



# Will PA Use the ARP to Invest in Us or to Make Up for Irresponsible Corporate Tax Cuts?

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April 29, 2021

## The Choice PA Must Make

President Biden's American Rescue Plan (ARP) creates an unprecedented opportunity to not only address the problems created by the pandemic but to begin to fix the failures and injustices revealed by it. These funds can, and should, be used to invest in Pennsylvanians, providing immediate relief to front-line workers and small businesses as well as a down payment on programs to address deep inequities in Pennsylvania in wages and benefits, in access to health and housing and education at all levels, and in our tax system.

The key question for the General Assembly is whether it will seize this opportunity for progress or use ARP money to fund reckless corporate tax cuts that have failed to boost the economy and have left the state consistently short of funds to meet our needs.

We are about to enter the month of May when serious discussions about the state budget take place. Yet House and Senate Republicans, who hold a majority in both houses of the General Assembly, have failed to say how they will use ARP funds, raising our concern that they will squander them.

Only House Democrats have presented any plan for spending ARP funds. (Senate Democrats are expected to do so shortly.)

Pennsylvanians deserve a public discussion and debate about the use of ARP funds, not a backroom decision by legislative leaders, some of whom have consistently ignored their needs.

ARP funds were not meant to be used to close long-standing deficits. Indeed, both Democrats and Republicans in Congress insisted that they should not be used that way. They should be used to invest in us—the people of Pennsylvania—while the wealthy and big corporations should finally pay for their share of the budget to make up the difference.

## The Opportunity Provided by the American Rescue Plan

The American Rescue Plan provides more than \$7 billion to the state government to use as the governor and General Assembly see fit.<sup>1</sup> There are three key goals for this funding, all aimed to help the country “build back better”:

1. Help states deal with the loss of revenues due to the COVID-19.
2. Enable states to respond to the immediate crisis in the lives of its citizens by supplementing the funds dedicated to specific purposes, such as those mentioned above.
3. Enable the state to undertake initiatives that address long-standing inequities that, long known to particular communities and some policy analysts, were revealed to the broad public by the pandemic itself.

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<sup>1</sup>It also provides dedicated billions in funds for local school districts that have lost local revenues and have had to adjust to remote learning; small businesses, especially in the hospitality sector, suffering from the loss of revenues due to the pandemic; renters and homeowners who have been unable to make their housing payments; and many others. It is critical that these funds be spent in effective ways, but there are limits on the purposes to which they can be put. We focus in this paper on the \$7.3 billion in funds that can be spent, within limits, however the General Assembly sees fit.

We have seen the pandemic hurt front-line workers in Pennsylvania, most of whom work at very low wages and who have been working in dangerous conditions and with insufficient protective equipment. We have seen the pandemic deepen a housing crisis in Pennsylvania in which a substantial part of our population is severely burdened by the cost of housing. We have seen the differential ability of school districts to adapt to remote learning reveal deep and persistent economic and racial inequities in school funding. And we have seen the challenges of the pandemic deepen the ongoing crisis in Pennsylvania’s state colleges.

ARP funding gives Pennsylvania an opportunity, not just to balance its budget and respond to the immediate crisis, but to address the profound inequities in our state.

The question is whether we will use this opportunity well or whether we will squander it.

### Projected Tax Revenue Losses

To understand this choice in full, we must look at the state budget in more detail.

The first and most obvious role for the American Rescue Plan is make up for state revenues lost because of the impact of the pandemic on the state’s economy. So, we need some estimate of what they are likely to be.

One way to estimate the extent of those losses is to compare revenue projections made by the Independent Fiscal Office in early 2020 with those made in early 2021.<sup>2 3</sup> We focus on the three fiscal years beginning in July 2021, 2022, and 2023 because we expect most of the American Rescue Plan funds to be spent in those fiscal years.<sup>4</sup> We agree with the IFO that the state will have higher than expected revenues in the current fiscal year (2020-2021) for two reasons: the \$1.9 billion in revenues shifted from 2019-2020 to the current year as a result of the change in the due date for taxes for calendar year 2020 and an economic recovery that, except for continued high unemployment numbers, is more robust than many of us expected six months or a year ago.

While tax revenues are coming in strongly this year, the IFO’s current projections for the next three years are substantially lower than the projections it made in early 2020, as shown in Table 1.

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<sup>2</sup> This is not a fine-grained exercise as there are many reasons why those estimates might have differed even if there were no pandemic, from the inherent uncertainty about projecting revenue to economic changes that would have—or did—take place regardless of the pandemic. For our present purpose of getting a rough idea of the magnitudes of predicted revenue losses and budget shortfalls, it is sufficient.

<sup>3</sup> We could theoretically use the governor’s revenue projections for this exercise. But this is more difficult because the projections in the governor’s Executive Budget includes estimates of the impact of his tax proposals. We do not think that exercise would give us substantially different results. If we compare the governor’s revenue projects made in February 2020 and February 2021, and adjust his FY 21-22 proposal to take into account projections of the impact of the governor’s tax proposals for that year, we get roughly the same estimate of tax revenue losses due to the pandemic for FY 21-22.

<sup>4</sup> ARP funds can be spent through the first half of the fiscal year that begins on July 1, 2024. We leave FY 2024 out of the analysis for two reasons. First, it only would be available for half the fiscal year. Second, and more importantly, we expect that the impact of the pandemic on state revenues will mostly be over by FY 24-25. Our view is more optimistic than that of the IFO, but we believe it is justified by recent studies pointing to the strong stimulus provided by the ARP. That same optimism would lead us to conclude that our IFO-derived estimate of tax revenue losses in FY 23-24 are somewhat overstated, that is, more pessimistic than is warranted.

Table 1

Projected Tax Revenue Losses	
FY 21-22 to 24-25	
21-22	\$ 1,551,000
22-23	\$ 1,202,000
23-24	\$ 1,128,000
3 years	\$ 3,881,000

Source: PBPC Analysis of IFO projections of February 2020 and March 2021<sup>5</sup>

Note that these estimates don't fully consider the impact of the American Recovery Plan on the economy. Given that recent economic analyses have suggested that the huge stimulus provided by the ARP will lead to faster economic growth than predicted earlier in the year, we believe that these estimates of revenue losses are high. So, even if the first purpose of the \$7.4 billion in ARP funds is to compensate the state for a loss in tax revenues due to COVID-19, the total needed would be no more than \$3.8 billion—and possibly much less—over three years. That would leave a minimum of \$3.6 billion for other purposes.

### Projected Deficits

While IFO projections suggest that tax revenue losses total \$3.8 billion over three fiscal years, FY 21, 22, and 23, the IFO's projections of deficits in the state budget is far higher: \$7.6 billion over the same three years.

Table 2

IFO Projected Deficits	
FY 21-22-24-25	
21-22	2,500,000
22-23	2,600,000
23-24	2,488,000
Three years	7,588,000

Source: Independent Fiscal Office, Budget and Economic Update, March 11, 2021

[http://www.ifo.state.pa.us/download.cfm?file=Resources/Documents/CompetePA\\_March\\_11\\_2021.pdf](http://www.ifo.state.pa.us/download.cfm?file=Resources/Documents/CompetePA_March_11_2021.pdf).

The difference between projected tax revenue losses and projected deficits is \$3.7 billion over three years, or about \$1.25 billion per year. This difference is the structural deficit in the state General Fund

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<sup>5</sup> Independent Fiscal Office, Economic and Budget Update, February 28, 2020, <http://www.ifo.state.pa.us/download.cfm?file=Resources/Documents/EPLC%20Feb%202020%20FINAL.pdf> and Independent Fiscal Office, Budget and Economic Update, March 11, 2021, [http://www.ifo.state.pa.us/download.cfm?file=Resources/Documents/CompetePA\\_March\\_11\\_2021.pdf](http://www.ifo.state.pa.us/download.cfm?file=Resources/Documents/CompetePA_March_11_2021.pdf).

budget, the persistent gap between recurring revenues brought by the current state tax structure and continuing expenditures to do what the state already does (Table 3).

Table 3

Projected Structural Deficits	
FY 21-22-24-25	
21-22	949,000
22-23	1,398,000
23-24	1,360,000
Three years	3,707,000

The structural deficit in the General Fund has more than one source. From a long-term perspective, the most important one is the decisions by the General Assembly, under both Governors Rendell and Corbett, to cut corporate taxes.<sup>6</sup> As we have shown elsewhere, corporate tax reductions currently cost the state about \$4 billion per year.<sup>7</sup> The elimination of the Capital Stock and Franchise Tax, by itself, costs the state almost \$3 billion per year. Those tax cuts—which were sponsored and encouraged by right-wing advocacy organizations such as ALEC and Americans for Prosperity and their local allies—were made with the promise that they would lead to faster economic growth and higher tax revenues. Pennsylvania’s experience, like that of many other states that were led down the same path by the same corporate-sponsored advocates, has shown these tax cuts have accomplished neither goal.<sup>8</sup> Despite substantial business tax cuts Pennsylvania has seen no spike in economic growth. The state’s economic growth between 2005 and 2020 has been about in the middle of all states and about average for all Northeast states.<sup>9</sup> And other tax revenues have not increased to make up for the revenues lost to corporate tax cuts.

Corporate tax cuts are the initial source of the structural deficit in the General Fund. The continuing source of the structural deficit is the reckless failure of the General Assembly’s Republican leadership to enact recurring sources of revenue to replace the revenues lost to corporate tax cuts. For close to a decade, the General Assembly has enacted budgets that were balanced in name only, closing deficits with various one-time revenues or budget gimmicks. These include:

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<sup>6</sup> In 2015, Governor Corbett also made a unilateral decision to adjust the basis of the Corporate Net Income Tax when federal tax law changed. This cost the state roughly \$140 million per year at the time.

<sup>7</sup> We demonstrated the drastic reduction in state revenues due to corporate tax cuts in Stephen Herzenberg, Diana Polson, and Marc Stier, [Corporate Tax Cuts Since 2002 Now Cost PA \\$4.2 Billion Yearly: Pennsylvania Should Pass Worldwide Combined Reporting](#), January 27, 2020.

<sup>8</sup> On the general ineffectiveness of corporate tax cuts as an economic development strategy, see Soledad Artiz Prillaman and Kenneth J. Meier, [Taxes, Incentives, and Economic Growth: Assessing the Impact of Pro-business taxes on U.S. State Economies](#), the Journal of Politics, Vol 75, No. 2 (February 28, 2015), pp. 364-379. Additional references to what is now an extensive literature demonstrating that state corporate tax cuts do not spur economic growth can be found in the web resource assembled by Professor Peter Fisher’s “Grading Places” project [“The Problem with Tax Cutting as Economic Policy at the State Level”](#) and Michael Mazerov, [Cutting State Corporate Income Taxes Is Unlikely to Create Many Jobs](#), Center for Budget and Policy Priorities, September 14, 2010.

<sup>9</sup> Pennsylvania’s GDP grew by 3.7% per year between the fourth quarter of 2005 and the fourth quarter of 2020, placing it 26th out of 50 states and the District of Columbia. Data can be found at the Bureau of Economic Analysis here: <https://apps.bea.gov/iTable/iTable.cfm?reqid=70&step=1&isuri=1&acrdn=1#reqid=70&step=1&isuri=1&acrdn=1>.

- one-time, non-recurring revenues, e.g., selling gaming licenses.
- moving General Fund operating expenditures into the capital budget, e.g., with PLANCON.
- underestimating Medicaid caseloads that are then paid with supplemental appropriations and rolled into the next budget year.<sup>10</sup>
- shifting expenditures from one year to the next and revenues back to a previous one.
- shifting money from special funds to the General Fund.

## The ARP and the Structural Deficits

How is the structural deficit likely to interact with ARP funds? Our fear is that it's the intention of the majority party of the General Assembly to use all of the \$7.4 billion to close the structural deficit over the next three fiscal years. There are two very serious problems with this plan.

First, it does not solve the structural deficit problem. It just puts it off by using temporary federal funds to close a recurring gap. By FY 25-26, the state will once again begin the year with a deficit of at least \$1.5 billion without any federal funds to close the gap. We will be back in the situation of having very tight, precariously balanced budgets that do not secure enough revenue to support what Pennsylvanians already expect from government, let alone to advance proposals to fix what we have called the public investment crisis in our commonwealth. This crisis is evident in our failure to provide adequate and equitable funding for education at all levels and funding for infrastructure repair and improvements; environmental protection; and critical human services, including childcare assistance, housing assistance, mental healthcare, and aid to those with intellectual disabilities.

Second, it does not leave funds to invest in us now—that is to provide continued relief from the impact of the pandemic and the investments in wages, education, and the safety net that will improve the lives of Pennsylvanians now and in the future.

This brief is not the place to provide a full program. But we believe that the state should be using at least \$4.5 billion of federal ARP funds to invest in our future, as well as dedicated funding provided by the ARP for at least some of the following purposes. (And if the state asks corporations and the very rich to pay their fair share of tax revenues, we could do even more.)

### *Wage Support*

- Hazard pay for front-line workers
- Funds for a long-term fix to the unemployment compensation system
- A fund for immigrants and others excluded from previous relief programs

### *Safety Net Expansion*

- Start-up funding for a paid family and medical leave program
- Start-up funding for a retirement savings program for workers without an employee option
- Elimination of the waiting list for subsidized childcare and a raise of reimbursement rates for childcare providers

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<sup>10</sup> The year-after-year underestimate of Medicaid caseloads may be well over \$600 million per year by now.

### *Education*

- Move in the direction of the governor’s plan to distribute more state aid to schools through the funding formula or funds for improving the “Level Up” program for historically underfunded school districts
- Enact the Nellie Bly plan to make college more affordable
- A down payment on the governor’s tax reform plan with a “**recovery grant**” to all low-income workers

### *Support for Small Businesses*

- Additional help for small businesses that have been damaged by the pandemic, if dedicated ARP funds are insufficient
- A community development investment strategy to provide start-up capital, technical assistance, and commercial corridor development programs to help entrepreneurs in low-income and Black and brown communities
- Expansion of broadband access if dedicated funds are insufficient.

### *Health Care and Elder Care*

- Full funding and modernization of the public health system
- Training and increased pay and benefits for direct care workers
- Ensuring that increased funding for nursing homes goes to patient care

### *Housing*

- Expansion of short-term rental-assistance programs to form a nucleus for a long-term rental subsidy program

### *Immigrants*

- Inclusion of documented and undocumented immigrants, who make major contributions to the PA economy, in all state benefit programs

## Replacing Revenues Lost to Corporate Tax Cuts

If we do not use ARP funds to make up for corporate tax cuts, how should Pennsylvania close its structural deficit?

We have a tax system that is totally upside down: the share of income paid in taxes by the top 1% is half the rate of the lowest 20% of households. Fixing this system would bring in billions in new revenues, while cutting taxes for the majority of Pennsylvanians. We have put forward a proposal we call the Fair Share Tax that would now raise about \$2.5 billion per year. Half of that would come from the top 1%. Sixty percent of families in the state would receive a small tax cut and another 25% of families would see their tax rate stay the same.<sup>11</sup> The tax proposal presented by the governor in February would raise even more, while also cutting taxes or leaving them unchanged for two-thirds of Pennsylvania families.<sup>12</sup>

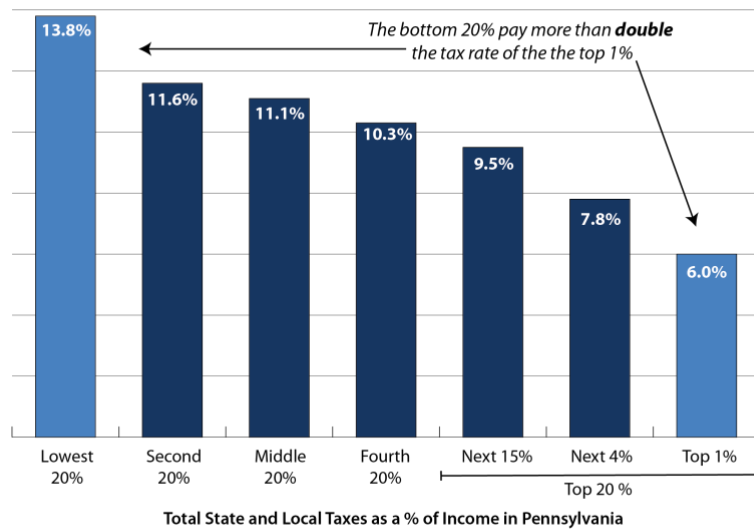
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<sup>11</sup> See Marc Stier and Diana Polson, [A Fair Share Tax Plan for Pennsylvania—2019 Update](#), April 15, 2019.

<sup>12</sup> See our detailed analysis of the governor’s tax proposal in Diana Polson, Marc Stier, and Stephen Herzenberg, [A Bold Proposal for This Moment of Crisis and Beyond: An Analysis of the Governor’s Proposed 2021-22 Budget](#), March 2021.



## In Pennsylvania, Higher Income Taxpayers Pay a Lower Share of Their Income in State and Local Taxes



Source: Institute on Taxation and Economic Policy, Who Pays? <http://www.itep.org/whopays/>

Closing not only the Delaware loophole but the Cayman Islands loophole in our corporate tax system—which allows 73% of the corporations operating in Pennsylvania to escape paying any taxes by declaring profits made in Pennsylvania as income in other states or countries that have no or low corporate income taxes—would raise \$729 million.<sup>13</sup>

### Conclusion

A plan to use ARP funds to invest in the people of Pennsylvania is far preferable than one to use those funds to make up for the reckless decisions to cut corporate taxes made by the General Assembly in the past. And the investments in the people of Pennsylvania we propose are likely to do what corporate tax cuts have never done—make our existing work force more productive, enable more people to work, generate new spending that spurs business growth, and thus generates the new revenues that could very well reduce substantially, if not eliminate, the structural deficit when ARP funding ends.

Closing the long-term structural budget deficit will eventually require the state to raise new revenues. Those who say we can “cut” our way out of these deficits have never—not once—proposed a plan that names specific cuts to the budget. The reason is obvious—Pennsylvania’s government has been shrinking relative to the state gross product for years, and the voters of this state want more services from the government, not less.<sup>14</sup>

And we will have to raise revenues not just to close the budget deficit created by corporate tax cuts but to close the public investment deficit that has plagued our state for decades. It is clear, in ways that it has not been since 1980, that broadly shared prosperity won’t be created by the failed strategy

<sup>13</sup>Stephen Herzenberg, Diana Polson, and Marc Stier, [Corporate Tax Cuts Since 2002 Now Cost PA \\$4.2 Billion Yearly: Pennsylvania Should Pass Worldwide Combined Reporting](#), January 27, 2020.

<sup>14</sup> We have been pointing to the decline in both state revenues and expenditures in the General Fund for many years included here: Diana Polson, Marc Stier, and Stephen Herzenberg, [A Bold Budget for This Moment of Crisis and Beyond: An Analysis of the Governor’s Proposed 2021-22 Budget](#), March 2021, pp. 8-9.

of cutting taxes for the rich, cutting government services for everyone else, and holding wages down. President Biden has embraced a different approach—one that we have been proposing for years—that aims to create a vibrant economy by raising wages and expanding the social safety net, by investing in people through expanding access to education at all levels and childcare, and by investing in infrastructure, including roads, bridges, public transit, and programs to drastically reduce our reliance on greenhouse gas-producing fossil fuels. Pennsylvania has to do its part in embracing that strategy. Today, the state’s share of funding for K-12 education is among the lowest—and the result is the most unequally funded schools in the country. We are also ranked last in higher education spending and are tied for the state with the highest-cost state colleges relative to the median income. We have a crumbling infrastructure that undermines our economy. The only way to create a growing, productive, and more equal economy is to reduce this public investment deficit.

Using ARP and other funds to invest in us might require the state to raise new tax revenues sooner rather than later—but doing so is inevitable. Fortunately, there are ways to do so that would make our economy stronger than it was before the pandemic. Adopting the governor’s tax reform plan, or our bolder Fair Share Tax plan would reduce taxes for most Pennsylvanians by asking everyone to pay their fair share. And combined with the spending programs we propose, it would put more money in the hands of working people, leading to faster economic growth and a brighter future for everyone.

Using most or all of the ARP funds to make up for the General Assembly’s reckless financial decisions would confirm the fears of Senator Mitch McConnell, who opposed the ARP on the grounds that states would use the funds to make up for the bad decisions they had made in the past. When Senator McConnell made that claim, he specifically said it was Democratic state legislatures that would use the funds not for fiscal relief or to help people but to balance budgets, cut taxes or fix pensions that had become dangerously underfunded.<sup>15</sup>

We disagreed with McConnell because we knew that states in general, and Pennsylvania in particular, had real needs, both to make up for tax revenues lost to COVID-19 and to deal with serious short-term and long-term issues. And we still believe his claim that Democrat-controlled states would waste federal funds is tendentious and wrong-headed.

Sadly, it appears that McConnell’s fears about the states using federal funds badly could come true in Pennsylvania—and that if it happens, it will be because of a General Assembly dominated by Republicans.

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<sup>15</sup> While we accuse the General Assembly of adopting reckless budget proposals in recent years, one thing it has done at the insistence of Governor Wolf is to continue to make actuarially required contributions to both PSERS and SERS. As a result, the state is on the path to eliminating the unfunded liability in both systems.