

BLUEPRINT  
FOR A  
PROSPEROUS  
*Pennsylvania*



Commonwealth  
Foundation  
for PUBLIC POLICY ALTERNATIVES



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# Blueprint for a Prosperous Pennsylvania

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## Executive Summary

Over the past six fiscal years, the commonwealth has spent more than it has taken in. This fiscal gap is projected to widen as expenditures are on pace to grow faster than future revenue. Such a structural deficit poses a threat to the very foundations of economic growth and job creation that lead to prosperity for Pennsylvania's taxpayers.

From 1970 to 2014, state government spending rose from \$4 billion to nearly \$67 billion—the highest in state history. Adjusting for inflation, that's an increase of \$3,163 per resident.

This decades-long pattern has placed an undue burden on the backs of state taxpayers. Pennsylvania has the 10th highest state and local tax burden in the nation. Meanwhile, state and local government debt has grown to a combined \$125 billion—nearly \$10,000 per resident.

High spending, taxes, and debt hinders Pennsylvania families' opportunities for prosperity. The commonwealth is near the bottom in most state rankings of economic climate and has lagged the rest of the nation in job and income growth for decades.

Unfortunately, the prospects for improvement are overshadowed by the challenges lawmakers face in balancing our state budget.

Recent budgets relied heavily on temporary federal stimulus dollars and one-time revenue sources, creating an imbalance between spending and revenue that has not yet been resolved. Spending on Public Welfare—the largest department in the commonwealth's budget—continues to grow faster than taxpayers' income. Debt payments and prison costs continue to eat a large share of the state budget.

The most pressing threat to our fiscal house is a looming public pension crisis. With \$47 billion (and growing) in unfunded pension liabilities between the two statewide plans for public employees, state pension contributions will skyrocket by 143% in the next five years.

This report outlines reforms to help build a foundation for lasting prosperity. Our analysis focuses on three categories of reform.

First we address short-term fiscal reforms to deal with challenges facing our state budget. We also identify long-term reforms to bring spending in line with inflation while reducing the size of government and the burden on taxpayers. Finally, we discuss policy reforms aimed at economic growth.

These recommendations include:

- ❑ Cut corporate welfare spending—including Redevelopment Assistance Capital Spending, the Commonwealth Financing Authority, and the Horse Race Development Fund—and targeted tax incentives in favor of tax relief for all.
- ❑ Utilize part of the legislative reserve fund.
- ❑ Reduce reliance on driver charges and general tax revenue to fund mass transit, and shift to greater user fees.
- ❑ Allow school districts to use fund reserves to invest in pension funds and receive a credit for their future pension costs.
- ❑ Privatize and utilize competitively-bid management contracts for “yellow-pages” government, including state liquor stores, the Pennsylvania Lottery and the Pennsylvania Turnpike.
- ❑ Enact comprehensive welfare reform to slow the rate of spending growth while also reducing poverty.
- ❑ Enact long-term care reform to encourage private long-term care insurance and reduce reliance on government programs.
- ❑ Increase school choice programs to provide families with greater educational opportunities at a lower cost per student.
- ❑ Limit future increases in government spending to inflation plus population growth.
- ❑ Lower the overall tax burden, rather than relying on economic development programs, to encourage economic growth.
- ❑ Enact a Right-to-Work law to make Pennsylvania more competitive with other states in attracting business investment.

Combined, these reforms detail a blueprint for a stable fiscal house that will provide opportunities for prosperity for all Pennsylvania families.

### **Pennsylvania’s Fiscal Crisis**

Pennsylvania faces a structural budget deficit. State expenditures—which already exceed annual revenue collections—continue to grow faster than tax revenue. The Independent Fiscal Office (IFO) has projected a budget deficit every year for the next five years, exceeding \$2 billion in 2018-2019.<sup>1</sup>

These budget projections assume economic conditions will improve. Should the economy continue to sputter and revenue growth remain slow, Pennsylvania will face an even deeper fiscal crisis than currently forecasted.

Budget shortfalls, amplified by decades of spending growth, have plagued Pennsylvania for years. For six consecutive budgets (fiscal years 2008-09 to 2013-14), state General Fund

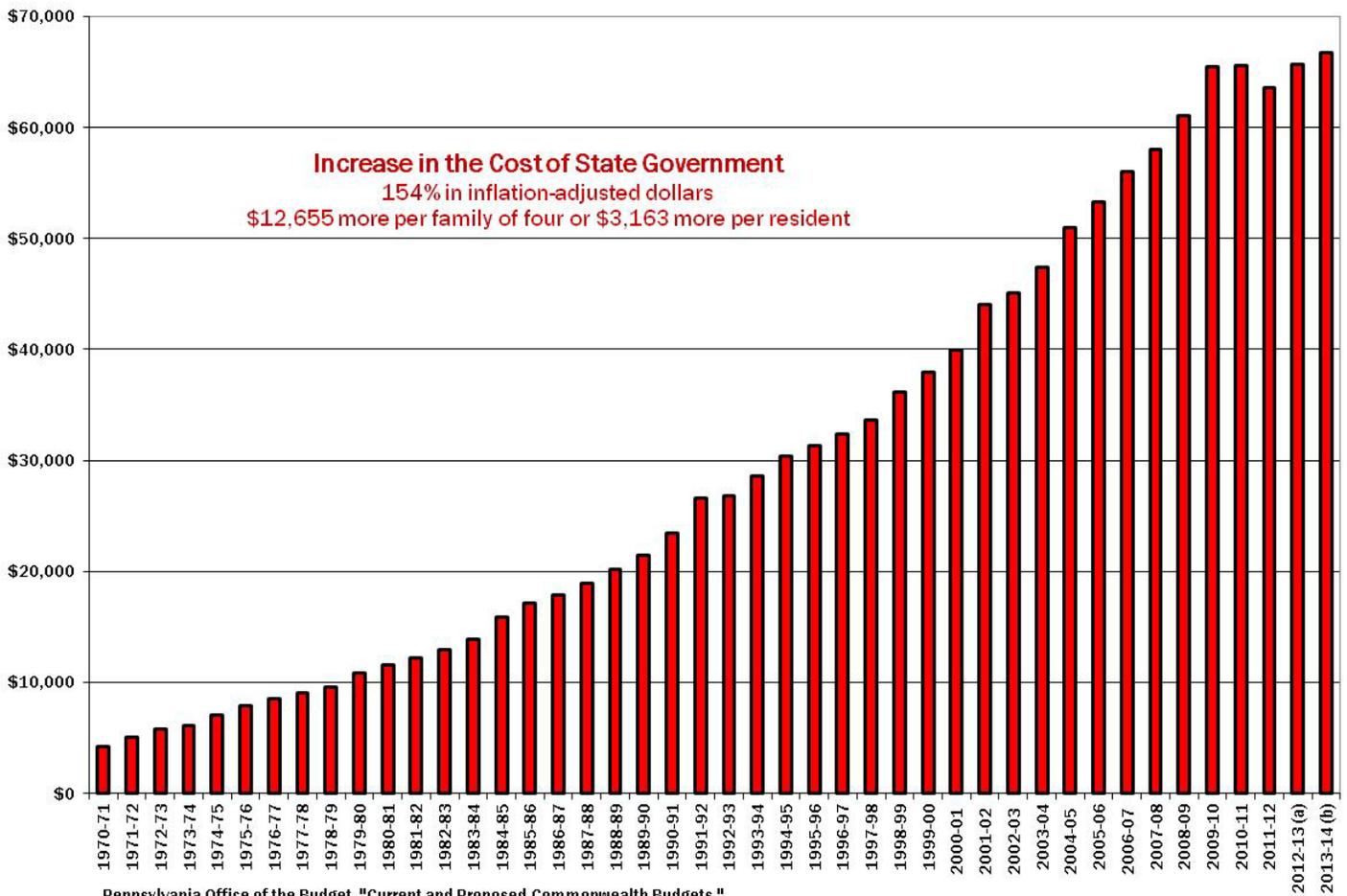
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<sup>1</sup>Pennsylvania Independent Fiscal Office, “Pennsylvania’s Economic and Budget Outlook,” November 14, 2013, <http://www.ifo.state.pa.us/download.cfm?file=/resources/PDF/Five-Year-Economic-and-Budget-Outlook-Nov-2013.pdf>.

spending exceeded revenue collections. Federal stimulus funds, taking \$3 billion from the “Rainy Day Fund,” and using revenue from other state funds allowed state government to spend beyond its means. This practice cannot be sustained.

From 1970 to 2014, state government spending increased from \$4 billion to almost \$67 billion, an inflation-adjusted increase of \$12,655 per family of four (or \$3,163 more per resident).<sup>2</sup> If state government’s total spending had grown at the rate of inflation plus population since 2000, taxpayers would be saving more than \$11 billion dollars this year, or \$3,673 per family of four (\$918 per resident).<sup>3</sup>

**Pennsylvania State Total Operating Budget, 1970-2014**  
in millions of dollars



Pennsylvania Office of the Budget, "Current and Proposed Commonwealth Budgets," [http://www.budget.state.pa.us/portal/server.pt/community/current\\_and\\_proposed\\_commonwealth\\_budgets/4566](http://www.budget.state.pa.us/portal/server.pt/community/current_and_proposed_commonwealth_budgets/4566), "Past Budgets," [http://www.budget.state.pa.us/portal/server.pt/community/past\\_budgets/4571](http://www.budget.state.pa.us/portal/server.pt/community/past_budgets/4571).

<sup>2</sup> Pennsylvania Office of the Budget, “2013-14 Governor’s Executive Budget,” [http://www.portal.state.pa.us/portal/server.pt/community/current\\_and\\_proposed\\_commonwealth\\_budgets/4566](http://www.portal.state.pa.us/portal/server.pt/community/current_and_proposed_commonwealth_budgets/4566); U.S. Census Bureau, Population Estimates, <http://www.census.gov/popest>.

<sup>3</sup> Commonwealth Foundation Analysis of Governor’s Executive Budget; U.S. Census Bureau, Population Estimates, <http://www.census.gov/popest>; U.S. Bureau of Labor Statistics, Consumer Price Index, <http://www.bls.gov/cpi>.

### ***Pennsylvania's Budget***

Pennsylvania's total operating budget consists of the General Fund, special and other state funds, as well as federal funds. The \$28 billion General Fund, which most press accounts and legislative budget negotiations center on, represents less than half of the \$67 billion operating budget.

Special and other state funds include state taxes and fees dedicated to specific purposes, such as the Motor License Fund for roads and bridges; the Lottery Fund for seniors' programs; mass transit funds, and funds for workers' compensation and unemployment benefits. Federal funds to the state in the form of block grants or formulas that match state funds supplement taxes collected at the state level.

The IFO predicts significant growth in both the Department of Treasury (21%) and Corrections (16%) budgets by 2018-2019.<sup>4</sup> Despite the corrections reforms enacted in 2012 and a projected decline in prison population, employee compensation costs will continue to drive up the Department of Corrections' budget.<sup>5</sup> Required debt payments out of the Treasury will also increase as a result of an escalation in state borrowing.

Welfare spending places an even greater burden upon the state budget. In 2013-2014, state government will spend close to \$11 billion from the General Fund on welfare alone. By 2018-2019, that number will reach nearly \$14 billion.<sup>6</sup> A change in the federal matching formula places additional pressures on the state—requiring an increase in the state share or cuts in spending of \$300 million.<sup>7</sup>

### ***Pension Funding***

The most pressing fiscal challenge facing lawmakers is the state's public pension crisis. Pension costs will skyrocket over the next few years, increasing nearly 143% by 2018-2019, from \$1.4 billion to almost \$3.4 billion.<sup>8</sup> School districts will face similar increases in their pension contributions. Pennsylvania taxpayers fund statewide pension plans for government employees—the State Employees' Retirement System (SERS) for state employees and the Public School Employees' Retirement System (PSERS) for school employees.

Combined, these two systems owe \$47 billion in unfunded liabilities.<sup>9</sup> Persistent state pension underfunding, benefit increases, and investment losses have created these long-term liabilities, which will require significantly higher taxpayer contributions for decades.<sup>10</sup>

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<sup>4</sup> Pennsylvania Independent Fiscal Office, "Pennsylvania's Economic and Budget Outlook," November 14, 2013, <http://www.ifo.state.pa.us/download.cfm?file=/resources/PDF/Five-Year-Economic-and-Budget-Outlook-Nov-2013.pdf>.

<sup>5</sup> *Ibid.*

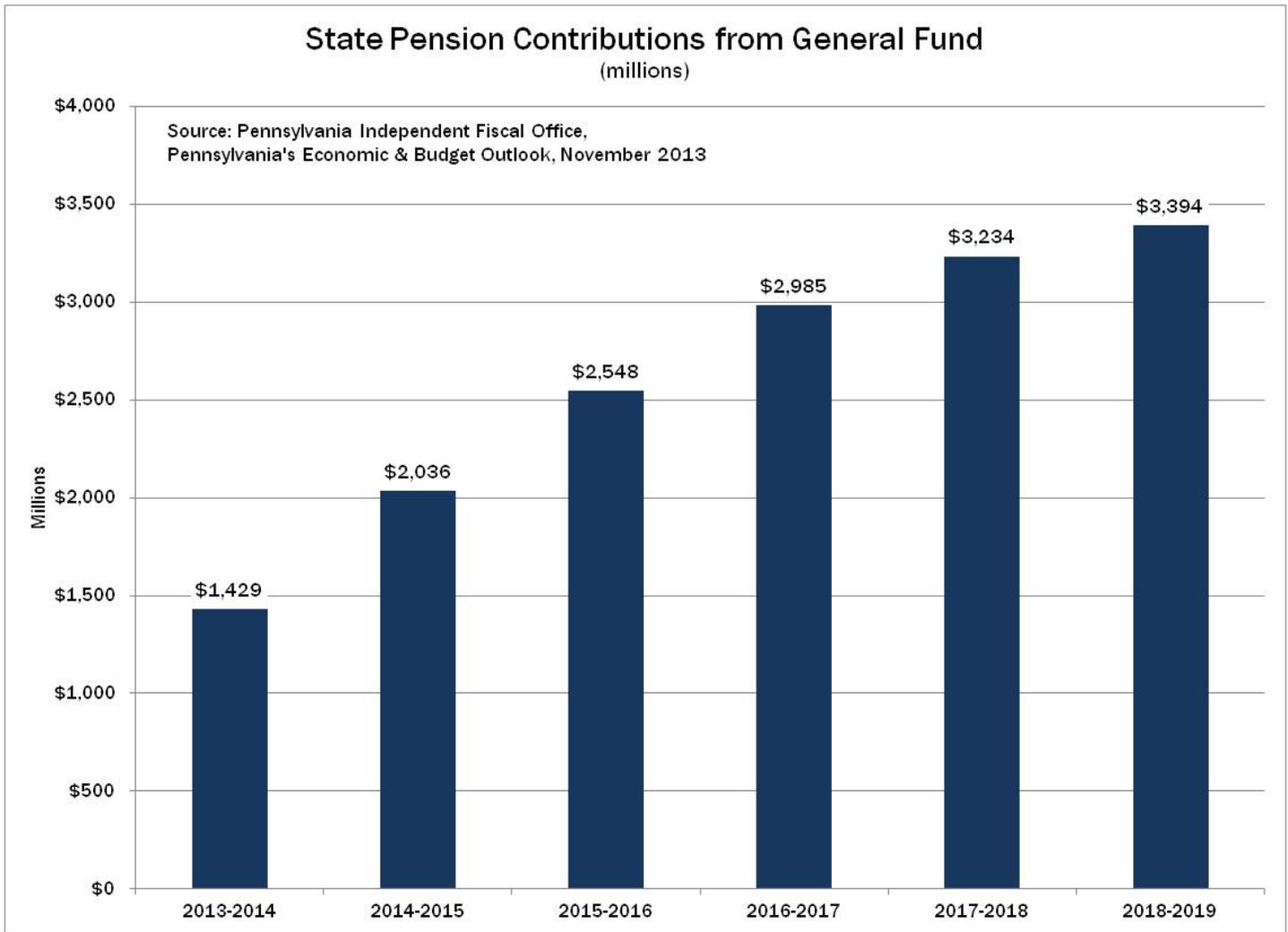
<sup>6</sup> *Ibid.*

<sup>7</sup> Pennsylvania Office of the Budget, "2013-14 Mid-Year Budget Briefing,"

[http://www.portal.state.pa.us/portal/server.pt/community/current\\_and\\_proposed\\_commonwealth\\_budgets/4566](http://www.portal.state.pa.us/portal/server.pt/community/current_and_proposed_commonwealth_budgets/4566).

<sup>8</sup> Pennsylvania Independent Fiscal Office, "Pennsylvania's Economic and Budget Outlook," November 14, 2013, <http://www.ifo.state.pa.us/download.cfm?file=/resources/PDF/Five-Year-Economic-and-Budget-Outlook-Nov-2013.pdf>.

<sup>9</sup> State Employees' Retirement System, "2013 Supplemental Budget Information," Feb. 11, 2013, [http://www.portal.state.pa.us/portal/server.pt/document/1324311/budgetbinder2013\\_pdf](http://www.portal.state.pa.us/portal/server.pt/document/1324311/budgetbinder2013_pdf); The Public School Employees'



Stock market and investment losses account for only about half of today’s pension crisis. The remaining unfunded liability is the result of the following political factors unique to Pennsylvania’s pension plans:

- Legislation in 2001 that retroactively increased pension benefits for all state and school employees, followed by a cost-of-living adjustment in 2002.
- Legislation in 2003 and 2010 deferring pension contributions, which reduced state and school district contributions for a few years by requiring higher future taxpayer payments.
- Changes in assumptions of future returns from 8% to 7.5% by SERS and PSERS fund managers, which added over \$6 billion in the unfunded liability overnight to the

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Retirement System of Pennsylvania, “Comprehensive Annual Financial Report,” Dec. 16, 2013, <http://www.psers.state.pa.us/content/publications/financial/cafr/cafr13/2013CAFR.pdf>.

<sup>10</sup> Moody’s Investors Service, “Moody’s Assigns Aa2 to \$750M Commonwealth of Pennsylvania’s General Obligation Bonds,” Oct. 17, 2013, [https://www.moody.com/research/Moodys-assigns-Aa2-to-750M-Commonwealth-of-Pennsylvanias-General-Obligation--PR\\_284781](https://www.moody.com/research/Moodys-assigns-Aa2-to-750M-Commonwealth-of-Pennsylvanias-General-Obligation--PR_284781).

state’s pension shortfall. Lower returns—as occurred during the recent recessions—will result in even higher taxpayer contributions.<sup>11</sup>

***State and Local Debt***

Years of overspending have also resulted in dramatic increases in state and local debt. State borrowing is done through a “capital budget,” separate from the state operating budget. Several state agencies can also issue bonds—either connected to revenue streams (like Turnpike Commission bonds tied to tolls) or the payments from the state (like the Commonwealth Financing Authority).

The table below illustrates Pennsylvania’s debt problem.

<b>Pennsylvania State &amp; Local Government Debt</b>		
<b>Debtor</b>	<b>Debt Outstanding</b>	<b>Per Person</b>
<b>Total State</b>	<b>\$46,692,703,000</b>	<b>\$3,658</b>
<b>State</b>	<b>\$10,460,903,000</b>	<b>\$819</b>
<b>State Agencies &amp; Authorities</b>	<b>\$36,231,800,000</b>	<b>\$2,838</b>
<b>Total Local</b>	<b>\$78,216,434,000</b>	<b>\$6,128</b>
<b>School Districts</b>	<b>\$27,278,259,814</b>	<b>\$2,137</b>
<b>County/Municipal/Twp/Other</b>	<b>\$50,938,174,186</b>	<b>\$3,990</b>
<b>Total</b>	<b>\$124,909,137,000</b>	<b>\$9,786</b>
Sources: Governor’s Executive Budget ( <a href="http://www.budget.state.pa.us">http://www.budget.state.pa.us</a> ) December 2012 data; PA Dept of Education ( <a href="http://www.pde.state.pa.us">http://www.pde.state.pa.us</a> ) June 2012 data; U.S. Census Bureau ( <a href="http://www.census.gov/govs/www/estimate.html">http://www.census.gov/govs/www/estimate.html</a> ) 2011 data		

These totals represent debt in the form of government bonds, but exclude unfunded pension and health care liabilities for government workers, borrowing for unemployment compensation, and short-term tax anticipation notes, which add tens of billions more in obligations for Pennsylvania taxpayers.

As it stands now, every Pennsylvanian owes almost \$10,000 in state and local government debt. This is in addition to the hundreds of thousands of dollars in debt Pennsylvanians already owe to the federal government. Put simply, government at every level is spending beyond its means.

All three major bond rating agencies (Standard and Poor’s, Moody’s and Fitch) have warned that Pennsylvania needs to address its unfunded liabilities and lack of financial

<sup>11</sup> Public Employee Retirement Commission, “School and State Pension Legislation Enacted since 2001,” [http://www.perc.state.pa.us/portal/server.pt/community/perc\\_home/2513/pension\\_bills\\_enacted\\_since\\_2001/525841](http://www.perc.state.pa.us/portal/server.pt/community/perc_home/2513/pension_bills_enacted_since_2001/525841); The Public School Employees’ Retirement System of Pennsylvania. “Actuarial Valuation,” June 30, 2011. <http://www.psers.state.pa.us/content/publications/actuarialvaluations/PSERS%202011%20Val%20Actuary%27s%20Report%20%28Final%29.pdf>; Eric Boehm, “PA Public Pension Fund Lowers Expectations,” *Pennsylvania Independent*, May 3, 2012, <http://paindependent.com/2012/05/pa-public-pension-fund-lowers-expectations/>; “Pa Public Pensions’ Future May Mean Even Higher Taxpayer Costs,” *Pennsylvania Independent*, March 30, 2012, <http://paindependent.com/2012/03/pa-public-pensions-future-may-mean-even-higher-taxpayer-costs/>.

reserves. Both Moody's<sup>12</sup> and Fitch<sup>13</sup> have downgraded Pennsylvania's bond rating, while Standard and Poor's<sup>14</sup> rated Pennsylvania's fiscal outlook as negative, down from stable, citing pension debt and limited reserves. If Pennsylvania doesn't address chronic overspending, its bond rating could be downgraded again, which would increase the cost of borrowing and possibly widen the budget gap in future years.

### **Immediate Budget Fixes**

As discussed earlier, state spending has grown dramatically in recent years. Much of the growth, though, has occurred in areas that are not core functions of government. Corporate welfare programs, such as redevelopment projects, subsidize certain businesses and industries at the expense of others. Evidence shows that these programs are ineffective at generating overall economic growth. In order to support sustainable prosperity and economic growth, lawmakers should eliminate these programs and reallocate funds to crucial expenditures.

#### ***Reduce Corporate Welfare***

Through targeted tax breaks and subsidies, corporate welfare programs use taxpayer money to encourage select businesses or industries. Unfortunately, these incentives and subsidies often crowd out private investment and prevent broad-based tax reduction that would stimulate job growth for all Pennsylvanians.

Over the last eight years, the commonwealth out-spent every state in the country on "economic development," according to the Council for Community and Economic Research. However, such spending has been ineffective.<sup>15</sup> The 2010 Legislative Budget and Finance Committee report found little hard evidence that corporate welfare tax credit programs create promised jobs. Failure to submit documentation and meet program requirements, minimal Department of Community and Economic Development oversight, and sparse job creation led the report to conclude: "In general, scholars suggest the tax incentives have had mixed results, and tend to benefit persons and businesses in high tax brackets most and are difficult to administer."<sup>16</sup>

#### ***Scale Back the Commonwealth Financing Authority***

The Commonwealth Financing Authority (CFA), a panel directed by legislative appointees to approve or reject projects supported with state borrowing, is another tool to encourage economic development. Since its formation, CFA has issued ten revenue bonds

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<sup>12</sup> Moody's Investor Service, "Moody's downgrades to Aa2 from Aa1 Pennsylvania's general obligation rating; outlook revised to stable from negative," July 16, 2012, [https://www.moody.com/research/Moody-downgrades-to-Aa2-from-Aa1-Pennsylvanias-general-obligation-rating--PR\\_250920](https://www.moody.com/research/Moody-downgrades-to-Aa2-from-Aa1-Pennsylvanias-general-obligation-rating--PR_250920).

<sup>13</sup> Fitch Ratings, "Fitch Downgrades Pennsylvania's GO Bonds to 'AA' from 'AA+'; Outlook Remains Negative," July 16, 2013, [http://www.fitchratings.com/creditedesk/press\\_releases/detail.cfm?pr\\_id=796660&origin=home](http://www.fitchratings.com/creditedesk/press_releases/detail.cfm?pr_id=796660&origin=home).

<sup>14</sup> Standard and Poor's Rating Services, "Pennsylvania Outlook To Negative From Stable On Continued Pension Pressure, Slow Economic Growth, Limited Reserves," July 12, 2012, [http://www.bondsonline.com/print/Todays\\_Market/Credit\\_Rating\\_News\\_.php?DA=view&RID=26218](http://www.bondsonline.com/print/Todays_Market/Credit_Rating_News_.php?DA=view&RID=26218).

<sup>15</sup> Council for Community and Economic Research, "State Economic Development Expenditure Database," <http://www.stateexpenditures.org/expenditures.asp?action=summary&StateSelect=PA>.

<sup>16</sup> Legislative Budget and Finance Committee, "Pennsylvania's Tax Credit Programs," June 2010, <http://lbfc.legis.state.pa.us/reports/2010/49.PDF>.

totaling \$1.87 billion, including the most recent issuance in January 2013 of \$330 million. In fiscal year 2013, CFA's outstanding debt increased by \$235 million.<sup>17</sup>

Moody's warns that "CFA's financing activities include significant assistance to private entities and could become controversial if not successful or not well managed."<sup>18</sup> CFA bonds constitute capital spending and are not counted against the state debt limit. CFA's service agreement with the commonwealth fails to assure that sufficient funds will be appropriated annually from the state. Pennsylvania's unstable budget and increasing deficit means that CFA's continued bond issuance poses a great risk to taxpayers.

***Phase out the Redevelopment Assistance Capital Program***

Since 1986, the Redevelopment Assistance Capital Program (RACP) has spent more than \$5 billion on development projects, with \$340 million in RACP borrowing approved in the 2013-14 state budget.<sup>19</sup>

RACP effectively uses borrowed money—paid back with interest by taxpayers—for local "economic development" projects. Some of the more controversial projects include: the Arlen Specter Library, the corporate headquarters of Tastykake, numerous sports stadiums, and a \$3 million grant to the Second Mile, the charity founded by convicted child molester Jerry Sandusky.<sup>20</sup>

Former Auditor General Jack Wagner expressed concern over RACP spending. He found that the commonwealth could not verify whether \$1 billion in grants to local redevelopment and industrial development authorities generated jobs.<sup>21</sup>

State lawmakers recently passed Act 77 to reduce the RACP debt ceiling, limiting the possible total borrowing under RACP from \$4.05 billion to \$3.45 billion and providing greater accountability, oversight and transparency in awarding RACP grants.<sup>22</sup> While this slows debt accumulation, the state is best served by phasing out this program and redirecting taxpayer dollars to better use.

<sup>17</sup> Zelenkofske Exelrod LLC, "Commonwealth Financing Authority Financial Statements," Oct. 2, 2013. Provided to Commonwealth Foundation on request from the Pennsylvania Department of Community and Economic Development.

<sup>18</sup> Moody's Investors Service, "Moody's Assigns A1 Ratings to \$330 million of Pennsylvania CFA Revenue Bonds," Jan. 4, 2013, [https://www.moody's.com/research/Moodys-assigns-A1-ratings-to-330-million-of-Pennsylvania-CFA-PR\\_263122](https://www.moody's.com/research/Moodys-assigns-A1-ratings-to-330-million-of-Pennsylvania-CFA-PR_263122).

<sup>19</sup> Pennsylvania Office of the Budget, "Redevelopment Assistance Capital Program Grant Releases 1986-Current," March 11, 2013, <http://www.portal.state.pa.us/portal/server.pt?open=512&objID=4602&&PageID=461667&&mode=2>; Pennsylvania Office of the Budget, "Redevelopment Assistance Capital Program Grants Awarded by Governor Corbett, Funding Round 2013," Dec. 23, 2013, [http://www.budget.state.pa.us/portal/server.pt/community/redevelopment\\_assistance\\_capital\\_program/4602](http://www.budget.state.pa.us/portal/server.pt/community/redevelopment_assistance_capital_program/4602).

<sup>20</sup> Pennsylvania Office of the Budget, "Redevelopment Assistance Capital Program: Grant Releases 1986-Current," Mar. 11, 2013, <http://www.portal.state.pa.us/portal/server.pt?open=512&objID=4602&&PageID=461665&&mode=2>.

<sup>21</sup> Department of the Auditor General, "Auditor General Jack Wagner Says No Way to Verify Whether \$1B in Economic Development Funds Were Well-Spent," June 27, 2012, <http://www.auditorgen.state.pa.us/Department/Press/WagnerSaysNoWaytoVerifyFundsWereWell.html>.

<sup>22</sup> Pennsylvania General Assembly, "House Bill 493," <http://www.legis.state.pa.us/cfdocs/billinfo/billinfo.cfm?year=2013&sind=0&body=H&type=B&BN=0493>; House Committee on Appropriations, "Fiscal Note, House Bill 493," <http://www.legis.state.pa.us/WU01/LI/BI/FN/2013/0/HB0493P2493.pdf>; Pennsylvania Office of the Budget, "2013-14 Governor's Executive Budget," Feb. 5, 2013, [http://www.portal.state.pa.us/portal/server.pt/community/current\\_and\\_proposed\\_commonwealth\\_budgets/4566](http://www.portal.state.pa.us/portal/server.pt/community/current_and_proposed_commonwealth_budgets/4566).

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<b>Corporate Welfare Grant &amp; Loan Programs</b>	<b>2013-14 Budget (Thousands)</b>
<b>General and Special Funds</b>	
Agricultural Research	\$787
Agricultural Promotion, Education and Exports	\$196
Ben Franklin Tech Development Authority Transfer	\$14,500
Commonwealth Financing Authority Transfer	\$78,019
Council on the Arts	\$886
Discovered in PA Developed in PA	\$9,900
Food and Marketing Research	\$494
Grants to the Arts	\$8,179
Hardwoods Research and Promotion	\$350
Industry Partnerships	\$1,813
Infrastructure and Facilities Improvement Grants	\$19,409
Keystone Communities	\$11,300
Keystone Works	\$1,000
Livestock Show	\$177
Marketing to Attract Business	\$3,442
Marketing to Attract Tourists	\$7,435
Municipalities Financial Recovery Revolving Fund Transfer	\$7,096
New Choices/New Options	\$500
Open Dairy Show	\$177
Partnerships for Regional Economic Performance	\$11,880
Pennsylvania First	\$37,800
Pennsylvania Race Horse Development Fund	\$301,225
Tourism-Accredited Zoos	\$550
World Trade PA	\$7,296
Youth Shows	\$140
<b>Total General and Special Funds</b>	<b>\$524,551</b>
<b>Independent Agencies</b>	
Commonwealth Financing Authority	\$330,000
Redevelopment Assistance Capital Program	\$340,000
Pennsylvania Economic Development Financing Authority	\$225,000
<b>Total Independent Agencies</b>	<b>\$895,000</b>
<b>Targeted Tax Credits</b>	
Film Tax Credit	\$60,000
Job Creation Tax Credit	\$10,100
Research and Development Tax Credit	\$55,000
Keystone Opportunity Zone	\$21,800
Keystone Innovation Zone	\$25,000
Alternative Energy Production Tax Credit	\$10,000
<b>Total Targeted Tax Credits</b>	<b>\$181,900</b>
<b>Total Amount</b>	<b>\$1,601,451</b>

### ***Legislative Reserve Fund***

Over the last few years, the state legislature has built up a significant reserve fund. To alleviate short-term fiscal pressures, and eliminate the need to increase taxes on families, some of this money should be returned to the General Fund.

This reserve fund is intended to allow the legislature to keep running and make payroll during an extended budget impasse. The legislature ended the FY 2011-12 with \$140.7 million in reserve, far above what would be needed in such a scenario.<sup>23</sup>

The General Assembly currently lacks a formally adopted policy to determine the appropriate amount of the legislature's financial reserve. An audit of legislative spending highlighted clerical errors such as summarized credit card receipts, lack of purchase specificity leading to unnecessary spending on items such as parking tickets and expensive dinners, and unidentified employees collecting salaries above the maximum pay guidelines.<sup>24</sup>

The legislature should reallocate some of this reserve funding to help balance the budget and combat the fiscal crisis.

### ***Mass Transit Funding***

The commonwealth budgeted nearly \$1.5 billion for mass transit in FY 2013-14, a 163% increase since 2007-08. In contrast, funding for roads, bridges, and other programs increased only 5%. Act 89 of 2013 will further boost mass transit funding by \$355 million next year and nearly \$500 million in 2017-18.<sup>25</sup>

Transportation, to the extent possible, should be funded by user fees. Gasoline taxes and vehicle fees represent an effort to do this for road funding. But mass transit funding comes from driver fees and fines, Turnpike toll money, and sales tax revenue. Transit systems should instead be funded through user fees, freeing driver charges to fund the roads they use and moving sales tax revenues back to the General Fund. Moreover, if users of mass transit shouldered more of the costs of their transportation choices, transit agencies would improve to attract customers with quality service, rather than requiring higher taxpayer subsidies.

Competitive contracting of mass transit operations should be used to reduce costs and improve service.<sup>26</sup> With competitive contracting, private contractors risk their funds in the operation of mass transit while government retains ownership and oversight, ultimately

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<sup>23</sup>Mitchell and Titus, "General Assembly of Pennsylvania," Nov. 28, 2012, <http://www.repdenlinger.com/Audit.aspx>.

<sup>24</sup>Murphy, Jan, "Legislature sat on \$141 million financial cushion at the end of the last fiscal year," *The Patriot News*, April 24, 2013, [http://www.pennlive.com/midstate/index.ssf/2013/04/legislature\\_sat\\_on\\_141\\_million.html](http://www.pennlive.com/midstate/index.ssf/2013/04/legislature_sat_on_141_million.html).

<sup>25</sup>The House Appropriations Committee, "Memo: Transportation Funding Proposal Fiscal Analysis," Nov. 17, 2013, [http://www.pahouse.com/HACD/series/2768/TRANS\\_HB106\\_HannaA04495\\_MicozzieA04465\\_111713.pdf](http://www.pahouse.com/HACD/series/2768/TRANS_HB106_HannaA04495_MicozzieA04465_111713.pdf); Pennsylvania General Assembly, "House Bill 1060," Nov. 2013, <http://www.legis.state.pa.us/cfdocs/billinfo/billinfo.cfm?syear=2013&sind=0&body=H&type=B&bn=1060>.

<sup>26</sup>Guilbon, Grant, "Mass Transit Reform: Lessons for Pennsylvania," Commonwealth Foundation, June 2007, [http://www.commonwealthfoundation.org/docLib/20090904\\_MassTransitPB.pdf](http://www.commonwealthfoundation.org/docLib/20090904_MassTransitPB.pdf).

saving taxpayers money. As of January 2013, 33 states including Pennsylvania have enacted laws authorizing competitive contracting or public-private partnerships.<sup>27</sup>

Fare assistance tax credit and vouchers can be offered for low-income transit users rather than subsidizing riders who can afford to pay the true cost of their trip.<sup>28</sup> This mass transit reform provides another opportunity to protect taxpayers from bearing the costs of services they may not use and promotes more effective resource management.

### ***Pre-payment of School Pension Contributions***

As of June 30, 2012, Pennsylvania's 500 school districts, along with charter schools and other public school entities, had more than \$3.8 billion in total reserve fund balances, an increase of \$300 million from the prior year.<sup>29</sup> Many school districts have rationally built up these reserve funds to deal with the coming increases in pension contributions.

However, it would be better for taxpayers if public schools were able to invest these funds in the pension system now, get investment returns, and pay off part of that \$47 billion unfunded liability. Unfortunately, there is no incentive for schools to do so now—there is no mechanism to reduce their future district pension contributions, and they might not receive the full state match.

Legislators should look to develop a formula for schools to “prepay” their pension contributions and get a credit for future costs. This could be done by creating separate accounts within PSERS that are invested, but still owned by public schools in order to pay their pension costs in future years. Doing this could reduce the unfunded liability by several billion dollars and alleviate some of the pressure for higher local taxes.

### **Long-Term Fiscal Reforms**

Spending cuts in the short-term can help Pennsylvania avoid harmful tax increases, but the commonwealth will continue to face budget deficits and growing long-term debt unless lawmakers enact structural reforms.

### ***Privatization***

Unprecedented fiscal challenges call for innovative policy solutions. Governments around the world have used various forms of privatization to better the lives of their citizens by offering them higher quality services at lower costs, allowing governments to do more with less. Privatization ranges from outright sale of a government asset, to outsourcing

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<sup>27</sup> National Conference of State Legislatures, “Public-Private Partnerships for Transportation: a Toolkit for Legislators,” Oct. 2010, <http://www.ncsl.org/documents/transportation/PPPTOOLKIT.pdf>; National Conference of State Legislatures, “Public-Private Partnerships for Transportation: A Toolkit for Legislators, January 2013 Updates and Corrections,” January 2013, <http://www.ncsl.org/documents/transportation/PPPTOOLKIT-update-Jan2013.pdf>; Reason Foundation, “Annual Privatization Report, 2013,” April 2013, <http://reason.org/news/show/annual-privatization-report-2013>.

<sup>28</sup> National Employment Law Project, “You Get What You Pay for: User Fees and the Financing of U.S. Transportation Infrastructure,” Nov. 2013, [http://www.nelp.org/page/-/Job\\_Creation/Report-Financing-Transportation-Infrastructure-User-Fees.pdf?nocdn=1](http://www.nelp.org/page/-/Job_Creation/Report-Financing-Transportation-Infrastructure-User-Fees.pdf?nocdn=1).

<sup>29</sup> Pennsylvania Department of Education, Summaries of Annual Financial Report Data, General Fund Balance: 1996-97 to 2011-12, [http://www.portal.state.pa.us/portal/server.pt/community/summaries\\_of\\_annual\\_financial\\_report\\_data/7673/other\\_financial\\_information/509049](http://www.portal.state.pa.us/portal/server.pt/community/summaries_of_annual_financial_report_data/7673/other_financial_information/509049)

management, to competitive contracting of specific services. Whatever form of privatization a government pursues, transparency and accountability through a performance-based contract is essential to improve services at a lower cost.

### ***Competitively Bid Lottery Management***

The Pennsylvania Lottery funds programs for senior citizens, a population that is projected to grow steadily over the next 20 years. A Legislative Budget and Finance Committee report projected that Lottery profit shortfalls will threaten the sustainability of senior services.<sup>30</sup> The Corbett administration sought a private management agreement to ensure Lottery profits will grow along with the demand for these programs. Lottery services company Camelot submitted a bid that guaranteed at least \$34 billion in profits over the next 20 years, billions more than projected profits from the state-operated system.<sup>31</sup> After numerous extensions, the agreement expired on January 1, 2014, but the opportunity remains to reengage in an open, competitive bidding process for management of the Lottery.<sup>32</sup> Illinois, Indiana and New Jersey have competitively bid out operations of their lotteries.

### ***Privatize the State Liquor Stores***

Pennsylvania and Utah are the only two states with complete government control over the wholesale and retail sale of wine and spirits. Forty-eight other states rely on the private sector, in some capacity, to sell liquor to residents. Privatizing the state liquor stores, while retaining Liquor Control Board enforcement of laws and regulation of alcohol, could generate an estimated \$800 million in one-time revenues<sup>33</sup> and an additional \$2.1 million in tax revenue to the state each year.<sup>34</sup> The privatization of the state liquor stores could increase state revenue, lower prices,<sup>35</sup> and provide consumers with greater choices and convenience without sacrificing public safety.<sup>36</sup>

### ***Revisit Leasing the Pennsylvania Turnpike***

The Pennsylvania Turnpike Commission (PTC) has historically been a haven for political patronage and inefficiency. The PTC continues to grow deeper in debt, owing more than \$8

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<sup>30</sup> Pennsylvania Legislative Budget and Finance Committee, "Pennsylvania Lottery Funding of Programs and Services for Older Pennsylvanians," February 2012, <http://lbfc.legis.state.pa.us/>.

<sup>31</sup> Pennsylvania Management Lottery Agreement bid form, <http://www.emarketplace.state.pa.us/FileDownload.aspx?file=11162012\TabFile.pdf>.

<sup>32</sup> Pennsylvania Department of Revenue, "Governor Corbett Announces Pennsylvania Will Not Extend Lottery Private Management Agreement Bid," December 20, 2013, <http://www.pa.gov/Pages/NewsDetails.aspx?agency=Revenue&item=15133>.

<sup>33</sup> Pennsylvania Office of the Budget, "Liquor Modernization Analysis," January 24, 2013,

[http://www.portal.state.pa.us/portal/server.pt/gateway/PTARGS\\_0\\_2\\_152321\\_21112\\_1407886\\_43/http%3B/pubcontent.state.pa.us/publishedcontent/publish/marketing/sites/governor\\_pa\\_gov/images/lcb/lcb\\_pfm\\_report.pdf](http://www.portal.state.pa.us/portal/server.pt/gateway/PTARGS_0_2_152321_21112_1407886_43/http%3B/pubcontent.state.pa.us/publishedcontent/publish/marketing/sites/governor_pa_gov/images/lcb/lcb_pfm_report.pdf).

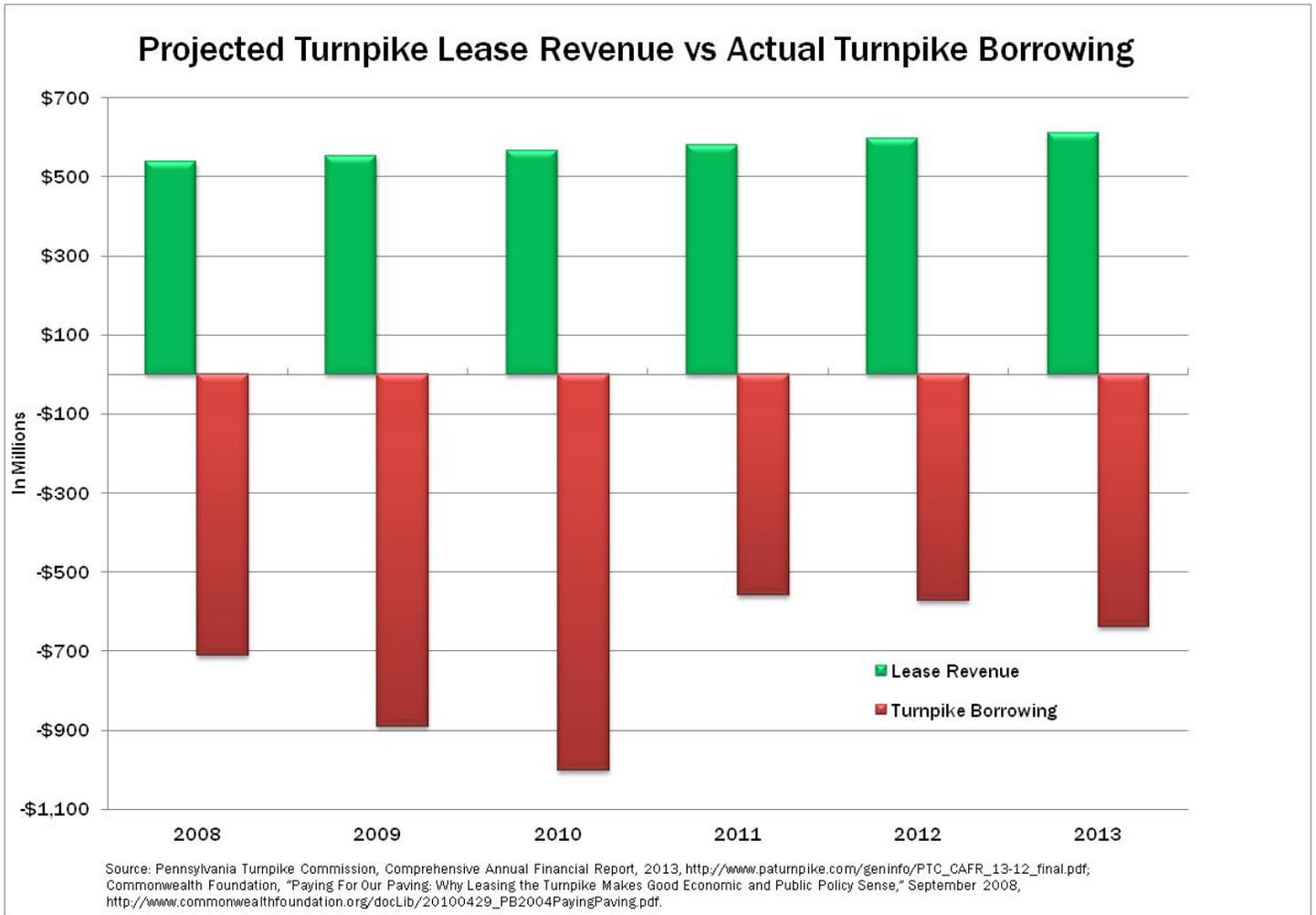
<sup>34</sup> *Ibid.*

<sup>35</sup> Siegel, Michael et. al., "Differences in liquor prices between control state-operated and license-state retail outlets in the United States," *Addiction*, 108:2 pg. 339–347, February 2013, <http://onlinelibrary.wiley.com/doi/10.1111/j.1360-0443.2012.04069.x/abstract>.

<sup>36</sup> Pulito, John & Davies, Antony "Government-Run Liquor Stores: The Social Impact of Privatization," October 2009, [https://www.commonwealthfoundation.org/docLib/20091029\\_StateStores\(Pulito\).pdf](https://www.commonwealthfoundation.org/docLib/20091029_StateStores(Pulito).pdf).

billion at the end of 2012. It's one of the most expensive long-distance toll roads in the nation.<sup>37</sup>

Pennsylvania missed a great opportunity by failing to act on a 2008 proposal to lease the Turnpike and dedicate the proceeds to roads, bridges, and highways. Leasing the Turnpike would have generated an estimated \$60 billion over 50 years.<sup>38</sup> Instead, Act 44 of 2007 allowed the Turnpike Commission to borrow each year against future tolls to make payments to the state. Since 2007, cash tolls have increased 84%.



<sup>37</sup> Schmitz, John, "Pennsylvania Turnpike tolls will increase again on Jan. 6," *Pittsburgh Post-Gazette*, December 2012, <http://www.post-gazette.com/news/transportation/2012/12/28/Pennsylvania-Turnpike-tolls-will-increase-again-on-Jan-6/stories/201212280146>.

<sup>38</sup> Commonwealth Foundation, "Paying For Our Paving: Why Leasing the Turnpike Makes Good Economic and Public Policy Sense," September 2008, [http://www.commonwealthfoundation.org/docLib/20100429\\_PB2004PayingPaving.pdf](http://www.commonwealthfoundation.org/docLib/20100429_PB2004PayingPaving.pdf).

Meanwhile, the PTC has borrowed more than \$9 billion; Auditor General DePasquale noted this borrowing is unsustainable.<sup>39</sup> Indeed, Act 89 of 2013 represents an admission of this, cutting Turnpike payments under Act 44 by 90% in eight years.<sup>40</sup>

While passing on the initial lease deal was a missed opportunity, a new, less generous lease could be explored to pay off the Turnpike's extensive debt without adding additional burdens to motorists.

Up-front cash from a Turnpike lease could generate hundreds of millions in interest each year and shift financial risk from taxpayers to a private-sector partner where standards of operation and maintenance must be met irrespective of marketplace fluctuations. In addition, the agreement could legally cap tolls.

### ***Privatize Yellow Pages Government***

The “yellow pages test” says that if a service can be found in the yellow pages of a phone book, it should be provided by a private operator rather than government. There are numerous opportunities to apply the yellow pages test in state government.

- **Managing State Parks:** Pennsylvania has 117 state parks run by the Department of Conservation and Natural Resources. Limited state revenues don't have to result in less accessible parks. By contracting with private-sector partners, state government can improve services to visitors, save taxpayer dollars and better manage our public lands. Approximately 150 concessions are already operated by private companies through leasing agreements.<sup>41</sup> Contracting out additional services, such as building and trail maintenance, could provide cost savings of 10 to 30%.<sup>42</sup>
- **Museums and Historic Sites:** Privatizing museums could relieve budget pressures while improving the quality of historical sites. The Pennsylvania Historical and Museum Commission (PHMC) currently owns and operates 24 museums or historical locations, many without entrance fees. In contrast, the best historical sites in Pennsylvania,<sup>43</sup> according to the History Channel, are privately owned and operated.
- **Higher Education:** Public university administrators should tap privatization to drive down costs and improve services. Commonly outsourced services include facility maintenance, landscaping and grounds maintenance, security operations, parking operations, financing of capital projects, and administrative support functions. The savings can be significant and ensure future financial stability. In September 2012,

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<sup>39</sup> Pennsylvania Office of the Auditor General, “DePasquale Says Turnpike Debt Unsustainable,” June 2013, <http://www.auditorgen.state.pa.us/Department/Press/DePasqualeSaysTurnpikeDebtUnsustainable.html>; Pennsylvania Turnpike Commission, Comprehensive Annual Financial Report, 2013, [http://www.paturnpike.com/geninfo/PTC\\_CAFR\\_13-12\\_final.pdf](http://www.paturnpike.com/geninfo/PTC_CAFR_13-12_final.pdf).

<sup>40</sup> Rodrigo, Tom, House Committee on Appropriations, “Fiscal Note,” Nov. 21, 2013, <http://www.legis.state.pa.us/cfdocs/billinfo/billinfo.cfm?year=2013&sind=0&body=H&type=B&bn=1060>.

<sup>41</sup> Department of Conservation and Natural Resources, “State Park Concessions,” [www.dcnr.state.pa.us/stateparks/business/conlist.aspx](http://www.dcnr.state.pa.us/stateparks/business/conlist.aspx).

<sup>42</sup> Segal, Geoffrey et al., “Streamlining San Diego: Achieving Taxpayer Savings and Government Reforms through Managed Competition,” Reason and San Diego Institute for Policy Research, September 2007, <http://reason.org/files/db38316bd23c0beef9d021a9fd7af1ea.pdf>.

<sup>43</sup> Anderson, Katrina, “Private Historical Sites are More Popular,” Commonwealth Foundation, [www.commonwealthfoundation.org](http://www.commonwealthfoundation.org).

The Ohio State University announced a groundbreaking 50-year, \$483 million lease of its parking assets to a private consortium with the bulk of the payment going to the university's endowment.<sup>44</sup>

- **Health Facilities:** State-operated psychiatric hospitals have been or are currently being privatized in Florida, Kentucky, South Carolina, Massachusetts, New Hampshire, and Texas, demonstrating privatization can reduce costs and improve quality.<sup>45</sup> Pennsylvania state and local policymakers should inventory the six hospitals, psychiatric facilities, nursing homes, and other government health and human service facilities to evaluate where there may be opportunities to transfer residents to existing private providers, consolidate, outsource services, or enter larger-scale operating partnerships.

### ***Reform the State Prevailing Wage Mandates***

Enacted in 1961, Pennsylvania's Prevailing Wage Act mandates contractors pay inflated wages on most state or local government-funded construction projects.<sup>46</sup> Mandating the highest "prevailing" wages on qualifying government construction projects has increased costs by 10 to 30%<sup>47</sup> more than what contractors would pay workers for identical projects funded with private dollars. Allowing construction companies to compete for contracts based on market wages would provide services at lower costs to taxpayers. The commonwealth and local governments spent approximately \$6.3 billion on construction projects subject to the Prevailing Wage Act in 2012, according to the Department of Labor and Industry.<sup>48</sup> If the mandate were ended, taxpayers could save upwards of a billion dollars.

### ***Enact Welfare Reform***

Public Welfare spending is the single largest area of the state budget, consuming 40 cents of every dollar state government spends. Moreover, welfare spending is increasing as a share of the total budget. The IFO projects Public Welfare to grow by 4.9% per year for the next five years, faster than state revenues at 3.1%.<sup>49</sup>

While spending grows at unsustainable rates, fraud, waste, and abuse are rampant. In FY 2011-2012, the Office of Inspector General saved and collected more than \$75.5 million from individuals who did not qualify for benefits. In one extreme case, a lottery winner

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<sup>44</sup> Gilroy, Len, "Annual Privatization Report 2013: State Government Privatization," Reason Foundation, April 22, 2013, <http://reason.org/news/show/apr-2013-higher-education#refE1>.

<sup>45</sup> Gilroy, Len et. al., "Privatizing Yellow Pages Government," Commonwealth Foundation and Reason Foundation, May 26, 2011, [http://www.commonwealthfoundation.org/issues/research\\_detail.asp?id=1825](http://www.commonwealthfoundation.org/issues/research_detail.asp?id=1825).

<sup>46</sup> Pennsylvania Department of Labor and Industry, Prevailing Wage Project, <http://www.portal.state.pa.us/portal/server.pt?open=514&objID=553543&mode=2>.

<sup>47</sup> Rodrigo, Tom, House Committee on Appropriations, "Fiscal Note," June 29, 2012, <http://www.legis.state.pa.us/WU01/LI/BI/FN/2013/0/HB0665P1495.pdf>.

<sup>48</sup> Labor and Industry Committee, "Public Hearing – Prevailing Wage Reform (HB 796 & HB 665)," Thursday August 29, 2013, [http://www.legis.state.pa.us/cfdocs/legis/tr/transcripts/2013\\_0153T.pdf](http://www.legis.state.pa.us/cfdocs/legis/tr/transcripts/2013_0153T.pdf).

<sup>49</sup> Pennsylvania Independent Fiscal Office, "Pennsylvania's Economic and Budget Outlook," November 14, 2013, <http://www.ifo.state.pa.us/download.cfm?file=/resources/PDF/Five-Year-Economic-and-Budget-Outlook-Nov-2013.pdf>.

continued to collect Medicaid and child support payments after winning over \$300,000 in the Pennsylvania Lottery.<sup>50</sup>

However, beneficiaries are not the only offenders.<sup>51</sup> Audits of service providers reveal tax dollars were used to lease luxury vehicles and purchase items such as a chandelier and a six-person hot tub.<sup>52</sup>

In Medicaid, the largest welfare program, former Auditor General Jack Wagner found error rates exceeding 15%.<sup>53</sup> Reducing the error rate in Medicaid by just one-tenth would have saved \$439 million in FY 2011-12 and \$1.9 billion through FY 2015-16.

Simply reducing the rate of growth in Medicaid spending would have a dramatic impact on Pennsylvania's budget picture. If Medicaid spending grew each year by 3%—instead of the 5.7% average annual increase of the past decade—taxpayers would save \$3.2 billion by 2017-18.

To reduce fraud, waste, and abuse, the state should enforce eligibility standards, strengthen whistleblower protections, and enact recovery audits. Enforcing eligibility standards includes conducting scheduled eligibility renewals to protect benefits for the truly needy. Enhanced whistleblower protections are one way to shift workers' focus to long-term poverty alleviation instead of growing enrollment. Finally, recovery audits allow private contractors to search for fraud without additional state investment since investigators keep a portion of what they recover.<sup>54</sup>

In addition, Pennsylvania should demand flexibility from the federal government to fundamentally restructure the welfare system's incentives, which encourage waste. People are often punished for earning more income as reductions in their benefits far surpass income gains from promotions or new employment. As a result, recipients are reluctant to risk a guaranteed income for the chance at a higher income in the future. To restore the dignity of work, the commonwealth should strengthen work requirements, reward long-term employment rather than job searches or work search activities, and enforce time limits. These same principles should be applied to the Medicaid program by pursuing a waiver to provide more plan choices and rewards for healthy behaviors.

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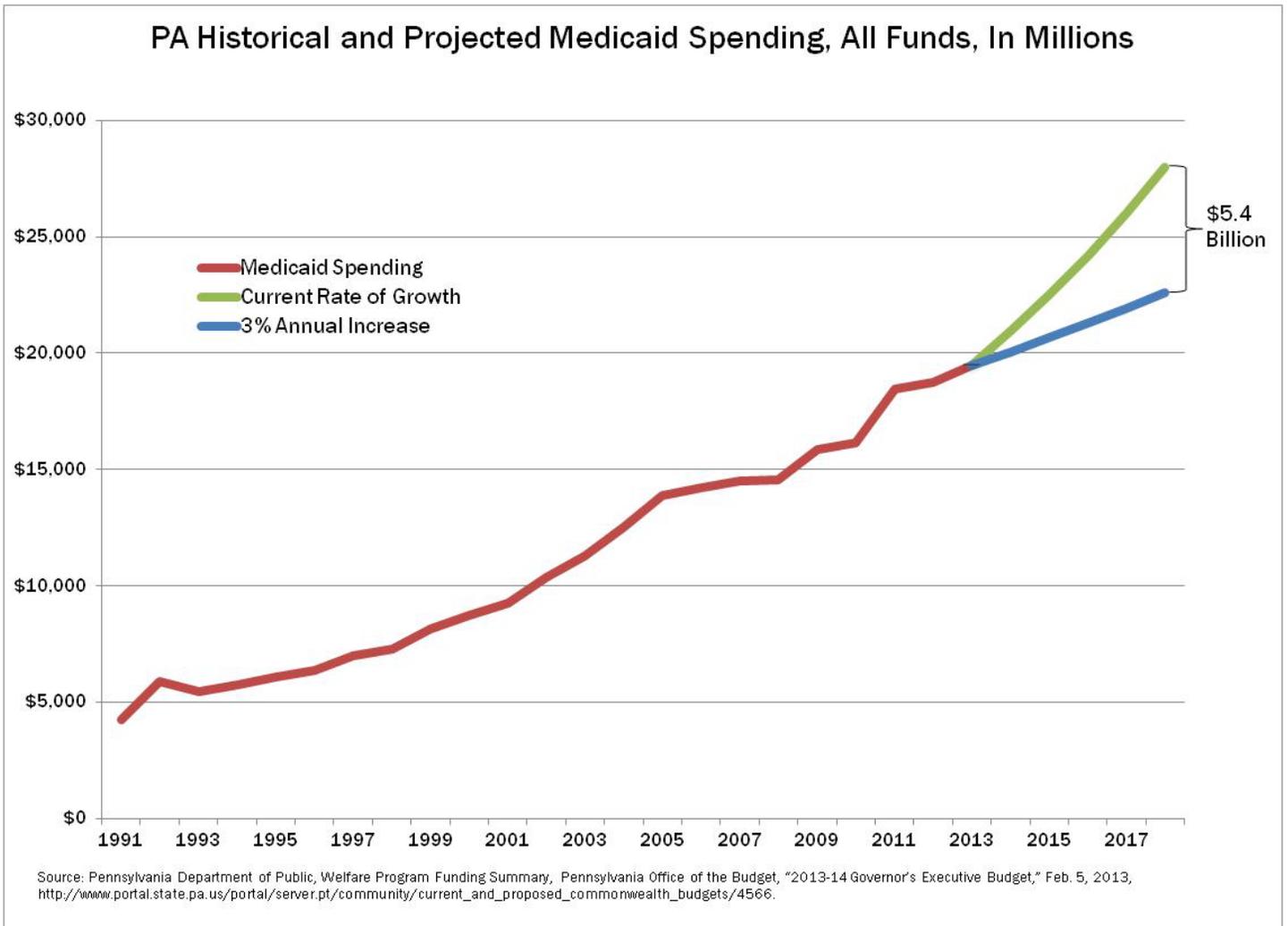
<sup>50</sup> Papst, Chris, "Lotto winners bilk the welfare system by continuing to collect after hitting huge jackpots," CBS21, November 2013, [http://www.local21news.com/template/cgi-bin/archived.pl?type=basic&file=/news/features/top-stories/stories/archive/2013/11/biBWZa9K.xml#.UsHXTLS\\_ocl](http://www.local21news.com/template/cgi-bin/archived.pl?type=basic&file=/news/features/top-stories/stories/archive/2013/11/biBWZa9K.xml#.UsHXTLS_ocl).

<sup>51</sup> Office of the Inspector General, "Annual Report 2011-2012," [http://www.oig.state.pa.us/portal/server.pt/gateway/PTARGS\\_0\\_2\\_131797\\_19548\\_766095\\_43/http%3B/pubcontent.state.pa.us/publishedcontent/publish/cop\\_hhs/oig/oig\\_annual\\_report/annual\\_report\\_2012.pdf](http://www.oig.state.pa.us/portal/server.pt/gateway/PTARGS_0_2_131797_19548_766095_43/http%3B/pubcontent.state.pa.us/publishedcontent/publish/cop_hhs/oig/oig_annual_report/annual_report_2012.pdf).

<sup>52</sup> "Getting Rich off the Poor: Examining Welfare Abuse," Commonwealth Foundation, June 5, 2012, <http://www.commonwealthfoundation.org/research/detail/getting-rich-off-the-poor-examining-welfare-abuse>.

<sup>53</sup> Pennsylvania Office of the Auditor General, "Auditor General Jack Wagner Says Reducing Medicaid Error Rate Would Save Hundreds of Millions of Dollars," <http://www.auditorgen.state.pa.us/Department/Press/WagnerSaysReducingMedicaidErrRtWldSvMillions.html>.

<sup>54</sup> Stelle, Elizabeth, Testimony to the Pennsylvania House Republican Policy Committee, June, 2010, <http://www.commonwealthfoundation.org/research/detail/welfare-fraud-and-abuse>.



### ***Implement Long Term Care Reform***

A form of Medicaid, long-term care costs the commonwealth more than \$6 billion and pays primarily for nursing home and home care for the elderly.<sup>55</sup> Long-term care creates perverse incentives, encouraging middle-class seniors to hide or transfer their homes and other wealth to relatives to qualify for a program intended for the truly needy. Pennsylvania must encourage alternative methods of financing long-term care, including: requiring seniors to spend more of their assets before they seek Medicaid, recovering the cost of care from estate sales after a beneficiary dies, and encouraging private long-term care insurance. These reforms could save more than \$1 billion annually.<sup>56</sup>

<sup>55</sup> Pennsylvania Office of the Budget, "2013-14 Governor's Executive Budget," [http://www.portal.state.pa.us/portal/server.pt/community/current\\_and\\_proposed\\_commonwealth\\_budgets/4566](http://www.portal.state.pa.us/portal/server.pt/community/current_and_proposed_commonwealth_budgets/4566).

<sup>56</sup> Moses, Stephen A., "Long-Term Care Reform: More Access to Better Care at a Lower Cost," Commonwealth Foundation, January 11, 2011, <http://www.commonwealthfoundation.org/research/detail/long-term-care-reform>.

### ***Increase School Choice***

The Pennsylvania Department of Education budget reached \$11.2 billion in FY 2013-14, more than one-third of the total \$28.4 billion General Fund appropriations.<sup>57</sup> Basic education funding alone increased by \$90 million, bringing that line item to nearly \$5.5 billion. This year represents the highest level of state funding ever provided to school districts.<sup>58</sup>

While school district spending exceeds \$14,000 per student,<sup>59</sup> ranking 10th in the nation,<sup>60</sup> performance has not improved with spending increases. The National Assessment of Educational Progress shows nearly 60% of Pennsylvania’s 8th grade students aren’t making proficiency in reading and math.<sup>61</sup> Meanwhile, Pennsylvania public schools reported 14,572 violent incidents in the 2012-2013 school year.<sup>62</sup>

In contrast, schools of choice have become increasingly popular as they spend less per student and provide better and safer schools for families. School choice saves Pennsylvania taxpayers millions of dollars each year. Public charter schools and cyber charter schools educate children for a fraction of the \$14,027 per pupil spent in public district schools. The average EITC scholarship, which allows a child to leave a district school for a school of his or her choice, was \$1,100 in 2011-12, while non-public schools receive about \$1,250 per pupil in taxpayer support. If each of the 391,657 students utilizing school choice returned to public district schools, schools would require an additional \$3.8 billion in revenue to handle the enrollment.

A report by the Friedman Foundation for Education Choice found that school choice “improves academic outcomes for participants and public schools, saves taxpayer money, [and] moves students into more integrated classrooms.” The report includes numerous empirical studies.<sup>63</sup> It finds 11 out of 12 gold standard studies found school choice improved academic outcomes for participants, and all six empirical studies of school choice’s fiscal impact found that school choice saves taxpayer money. Not only is school choice a sound investment for the state, it places power back into the hands of parents.

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<sup>57</sup> Independent Fiscal Office, “Pennsylvania’s Economic and Budget Outlook,” November 14, 2013, <http://www.ifo.state.pa.us/download.cfm?file=/resources/PDF/Five-Year-Economic-and-Budget-Outlook-Nov-2013.pdf>.

<sup>58</sup> Pennsylvania Office of the Budget, “2013-14 Governor’s Executive Budget,” [http://www.portal.state.pa.us/portal/server.pt/community/current\\_and\\_proposed\\_commonwealth\\_budgets/4566](http://www.portal.state.pa.us/portal/server.pt/community/current_and_proposed_commonwealth_budgets/4566).

<sup>59</sup> Pennsylvania Department of Education, “Revenue Data for All LEAs,” 1995-96 to 2011-12, [http://www.portal.state.pa.us/portal/server.pt/community/summaries\\_of\\_annual\\_financial\\_report\\_data/7673/afr\\_excel\\_data\\_files/509047](http://www.portal.state.pa.us/portal/server.pt/community/summaries_of_annual_financial_report_data/7673/afr_excel_data_files/509047).

<sup>60</sup> National Center for Education Statistics, Digest of Education Statistics, “Total and Current Expenditures Per Pupil in Fall Enrollment in Public Elementary and Secondary Education, by Function and State or Jurisdiction: 2010-11,” [http://nces.ed.gov/programs/digest/d13/tables/dt13\\_236.75.asp](http://nces.ed.gov/programs/digest/d13/tables/dt13_236.75.asp).

<sup>61</sup> National Center for Education Statistics, “National Assessment of Education Progress, State Profiles,” <http://nces.ed.gov/nationsreportcard/states>.

<sup>62</sup> Pennsylvania Department of Education, “Safe Schools—Statewide Report,” 2012-2013, <https://www.safeschools.state.pa.us/Main.aspx?App=6a935f44-7cbf-45e1-850b-e29b2f1ff17f&Menu=dbd39a1f-3319-4a75-8f69-d1166dba5d70&res=> (Note: Bullying and suicide attempts were excluded from total incidents, along with incidents at charter schools.)

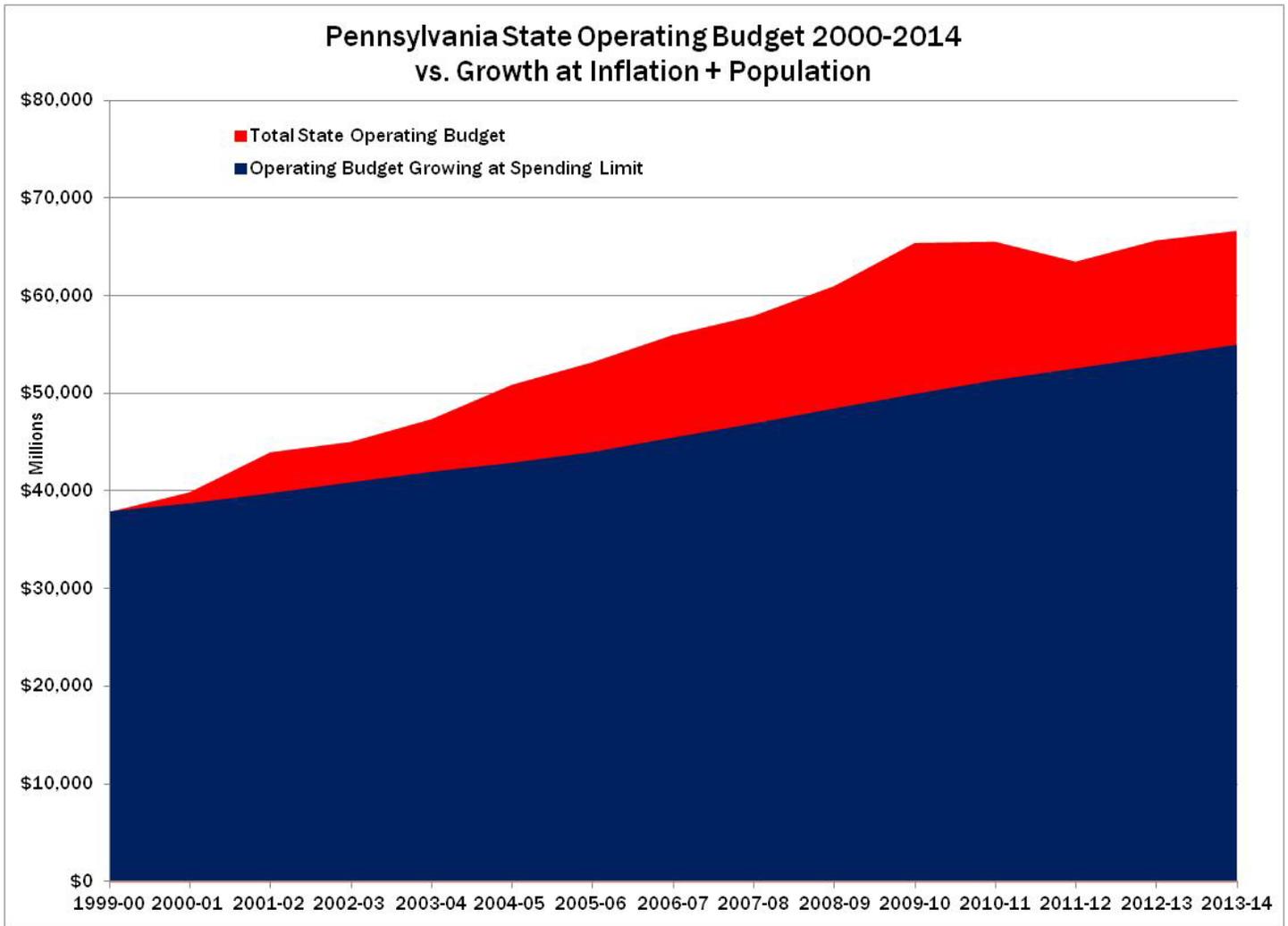
<sup>63</sup> Friedman Foundation for Education Choice, “A Win-Win Solution: the Empirical Evidence on School Choice,” <http://www.edchoice.org/Research/Reports/A-Win-Win-Solution--The-Empirical-Evidence-on-School-Choice.aspx>.

<b>Total Taxpayer Savings from Students Attending Schools of Choice</b>			
<b>2011-12 School Year</b>			
	<b>Savings Per Student*</b>	<b>Number of Students**</b>	<b>Total Savings</b>
<b>Private and Nonpublic</b>	<b>\$12,777</b>	<b>265,724</b>	<b>\$3,395,155,548</b>
<b>EITC Scholarship Students</b>	<b>\$11,677</b>	<b>45,200</b>	<b>\$527,800,400</b>
<b>Home School</b>	<b>\$14,027</b>	<b>20,897</b>	<b>\$293,122,219</b>
<b>Public Charter (Total)</b>	<b>\$1,429</b>	<b>105,036</b>	<b>\$150,096,444</b>
<b>Cyber Charter</b>	<b>\$2,516</b>	<b>32,322</b>	<b>\$81,322,152</b>
<b>Total</b>		<b>391,657</b>	<b>\$3,838,374,211</b>
* Includes All state funding for nonpublic schools plus tax credits for EITC scholarships as a cost. ** Homeschooling enrollment estimate based on 2009-10 PDE data.			
Sources: PA Department of Education, Summaries of Annual Financial Report Data; Public School Enrollment Reports, <a href="http://www.portal.state.pa.us/portal/server.pt/community/data_and_statistics/7202">http://www.portal.state.pa.us/portal/server.pt/community/data_and_statistics/7202</a>			

### ***Enact Spending Limits***

In order to put Pennsylvania on a sustainable path, lawmakers should adopt fiscal restraints in the form of constitutional spending limits. Spending limits would not mandate program or funding cuts, but would control the growth of spending by tying expenditures to inflation and population growth. Since 2000, the total state operating budget increased by \$26 billion. If spending growth had matched inflation and population growth, total state spending would have increased by \$16 billion, saving taxpayers nearly \$4,000 per family last year.<sup>64</sup>

<sup>64</sup> Pennsylvania's Office of the Budget, "2013-2014 Governor's Budget," February 5, 2013, [http://www.budget.state.pa.us/portal/server.pt/community/current\\_and\\_proposed\\_commonwealth\\_budgets/45](http://www.budget.state.pa.us/portal/server.pt/community/current_and_proposed_commonwealth_budgets/45).



### Economic Growth and Prosperity

All of the fiscal reforms identified above will be rendered moot if Pennsylvania’s economic growth continues to remain sluggish. Economic freedom—which drives economic growth—can help repair our fiscal house. As residents’ incomes grow, so do tax revenues. More importantly, economic freedom ensures greater prosperity across the board for Pennsylvania families.

***Pennsylvania’s Uncompetitive Economy***

Today, Pennsylvania has the 10th highest state and local tax burden in the nation, up from 24th in 1991.<sup>65</sup> This heavy tax burden drags down the state’s economy. From 1991 to 2013, Pennsylvania has ranked a dismal 44th, 38th, and 46th, in job growth, personal income growth, and population growth respectively.

<b>Employment (Thousands)</b>				
	<b>1991</b>	<b>2013</b>	<b>Change</b>	<b>Rank</b>
<b>United States</b>	<b>107,625</b>	<b>273,783</b>	<b>154%</b>	
<b>Pennsylvania</b>	<b>5,069</b>	<b>5,833</b>	<b>15%</b>	<b>44</b>
<b>Personal Income (Thousands)</b>				
	<b>1991</b>	<b>2013</b>	<b>Change</b>	<b>Rank</b>
<b>United States</b>	<b>\$5,015,631,831</b>	<b>\$13,729,063,000</b>	<b>174%</b>	
<b>Pennsylvania</b>	<b>\$242,821,685</b>	<b>\$575,424,657</b>	<b>137%</b>	<b>38</b>
<b>Population</b>				
	<b>1991</b>	<b>2013</b>	<b>Change</b>	<b>Rank</b>
<b>United States</b>	<b>251,559,853</b>	<b>316,128,839</b>	<b>26%</b>	
<b>Pennsylvania</b>	<b>11,943,160</b>	<b>12,773,801</b>	<b>7%</b>	<b>46</b>

Pennsylvania’s economic and business climate remains comparatively unattractive to job creators. The commonwealth ranks 39th in state economic competitiveness according to the Beacon Hill Institute *State Competitiveness Index*,<sup>66</sup> and CEO Magazine lists the Keystone State as the 42nd “best state for business.”<sup>67</sup> Pennsylvania also scored a lowly 33rd in economic performance and 34th in economic outlook according to the American Legislative Exchange Council’s *Rich States, Poor States*.<sup>68</sup>

An unattractive business climate has real consequences; residents continue to flee Pennsylvania for states with lower taxes, less regulation, and greater job growth. From 2000-10, the state lost a net 77,184 taxpayers who moved to other states, according to IRS data. The net loss in personal income these taxpayers took elsewhere totaled \$4.3 billion.<sup>69</sup>

If Pennsylvania is to bring jobs and people back to the state, it must enact policies that are conducive for economic growth. Cutting taxes and government spending as a way to put

<sup>65</sup> Tax Foundation, “Pennsylvania’s State and Local Tax Burden, 1977-2010,” October 23, 2012, <http://taxfoundation.org/article/pennsylvanias-state-and-local-tax-burden-1977-2010>.

<sup>66</sup> Beacon Hill Institute, “12<sup>th</sup> Annual State Competitiveness Index,” April 2013, <http://www.beaconhill.org/CompetitivenessHomePage.html>.

<sup>67</sup> Donlon, JP, “2013 Best & Worst States for Business,” *CEO Magazine*, May 6, 2013, <http://chiefexecutive.net/best-worst-states-for-business-2013>.

<sup>68</sup> Laffer, Arthur B., et. al., “Rich States, Poor States, 6<sup>th</sup> Edition: ALEC-Laffer State Economic Competitiveness Index, American Legislative Exchange Council,” <http://www.alec.org/publications/rich-states-poor-states/>.

<sup>69</sup> Tax Foundation, “State to State Migration Data,” <http://interactive.taxfoundation.org/migration/graph.php>.

money back in the hands of those who earned it would encourage and attract private savings and investment, which is the key to economic growth.<sup>70</sup>

***Lower Taxes vs. Economic Development***

State and local governments spend billions of dollars each year on “economic development” programs in order to stimulate their economies. Yet evidence suggests economic development spending is less effective in creating jobs than lowering the tax burden on working people and businesses. As the table below indicates, states that spent the most on economic development in the form of subsidies, loans, and tax credits actually had slower job growth than states spending the least.

<b>Expenditures on Economic Development Programs</b>				
<b>Top Ten States</b>				
<b>States</b>	<b>Total FY 2007-14</b>	<b>Population</b>	<b>Per-Capita</b>	<b>Job Growth FY 2003-13</b>
Pennsylvania	\$5,099,048,477	12,763,536	\$400	2.56%
Ohio	\$4,635,133,424	11,544,225	\$402	-3.60%
California	\$4,458,817,000	38,041,430	\$117	1.69%
Louisiana	\$3,269,130,453	4,601,893	\$710	2.47%
New Jersey	\$2,891,965,000	8,864,590	\$326	-1.00%
Florida	\$2,806,836,571	19,317,568	\$145	3.02%
Kentucky	\$2,390,976,948	4,380,415	\$546	1.81%
Arizona	\$2,386,631,775	6,553,255	\$364	7.06%
Texas	\$2,385,404,844	26,059,203	\$92	19.30%
New York	\$2,318,185,102	19,570,261	\$118	5.38%
<b>Average</b>			<b>\$322</b>	<b>3.87%</b>
<b>Bottom Ten States</b>				
<b>States</b>	<b>Total FY 2007-14</b>	<b>Population</b>	<b>Per-Capita</b>	<b>Job Growth FY 2003-13</b>
Nevada	\$483,109,516	2,758,931	\$175	5.03%
New Mexico	\$386,315,600	2,085,538	\$185	3.38%
Rhode Island	\$346,992,377	1,050,292	\$330	-3.39%
Maine	\$337,491,972	1,329,192	\$254	-0.36%
Nebraska	\$298,183,050	1,855,525	\$161	6.81%
Delaware	\$214,754,300	917,092	\$234	1.37%
Vermont	\$213,484,452	626,011	\$341	1.30%
Montana	\$197,028,847	1,005,141	\$196	12.07%
New Hampshire	\$195,003,279	1,320,718	\$148	2.54%
Idaho	\$186,680,900	1,595,728	\$117	12.49%
<b>Average</b>			<b>\$214</b>	<b>4.12%</b>
Source: State Economic Development Expenditure Database, The Council for Community and Economic Research ( <a href="http://c2er.org">http://c2er.org</a> )				

<sup>70</sup> Higgs, Robert, “One More Time: Consumption Spending HAS Already Recovered,” Independent Institute <http://blog.independent.org/2011/09/09/one-more-time-consumption-spending-has-already-recovered/>.

In the states that spent the most on economic development, the average job growth over a 10-year period was 3.87%. For those states that spent the least, average job growth over the same 10-year period was 4.12%.

While economic development spending has not proven to be an effective tool for job growth, low-tax states have had success in growing their economies, especially when compared to high-tax states. Low-tax states saw personal incomes grow 13.76% more than high-tax states. States with the highest tax burden saw job growth of only 1.77%. In contrast, low-tax states saw average job growth of 7.91%.

<b>Tax Burden as Percentage of Personal Income</b>			
<b>Ten States with the Lowest Tax Burden</b>			
<b>States</b>	<b>State and Local Tax Burden as % of Income</b>	<b>Personal Income Growth Rate (2003-2013)</b>	<b>Non-Farm Payroll Employment Growth (2003-2013)</b>
Alaska	7.00%	63.22%	11.73%
South Dakota	7.60%	66.93%	11.41%
Tennessee	7.70%	44.84%	3.70%
Louisiana	7.80%	59.08%	2.70%
Wyoming	7.80%	78.39%	16.09%
Texas	7.90%	75.34%	19.93%
New Hampshire	8.10%	44.68%	2.27%
Alabama	8.20%	45.86%	0.37%
Nevada	8.20%	45.86%	5.74%
South Carolina	8.40%	52.55%	5.19%
<b>Average</b>	<b>7.87%</b>	<b>57.68%</b>	<b>7.91%</b>
<b>Ten States with the Highest Tax Burden</b>			
<b>States</b>	<b>State and Local Tax Burden as % of Income</b>	<b>Personal Income Growth Rate (2003-2013)</b>	<b>Non-Farm Payroll Employment Growth (2003-2013)</b>
Pennsylvania	10.20%	44.75%	2.80%
Maine	10.30%	38.88%	-1.11%
Massachusetts	10.40%	46.75%	4.88%
Minnesota	10.80%	46.05%	4.75%
Rhode Island	10.90%	46.66%	-3.66%
Wisconsin	11.10%	42.89%	2.09%
California	11.20%	46.56%	2.20%
Connecticut	12.30%	44.21%	0.57%
New Jersey	12.40%	41.48%	-0.57%
New York	12.80%	50.95%	5.71%
<b>Average</b>	<b>11.24%</b>	<b>44.92%</b>	<b>1.77%</b>

Sources: Tax Foundation, US Bureau of Economic Analysis, US Bureau of Labor Statistics.

***Right-to-Work***

Right-to-Work laws protect the rights of workers to decide whether or not to join or financially support a union. Right-to-Work laws allow individual employees to negotiate

their contracts without being forced to give part of their paychecks to a union to keep their jobs. Already enacted in 24 states, Right-to-Work laws correlate with economic prosperity.<sup>71</sup>

A report from the Mackinac Center for Public Policy shows that from 1947-2011, Right-to-Work laws have caused one-time, permanent increases in the rates of economic growth in those states. Analysis of employment, real personal income, and population increases over this 64-year period suggest that Right-to-Work laws “have a positive—at times very positive—impact on the economic well-being of a state and its residents.”<sup>72</sup>

Right-to-Work states have a lower nominal median income than compulsory union states. However, Right-to-Work states have a higher standard of living and residents earn more when adjusting for cost of living.<sup>73</sup> Furthermore, migration patterns show citizens moving out of compulsory union states and into Right-to-Work states.

<b>National Comparison of Right to Work State vs Forced Unionism States</b>		
	<b>Right-to-Work States</b>	<b>Forced Unionism States</b>
<b>Unemployment Rate</b>	<b>7.00%</b>	<b>7.50%</b>
<b>Absolute Median Incomes</b>	<b>\$48,324</b>	<b>\$54,757</b>
<b>Median Incomes Adjusted for Cost of Living</b>	<b>\$51,345</b>	<b>\$46,084</b>
<b>Net Interstate Migration 2010-2012</b>	<b>809,000</b>	<b>-823,000</b>
Sources: Bureau of Labor Statistics, “Current Unemployment Rates for States and Historical Highs/Lows2012,” Nov. 22, 2013, <a href="http://www.bls.gov/web/laus/lausthl.htm">http://www.bls.gov/web/laus/lausthl.htm</a> ; Department of Commerce, “State Median Income,” 2012, <a href="http://www.census.gov/hhes/www/income/data/statemedian/index.html">http://www.census.gov/hhes/www/income/data/statemedian/index.html</a> ; Top 50 States, “Cost of Living by State,” <a href="http://www.top50states.com/cost-of-living-by-state.html">http://www.top50states.com/cost-of-living-by-state.html</a> ; US Census Bureau, Estimates of the Components of Resident Population Change; April 1, 2010 to July 1, 2012, <a href="http://www.census.gov/people">http://www.census.gov/people</a>		

Right-to-Work laws both protect the economic freedom of business owners and employees, while promoting economic growth beneficial to all taxpayers. Pennsylvania’s structural budget deficit requires such economic impetus.

## Conclusion

Pennsylvania cannot sustain its current fiscal path. Without fiscal and economic reforms, taxpayers will be forced to give more of their hard-earned dollars over to the state. If Pennsylvania policymakers want to protect taxpayers, they must fix the structural drivers of Pennsylvania’s deficit, reduce government debt and unfunded pensions, and implement pro-growth policies. By building this foundation for our fiscal house, Pennsylvanians can expect a more prosperous state for generations to come.

<sup>71</sup> National Right to Work Legal Defense Foundation, Inc, “Right to Work States,” 2012, <http://www.nrtw.org/rtws.htm>.

<sup>72</sup> Michael Hicks, PhD and Michael LaFaive, “Economic Growth and Right-to-Work Laws,” The Mackinac Center for Public Policy, 2013, <http://www.mackinac.org/archives/2013/s2013-05.pdf>.

<sup>73</sup> Charles Koch Institute, “Economic Freedom Roundup,” <http://7f36618d22d43f083d0f-70f1d730d159ba9588ca85de883347b8.r24.cf2.rackcdn.com/EF%20Roundup%20-%20RTW%20States%20Compared%20to%20Non-RTW%20States.pdf>.

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The Commonwealth Foundation ([CommonwealthFoundation.org](http://CommonwealthFoundation.org)) is Pennsylvania's free-market think tank. The Commonwealth Foundation crafts free-market policies, convinces Pennsylvanians of their benefits, and counters attacks on liberty.

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