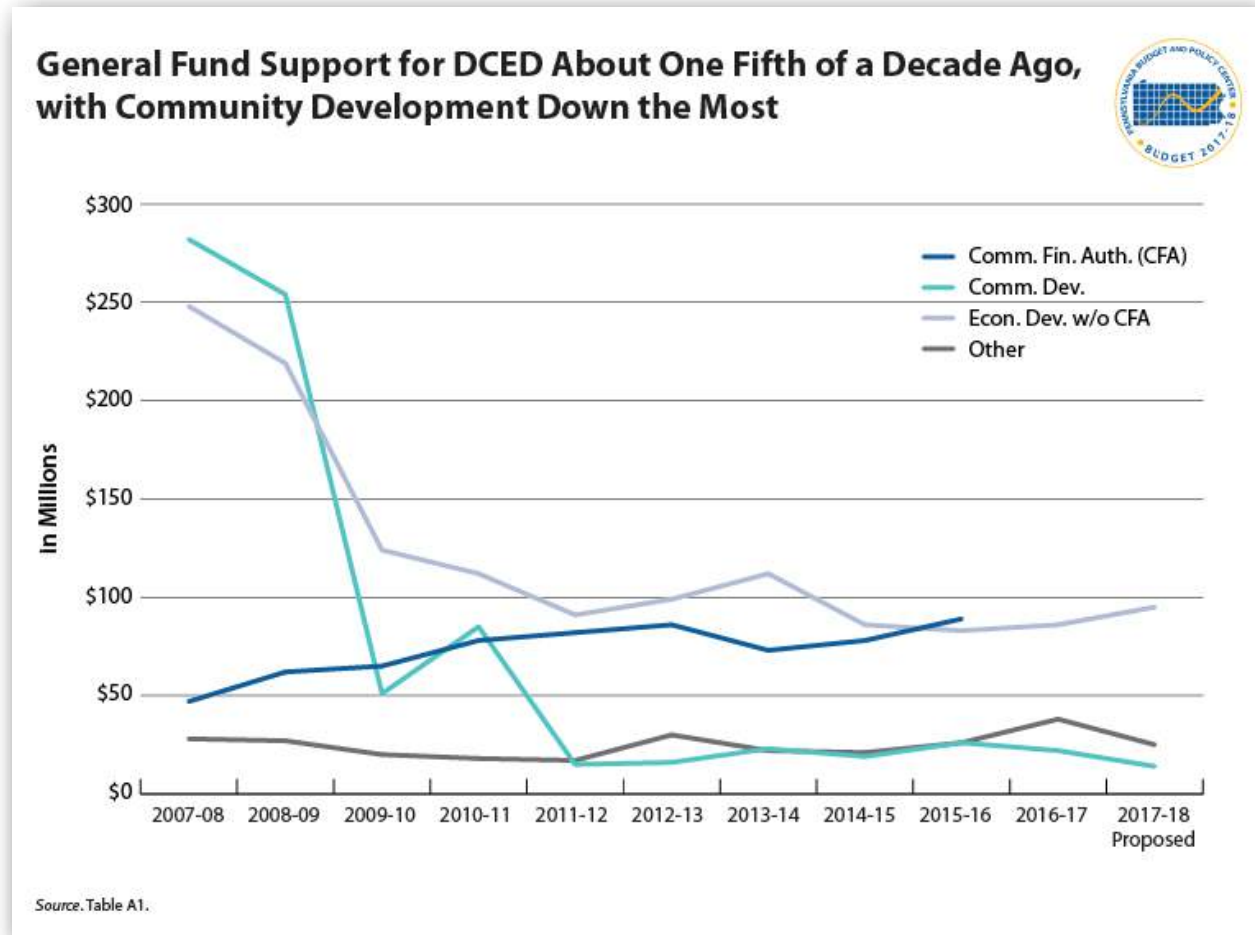
Figure 17.



The next figure, Figure 18, breaks down General Fund support for DCED into four categories: economic development, community development, the Commonwealth Financing Authority (which supports programs spanning economic and community development), and a residual “other” category. It shows that the community development programs supported by the General Fund have been decimated. Some of the resources that in 2007-08 provided modest community development funding for many communities now pay for more substantial tax credits that support development in parts of four municipalities.²⁰ Even with the cuts of the past decade, the Governor’s Budget maintains that “Last year, the Department of Community and Economic Development approved nearly \$1.1 billion in low-interest loans, tax credits, and grants for projects across the commonwealth...”

²⁰ Two new tax credits for businesses investing in select neighborhoods are the Allentown Neighborhood Improvement Zone (NIZ) Fund (estimated cost \$56.6 million in 2017-18; and the City Revitalization and Improvement (CRIZ) Fund (estimated cost \$12.5 million in 2017-18), which current supports development in parts of Bethlehem, Lancaster, and Tamacqua; 2017-18 Governor’s Executive Budget, p. H50 and H15.

Figure 18.



Manufacturing PA

Turning now to more specific proposals in this year’s DCED budget, Governor Wolf proposes a new \$12 million “Manufacturing PA” initiative. The \$12 million includes \$2 million taken from the Partnerships for Regional Economic Performance (PREP) line (which falls from \$11.9 to \$9.9 million) based on the expectation that state funding for Industrial Resource Centers (funded in the past at about \$5.2 million out of PREP) would now be part of “Manufacturing PA.” Manufacturing PA would also cover:

- Up to \$1.8 million to establish a partnership among research universities and Industrial Resource Centers to accelerate manufacturing technology advancement and adoption, foster manufacturing innovation and commercialization, and build a 21st century workforce; and
- \$5 million for a manufacturing training-to-career-grant program (described in the workforce section below).

In addition, the Governor’s proposed budget includes a grant program for apprenticeships that would be funded by increasing accountability and clawing back more money when businesses that receive grants and tax credits fail to create promised jobs.²¹ While the 2017-18 Governor’s Executive Budget-in-Brief budget (p. 5 and p. 10) and the full 2017-18 Governor’s budget (p. A1-11) describe this apprenticeship program under the “Manufacturing PA” subhead, DCED says that this program will support apprenticeships in non-manufacturing as well as manufacturing.

²¹ Keystone Research Center has long recommended stronger accountability and clawbacks. See, for example, Maria Cristina Herrera, Stephen Herzenberg and Michael Wood, Good Jobs, Strong Industries, a Better Pennsylvania: Towards a 21st Century Economic Development Strategy, Keystone Research Center, March 2010.

While “Manufacturing PA” initiatives remain to be spelled out, and its total budget is too small to have a major impact, the proposal provides a starting point for a bipartisan effort to craft and implement a new Pennsylvania manufacturing strategy. Such an effort is well-timed because it could capitalize on a “reshoring movement” that has led many U.S. manufacturers to recognize the downsides of distant sourcing. A state manufacturing initiative could also benefit from a new focus on manufacturing in Washington D.C. and from infrastructure investments that expand opportunities for “Made in America” and “Made in Pennsylvania” procurement.

A Focus on Retaining and Expanding Existing Businesses

The Governor’s budget restores \$2.5 million funding for the “Business Calling program.”²² In restoring a program zeroed out of several previous budgets, the administration aims to better meet the needs of existing Pennsylvania businesses. As the budget book explains, “...the state must prioritize resources on supporting businesses that already have their roots here in Pennsylvania. This is smart policy – helping businesses already operating in Pennsylvania to retain or expand their footprint here costs a fraction of what is required to attract new businesses to the commonwealth. Studies suggest an estimated 80 percent of jobs and capital investment result from existing business investment” (2017-18 Governor’s budget, p. A-12).

Other Changes to the DCED Budget

In other changes, the Governor’s budget:

- Reverses an increase in funding for “Keystone Communities” in the previous budget, putting the program back to \$6.4 million from \$12.2 million;
- Provides \$11 million for Smart Cities grants (funded through a special fund not the General Fund) to develop a network of smart corridors which combine environmental, communications, energy, and transportation (including intelligent transportation systems) infrastructure to improve connections between historically isolated neighborhoods and major centers of employment and health care services; and²³
- Proposes reducing the total amount available for tax credits by \$100 million by converting existing tax credit incentives into a block grant that would then focus on “credits that have demonstrated the greatest return in new business investment, educational access and community development.” From a policy point of view, this kind of block grant is appealing because it forces each region to choose among competing priorities rather than using the political system to pay for ever-expanding credits that, in any particular case, get paid for by the state as a whole.

²² Removing this \$2.5 million from the \$9.9 million for the Regional Economic Performance (PREP) program, leaves \$7.4 million for PREP partners others than IRCs, compared to \$6.7 million last year (i.e., \$11.9 million minus the \$5.2 million for IRCs now funded as part of Manufacturing PA).

²³ See 2017-18 Governor’s Executive Budget, p. A1-13. These grants will be financed by a portion of the first third of \$387.4 million in Commonwealth Financing Authority (CFA) bond financing for the “Pennsylvania Economic Revitalization Fund.” The Wolf budget (p. H53) proposes to pay the debt service on the bonds through an additional sales and use tax transfer to CFA beginning in 2018-19.

Workforce Development

As noted briefly in the discussion of Manufacturing PA, the Governor's budget includes two new training initiatives.

- A manufacturing training-to-career-grant program at a cost of \$5 million. Through this new grant program, manufacturing businesses will receive funds to partner with technical programs and community colleges to develop new training programs that align with their workforce needs. In addition to expanding manufacturing training opportunities, these programs will offer apprenticeship programs, on-the-job training opportunities or paid internships.
- A new apprenticeship grant program established to ensure that new high school graduates and older, mid-career workers can receive training aligned to business skill needs. Businesses can seek grant funding of up to \$2,000 for each participant employed in a registered apprenticeship program.

In addition, the Governor's budget proposes to move \$1.8 million in Industry Partnership grant funding to DCED from the Department of Labor and Industry. (Industry Partnership grants support training overseen by consortia of multiple firms that have overlapping skill needs.)

The budget does not spell out what the relationship will be among the Industry Partnership program and the manufacturing training-to-career grant program or the apprenticeship grant program. At the height of the Industry Partnership program, the state had 14 regional manufacturing partnerships as well as a Pennsylvania Center for Advanced Manufacturing Careers that promoted peer learning among these partnerships. A wide range of entities managed (and often still manage) these partnerships, including regional manufacturing associations, economic development organizations, non-profit organizations that partner with industry associations, and local workforce boards. If Industry Partnerships can still demonstrate relationships with many area manufacturers, it would make sense for them to coordinate the manufacturing training-to-career grant training. This could include defining skill gaps, identifying the best service provider, and coordinating on-the-job training opportunities and internships. With regard to the apprenticeship program, to achieve efficiencies and scale up apprenticeships more quickly, the state could give priority to placements within multi-employer apprenticeship programs or within single-employer apprenticeships in which classroom education and recruitment are coordinated across multiple employers.

The proposal to move the Industry Partnership program to DCED also raises several questions. It could, for example, increase the historic split between the two biggest "silos" in workforce development, the supply side programs managed by PDL&I and drawn together into Pennsylvania's one-stop workforce system (CareerLink®) and demand-side programs including Industry Partnerships in DCED. This could unintentionally run counter to the emphasis in the Governor's budget proposal on overcoming silos. The proposed move also raises questions about whether DCED will now assume all of the responsibilities regarding Industry Partnerships in the state's Workforce Investment and Opportunity Act (WIOA) plan (related to sustainable funding for partnerships, capacity building, and performance management). Removing Industry Partnerships from the agency most committed to workers, moreover, could also make it less likely that Industry Partnerships will become a more strategic component of the Governor's middle-class agenda.

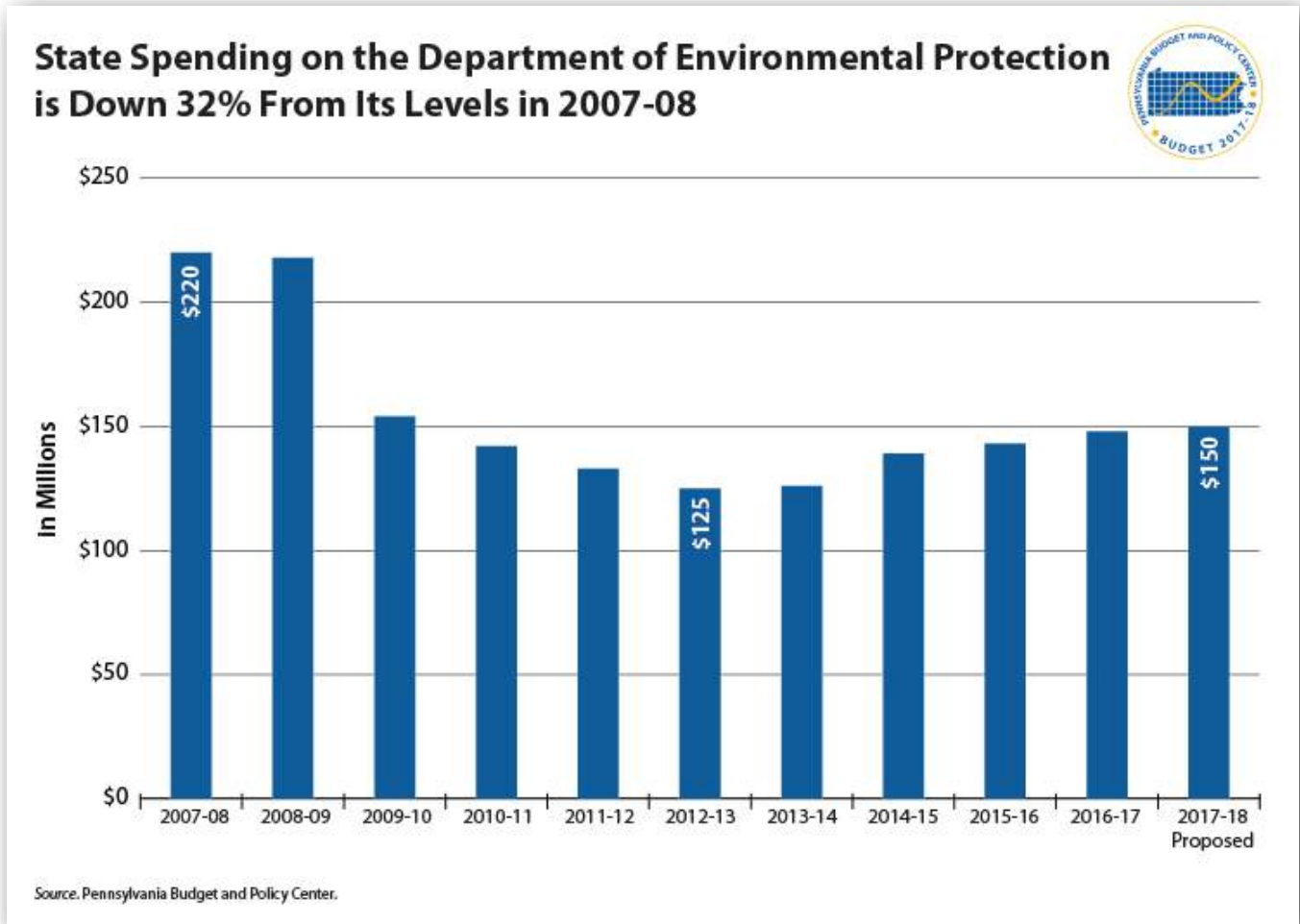
In the end, the central issue is not which agency manages a particular program but whether there is an overall coherent state workforce vision. A shared vision across agencies, and shared commitment to implementing that vision, is the best way to achieve robust Industry Partnerships capable of making workforce (and economic development) programs deliver a higher return on state investment for workers, employers, and communities.

Environmental Protection

Department of Environmental Protection

The Department of Environmental Protection receives a \$1.3 million, or 1% increase over last year's budget under the Governor's proposal. As Figure 19 shows, at a time when natural gas drilling threatens the quality of our air and water and releases a especially problematic greenhouse gas, methane, and when it is difficult to find the resources to inspect and decommission abandoned oil and gas wells, funding is 32% below its level in 2007-2008.

Figure 19.



Department of Conservation and Natural Resources

The Governor proposes increasing DCNR's budget from all funds by 3%. But funding sources for DCNR programs will be changed.

As we pointed out above, the Governor's government restructuring program calls for Environmental Stewardship Fund grants to be paid for with funds from a new bond rather than the General Fund Revenues. Funding for DCNR grants previously funded by the Environmental Stewardship Fund will fall from \$38 million to \$16 million.

The Governor calls for transferring \$37 million from the Environmental Stewardship Fund to the Oil and Gas Lease Fund. This will allow a transfer under Act 13 of 2012 from the Oil and Gas Fund to the Hazardous Sites Cleanup Fund, which was previously funded by the Capital Stock and Transfer Tax. The transfer to the Oil and Gas Lease Fund will also increase its share of DCNR funding, primarily for state parks and forests. Funding for state parks and forests from all sources will increase by 7%. As we saw above in the Government Reform and Restructuring section, this will reduce General Fund spending by \$8 million. Overall, the percentage of DCNR expenditures funded by the Oil and Gas Lease Fund will increase from 13% this year to 31% in 2017-2018.