Principles for a Better Budget

PENNSYLVANIA
Budget and Policy Center

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Coming Out on Top

Building Pennsylvania's Future Coming Out of the Recession

Pennsylvania is poised for growth and prosperity coming out of the recession. The Commonwealth ranked third among all states in job creation in 2010, adding 65,000 new jobs. As bad as the recession has been, Pennsylvania weathered it better than most states, with unemployment below the national average for 35 of the 36 months of the recession.

States that saw rapid growth during the housing boom now face declining fortunes and fading prospects. Nevada, Florida and Arizona have led the nation in population growth but now lead the nation in foreclosures and unemployment. Texas, long heralded as an example of fiscal restraint, has the second highest budget deficit of any state in 2011, more than 30% of its General Fund.[1] It is a lesson we should not take lightly: economic prosperity must be based on granite rather than sand.

Pennsylvania's stronger-than-average performance through the recession is not an anomaly or a product of luck. It is based on economic policies that invest in communities and families, in infrastructure and innovation, and in clean energy.

State general fund and capital spending accounts for about 6% of the overall economy, but that 6% is important. It lays the foundation for economic growth and, in partnership with private capital, creates jobs and wealth. It has helped the population—businesses and citizens—to make the difficult transition from a manufacturing economy to one that is more diverse. It has improved our ability to compete in the world of globalized technology, manufacturing and services. Smart, strategic investments have made Pennsylvania a leader in clean energy and a model for other states.

The recession has created an imbalance between the needs of the citizens and the resources available to pay for them. Like 48 other states, the Commonwealth has seen an unprecedented decline in revenue and record-breaking demand for services. People who have lived the American dream are now relying on food stamps. Our faith has been shaken, in our nation and our government, but we are Americans and we know, deep down, we will prevail, better and stronger.

Like President Obama, Governor Corbett has inherited a battered economy and has choices to make that will determine Pennsylvania's path well into the future. The state budget is one of the tools at his disposal to create jobs and ensure prosperity. We offer here principles for a prosperous Pennsylvania. These are a starting point for discussion. They represent a pragmatic alternative path for our new Governor, legislature, and state. These principles should serve as goals and values against which to measure the budget that will be announced on March 8 and budget proposals made subsequently.

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[1] Liz McNichol, Phil Oliff, Nick Johnson. *States Continue to Feel Recession's Impact*. Center on Budget and Policy Priorities, February 10, 2011, http://www.cbpp.org/cms/?fa=view&id=711.

Create or Preserve Jobs

In December 2010, 437,000 Pennsylvanians were unemployed, down from a peak of 500,000 but almost 300,000 more than before the recession. The first priority of any budget proposal should be to create or preserve jobs.

The private sector adds jobs at its own rate, currently too slowly. Many large companies are flush with cash, too much of which they are hoarding. Some economists predict that rather than reinvesting that cash to create jobs, businesses will embark on a new wave of stock buybacks that will inflate executive salaries.

Companies will expand their ranks—and create jobs—when they are confident there will be customers for their products and services. When times are tough and the economy remains far below full employment, federal and state governments have a role to play in priming the economic pump through short-term job creation.

While the downturn affected every part of our economy, there were several concentrations of job losses: residential and commercial construction, manufacturing, and jobs for low-skill city and rural residents. State strategies can jumpstart employment in these areas, buying time for a more robust private sector to pick up more of the slack.

Spending Cuts Could Derail the Recovery

A wide range of private and public economic forecasters have expressed concern that reductions in state spending will slow job growth in 2011. Over the next year, state budget cuts could result in 850,000 additional job losses across the United States.[2]

A $1 billion cut in state spending would subtract an estimated 28,500 jobs from employment growth here in Pennsylvania. The failure of cut-and-grow strategies during periods of very high unemployment can best be seen in New Jersey where state budget cuts have helped rank that state dead last in job growth for 2010.

Action Steps to Create or Preserve Jobs

The "Buy Low" Rebuild PA Initiative: The state should increase its bond-financed investments in infrastructure, transportation, schools, renewable energy and energy efficiency retrofits. As a result of the steep downturn in the construction industry, major projects can cost 20% less than just a few years ago, significantly stretching the public investment dollar. It was for this reason that the Commonwealth was able to finance 28% more projects with Recovery Act dollars than initially estimated.[3]

By ramping up construction projects now, the state would create additional jobs as well as get much better value for its money. This initiative also fits with other critical values that should shape the state budget, including improving the efficiency of state government and supporting Pennsylvania's long-term economic success.

Claim Additional Federal Funds for Unemployed Workers: The state is at risk of leaving $273 million in federal Recovery Act dollars on the table that would expand unemployment insurance benefits for jobless workers. This policy change would benefit workers who already pay into the state's UI fund but don't qualify for benefits because of arcane rules that ignore their most recent months of work when determining their eligibility for benefits. Pennsylvania is one of a small handful of states yet to harvest the available Recovery Act money for this change, while even fairly conservative states like South Carolina are accepting it. While the official deadline to claim these funds is August 2011, Washington could try to take back unspent funds before then. Therefore, the legislature should act immediately to modernize the state's unemployment insurance rules and access these funds.

Increase Marcellus Jobs for Pennsylvanians: Several thousand good-paying jobs in Pennsylvania are currently going to out-of-state workers from big energy states, like Texas, Colorado and Louisiana.

[2]Ibid. Page 8.

[3]Commonwealth of Pennsylvania, Office of the Budget. *Budget Sense*. January 2011

Pennsylvania should require that companies with permits to extract natural gas within the state establish plans to ensure that Pennsylvanians have the skills needed to perform extraction work. Skills upgrading could be accomplished through collaboration with industry training partnerships across the state, to which many gas companies already belong. The state Department of Labor and Industry should report annually on the share of Marcellus workers from out of state, with the goal of bringing the industry share to the average for all Pennsylvania industries by the end of 2013.

Allow Part-Time Unemployment Benefits Through Work Sharing: The state should enact a work-sharing law that allows workers to receive partial unemployment insurance benefits if their hours are reduced to part-time because their employer does not have sufficient customer demand. Seventeen other states have such "work-sharing" programs, which enable employers, on a voluntary basis, to avoid losing valued skilled workers and to restore them to full-time positions as soon as customer demand recovers.

Establish a State Way-to-Work Partnership to Subsidize Wages for Employers: In 2010, Pennsylvania used TANF emergency contingency funds to create the Way-to-Work program, which provided a 100% wage subsidy to employers willing to hire and train unemployed workers. It was targeted to lower-income, lower-skill workers with weak workforce attachment who were among the first to lose jobs in a downturn. Individuals were matched with current employer job postings allowing quick access to available positions. The Commonwealth should reestablish the program offering a 20% to 25% wage subsidy for jobs that pay at least $13 per hour.

Improve Efficiency, Effectiveness and Transparency of Government

> "I will mandate transparency and accountability throughout state government. Pennsylvania taxpayers deserve to know how their money is being spent and how state agencies operate. I will make that information available online so citizens can search for information about state agency budgets, transactions and operations. A more transparent government is a more responsible government."
>
> Tom Corbett—"50 Ways to Rebuild PA"

The need for better transparency and accountability in government was a core theme of Governor Corbett's campaign. Such transparency and accountability is especially essential in state economic and community development funding—to check the reality or perception of "pay to play" handouts to politically-connected companies, and to inform open policy dialogue about the projects and places that legitimately warrant public funds. Pennsylvania should implement transparency reforms in four steps.

Action Steps to Improve Accountability and Transparency

Enact a General State Government Transparency Bill: A general state government transparency bill unanimously passed the House of Representatives and is a priority of the Senate. Implementation of this bill by either the Independent Fiscal Office (as proposed by the Senate) or the Department of the Treasury (as proposed by the House) should ensure that critical up-front information is captured that documents the actual address or geographical area where state funds are actually used. That will allow planning professionals and the public to evaluate whether the state is smartly targeting the communities that most need funds and using already developed lands as much as practical. Implementation of a general transparency bill should also improve up-front reporting of the performance outcomes expected from state funds and back-end reporting on the performance outcomes achieved.

Transparency in Capital Budgeting: There has been growing controversy in recent months about the distribution of Redevelopment Assistance Capital Program (RACP) grants.[4] Retaining a role for public investment in regional and community assets makes sense, but the lack of an open and transparent process for applying for funding and evaluating projects has undermined public confidence in the program and left it vulnerable to political interference. The RCAP program has many strengths: for example, it has clear project criteria and requires all stakeholders including local governments to sign off on a project. Moreover, it is a last-dollar-in program which reimburses projects once financing has been arranged. For this reason, RCAP projects have a very high completion rate. Criteria for distributing RACP funds, the scores of competing proposals, and copies of those proposals should be publicly available on the web.

Transparency and Accountability when Distributing Business Subsidies and Tax Breaks: The legislature and new administration should partner to implement a stand-alone economic development transparency bill, using as a vehicle 2009-10 legislation proposed by Senate Majority Whip Pat Browne. A stand-alone bill should require online reporting on whether recipients of business subsidies and tax breaks actually deliver promised jobs and wages, along with basic information on the wages they pay and whether they pay health benefits. Economic development accountability should also include market-based wage standards so that companies receiving subsidies cannot pay far below the industry average in the county of the project, and "clawback provisions" to ensure that the state recaptures subsidies if companies fail to deliver promised jobs.

Establish Within the Fiscal Office an Office for Continuous Improvement: The Office for Continuous Improvement would oversee and implement management and cost-savings strategies on a permanent basis. (See for more: http://www.tccp.org/node/182.) This office should explore opportunities for in-sourcing work when it can be performed more cost-effectively by state government. It should also emphasize savings that result from increased efficiency not savings that are based on paying substandard wages and benefits.

[4]For one editorial outlining a need for greater transparency, including explicit criteria and information on how competing proposals rank on the criteria, see Philadelphia Inquirer article "Not So Fast With Grants."

Promote Long-Term Economic Success

State expenditures play a critical role in generating economic activity. A substantial body of economic research has documented the importance of basic education, higher education, transportation systems, and other infrastructure, to state and local economic success. Businesses need roads to move goods and skilled workers to produce them. Colleges and universities have been centers of innovation, fueling private sector initiative. It is no wonder than Silicon Valley, the Research Triangle and Boston's Route 128 corridor are epicenters of growth and job creation—each located in a cradle of higher learning that benefits from substantial public investment.

Action Steps to Promote Long-term Economic Success

Improve Student Performance and Student Success in the Classroom: Each year, the Organisation for Economic Co-operation and Development (OECD) publishes new rankings on educational performance of students by nation and each year students in the U.S. come out in the middle. Several common features distinguish the world's most successful educational systems. Maybe the most critical is that school funding in world-class systems is the same or higher in low-income areas as in high-income — whereas school funding in Pennsylvania still depends heavily on the wealth of the local community. Top-ranked countries also tend to integrate social services, such as health care for mother and child, housing, and nutrition, with funding for all schools sufficient to pay for a quality education. Top-ranked nations also provide greater support in top-ranked nations for teachers to become more effective in the classroom. This usually includes mentors and systematic feedback to help new teachers.

Pennsylvania already has tremendous advantages. Our public school students score in the top 10% of states on standardized tests, and student performance is improving. The Center on Education Policy singled Pennsylvania out as the only state to improve student performance in all categories at every grade level between 2002 and 2008. [5]

Student performance has improved at the top and at the bottom. Since 2003, the share of students performing below basic in math has declined from 42% to 24%. Improvement in reading was smaller but steady. On the flip side, the share of students performing at an advanced level increased from 58% to 76% in math and from 66% to 72% in reading.[6]

In Pennsylvania, student success is highly correlated to resources available in their school districts. 80% of students scored at or above proficiency levels in wealthier school districts, compared to just 55% in districts with fewer resources.[7]

Maintain Basic Education Funding at Current Levels in 2011-12: State basic education funding for 2010-11, at $5.7 billion, relies upon almost $1 billion in temporary funding from the American Recovery and Reinvestment Act (ARRA) and the Education Jobs program that will end in June. This funding will need to be replaced in order for state support of education to remain flat in the next fiscal year.

Reducing state funding in 2012 will force school districts to cut courses, increase class sizes, and eliminate programs that help students get into college. The potential loss of funding is so significant that districts will likely make significant cuts and increase property taxes.

Almost 1.8 million children are enrolled in public schools in the Commonwealth in 2011. These students should not become a casualty of the recession; we would be doing great harm to them and to the economic prospects of the Commonwealth to shortchange their education in response to a temporary, although deep and painful, recession.

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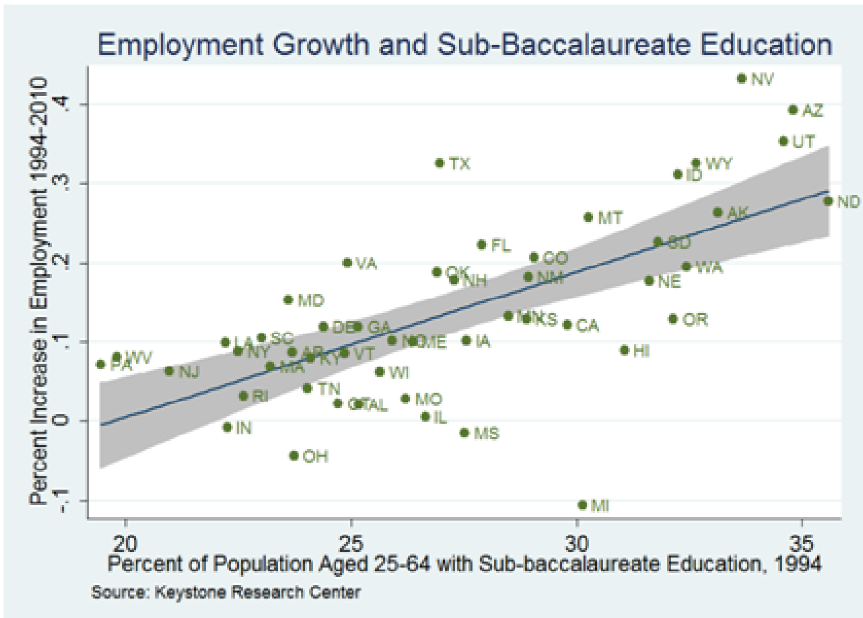
[5]Chudowski, Naomi, Victor Chudowski and Nancy Kober. "State Test Score Trends Through 2007-08 Part 1". *Center on Education Policy*, 2009 http://www.cep-dc.org/displayDocument.cfm?DocumentID=304.
[6]Education Policy Leadership Center, *Funding Basic Education in Pennsylvania, A Status Report*. Winter 2011 http://www.eplc.org/pdfs/StatusReportWinter2011FINALVERSIONIV2.pdf.
[7]Ibid

Maintain Investment in Higher Education. With the shift to a more knowledge-based economy, investment in higher education has become increasingly important to economic growth. The following figure plots employment growth between 1994 and 2010 in the 50 states against the percentage of population with a sub-baccalaureate (i.e., some college) education. The correlation is easily visible in the form of a trend upward and to the right indicating that states which a higher share of residents with a sub-baccalaureate education have experienced stronger job growth.[8] These data underscore that Pennsylvania must make every effort to avoid deep cuts in higher education that could undermine the state's recent progress on job growth.[9]



As of 1994, Pennsylvania ranked in the bottom five states measured by the share of the workforce with education beyond high school, hampering the state's growth as middle-skill jobs have become increasingly important.

One of the reasons for Pennsylvania's poor showing is the regional gaps in its higher education infrastructure, with large rural parts of the state and the Erie metro area having no community college nearby. In addition, higher education tuition is high in Pennsylvania, at the community college and public higher education level. Pennsylvania has not made higher education a priority. The Commonwealth ranked 45th in state funding as a share of personal income in 2010-11.[10]

Maintain the State's Industry Partnership Program: While spending less on economic development subsidies to individual companies, the state should invest in innovative and strategic workforce and economic development programs that strengthen Pennsylvania's critical industries. This includes the state's nationally recognized Industry Partnerships, which ensure that training programs develop the skills employers need to create good jobs.

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[8]The bivariate correlation is strong at 0.6479 and significant at the 95% confidence level.

[9]Other research supports this conclusion, suggesting that regional growth depends on sub-baccalaureate educational attainment. Curtis J. Simon, "Human Capital and Metropolitan Employment Growth," *Journal of Urban Economics*, Vol. 43, 1998, pp. 223-243. Edward L. Glaeser, Jose A. Scheinkman, and Andrei Shleifer, "Economic Growth in a Cross-section of Cities," *Journal of Monetary Economics*, Vol. 36, 1995, pp. 117-143.

[10]Illinois State University, Grapevine data, http://www.grapevine.ilstu.edu/tables/FY11/Grapevine_Table5.xls.

Already more than 60 Industry Partnerships have trained more than 87,000 workers and engaged more than 6,300 businesses. Even more valuable, these partnerships have collaborated on common challenges that help all businesses become more competitive

Promote Clean Manufacturing and Other Key Industries through Economic Development Partnerships: The state should expand the basic approach of partnering with industry to the economic development sphere, as well. This can be accomplished by funding competitive grants from groups of employers with good ideas for increasing jobs and boosting long-term competitiveness—such as clean processing partnerships, supply chain development and in-sourcing initiatives, joint technology diffusion or innovation, or joint marketing. Since industry cluster initiatives are aligned with national economic development strategies, it should be possible to leverage additional federal funds to help pay for them in Pennsylvania.

Invest in Clean Energy and Energy Efficiency

Pennsylvania needs to update its clean energy policies to harness private investments and create robust market opportunities in our clean energy sector. Governor Corbett has an opportunity here to spur economic development without impacting the state budget.

The Pennsylvania Department of Labor and Industry reports that 106,000 people are now working in renewable energy and energy efficiency jobs.[11] These jobs include carpenters and electricians installing solar panels, steelworkers constructing wind turbines, clean room workers manufacturing high-tech solar cells, and a host of trades upgrading the lighting, heating and air systems and insulating our aging buildings. Pennsylvania now ranks third in the nation for operating solar projects. We have 14 operating wind farms generating enough electricity to power numerous homes.

The spectacular growth of this sector has been created by forward-thinking policies and strategic public and private investments. Key to this success is the Alternative Energy Portfolio Standards Act. Enacted in 2004, this law requires 8% of our electricity to come from renewable resources by 2019. This initiative was buttressed by the 2008 passage of the Energy Savings Act (Act 129), which set a goal of reducing the overall demand for electricity by 3% and peak demand by 4.5% by 2013. The Alternative Energy Investment Act, also passed in 2008, provided $650 million for renewable energy, including the $100 million Pennsylvania Sunshine Program.

Action Steps to Invest in Clean Energy and Energy Efficiency

Increase Renewable Energy Standards: Competition for renewable energy investments and jobs is fierce in the Mid-Atlantic region, and Pennsylvania is now, unfortunately, in danger of falling behind and losing our competitive advantages. The surrounding states of Maryland, Delaware, New Jersey and New York all have more robust solar energy standards, and project money is starting to cross our borders for greener pastures in those states. To keep our clean economy growing and producing jobs, Pennsylvania needs to increase its renewable energy standard for electricity from the current 8% to at least 15%. We also must at least double our solar requirement from the current 0.5% to 1.5%. These policy updates will leverage billions in private investments, ensure vibrant renewable energy markets and continue creating new jobs.

[11] Pennsylvania Department of Labor and Industry, Center for Workforce Information and Analysis, *The Pennsylvania Green Jobs Survey Report,* December 2010 http://www.paworkforce.state.pa.us/portal/server.pt/community/pa_center_for_green_careers/18911.

Prevent a Tax Shift to Local Property Taxes

The Commonwealth of Pennsylvania delivers most of its important services, including education, health care and services for its most vulnerable citizens, in partnership with local governments and institutions.

Cuts to state funding for health care, community colleges, municipal pensions and law enforcement will shift costs down to the local level – where services have to be provided. As costs increase for local governments, more pressure is placed on local officials to raise property taxes.

The Commonwealth Relies Heavily on Property Taxes

Pennsylvanians paid $15.5 billion in local property taxes in 2008. Property taxes equaled 3.1% of Pennsylvania's personal income that year, ranking 21st highest of the states. Over time, the Commonwealth has become more reliant on property taxes to fund services. (see table below).

Year	Local Property Taxes as Share of Personal Income	Pennsylvania's Ranking (High to Low)
1992	2.79%	31
1996	2.84%	25
2000	2.69%	25
2004	2.98%	22
2008	3.10%	21

The trend runs counter to the nation as a whole. Nationally, property taxes represented 35.5% of state and local revenue in 1977, but by 2008 the share had dropped to 28.8%. Although still below the national average, Pennsylvania property taxes have grown as a share of total state and local revenue, from 26.1% in 1977 to 28.7% in 2008.[12]

In 2009-10, Pennsylvania allocated more than $2 billion to county governments for assistance for their most vulnerable residents. These services include investigations of child abuse and neglect, homeless shelters, community-based assistance to children and adults with mental retardation, treatment for drug and alcohol abuse and mental health treatment. In total, the lives of more than 1 million Pennsylvanians have been touched by these vital services.

Action Steps to Prevent a Tax Shift to Local Property Taxes

The Commonwealth consistently ranks on the bottom in state share of education spending. In 2007-08, state funds accounted for 36% of all funding, while local property taxes paid for 57% of total education funding. Only three states provided a smaller share of state support.

Pennsylvania began to reverse the trend in funding starting in 2004. The Commonwealth boosted the personal income tax rate from 2.87% to 3.07%, still the second lowest top income tax rate in the nation. This increase supported additional state funding for preK-12 education by $1.8 billion. This increase had the effect of reversing the school funding trend, with Pennsylvania's share of property taxes declining from its peak of 29.3% down to 28.7% in 2008.

Maintain Basic Education Funding to Prevent A Tax Shift: For more than a decade, Pennsylvania had no rational system for distributing billions of dollars in state assistance to local school districts. School district funding was not related to the number of children, the educational needs of those children, or even the share of students needing special education services. That changed in 2006 when the General Assembly commissioned a study to determine the actual cost to school districts for all children to meet proficiency standards, and in 2008, when a funding formula based on costs and needs, rather than 11th hour backroom dealing, was adopted.

[12] Tax Policy Center, *State and Local Property Tax Revenue as a Percentage of Total Tax, Selected Years 1977-2008*, November 4, 2010 http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=517.

A rational formula that allows districts to meet the needs of students while reducing pressure on local taxpayers should be continued.

County-based Services

Many county-based services are mandated by federal and state law. While counties have argued for legislative relief for some mandates, such changes would not impact the bulk of services or the vast majority of funds needed to support them. Mandate relief that reduces paperwork and improves flexibility, while still maintaining accountability, should be adopted. Some of the changes sought by the counties, including allowing inmates in county jails to maintain state health care benefits, would increase state costs.

Increase County Flexible Funding through the Human Services Development Fund: County governments are on the front lines protecting safety, investigating and prosecuting child abuse and neglect, and helping citizens who suffer with disabilities and addictions. They often do so under the mandates of state and federal law, but ultimately they provide services to protect their residents and offer them a chance to improve their quality of life. Counties are funded for the mandatory services, but over time counties have created prevention programs that can reduce the necessity for mandated services and have identified unique local needs that must be addressed. The Human Services Development Fund gives counties flexible funding to pay for innovative and cost-saving programs, and should be continued.

Maintain Programs That Achieve Long-Term Cost Savings for Taxpayers

Spending strategically today can save the Commonwealth money in the future. In the same spirit, it makes no sense to cut programs today that will increase costs to taxpayers down the road. When services and investments are literally cases of "pay me now or pay me a lot more later," we should pay now.

Action Steps to Maintain Programs that Achieve Long-term Cost Savings

Maintain Investment in Early Childhood Education: A decade of research makes the definitive case that investments in early childhood education produce long-term savings in education, criminal justice and social welfare cost. The potential return on investment is significant; long-term studies of early childhood expenditures suggest that each dollar spent returned between $7 and $16 in savings, increased earnings and resulted in greater tax revenue.[13]

Early childhood investments also reduce costs for Pennsylvania school districts in the short term. A 2006 study by the City University of New York demonstrated that school districts could recoup as much as 78% of state pre-K spending in education savings, while special education costs could be reduced statewide by at least 8% annually. [14]

Reduce Criminal Justice Costs through Prevention Programs: At a cost of more than $32,000 per inmate per year, prison spending is a lousy deal for Pennsylvanians.[15] We do not have to keep going down the path of opening more prisons to house more prisoners. There are many evidence-based programs that show positive rates of return over the long haul for young people, such as providing life skills training, functional family therapy, and support through Big Brothers/Big Sisters programs. These services help better prepare kids for adulthood – and lower prison costs down the road. These programs were shown to return up to $26 for every dollar spent.[16]

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[13]Pennsylvania Partnerships for Children, *Public-Funded Pre-Kindergarten in Pennsylvania 2010 Fact Sheet*, http://www.papartnerships.org/reports/factsheets/2010_PreK_Fact_Sheet.pdf.

[14]Pennsylvania Build Initiative. *Invest Now or Pay Later*.

[15]Pennsylvania Department of Corrections, *2010-11 Costs & Population*, http://www.portal.state.pa.us/portal/server.pt/document/915925/2010-2011_costs_and_population_pdf.

[16]Brian Bumbarger, *Pennsylvania's Corrections Crisis: The Role of Evidence-based Prevention and Intervention*, Testimony before the Pennsylvania Senate Judiciary Committee, February 15, 2011.

Cut Costs

Cutting costs will be a necessary component of any state budget in the current economic climate. The challenge for Governor Corbett and state policymakers will be to identify cuts that aid in balancing the budget, without harming the economy, local communities or the quality of life of all Pennsylvanians.

Action Steps to Cut Costs

Crack Down on Medicaid Provider Fraud: Federal efforts to track down and prosecute Medicare provider fraud have been quite robust, but similar efforts for Medicaid, which is partially funded by the states, have lagged behind. Some estimates found that 7.9% to 13% of Medicaid provider bills costs are fraudulent. If Pennsylvania reduced Medicaid costs by 5%, it could save hundreds of millions of dollars. Pennsylvania should join 28 states in enacting a False Claims Act, which allows whistleblowers to file fraud claims against providers and sets stiff penalties for offenders. Such a law would bring with it a higher FMAP rate for Pennsylvania and greater state share of federal false claims recoveries.

Rebalance Long-term Care: Pennsylvania spends much more than the national average on nursing home care, failing to move more seniors into less costly home- and community-based services. Pennsylvania spends 22% of the long-term care budget on home- and community-based services--Raising the average to just 25% would allow the Commonwealth to access a higher federal matching rate, saving $248 million in 2012. Reaching the national average of 40% of seniors in home and community-based services would increase savings by hundreds of millions more.

Reducing Prison Costs through Prevention and Sentencing Reform: Pennsylvania's prison population has skyrocketed by 500% between 1980 and 2010, and expenditures have grown to $1.8 billion, an increase that is six times faster than basic education spending.[17] The Commonwealth plans to spend $1 billion on five new prisons by 2016.

Most state prisoners are not violent offenders, but strict mandatory sentencing guidelines and other get tough policies have filled the prisons. States like Michigan and Texas have used treatment programs and other evidenced-based strategies to reduce prison populations--not merely slow growth. These types of programs should be investigated in Pennsylvania to reform the system and more wisely use scarce public dollars--without jeopardizing public safety.[18]

A Balanced Approach: Raising Revenue

In the short-term, Pennsylvania has a gap between its income and its needs. The recession of 2007 brought with it a significant loss of employment, which fell by 4.5% from its pre-recession peak. In contrast, during the two previous recessions employment dropped by about 2% . The recession battered state revenue as well: between October 2008 and September 2009, states took in $87 billion less in revenue than in the previous 12 months. Pennsylvania saw a steep reduction in its tax revenue, which dropped by $2.4 billion from $27.9 billion in 2007-08 to $25.5 billion in 2008-09.

In 1991 and 2002, Pennsylvania's policymakers took a balanced approach to the short-term fiscal crisis, which included the use of reserves, targeted program cuts, and new revenue. In order to achieve the goals outlined above, lawmakers should pursue the same strategy in 2011-12.

Raising revenue does not appear to impede a states' post-recession economic growth. Measured by personal income, employment or median wage, the 30 states that raised revenue during 2001-02 did about as well as those that did not. [19]

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[17] Donald Gilliland, "A System that Puts Taxpayers in Chains," Harrisburg Patriot-News, February 28, 2011.
[18] Donald Gilliland, "Now is the Time," Harrisburg Patriot-News, February 28, 2011.

Action Steps to Achieve a Balanced Approach

Like anything else citizens are willing to pay taxes when they know what they are purchasing, and are confident that the tax system limits special exemptions and deductions. At the end of the day, two people earning the same income, or making the same profit should pay roughly the same tax. That does not occur. By eliminating tax breaks and exemptions and loopholes, Pennsylvania can raise the same revenue with a lower rate.

Different types of economic activity generate different revenue that contributes to the common good. All residents benefit from good public schools, affordable colleges and universities, adequate transportation systems, clean water, and the preservation of the environment, parks and farmland.

Enact a drilling tax on producers of natural gas and other gas products—$200 million in 2011-12 and more than $400 million by 2015-16: Pennsylvania is now the 12th- largest producer of natural gas in the country, with 274 billion cubic feet extracted in 2009, yet remains the only one of the top 15 producers without a severance tax or conservation fee. States that extract and export minerals commonly impose a tax. The State of Texas taxes everything from oil and gas to cement, sulfur and even oysters--and it is still the largest producer of gas and oil in the US. The revenue compensates state residents for the removal of the resources and subsidizes both the direct and indirect costs of extraction. The drilling tax will bring in new revenue, reinvest in environmental conservation and restoration, compensate local governments dealing with drilling impacts and on balance increase employment.

A drilling tax will also create jobs. A Penn State analysis found that every $100 million in drilling tax revenue will create a net gain of 1100-1900 new jobs.[20]

Expand the scope of the tabacco excise tax to include other tobacco products—$42 million: Tobacco products have health consequences for tobacco users, and taxing tobacco to help recover social costs of tobacco use is a common practice. Every state assesses an excise tax on cigarettes, but Pennsylvania remains the only state that doesn't tax smokeless tobacco and one of only two that doesn't tax cigars. Pennsylvania should expand its definition of tobacco to include other tobacco products, including smokeless tobacco and cigars.

Enact a temporary surcharge on capital gains and other unearned income—$635 million for two years: In December 2010, Congress voted to extend tax rate reductions enacted in 2001 and 2003 until 2012. These rate reductions have a modest impact on the average Pennsylvanian, but generate a substantial windfall for the wealthiest 5% of taxpayers.

The total tax windfall for the top 5% of Pennsylvania taxpayers from the extension of the Bush tax cuts equals $4.6 billion, which is more than the Commonwealth's projected budget deficit for 2011-12. The top 5%, with an average income of $258,000, will receive an annual tax cut of $7,217 in 2011 and 2012, while the top 1%, with an average income of $1.1 million, will get an annual tax cut of $48,149.

Pennsylvania should enact a two-year temporary increase in the Pennsylvania tax rate on capital gains and dividends. (This extension is allowable under the state's flat-tax constitutional provision because taxes need only be uniform on each "class" of income. Capital gains and dividends are each their own class.) This increase could recapture 15% of the two-year extension of tax cuts for the wealthy that was part of the December 2010 federal compromise.

Recapturing some funds to finance state services and investment makes particular sense because, while profits have recovered more rapidly than previous recessions, business investment has lagged behind. Some big businesses appear to be hoarding funds, sometimes because they are worried about the strength of the recovery and in some cases to finance stock buybacks that drive up executive compensation. Instead of capital gains and stock dividends largely staying on the sidelines, they should be put to work investing in Pennsylvania's future—and creating a stronger foundation for future increases in capital gains as well as in wages.

[19] Nick Johnson, Catherine Collins, Ashali Singham, State Tax Changes in Response to the Recession, Center on Budget and Policy Priorities, March 8, 2010.
[20]http://pennbpc.org/fact-check-severance-taxes-and-marcellus-shale.

Lift the cap on the oil franchise tax—$181 million or more: Road construction, bridge repair and most other transportation improvements are supported by user fees and fuel taxes. Pennsylvania's gas tax is 31.2 cents per gallon, which includes a 12 cent liquid fuels tax and a 19.2 cent oil company franchise tax,. The oil franchise tax is calculated using the market price of gasoline which was capped at $1.25 in 1997. Raising the cap from $1.25 to $1.75 to better reflect current gasoline prices would generate $181 million, raising it to $2.00 would generate $272 million in additional revenue.

Eliminating the sales tax exclusion for gasoline and reducing the gas tax rate—$335 million: The liquid fuels tax is fixed at 12 cents per gallon. A sales tax of 6% would fluctuate with price. Replacing the gas tax with a sales tax on fuel (technically eliminating the sales tax exemption for fuel would provide the Commonwealth with more flexible transportation funding, and better reflect market prices. The sales tax would not be limited to roads and bridges, so a portion could be used to support the Commonwealth's economically crucial public transportation systems. Of the gas tax with 6% sales tax on fuel. 1% could go to public transportation, and 5% could go to Motor License Fund for road and bridge projects. A sales tax on fuel allocated this way would raise the same amount of revenue for roads and bridges as the current gas tax, with fuel prices at $2 per gallon. With gas prices at $2.50 per gallon, a sales tax on fuel would provide $140 million or transit. With gas prices at $3 per gallon, collections would increase by $335 million.

Close corporate tax loopholes by adopting combined reporting - Once phased in, over $600 million per year: Under our current antiquated tax system, multi-state corporations are able to shift profits out of Pennsylvania to low- or no-tax states. They do this by using accounting gimmicks like the "Delaware loophole," which allows companies to send profit to subsidiaries in Delaware and other tax havens. This costs the Commonwealth hundreds of millions of dollars in tax collections each year. It also gives large, multi-state corporations an unfair advantage over smaller corporations that only operate within the state. Pennsylvania can close these loopholes, level the playing field for all corporations, and raise additional revenue by enacting combined reporting.

Opt-out of federal "bonus depreciation" – At least $200 million(with some estimates as high as $800 million) over the next two years: Pennsylvania realized this was an expensive and unproductive give-away of state tax dollars back in 2002 when it enacted a law allowing bonus depreciation. That law is still on the books, but the Corbett administration recently announced it would adopt the new federal rules as a matter of tax policy. Without legislative action, Pennsylvania will be giving companies an additional tax break to buy and use equipment in Arizona, Florida, or California, not just Pennsylvania. At the time the state is slashing funding for health care, education, and environmental protection, we can't afford more unaccountable giveaways to big business. Each tax dollar that is given away likely means an additional dollar of program cuts.

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