

Taxpayers' Framework for Pennsylvania: *Pathway to Economic Expansion & Prosperity*

Report By the
Taxpayers' Caucus



May 24, 2016

Jordan Grant, Legislative Aide
Office of Representative Seth Grove

Jason High, Chief of Staff
Office of Senator Scott Wagner

Index

About the Caucus	Page 3
Executive Summary	Page 4
Structural Deficit vs. Cyclical Deficit	Pages 5-7
Long-Term Budget Reforms	Pages 8-10
Overview of Savings/Revenue	Page 11
Balancing the 2016-2017 Budget	Pages 12-25
Short-Term Budget Reforms	Pages 26-29
Economic Growth	Pages 30-33
Conclusions & Recommendations	Pages 34-35

About the Taxpayers' Caucus

About

Founded as a result of the 2015-2016 budget impasse, the Taxpayers' Caucus was created by members of the House and Senate with the single purpose of changing the culture of Harrisburg. Too often, in the past, state government has required Pennsylvanians to direct more of their money to Harrisburg without giving an account for how the money is used.

The lack of financial accountability within state government has created the current culture where the only discussion is over how much the state increases spending. In order to cover the increased costs of the status quo in state government, Harrisburg continues to ask taxpayers to adjust their budgets without ever adjusting our own.

As elected officials chosen by their neighbors to be stewards of their money, members of the Taxpayers Caucus have come together to change this culture. In order to achieve this change the Taxpayers Caucus will continue to advocate for reforms, which improve financial accountability and oversight while protecting taxpayers.

Mission Statement

The goal of the Taxpayers' Caucus is to protect the taxpayers of Pennsylvania by identifying and promoting:

- Budget reforms which increase transparency and accountability
- Opportunities to reform programs to maximize service to Pennsylvanians while minimizing costs.
- Opportunities to eliminate or consolidate programs that provide services that are either duplicative or not necessary.

Executive Summary

When the Commonwealth began the 2015-2016 budget process, the state estimated a budget deficit of \$1.2 billion. However, by the time budget negotiations began in June, this number was reduced by economic growth to approximately \$1 billion. After Governor Wolf vetoed the entire budget on June 30th, the resulting impasse lasted nine months before the 2015-2016 budget was finalized. The budget for the current fiscal year closed out the deficit, while increasing spending by \$878 million. This achievement was accomplished by prudent fiscal management from the General Assembly.

Building upon the efforts of the General Assembly, for the current budget, the Legislature should begin examining cost savings within the budget to apply towards the budget deficit next year. These cost savings include the \$500 million from the governor's unilateral expansion of Medicaid in his executive budget. State government can find additional savings through GO-TIME (lean government) initiatives as lean government saved taxpayers \$150 million last year and \$699 million during the Corbett Administration.

Another option, which is available to address the budget deficit, is the use of unspent funds from previous fiscal years (lapsed funds). During last year's budget impasse, the Wolf Administration utilized \$2.7 billion in lapsed state funds. The state, on average, utilizes \$2.3 billion in lapsed funds each year. This means the Wolf Administration found an extra \$400 million to pay for Harrisburg's priorities. However, the General Assembly could utilize a portion of lapsed funds to address the deficit.

Although we can address the budget next year through cutting waste, growing nontax revenue and using lapsed funds, the effort to address the deficit long-term requires real budgetary reforms. These reforms must end the status quo and take the Commonwealth's state budget off auto-pilot. Lawmakers should reform the budget process through a hybrid model of zero-based and performance-based budgeting. By measuring the success of state programs, the state can utilize its current revenues more effectively to fund the priorities of Pennsylvanians. These reforms should be supplemented with legislation that would increase legislative oversight of executive spending and improve government accountability with taxpayers' money.

In order to protect taxpayers and address the budget deficit, the culture of Harrisburg has to change. In the short-term, this requires not only prudent fiscal management, but reducing costs, growing nontax revenue and maximizing our current revenues. Over the long term, the state must adopt reforms to the budget process which increase accountability and oversight. Reforming this process requires funding to be based upon program performance and whether that performance matches the priorities of Pennsylvanians. As a result of changing the culture of Harrisburg in the short and long term, the state can protect taxpayers and balance the budget.

This report offers a series of recommendations and policy proposals that demonstrate alternatives to the status quo. These recommendations are not an exhaustive list, but are items the Taxpayers' Caucus believes merits further public discussion and legislative deliberation.

Structural Deficit vs Cyclical Deficit

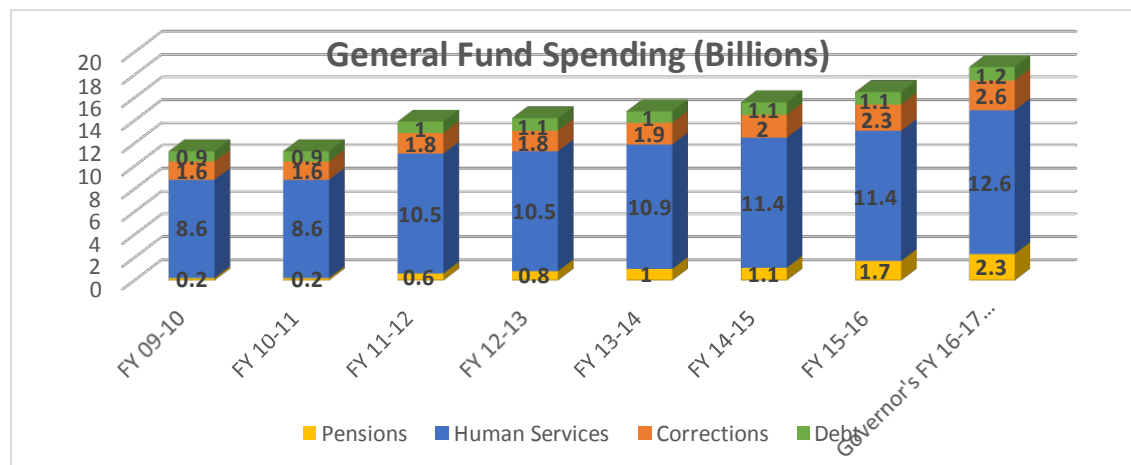
Throughout the 2015-2016 budget impasse, the governor continually discussed the need for addressing the structural deficit. In many ways, Governor Wolf made the structural deficit a defining issue of the budget impasse. Due to the Wolf Administration placing the issue front and center, it is important to define the term and understand what constitutes a structural deficit. Under the definition from Reuters a structural deficit is:

“ . . . the portion of a budget deficit that is not the result of changes in the economic cycle. The structural deficit will exist even when the economy is at the peak of the cycle.”¹

As Pennsylvania has yet to reach the peak of its economic cycle, the Commonwealth does not have a structural deficit like the Wolf Administration claims. Rather, Pennsylvania is facing a cyclical deficit. According to Reuters a cyclical deficit is:

“ . . . that portion of a country’s budget deficit that reflects changes in the economic cycle. Budget positions tend to deteriorate as economies slow as tax revenues fall and welfare spending rises; they improve as economic growth returns, tax revenues rise and welfare spending is reduced”.²

Still in the midst of economic recovery, the current budget outlook for the Commonwealth matches Reuters’ definition of a cyclical deficit. The cost drivers within the budget are well-known and have remained the same over the past few decades, with the bulk of state funds covering General Obligation Debt Payments, the Department of Corrections, the Department of Human Services and pension costs. At the start of the decade, the Commonwealth, in part due to federal stimulus funds, spent approximately \$10 billion to cover expenses in these four areas. However, these costs have grown significantly despite fiscal restraint over the past five years.



¹ http://glossary.reuters.com/index.php?title=Structural_Deficit

² http://glossary.reuters.com/index.php?title=Cyclical_Deficit

<http://www.pahousegop.com/NewsItem.aspx?NewsID=23374>

The growth of these cost drivers, within the budget, can be seen in the current fiscal year as these cost drivers amount to \$16.5 billion of General Fund spending. Effectively, this means within the current budget, 55% of all General Fund spending covers expenses within these four areas. This is almost 20% higher than the amount the Commonwealth spends on education, excluding higher education, and dwarfs all other budgetary expenses.

Unfortunately, the costs within these budgetary items are only anticipated to increase. This increase is evidenced by the Department of Human Services and their estimation, within the governor's budget, the cost to maintain current services will require an increase of over \$800 million. This amounts to over \$200 million more than the expected cost estimated last year by the department.

In order to meet our required pension obligations, the Commonwealth will also have to increase its pension payments for next fiscal year by approximately \$500 million. The growing cost of only pensions and welfare equals totals the entire budget deficit for the 2016-2017 budget.

Increases within these cost drivers are not limited to pensions or human services as the Department of Corrections saw their costs increase at the start of the decade from \$1.6 billion to \$2.3 billion.³ This amounts to an increase of over \$100 million every year through the current fiscal year. Not surprisingly, the cost increase projected by the Wolf Administration for the Department of Corrections next fiscal year is \$178 million.

Despite reducing the Commonwealth's overall capacity to borrow and the paying down of debt over the past five years, these costs within the budget have continued to increase as well. In 2010, the state's General Obligation Debt Payments in the General Fund amounted to \$900 million of state expenditures. In the current fiscal year, the Commonwealth's debt payments had increased by almost \$300 million.

The increase in debt payments, in part, is due to credit downgrades over the cyclical deficit as the state's economy grows more slowly than the increase in our spending. As the Commonwealth has failed to address its primary cost drivers, including its pension costs, rating agencies such as Moodys have downgraded our credit rating.⁴ The result of the state's failure to address these cost drivers has been seen in the increased spending on debt payments.

When combined, the increased spending on these cost drivers within the General Fund it exceeds the budget deficit for next fiscal year by almost \$100 million.⁵ The growth of these expenses is not only troubling, but indicates the cyclical nature of the Commonwealth's budget deficit. While revenue from economic growth is estimated to increase 1.8% over last year, expenditures for three of these cost drivers see an increase of approximately 8%.⁶ The inequity between revenue increases from

³ <http://www.budget.pa.gov/PublicationsAndReports/Documents/2009-10%20Enacted%20Budget%20Line%20Item%20Appropriations%20.pdf>

⁴ https://www.moodys.com/research/Moodys-revises-Pennsylvania-GO-outlook-to-negative-affirms-Aa3-rating--PR_336836

⁵ <http://www.pabudget.com/Display/SiteFiles/154/Documents/FY%202016-17%20GF%20Budget/Gov%20Budget%20Proposal/2016-17%20Budget%20-%20Gov%20Proposed%20vs%202015-16%204%20Col.pdf>

⁶ http://www.ifo.state.pa.us/download.cfm?file=/Resources/PDF/Revenue_Estimate_2016-05-03.pdf

economic growth and expenditure increases is evidenced in the Independent Fiscal Office (IFO) initial revenue report for next fiscal year. In its presentation, the IFO reported revenue from the Corporate Net Income Tax only grew by .9%.⁷ Effectively, our budget deficit exists because state spending is increasing dramatically above growth of the economy.

Closing this deficit can be accomplished through different combinations of the following options: raising tax revenues, reducing expenditures, improved fiscal management, identifying new non-tax revenue. However, if the Commonwealth were to increase tax rates; the state would begin to cannibalize the very economic growth needed to close the cyclical deficit. In order to balance the budget, protect taxpayers and close the cyclical deficit, the Taxpayer's Caucus has suggested several proposals to strengthen our economy and close the cyclical deficit.

As the General Assembly works to address our long-term cost drivers and the cyclical deficit, long-term reforms to its budgeting process will also be necessary to ensure continued prudent management of taxpayer funds. The current process, with nearly automatic spending increases and a lack of fiscal accountability, does not position the Commonwealth for future economic growth. A new budget process must focus on the priorities of Pennsylvania with financial decisions being based on performance metrics to provide increase accountability and transparency to taxpayers.

⁷ file:///C:/Users/Owner/Downloads/Revenue_Estimate_2016-05-03.pdf

Long-Term Budget Reforms

Pennsylvania like many states, employs an annual budget process which uses the prior year's budget as a baseline, while negotiating over new spending. The problem with this current approach is the lack of accountability to taxpayers within the budget, as cost savings are often spent without notification. In addition, state programs which receive an increase in state funds lack performance metrics to determine if the program is meeting its objective.

Changing the culture of Harrisburg, to one more accountable to the taxpayers, requires a hybrid use of performance-based budgeting and priority-based budgeting. Moving forward, the Commonwealth should base budget decisions off the priorities and interests of Pennsylvanians, determined through a dialogue between the administration and the General Assembly. Programs which meet these priorities should have their funding adjusted based on established metrics which inform the Legislature and taxpayers about the program's performance.

This hybrid model should also include a discussion on whether the Commonwealth should amend the constitution and adopt a two-year budget process. As stated by supporters of biennial budgeting, the opportunity for economic growth and improved fiscal oversight is worthy of extensive debate.

- **Performance-Based Budgeting**

The practice of budgeting through performance or Performance- Based Budgeting (PBB) looks to end the status quo by forcing existing programs to justify their allocations. In particular, this practice focuses on the measurable aspects of a program to provide legislators with a cost-to-benefit understanding for specific programs. These decisions often are made easier by measuring state programs by the outcomes they produce.

The effectiveness of adopting PBB was demonstrated by the Office of Management and Budget (OMB) with the Program Assessment Rating Tool (PART). This initiative from the Bush Administration allowed for the systematic review of federal programs. As a result of PART, the federal government was able to significantly increase available performance data on government programs. By the end of the Bush Administration, the number of programs which lacked any performance metrics was down from 50% to 19%. This data allowed Congress, which refused to cut spending, to invest new spending into programs that successfully reached their objectives.⁸

The federal government is not the only public entity to successfully use a performance based system for budgeting. After being elected as Governor of Indiana, Mitch Daniels formed his own Office of Management and Budget to implement a performance system. This was not surprising as Governor Daniels was previously the Director of OMB under President Bush and was familiar with the successes of PART.

⁸ <https://www.scribd.com/doc/126785694/State-Budget-Reform-Toolkit>

Despite his background in PBB, this task presented difficulty, as the State of Indiana had a \$700 million deficit and failed to balance a budget in the previous seven years. Under the Daniels Administration, the State of Indiana used performance data to drive budgetary decisions. These decisions include whether to cut a program for failing to meet its goals. For example, the state ended a \$600,000 library grant because the data showed it failed to provide meaningful assistance to public libraries. Indiana also used performance metrics to cut a \$900,000 agriculture program because the program was too broadly defined. Indiana also used PBB to determine when a program's failures were due to a lack of resources as demonstrated in their handling of children caseworkers.⁹

Indiana is not the only state to successfully use a PBB system as Virginia, Utah and Maryland have used a performance system to determine budgetary decisions. Pennsylvania has started the effort to establish a system for measuring the performance of state programs as House Bill 1205, introduced by Representative Dunbar, would provide the IFO with data on state programs. In addition, under House Bill 1205, the IFO is allowed to work with a nationally recognized organization to provide a cost-benefit analysis of state programs.¹⁰

• **Priority-Based Budgeting**

Priority Based Budgeting or Budgeting for Outcomes (BFO) is another method which has seen success in the states of Iowa and Washington. This system was first seen in Washington State as Governor Gary Locke, in 2002, faced a significant deficit within his budget.¹¹ In order meet the expectations of the people of Washington, the Locke Administration outlined 10 priorities for the state which included:

- Improve student achievement in elementary, middle and high schools
- Improve the quality and productivity of our workforce
- Improve the value of a postsecondary education
- Improve the health of Washington citizens
- Improve the security of Washington's vulnerable children and adults
- Improve the economic vitality of business and individuals
- Improve statewide mobility of people, goods, information and energy
- Improve the safety of people and property
- Improve the quality of Washington's natural resources
- Improve the cultural and recreational opportunities throughout the state

After outlining a set of priorities, the State of Washington began to organize programs within these priorities with "result teams" being given a specific amount to fund programs from the top to the bottom. These teams were made up of private, nonprofit and public sector leaders. Due to the constraints of the fiscal situation, the state was allowed to carve out its priorities while creatively finding ways to address their deficit.

⁹http://www.pewtrusts.org/~media/legacy/uploadedfiles/wwwpewtrustsorg/reports/government_performance/gpp20budget20brieffinal2web0209revisedpdf.pdf

¹⁰<http://www.legis.state.pa.us/cfdocs/Legis/CSM/showMemoPublic.cfm?chamber=H&SPick=20150&cosponId=183>

14

¹¹ <https://www.scribd.com/doc/126785694/State-Budget-Reform-Toolkit>

- **Biennial Budget**

The Commonwealth of Pennsylvania currently utilizes an annual budget, which is a time consuming process for the General Assembly and the executive branch. In order to reduce the time and costs associated with this process, approximately 20 states have adopted a biennial budget cycle. Most recently, the state of Iowa saw Governor Terry Branstad veto a spending bill for not providing appropriations for two fiscal years. The governor's reason was to ensure his state better managed its budget expenses than in previous years.¹²

Governor Branstad, the longest serving governor in American history, is not alone in his support for a biennial budget as many policymakers believe the process provides greater opportunity for budget oversight during the second fiscal year. Additionally, a two-year budget provides for greater stability within the budget which results in assisting the attraction of economic investment.

In the aftermath of this year's nine month budget impasse, the Commonwealth should begin considering the merits of a two-year budget process. This is further underscored by the fact the Commonwealth has failed 7 times over the last 10 years to meet the budget deadline of June 30th. There is legislation before the Senate Appropriations Committee, Senate Bill 1171, amending the state constitution to establish a biennial budget process. Introduced a few weeks ago, by Senator Aument, Senate Bill 1171 would establish a process to provide the Commonwealth a chance to comprehensively review state programs. Adding length to the budget process would allow for not only greater review, but serves to potentially reduce the time and costs associated with the budget process.¹³ As a result, the General Assembly would have more time to focus on important policy discussions outside the budget process which are neglected during budget season. Perhaps the most important benefit from a biennial budget is that it can serve as a mechanism to encourage outcome based evaluations of state programs.

By adopting the complimentary aspects of PBB and BFO, the Commonwealth can begin to better reflect the priorities of Pennsylvania taxpayers within its budget. At the same time, the General Assembly can improve the state's accountability to taxpayers and the legislative oversight of government spending by monitoring program performance.

¹² <http://westlibertyindex.com/article.php?viewID=3995>

¹³ <http://www.legis.state.pa.us/cfdocs/Legis/CSM/showMemoPublic.cfm?chamber=S&SPick=20150&cosponId=19651>

Taxpayers' Caucus Savings/Revenue for 2016-2017

Tax Amnesty Program	\$150 million
Improved Collection of Delinquent Taxes	\$75 million
Social Security Payment Collection	\$12.4 million
Lapsed Funding	\$319 million
Reforming State Healthcare Costs	\$153 million
Pension Reform	\$600 million
Pennsylvania State Police	\$43,384
Liquor Privatization	\$220 million
Uber PUC Fine:	\$11.4 million
PennDOT Selling Driver Information	\$26.1 million
Auditor General	\$167 million
Debt Reduction	\$10.6 million
Budget Reconciliation	\$200 million
GO-TIME	\$158.7 million
Department of Human Services	\$922 million
Energy Savings	\$3 million
<hr/>	
Total	\$3,028,243,384

Balancing the 2016-2017 Budget

While reforming the budget process over the long-term is essential to protecting taxpayers and improving the Commonwealth's fiscal management, the state must first balance the 2016-2017 budget. As the General Assembly struggled to get the governor to agree to a responsible budget, the early estimates for the budget deficit in the 2016-2017 fiscal year was estimated to be approximately \$2 billion. By controlling spending within the 2015-2016 budget, the General Assembly reduced the budget deficit by \$700 million, to the current estimate of \$1.5 billion.¹⁴

This deficit is nearly identical to the deficit closed by the current budget and can be addressed similarly without a tax increase. The following are a list of policy proposals which, if adopted, would direct over **\$3 billion** towards the deficit.

- **Department of Human Services: \$922 million**

The growing cost of entitlement programs within the Commonwealth is one of the greatest challenges facing our budget and the General Fund. As previously mentioned the projected cost increase next year for the Department of Human Services (DHS), formerly the Department of Public Welfare, will be approximately \$800 million.

Unfortunately, this is not surprising as DHS is one of the largest state agencies in the nation and comprises 38% of General Fund expenditures. In prior years, the expansion of costs within DHS has far exceeded not only other state departments, but even their own estimates. A prime example of this fact comes within the request for next fiscal year. Originally, the department anticipated a cost to carry of \$600 million, but this estimate has been increased in the governor's budget for next year. The increase request to cover the ambiguous "cost-to-carry" represents a 25% or \$200 million increased above their estimate. In order to protect taxpayers from the largest cost driver within the Commonwealth, the state should adopt reforms within the department. These reforms include:

- **Tort reform, \$50 million:** In 2002, the Commonwealth passed tort reform to protect physicians from frivolous lawsuits filed by out-of-state law firms. This reform, commonly referred to as MCARE, failed to include personal care homes under the same protections. The unfortunate result has been out-of-state law firms targeting personal care homes for frivolous law claims which has cost taxpayers \$95 million. Senate Bill 747, introduced by Senator Vogel, addresses this problem by adding personal care homes under the protections of MCARE.¹⁵ If enacted the state can save \$50 million from litigation costs and apply those savings to direct care services for the elderly.
- **Super Utilizers, \$90 million:** The hospitals in southcentral Pennsylvania realized they had certain individuals who consumed a large percentage of services (super utilizers). These

¹⁴ http://www.pennlive.com/politics/index.ssf/2016/04/house_appropriations_leader_sa.html

¹⁵ <http://ldpc6.legis.state.pa.us/WU01/LI/BI/SFN/2015/0/SB0747P1077.pdf>

hospitals reallocated staff to work with these individuals to reduce their medical usage. This saved Medicaid dollars and removed individuals from medical assistance by getting them back into the workforce. If applied statewide, this initiative can save taxpayer dollars and increase revenue collections.¹⁶

- **Act 92 of 2015, \$159 million:** House Bill 1322, sponsored by Representative Kaufer would save the Commonwealth money by working with other states to stop welfare payments going to recipients who no longer live in Pennsylvania.¹⁷
- **Medicaid Waiver*:** The Commonwealth previously had a waiver for complying with the federal government's new Medicaid requirements under the Affordable Care Act (ACA). The state can similarly apply for a new waiver to save taxpayers money and provide better health results. The Commonwealth can achieve this by adopting the consumer based model from the Healthy Indiana Plan established by Former Governor Mitch Daniels. Using a similar system as their healthcare plan for state employees, the state of Indiana has saved millions and expanded coverage.¹⁸ In order to save taxpayers money and expand coverage the system works to incentivize preventive care and reducing the number of "super utilizers". *no fiscal estimate available**
- **Medicaid Expansion, \$500 million:** In the Governor's 2016-2017 Executive Budget, the Administration projected \$500 million in cost savings from Medicaid expansion. The expansion of Medicaid was referenced prior to the Wolf Administration, as the IFO anticipated federal money under the Affordable Care Act would reduce costs for the state.¹⁹

As a result of the federal money, the IFO anticipated by transferring services over to Medicaid, the state would reduce costs within existing line items. As Governor Wolf anticipates that the state will save \$500 million from Medicaid expansion, the Commonwealth should use these savings to address the cyclical deficit.²⁰

- **Pfizer Settlement, \$12.4 million:** The Department of Justice announced a settlement deal with Pfizer, a pharmaceutical company, regarding the misconduct of their subdivision Wyeth. Prior to being acquired by Pfizer, Wyeth failed to disclose price discounts to the federal government which Wyeth offered only to private customers. As a result, Medicaid overpaid on two drugs offered by the company. The settlement will see the company reimburse state Medicaid programs \$371 million of which \$12.4 million will go to Pennsylvania.²¹

¹⁶ http://www.stltoday.com/news/opinion/medicaid-pilot-offers-cost-saving-solution-for-super-utilizers/article_d42776fd-9547-532b-aea9-9b77200b6e52.html

¹⁷ <http://ldpc6.legis.state.pa.us/WU01/LI/B1/FN/2015/0/HB1322P2628.pdf>

¹⁸ <http://mckinneylaw.iu.edu/ihr/pdf/vol7p57.pdf>

¹⁹ http://www.ifo.state.pa.us/download.cfm?file=/resources/PDF/Medicaid_Expansion_Report_%20May_13.pdf

²⁰ <http://www.budget.pa.gov/PublicationsAndReports/CommonwealthBudget/Documents/2016-17%20Proposed%20Budget/2016-17%20Budget%20Document%20Web.pdf>

²¹ <http://triblive.com/mobile/10380472-96/medicaid-million-wyeth>

- **Pharmacy Rebates, \$50 million:** Due to new rules imposed by the Department of Human Services on Managed Care Organizations, the Commonwealth will save millions on pharmacy rebates. These rules, combined with the changes by the federal government to the Federal Upper Limits, will generate \$50-100 million in savings.
- **CHIP Savings, \$100 million:** According to the governor’s executive budget, the Commonwealth will save millions by transitioning IT requirements from the Department of Insurance to the Department of Human Services. These administrative savings combined with increased federal funds will save taxpayers \$100 million.²²
- **Avoiding Improper Medicaid Payments, \$31 million:** On May 2, DHS sent a press release stating they are “on track to collect approximately \$613 million by the end of the fiscal year for cost of care payments initially made by Medicaid that should have been covered by private insurance . . . up from \$582 million the previous year.”²³

- **GO-TIME: \$158.7 million in cost savings**

On February 5, 2015, Governor Wolf issued an executive order which took the Governor’s Office of Innovation and reorganized it into the Governor’s Office of Transformation, Innovation, Management and Efficiency. When the Governor announced the establishment of GO-TIME the administration estimated cost savings of \$150 million.

Similar to Governor Corbett’s Office of Innovation, GO-TIME uses lean government practices adopted from the private sector to save taxpayer money. This was evidenced by the fact the Corbett Administration used lean government to save taxpayers’ over \$650 million.²⁴ As such, the General Assembly should require the Administration to identify cost savings. Projected savings by the administration include:

- Department of General Services: **\$100 million**
- Department of General Services Mailroom Consolidation: **\$1.76 million**
- Department of Corrections Regionalized Purchasing: **\$1.5 million**
- Department of Human Services Merger with E-Health Partnership: **\$1 million**
- Department of Human Services SNAP Asset Test Elimination: **\$3.5 million**²⁵
- Department of Human Services Online Portal for Third Party Liability: **\$31 million**²⁶
- Department of Agriculture: **\$11.4 million**²⁷
- Department of Transportation: **\$8.6 million**²⁸

These savings, among others identified by GO-TIME should be annualized and used to address the cyclical deficit within the budget.

²² <https://www.scribd.com/doc/298716129/2016-17-Governor-s-Executive-Budget>

²³ http://www.media.pa.gov/Pages/DHS_details.aspx?newsid=205

²⁴ <http://triblive.com/politics/politicalheadlines/7715538-74/wolf-office-state>

²⁵ <https://www.governor.pa.gov/governor-wolf-announces-new-efficiency-measures-success-of-gotime-in-first-year/>

²⁶ http://www.media.pa.gov/Pages/DHS_details.aspx?newsid=205

²⁷ http://www.media.pa.gov/pages/Agriculture_details.aspx?newsid=390

²⁸ <http://www.yourerie.com/news/local-news/penndot-employees-earn-highest-award>

- **Tax Amnesty Program: \$150 million**

House Bill 1888, introduced by Representative Quinn, would reinstitute a previously successful tax amnesty program. Under the program delinquent taxpayers would be allowed to file a tax return in exchange for “reduced interest on unpaid tax, abatement on penalties and in some instances, a limited look back on statute of limitations”. Early estimates show this legislation would generate \$150 million in tax revenue by maximizing our current revenue structure.

The tax amnesty program created by this legislation was used in 2010 by the Commonwealth with great success.²⁹ By the end of the amnesty program \$250 million in back taxes were paid and \$52 million were generated for the following fiscal year.

- **Improved Collection of Delinquent Taxes: \$75 million**

- **Senate Bill 995, \$75 million:** Proposed by Senator Browne, Senate Bill 995 would improve the collection of delinquent taxes by the Commonwealth. This legislation creates an entity to collect delinquent state taxes from the state and federal income tax returns of delinquent taxpayers. Not only does this legislation benefit state government by reducing payments to individuals who owe back taxes, but it helps local taxpayers as well. Senator Browne, in his co-sponsor memo, estimated this proposal could save state taxpayers **\$75 million**.³⁰

- **Social Security Payment Collection: \$12.4 million**

As provided for in Act 204 of 2014, the Department of Revenue is allowed to enter into contracts with other states to process their Social Security Payments (SSP).³¹ In 2004, the Commonwealth empowered the department to process the state’s SSP instead of the Social Security Administration. This change saves the Commonwealth on average \$30-35 million.³² By offering other states this same cost-effective alternative, we can generate millions in new revenue for the Commonwealth. This is already seen by the contract between the Department of Revenue and the state of New Jersey. The Commonwealth, as a result of this contract, generates **\$12.4 million**. Keeping this contract in mind, the Commonwealth is currently in the process of working out a similar agreement with the State of California which amounts to an additional **\$100 million**.

²⁹<http://www.legis.state.pa.us/cfdocs/Legis/CSM/showMemoPublic.cfm?chamber=H&SPick=20150&cosponId=19418>

³⁰<http://www.legis.state.pa.us/cfdocs/Legis/CSM/showMemoPublic.cfm?chamber=S&SPick=20150&cosponId=18661>

³¹<http://www.legis.state.pa.us/cfdocs/Legis/CSM/showMemoPublic.cfm?chamber=H&SPick=20130&cosponId=15176>

³² <http://ldpc6.legis.state.pa.us/WU01/LI/BI/FN/2013/0/HB2481P4309.pdf>

- **Lapsed Funding: \$319 million**

- **Funding from Prior Fiscal Years, \$200 million:** As previously mentioned Governor Wolf used lapsed funds to serve as a supplemental budget for state government during his impasse. According to the Treasury, by October 30th, the Wolf Administration spent **\$2.7 billion** of lapsed funds from prior fiscal years. For context, House Appropriations Committee informed members of the Taxpayers' Caucus that on average the state spends **\$2.3 billion** in lapsed funds. This means the governor and his administration found an additional \$400 million in lapsed funds. Not only are these amounts troubling, but they indicate that the Commonwealth overfunds many of the state's line items. These lapsed funds should be utilized to close the cyclical deficit.

Due the growing information about the Commonwealth's use of lapsed funds, the Taxpayers' Caucus assumes the availability of \$200 million in lapsed funds from the current year. This assumption is built on 3 facts. The first fact, is the use of \$400 million by the Wolf Administration in lapsed funds for impasse spending.³³ The second fact is the current budget uses of \$200 million in lapsed funds to ensure the budget is balanced. The third fact is the annual presence of \$2.3 billion in lapsed funds.

This means the Taxpayers' Caucus is only recommending that 8.6% from the average amount of lapsed funds be used to balance the budget. As this comprises only a small portion of the overall amount of lapsed funds, the state should dedicate this amount to balance the budget. If the budget process for the current fiscal year revealed anything, it is these funds exist and are available to protect taxpayers from an unnecessary tax increase.

- **2015-2016 End Balance, \$119 million:** At the end of the 2015-2016 fiscal year, the Commonwealth will have an end balance of **\$564 million**. Although the Independent Fiscal Office initially projected a lower end balance, the projection was based on a spend number of \$30.9 billion. Due to the final budget for the 2015-2016 fiscal year having a lower overall spend number combined with higher revenues, the end balance for the budget increased significantly. The IFO, at this point, estimates at least **\$119 million** of this revenue being available for next fiscal year.³⁴

- **Budget Reconciliation: \$200 million**

Following to the governor's unprecedented full veto of the 2015-2016 budget on June 30th, the Wolf Administration utilized lapsed funds from prior years as a supplemental budget. Upon the enactment of Act 1a of 2016, the Commonwealth had a full budget for all operational expenses for the 2015-2016 fiscal year. As previously mentioned, the Wolf Administration utilized \$2.7 billion in lapsed state funds which is \$400 million more the state average of \$2.3 billion. In order to balance the budget, the administration agreed during negotiations to lapse **\$200 million**. This

³³<http://www.repgrove.com/Display/SiteFiles/103/OtherDocuments/Grove%20Administration%20Spending%20Report%20Final%20.pdf>

³⁴ file:///C:/Users/Owner/Downloads/Revenue_Estimate_2016-05-03.pdf

action left \$200 million in Act 146 waivers unreconciled within the budget. By reconciling the current budget with the funds already spent, the Commonwealth can find the state millions of dollars to apply towards the projected budget deficit next fiscal year. *The total number from budgetary reconciliation has not been final amount will be higher.**

- **State Police:** The State police provide a great example of how budget reconciliation can be used to balance next year's budget. During last year's impasse, the state police waived almost \$34 million in funds from prior years from their GGO line item. At the same time, the state police are requesting \$16.4 million increase for next fiscal year. By reconciling the funds used during the impasse, the Commonwealth can save **\$17.6 million** while fully funding the budget request of the state police.

● **Addressing Corporate Welfare:**

The Commonwealth currently spends approximately \$700 million on economic development efforts. These efforts often take the form of tax credits or direct investments, but include investments outside the General Fund to spur economic growth. While one of the top priorities of the Commonwealth should be growing our economy, many of these tax credits or programs lack the metrics to determine whether the credits or programs are meeting their goals.

The areas of greatest concern, within these economic development initiatives, are the generous tax credits provided by the Commonwealth to specific industries. Some of these tax credits are important, such as the tax credit for research and development, but all credits should be measured against their effectiveness. This need was demonstrated by an analysis from the IFO from March of this year which reviewed these programs over the prior two fiscal years.³⁵ In the analysis, the IFO showed that 37%, approximately \$270 million a year, of the Commonwealth's economic development initiatives came from tax credits.

Disturbingly, many of these tax credits or programs lack the metrics to determine whether the credits or programs are meeting their goals. These tax credits are well-intended, but despite lawmakers' intention to generate economic growth, these credits often fail. The reason for this failure is that government, not the market, is attempting to create winners and losers amongst industries. Rather than stimulating economic growth, research shows that many tax credits can hurt the national economy while failing to benefit the state.³⁶

Equally troubling about the Commonwealth's model for economic development is the number of redundant programs used by the state to spend taxpayer funds on economic development programs. A quick review shows 30 out of 87 programs listed by the Department of Community Economic Development (DCED) are similar.³⁷ Examples of similar programs include:

- Community Revitalization Program

³⁵ <http://www.ifo.state.pa.us/download.cfm?file=/Resources/PDF/RB-2016-02.pdf>

³⁶ http://itep.org/itep_reports/2013/08/tax-incentives-costly-for-states-drag-on-the-nation.php#.VxkJ3qPD-mQ

³⁷ <http://www.newpa.com/program/#>

- Keystone Opportunities Program
- Keystone Special Development Zone Tax Credit
- Keystone Communities
- Keystone Innovation Network
- Keystone Innovation Zone
- JOB Partnership Fund
- PA Venture Capital Investment Program
- PA New Venture Guarantee Program

As stewards of taxpayer resources, the General Assembly should examine these programs to see which are necessary and/or effective. The General Assembly, in conjunction with the administration, should begin working to provide greater oversight of these programs. According to a report from the auditor general in 2014, of the companies which received an economic investment from the state, 44% failed to retain or keep the promised jobs. When the state imposed financial penalties on these companies DCED only regained 42%.³⁸

An example of this practice can be seen with DCED funding provided to Kraft through multiple grants and tax credits which amounted to \$339,500. After receiving these grants, Kraft began the process of merging its operations with Heinz and closing its doors which threatened 400 Pennsylvanian jobs. This example shows the impact of failures that stem from crony capitalism in terms of both the financial and personnel cost.³⁹

By examining our economic model to remove elements of crony capitalism, the state can address the cyclical deficit in the budget. This can take the form of covering the state's growing expenses or reducing the state's tax burden. The revenue gained from eliminating crony capitalism can be used to cover short-term revenue loss from reducing taxes.

Although lowering revenue seems counterintuitive for handling a budget deficit, economic research shows lower rates increase economic growth.⁴⁰ This economic growth will not only restore lost revenue, but it will begin to increase economic activity and return Pennsylvania to peak economic conditions. Until the state removes ineffective programs Pennsylvania will be unable to adopt an economic development model based on growth and free markets.

● **Reforming State Healthcare Costs: \$153 million**

Like to the private sector, the public sector has experienced a growing financial burden due to rising healthcare costs. According to the Office of Administration, the taxpayers of Pennsylvania paid \$1.63 billion for the healthcare of state employees. A driver of this high cost is that state employees only pay 11.7% for their healthcare costs. This amount is 8.3% less than their private sector counterparts pay. By reforming employee healthcare for state employees, the Commonwealth could reduce costs this fiscal year and reduce costs in the future. According to an

³⁸ <http://www.paauditor.gov/Media/Default/Reports/DCEDFinal12914.pdf>

³⁹ http://www.CommonwealthFoundation.org/docLib/20160422_TheCostsofCorporateWelfare.pdf

⁴⁰ <http://taxfoundation.org/blog/income-tax-cuts-increase-growth-reduce-revenue>

analysis from the Commonwealth Foundation taxpayers would save **\$153 million** annually if state employees paid the same percentage for healthcare as private sector employees.⁴¹

- Indiana, under Governor Mitch Daniels, provided a strong example of the benefit of reforming state healthcare. During his time in office, Governor Daniels provided employees with an option to move their insurance over to Health Savings Accounts (HSA). In order to cover the deductible costs associated with HSAs, the state of Indiana deposited \$2,250 at the start of the year into the account of each participant.

As a result of these changes by Governor Mitch Daniels, the employees of the state had better healthcare and saved Indiana taxpayers **\$20 million**.⁴² By 2011, 85% of employees had chosen to be covered under this new plan. This showed an increase of 81% percent over the plans first year. Due to the success of this model, the state adopted this plan as the foundation for their Medicaid expansion program with similar results.

In order to reduce costs and address the budget deficit, the Commonwealth should examine reforms to the state employee healthcare system. Since these generous benefits are costly and paid by the taxpayers, the state should reform its healthcare system before asking taxpayers to pay higher taxes. Whether these reforms bring our healthcare system in line with the private sector or mirror Indiana, the state should begin the debate on reforming our healthcare system.

● **Reducing Pennsylvania State Police Costs: \$43,384**

In order to reduce the strain on the General Fund and other budgetary accounts the General Assembly should consider methods which allow for the State Police to reduce their costs. These methods should include:

- **Reducing Cost of Issuing Tickets, \$43,384:** Currently, the Pennsylvania State Police (PSP) and some regional police departments use an electronic ticketing process. Upon printing the ticket, the department will print it on two sheets of paper which cost a total of 16 cents. However, by allowing departments to print via landscape printing, the state police can print a ticket on one sheet. The result will save the state police 8 cents per ticket. Based on data released, excluding Philadelphia County, by the Administrative Office of the Pennsylvania Courts, the PSP issued 542,300 tickets last year. At 8 cents saved per citation, this amounts to **\$43,384** saved.
- **State Police Contractual Program:** Over the past few years, the state police have seen their workload significantly increase, due to municipalities requesting the state police to take on the responsibility for local law enforcement. In 2014, of

⁴¹ <http://www.Commonwealthfoundation.org/issues/detail/redesigning-government-to-balance-state-and-local-budgets>

⁴² <http://www.sagamoreinstitute.org/mediafiles/ai-policy-brief-4.pdf>

Pennsylvania's 2,500 municipalities, the number of local governments with state police service was 1,279. As a result, the PSP are now providing municipalities with \$540 million worth of police coverage at no cost.⁴³ By allowing the PSP to contract police coverage with local municipalities, for municipalities with current local police coverage, the state can better fund the PSP for services provided to our communities. Additionally, should municipalities opt to eliminate their local police coverage; this policy will reduce the reliance on having the PSP as the primary law enforcement agency. Over time, this will reduce the demands on the PSP and reduce long term costs.

- **Freezing State Police Funding from the Motor License Fund:** Act 89 of 2013 provided \$2.3 billion in transportation funding, \$1 billion in mandated cost reduction for PennDOT and a threshold increase to the prevailing wage on certain transportation projects. The PSP is currently funded through the General Fund and the Motor Licensing Fund (MLF). Unfortunately, due to projected cost increases for the PSP, the Act 89 funding increase is being slowly shifted to the PSP instead of infrastructure projects. By freezing, at minimum, the funding of the PSP from the MLF, we can provide greater opportunity for economic growth through infrastructure investment.

• **Liquor Privatization: \$220 million**

As established in House Bill 466, the divestiture of the state store system would raise **\$220 million** in nontax revenue.⁴⁴ This includes the state recapturing \$100 million of lost revenue from Pennsylvanians purchasing alcohol from stores outside the Commonwealth. However, the fiscal analysis of House Bill 466 shows that recapturing lost revenue to border bleed could generate up to \$300 million.

Included in the analysis is additional vice-tax revenue from higher economic activity which is estimated to capture \$24-75 million above the current collection. Additionally, the proposal vetoed by the governor, would have generated \$2-5 million in higher income tax collections from business owners selling alcohol. Another positive impact included in House Bill 466 was from the costs saved by reducing operational expenses of the Liquor Control Board. These costs, primarily associated with overhead costs, would have eventually required General Fund revenue to bail out a failing system. The fiscal analysis from the Senate Appropriations Committee estimated these cost savings being over \$70 million or 16%.⁴⁵

By reducing costs and maximizing our current revenue rates; House Bill 466 is a prime example of how the Commonwealth can generate nontax revenue and address the cyclical deficit through economic growth.

⁴³ <http://lbfc.legis.state.pa.us/Resources/Documents/Reports/497.pdf>

⁴⁴ <http://ldpc6.legis.state.pa.us/WU01/LI/BI/FN/2015/0/HB0466P1985.pdf>

⁴⁵ <http://www.legis.state.pa.us/WU01/LI/BI/SFN/2015/0/HB0466P1985.pdf>

• Pension Reform: \$600 million*

With an unfunded pension liability of approximately \$63 billion, reforming the state's pension system must be a top priority for balancing the budget in both the short and long term. Failing to reform the state's pension system will lead to pension costs consuming 63 cents of every new tax dollar. The impact from the unsustainability of the state pension system will impair the ability of the Commonwealth to invest in our priorities including funding for the classroom.

- Senate Bill 1: passed by the General Assembly as part of the budget package last year on June 30th, would have saved taxpayers **\$13.2 billion** over 32 years.⁴⁶ When averaged out, this amounts to **\$413 million** in savings every fiscal year.
**These savings have not been assumed as part of this report*

Along with the savings from containing pension costs, Senate Bill 1, introduced by Senator Browne, saved taxpayers money by establishing a cash balance component within the plan. The inclusion of a cash balance component within the pension plan will capture excess interest and create a revenue stream to pay off the unfunded liability.

- Ending Private Management Fees: In the 2014-2015 fiscal year, private managers of the state pension funds were paid Pennsylvania paid **\$600 million**.⁴⁷ If these fees were eliminated over 10 years **\$6 billion** in savings would be generated for taxpayers. The cost savings from this measure would be available to cover the anticipated \$500 million increase next year in the pension system

As a result of making additional pension payments, the Commonwealth can avoid cost increases for borrowing. According to the Independent Fiscal Office over the next 20 years the cost to borrow will increase by \$1 billion or \$100 million per year.⁴⁸

• PUC Fines: \$11.4 million*

The Public Utilities Commission fined Uber for **\$11.4 million**, as a result of disobeying a cease and desist order from 2014.⁴⁹ The cease and desist order issued in the summer of 2014 because companies such as Uber and Lyft lacked a required certificate of public convenience.⁵⁰ The revenue from this fine should be used to address the cyclical deficit. **This number is subject to change based off the final result of court proceedings and appeals.*

⁴⁶ <http://ldpc6.legis.state.pa.us/WU01/LI/BI/FN/2015/0/SB0001P1132.pdf>

⁴⁷ http://articles.philly.com/2015-03-23/business/60373432_1_index-funds-investments-psers#uCWgyALGPHyckWZL.99

⁴⁸ http://www.ifo.state.pa.us/download.cfm?file=/resources/PDF/Five_Year_Outlook_2015.pdf

⁴⁹ <http://www.post-gazette.com/business/tech-news/2016/04/21/Uber-fined-11-4-million-by-state-Public-Utility-Commission-pennsylvania/stories/201604210168>

⁵⁰ <http://wesa.fm/post/puc-issues-cess-and-desist-orders-uber-lyft>

- **PennDOT Selling Driver Information: \$26.1 million***

Recently, it was discovered that the Department of Transportation sold personal information of Pennsylvania drivers to insurance entities and other companies which conduct background checks. As a result of this questionable practice, the department has generated \$157 million in nontax revenue. Effectively, PennDOT has made, on average, \$26.1 million per year from this practice.⁵¹ Due to this fact, the Taxpayers' Caucus assumes this revenue is available to address the cyclical deficit. **The assumption of revenue by the Taxpayers' Caucus is not an endorsement or a sign of support for the practice.*

- **Cost Savings Identified by the Auditor General: \$167 million**

During his time in office, Auditor General Eugene DePasquale has worked to identify cost savings within state government. As a result of this work, the auditor general and his staff identified cost savings through audits and best practices within his department and state government. The savings identified by the Auditor General's office are identified through numerous audits the department performs on schools, liquid fuels, corporate taxes, volunteer firefighter relief associations and special performance audits.⁵²

- **Audit Findings: \$165 million⁵³**

The Office of the Auditor General informed members of the Taxpayers' Caucus that its audits over the past 3 years have revealed more than \$150 million in cost savings. Unfortunately, as explained by the Wolf Administration, on multiple occasions the executive branch uses cost savings to spend taxpayer money. Keeping this in mind, this report assumes departments have been required to reconcile those spent savings to close the cyclical deficit. Examples of cost savings found through the audits performed by Auditor General Depasquale and his office include:

- Department of Education
 - Improper lease reimbursements: **\$1.8M**
 - Transportation overpayments: **\$54.9M**
- Department of Revenue
 - Corporation Tax Fund: **\$36.56** underpayments (net)
- Child and Youth Services: **\$14.49M**
- Volunteer Fire Relief Associations: **\$3.55M**
 - Unauthorized expenditures
 - State aid not deposited in timely manner
- Office of the Auditor General Savings: **\$2.08 million**

⁵¹ <http://wnep.com/2016/04/29/penn-dot-makes-millions-selling-your-data/>

⁵² http://www.bctv.org/special_reports/government/auditor-general-depasquale-pledges-to-build-on-savings-realized-through/article_e2093134-a284-11e5-b91c-13e9a5887a62.html

⁵³ <http://www.paauditor.gov/transparency-and-impact>

The effort of the auditor general to save taxpayer money is not limited to other state agencies or departments. Commendably, since being elected, the auditor general has identified \$2 million in annual savings in his office. The cost savings from the Auditor General's Office included:

- Reduction of travel costs: **\$830,645**
- Improvement of Human Resources and Financial Operations: **\$694,000**
- Eliminating leased office and parking spaces: **\$400,000**
- Reduction of printing costs by using existing Commonwealth resources: **\$164,000**⁵⁴

• **Debt Reduction: \$10.6 million**

In order to reduce expenditures, the Commonwealth should begin to address the four main cost drivers within the budget. One of these cost drivers is service payments on the state's debt. Currently, there are two proposals from the House which seek to reduce the Commonwealth's debt level focusing on limiting the state's ability to borrow:

- **House Bill 928 (2015-2016):** introduced by Representative Mentzer, amends state law to limit the amount of debt the Commonwealth can issue for Redevelopment Assistance Capital Projects (RACP). Under this legislation the cap for RACP debt would be reduced by \$50 million per year from \$3.4 billion down to \$2.9 billion. Fiscal analysis from the House Appropriation Committee showed the impact from reducing the cap on outstanding debt projects saved taxpayers **\$3.6 million** annually or \$72 million over 20 years.⁵⁵
- **House Bill 930 (2015-2016):** introduced by Representative Toohil, amends state law to limit the amount of debt the state can have outstanding within capital debt and RACP programs. Under the legislation, the state would be limited in the amount of new debt it can issue during a fiscal year. If adopted, the state could not issue more than \$350 million for capital debt projects or \$125 million for RACP projects. As a result, the state would save **\$7.2 million** annually or \$144 million over 20 years.⁵⁶

• **Reduced State Energy Costs: \$3 million**

The Commonwealth, at the start of the 2015-2016 fiscal year, saw gasoline prices drop below \$2.00 a gallon. As a result of the reduced energy costs, the state saved up to \$1 million a month. For the purpose of this report, savings from reduced energy prices were assumed to be \$500,000 or \$3 million over the first half of the fiscal year.⁵⁷

⁵⁴ <http://www.paauditor.gov/press-releases/auditor-general-depasquale-pledges-to-build-on-savings-realized-through-internal-cost-cutting-provide-high-quality-audits>

⁵⁵ <http://ldpc6.legis.state.pa.us/WU01/LI/BI/FN/2015/0/HB0928P2409.pdf>

⁵⁶ <http://www.legis.state.pa.us/WU01/LI/BI/FN/2015/0/HB0930P1455.pdf>

⁵⁷ <http://www.witf.org/news/2016/03/low-gas-prices-saving-the-state-at-least-500k-a-month.php>

• **Bipartisan Legislative Ideas: \$23.3 million**

The following are bills from the current session and prior session which would save taxpayers additional money:

- **Senate Bill 452 (2015-2016):** introduced by Senator Boscola, the legislation “amends the Prisons and Parole Code to discontinue the current policy within the Department of Corrections that provides inmates with postage-paid envelopes for personal use”. The Senator, in her co-sponsor memo, estimated her legislation would save the Commonwealth **\$2.7 million annually**.⁵⁸
- **House Bill 251 (2015-2016):** introduced by Representative Adam Harris, would require lottery winners to pay any delinquent taxes owed to the Commonwealth from their winnings. This legislation passed unanimously last year as House Bill 1489 and the fiscal note, attached to the bill, estimated the proposal saves Pennsylvania **\$173,000**.⁵⁹
- **House Bill 153 (2015-2016):** introduced by Representative Knowles, this legislation amends the Pennsylvania Constitution to reduce the size of the House of the Representatives. Under the bill, the House of Representatives would be reduced to 151 members from 203 members. Once enacted this will annually save taxpayers **\$10-15 million**. Next year the amendment will cost taxpayers \$1.5 million for advertisement.
- **House Bill 1112 (2015-2016):** introduced by Representative Brown, this legislation would reduce costs for school districts by eliminating burdensome or unnecessary data collection requirements.⁶⁰ The savings for the school district can be reapplied to their budget which reduces the amount financial assistance they will need from the state.
- **House Bill 1119 (2015-2016):** introduced by Representative Hill, this legislation would provide our school districts with much needed relief from burdensome mandates. Under the legislation, if a school district applies for a waiver from a mandate and can show how the new process is more efficient, economical or educational, the waiver will be approved by the Department of Education (PDE). Mandates included in the act are Prevailing Wage Act, Separations Act, State Board of Education regulations, standards from the Secretary of Education and most provisions of the school board.⁶¹ As a result, of the millions saved by school districts, the money can be reapplied to their budgets and will reduce the amount of financial assistance they will need from the state.
- **House Bill 403 (2014-2015):** Introduced last session to reduce fraud within the Unemployment Trust Fund. From July 1st of 2011 to June 30th of 2012, the state had \$158 million paid out to fraudulent unemployment claims. This was double the national average

⁵⁸<http://www.legis.state.pa.us/cfdocs/Legis/CSM/showMemoPublic.cfm?chamber=S&SPick=20150&cosponId=16713>

⁵⁹<http://www.legis.state.pa.us/cfdocs/Legis/CSM/showMemoPublic.cfm?chamber=H&SPick=20150&cosponId=16319>

⁶⁰ <http://ldpc6.legis.state.pa.us/WU01/LI/BI/FN/2015/0/HB1112P1798.pdf>

⁶¹<http://www.legis.state.pa.us/cfdocs/Legis/CSM/showMemoPublic.cfm?chamber=H&SPick=20150&cosponId=18201>

at the time and considerably higher than surrounding states. The legislation increased the number of penalty weeks for unemployment fraud and increased the penalty for fraud. The fiscal note for the legislation showed the proposal would save the state **\$22 million**.⁶²

⁶² <http://www.legis.state.pa.us/WU01/LI/BI/FN/2013/0/HB0403P1389.pdf>

Short-Term Budget Reforms

As we begin the conversations on how best to balance the budget for the next fiscal year, the General Assembly must simultaneously begin a process of rigorous legislative oversight and immediate reforms to the budget process. The combination of these reforms and improved legislative oversight will ensure that government spending prior to the implementation of long-term reforms benefits taxpayers.

Under the status quo, the Commonwealth assumes a flat and generic increase across most line items and programs. In four of the last five budgets, Republicans assumed an increase of costs within the budget at the rate of inflation. However, the current administration as sought to increase spending more than 5% for both 2015-2016 and 2016-2017. Budget spending assumed to be automatic with the only discussion being not whether programs need more funding, but how much more funding they will receive.

This practice of assuming automatic increases is troubling as the State Treasury that reported the Wolf Administration spent \$2.7 billion last fiscal year in lapsed funds. Even more troubling is the fact administrations, Republican and Democrat alike, spend on average \$2.3 billion in lapsed funds. Effectively, despite having billions of remaining funds every year, the Commonwealth still assumes automatic increases. In order to reform this practice, the Commonwealth should consider the following policies to improve accountability.

- **Taxpayers Bill of Rights**

The Taxpayers Bill of Rights (TABOR) refers to a practice of limiting expansion for state revenues and state expenditures. The limit for state expenditures under TABOR reflects the rate of inflation and population growth as policymakers try to rein in government spending.⁶³ In order to control spending and address the cyclical deficit, lawmakers have proposed a tax expenditure limitation (TEL). The proposal introduced by Senator Folmer, Senate Bill 7, was re-referred to the Senate Appropriations Committee in May of 2015.

As established in Senate Bill 7, the growth of state expenditures would be limited to the lowest of the following options:

- Changes in Personal Income Tax revenue over the past three years
- Changes in the state population over the past three years plus the rate inflation

Additionally, Senate Bill 7, the Taxpayers Protection Act would handle excess revenue by returning 25% to the taxpayers, 25% to the Rainy Day Fund and 50% to the current unfunded liability.⁶⁴

⁶³ <http://research.wpcarey.asu.edu/economics/tabor-laws-discipline-or-disaster-for-state-spending/>

⁶⁴ <http://www.legis.state.pa.us/cfdocs/Legis/CSM/showMemoPublic.cfm?chamber=S&SPick=20150&cosponId=157>

- **Act 146 Waivers**

Throughout this report, the abuse of lapsed funds by the Wolf Administration has been mentioned on multiple occasions. The methods for lapsing funds by a governor and his administration are provided for Act 146 of 1980. This law allows for Republican and Democrat administrations to manage cash flow by requesting the budget secretary to lapse unspent state funds. The budget secretary after approving the request will provide the appropriation committee of the House and Senate with written notice and requesting input from members. Despite this fact, the actual oversight from the General Assembly in this process is minimal at best. This was evidenced during the budget impasse as the Wolf Administration broke with prior precedent and used waivers as a supplemental budget.⁶⁵

In order to restore the intended use of Act 146 waivers, the General Assembly needs to enact reforms which would require waivers to receive the approval of both the House and Senate Appropriation Committee. This oversight will prevent the use of state funds for expenses such as a study on domesticated animals at a time when schools were not being funded.

- **Expand Legislative Oversight**

Due to the many questionable actions of the Wolf Administration, the General Assembly should strengthen its tools for legislative oversight of executive spending. The tools for this oversight should include:

- **Restricting Treasurer Payments:** On March 3, 2016, the treasurer, at the request of the Wolf administration released funds to the Department of Corrections. However, the amount of the funds exceeded the funding amount enacted into law. Not only did the payments exceed the amount enacted, but they exceeded the amount passed by the General Assembly prior to the governor's line-item veto. In order to protect the constitutional separation of powers and prevent executive overreach on spending, the General Assembly should pass legislation prohibiting similar payments.
- **Transparency of State Contracts:** Due to the budgetary impact of state contracts on long-term and short-term costs, the General Assembly should pass legislation to provide greater transparency. Legislating to expand Act 15 of 2016, would require all state contracts and contract amendments with executive agencies to include a fiscal note. The importance of a fiscal note for these actions is simple: the contracts signed by the governor impact the budget.
- **Transparency for Executive Orders:** Representative Gingrich's House Bill 826 would provide financial transparency for taxpayers by requiring executive orders from the governor to have a fiscal note attached. Similar to transparency concerning state contracts, the legislation is important due to the impact of executive orders on the budget.

⁶⁵<http://www.repgrove.com/Display/SiteFiles/103/OtherDocuments/Grove%20Administration%20Spending%20Report%20Final%20.pdf>

- **Federal Grant Transparency:** According to the Treasury Department the Commonwealth's total budget during Governor Corbett's, last year 2014-2015 was approximately \$99 billion. In comparison, the General Fund budget for the 2014-2015 fiscal year was \$29.4 billion or 30% of the total budget. This means that of the remaining 70% (\$69.6 billion), a significant portion of these dollars come from the federal government. These federal funds often take the form of grants providing taxpayer dollars to state governments in return to their adherence to a clear set of criteria. The criteria established by unelected bureaucrats in Washington have a major impact on state budgets. This type of impact is illustrated by the criteria established by the federal government under the ACA for Medicaid Expansion. In return for expanding our Medicaid program as defined by the rules established, the federal government provides the Commonwealth with a specific amount of federal funds. However, as the IFO reported, these funds are temporary and will eventually have to be replaced by state funds.⁶⁶

In order to prevent a crisis within our budget from the loss of federal funds, the Commonwealth should pass legislation requiring a full list of federally funded programs and their effectiveness. Additionally, state agencies should be required to establish contingency plans in the case federal funds are reduced or cut for those programs. The Commonwealth, by passing this reform, can insulate itself from the budgetary uncertainty in Washington D.C. while providing necessary services.

- The devastating impact on state budgets when federal funds are reduced or ended can be seen with the federal stimulus or The American Recovery and Reinvestment Act of 2009 (ARRA). In 2009, Pennsylvania used \$654 million of federal funds from the ARRA to fund basic education and \$1.6 billion to fund human services.⁶⁷ After the federal funds provided by the stimulus were no longer available, the Commonwealth faced a \$2.3 billion deficit in the general fund from these two line-items.
- **Strengthening PennWatch:** After it became known how the administration was using waivers for supplemental appropriations, attempts were made to track spending using PennWatch. This program was designed to allow the public and the legislature to track state spending. Disturbingly, the administration only disclosed 4% of its spending from July 1st –October 31st of 2015. As the complaints about the administration's lack of information for PennWatch have grown, the time has come to update the law. Representative Jim Christiana has a proposal to increase financial transparency by amending the law to have PennWatch administered by the IFO. This would remove the site from the administration's control. At the same time, Representative Christiana proposes PennWatch be updated to include:

⁶⁶ http://www.ifo.state.pa.us/download.cfm?file=/resources/PDF/Medicaid_Expansion_Report_%20May_13.pdf

⁶⁷ <http://www.budget.pa.gov/PublicationsAndReports/Documents/2009-10%20Enacted%20Budget%20Line%20Item%20Appropriations%20.pdf>

- Budget Information sent by the governor to the legislature including agency specific material.
- Official revenue estimates for each fiscal year
- All reports required by statute to be submitted to the General Assembly
- Links to official agency social media accounts not simply websites.

In addition to the changes proposed by Representative Christiania, PennWatch should provide flexible data which can be downloaded by the general public and legislators. These changes should be debated by the legislature to ensure PennWatch provides taxpayers with the financial transparency as intended.

- **Reporting of Cost Savings:** The General Assembly should introduce legislation to require the budget office to verify all cost savings from an official budget and financial documentation. This information should include whether or not the funds are available and the line-item from which the savings were generated.

• **Independent Fiscal Oversight**

In order to strengthen fiscal oversight and accountability within the executive branch, the General Assembly should pass legislation creating an independent Office of the Inspector General. Currently, the Inspector General is a cabinet level position chosen by the governor. Under House Bill 1618 and Senate Bill 1025, introduced by Representative Fee and Senator Aument, the inspector general would be provided with greater autonomy from the governor.

The legislation provides the Office of the Inspector General this autonomy by changing current law to have the Inspector General selected by the governor and confirmed by the Senate. This process is similar to the current process used for the Office of Open Records. Upon confirmation, the Inspector General would serve a six-year term which extends beyond a governor's term. No individual who was confirmed by the Senate could serve more than two terms which is the equivalent of three gubernatorial terms. By extending the office beyond the influence of any singular governor, regardless of party, the Inspector General would be empowered to pursue waste, fraud and abuse with greater effectiveness.

Economic Growth

Addressing the Commonwealth's budget deficit through the adoption of short-term and long-term reforms is absolutely critical for protecting taxpayers.

However, in order to address the economic aspect of the cyclical deficit, the Commonwealth must adopt prudent public policy measures directed at growing our economy. These pro-growth policies must include reduce the regulatory burden and improve the economic climate for private-sector job creation.

- **Commerce Court**

The City of Philadelphia, over the past decade, has been able to improve its economy through the Commerce Case Management Program. This specialty court served to improve the economy by fostering fairness, predictability and efficiency within Philadelphia's business law cases.⁶⁸ Philadelphia is not the only city in Pennsylvania that benefited from a business court as Pittsburgh has also seen business confidence increase. By adopting a statewide commerce court, the Commonwealth can create a powerful incentive to bring companies to Pennsylvania.

- **Regulatory Reform**

The impact of burdensome regulations on economic growth is well-known. Regulations reduce the rate of growth. The negative economic impact of regulations by some analysts suggests that regulations have reduced economic growth by 2%.⁶⁹ In order to reduce the Commonwealth's growing economic burden Representative Godshall introduced House Bill 965. This legislation empowers standing committees and their members to have greater oversight and authority to reject new regulations.⁷⁰ By improving the review process with thorough examination, the state can prevent the regulatory burden from discouraging economic growth.

- **Reducing the Corporate Net Income Tax**

As it currently stands, the State of Pennsylvania has the second highest corporate tax and the highest flat corporate tax in the country. The 9.99% corporate net income, when combined with the federal tax means a company will lose 44.99% of its earnings to taxation for operating in the Commonwealth.⁷¹ In order to make our state competitive with the rest of the country the Corporate Net Income (CNI) tax needs to be reduced. Reducing corporate tax rates has proven successful as the Commonwealth saw business tax revenue increase after phasing out the Capital Stock and Franchise tax. Another reason to reduce the corporate tax rate is the overwhelming research

⁶⁸<http://apps.americanbar.org/buslaw/committees/CL150011pub/materials/reports/Committeeof70.pdf>

⁶⁹ <http://www4.ncsu.edu/~jjseater/regulationandgrowth.pdf>

⁷⁰ <http://ldpc6.legis.state.pa.us/WU01/LI/BI/FN/2015/0/HB0965P1885.pdf>

⁷¹ <http://taxfoundation.org/article/state-corporate-income-tax-rates-and-brackets-2016>

indicating, in terms of economic growth, that the CNI is the most harmful tax.⁷² This being said, in order to be responsible stewards, the CNI should be gradually reduced to lower the short term revenue impact. Representative Ortity has a legislative proposal which would gradually reduce the CNI from 9.99-4.99%.⁷³

• **Corporate Tax Report Amendments**

House Bill 1198, introduced by Representative Dunbar, codifies a process for a company to amend its tax report. By placing in law a process for review and appeal of tax reports by the Department of Review, the legislation will place Pennsylvania's review process in line with other states. In addition the legislation will provide greater economic certainty within the process while generating additional tax revenue.⁷⁴

• **Small Business Tax Reform**

While the Commonwealth must reduce the corporate tax rate, the state must also address problems with our small business tax structure. Small businesses, providing up to approximately 65% of the state's jobs, are often placed at a disadvantage by operating under separate rules. Unfortunately, the rules for small business in Pennsylvania not only differ from federal rules, but the state's own rules for larger companies. In order to address these differences, members of the House and Senate have introduced three pieces of legislation to improve our small business tax law. These bills are:

- **House Bill 700 and Senate Bill 601:** Introduced by Representative Bloom and Senator Folmer, addresses a pertinent example of application the different rules prevailing on state and federal levels. Under current law, small businesses are liable for Pennsylvania taxes on exchanging assets of a similar nature while the same transaction is exempt from taxation on the federal level.⁷⁵
- **House Bill 702 and Senate Bill 703:** Introduced by Representative Dunbar and Senator Hutchinson, addresses another tax inequity for small businesses. Under this legislation, small businesses would be allowed to deduct Section 179 expenses as they are allowed on federal taxes. Currently, the income limit for this expense on the Personal Income Tax within the state is \$25,000. This legislation would expand that cap and match federal expensing requirements for small businesses.⁷⁶

⁷² <http://taxfoundation.org/article/what-evidence-taxes-and-growth>

⁷³ <http://www.legis.state.pa.us/cfdocs/Legis/CSM/showMemoPublic.cfm?chamber=H&SPick=20150&cosponId=19246>

⁷⁴ <http://www.legis.state.pa.us/WU01/LI/BI/FN/2015/0/HB1198P2683.pdf>

⁷⁵ <http://www.legis.state.pa.us/cfdocs/Legis/CSM/showMemoPublic.cfm?chamber=H&SPick=20150&cosponId=17019>

⁷⁶ <http://www.legis.state.pa.us/cfdocs/Legis/CSM/showMemoPublic.cfm?chamber=S&SPick=20150&cosponId=17155>

- **House Bill 701 and Senate Bill 602:** Introduced by Representative Grove and Senator Eichelberger, addresses a gap in the Commonwealth's current tax law for small businesses. Under current law, large companies which lose money in a given tax year are allowed to write off a portion of the loss from their tax liability in a different tax year. Oddly, although large companies are allowed to this option, the Commonwealth does not provide small business the same option. If enacted this legislation would allow small businesses to cope with early losses, a common occurrence, and use profits to expand their operations as time goes on.⁷⁷

● **Net Operating Loss Deductions**

As previously mentioned, the Commonwealth allows large companies to later write off a portion of their loss on their tax liability. The state currently caps this tax deduction at \$5 million or 30% of the total loss. In order to create an environment for the private sector to better handle tough economic years and hire new employees during profitable years, the Commonwealth should slowly increase the cap. This schedule would gradually increase over 10 years from year 1 at the current cap of \$5 million or 30% to \$14 million or 100% in year 10. Under the schedule, a company would file under whatever is the lower of the two options.

● **One-Stop Online Permitting Portal**

House Bill 2022, introduced by Representative Peifer and Senator Brooks during the session of 2011-2012, created a one-stop shop for permitting.⁷⁸ In particular, this legislation created an advisory committee within DCED to create a single place for companies when searching for applications, forms, permits, licenses and registrations. Although the legislation created a single place for companies to go, the bill did not interfere with existing regulatory authority. The impact, if enacted, would serve to reduce the burden and the time wasted that a company faces when interacting with state government.

● **Increased Energy Production & Utilization**

- **Non-Surface Disturbance Horizontal Drilling:** During the 2014-2015 fiscal year, executive order EO 3-2014 proposed to generate \$95 million in new nontax revenue for the Commonwealth through horizontal, non-surface disturbance drilling. This initiative reflects a policy adopted by current DEP Secretary John Quigley when he was formerly DCNR Secretary under Gov. Rendell. By restoring this policy, the Commonwealth could realize additional nontax revenue to address the structural deficit, while still ensuring protections for our natural resources. The result of restoring EO3-2014 will generate new nontax revenue. However, with the current uncertainty energy markets, the amount of revenue generated by this proposal is not known

⁷⁷<http://www.legis.state.pa.us/cfdocs/Legis/CSM/showMemoPublic.cfm?chamber=H&SPick=20150&cosponId=17019>

⁷⁸ <http://ldpc6.legis.state.pa.us/WU01/LI/BI/BS/2011/0/HB2022P3789.pdf>

- **Game Commission:** The ability of this proposal to generate revenue for the Commonwealth was seen this fiscal year as the Game Commission received \$22.1 million in nontax revenue last fiscal year. Despite the Executive Order from Governor Wolf, the commission implemented three transactions worth \$1.5 million in new revenue. This revenue excluded the 18% in royalty fees which the companies must pay as part of the agreement.⁷⁹
- **Permit reform:** Lack of predictable, regionally consistent permit review timeframes result in delayed projects and lost or reduced capital investment. By adopting sensible, predictable permitting timelines in statute, we will signal to capital investors that Pennsylvania is serious about infrastructure development and growing markets for our energy resources. Due to the inconsistent and lengthy permitting process across the Commonwealth, the regulatory environment is harmful to economic growth. Creating an efficient and uniform process across the Commonwealth will increase investments and grow our economy.⁸⁰
- **Targeted investment for maximum returns:** Act 25 of 2016 re-allocates \$12 million in unused funds from the Alternative Energy Investment Act to the newly created Natural Gas Infrastructure Development Fund to target for critical infrastructure projects that extend natural gas service to large users. By implementing this policy, and expanding funding through the use of other existing, under-utilized funding sources, the Commonwealth can attract and retain jobs, grow demand for Pennsylvania-produced energy, and increase revenue through new sales, income and other tax revenues.

⁷⁹ <http://triblive.com/business/headlines/9504996-74/game-commission-gas>

⁸⁰ <http://triblive.com/business/headlines/10418737-74/gas-business-permit>

Conclusion and Recommendations

As we enter negotiations for the 2016-2017 budget, much of the conversation will focus on addressing the budget deficit. However, the General Assembly must prioritize protecting taxpayers as it addresses the deficit. In order to protect taxpayers, this report serves to identify cost savings along with substantive budgetary reforms which merit legislative deliberation and consideration.

With the Commonwealth having just closed a deficit during the 2015-2016 fiscal year, the General Assembly should begin adopting similar policies for next fiscal year. These policies include utilizing cost reductions, maximizing our current revenues and adopting policies to grow our economy. The adoption of these policies would provide over **\$3 billion** to address the cyclical budget deficit of \$1.5 billion without increasing taxes.

Addressing the deficit is more than a series of policy proposals for the next fiscal year. If the Commonwealth is to address the cyclical deficit in the long term, the state must reform the entire budgetary process. In order to effectively protect taxpayers, these reforms must address the problems which were revealed during the budget impasse. These areas must include Act 146 Waivers and end the use of the Stat Treasury to bypass the legislature.

As mentioned on several occasions, the administration utilized Act 146 waivers to direct lapsed state funds as a supplemental budget. This included **\$140,000** for a study of domesticated animals.⁸¹ In order to prevent the misuse of lapsed funds, the General Assembly should pass legislation to require Act 146 waivers be approved by House and Senate Appropriation Committees.

Following the governor's request to the treasurer to fund the Department of Corrections, the General Assembly must pass legislation to protect the separations of power. Unfortunately, this action is necessary after the treasurer, upon the request of the Wolf Administration, funded corrections above the amounts enacted into law. The amounts approved by the treasurer even exceeded the amount approved by the General Assembly prior to Governor Wolf's line-item veto. Addressing this problem requires legislation which limits the loopholes for the administration to fund budget lines outside the General Assembly.

Along with passing reforms which change the budget process in the short-term, the legislature should adopt reforms which dramatically change the budgetary process. Although there is difficulty in a system which uses a zero-based budget, the Commonwealth should adopt legislation which requires a zero-based budget review every four years. During the fourth year, the administration and the General Assembly should meet, upon election or reelection of the governor to establish priorities for the Commonwealth over the next four years. These priorities would act

⁸¹<http://www.repgrove.com/Display/SiteFiles/103/OtherDocuments/Grove%20Administration%20Spending%20Report%20Final%20.pdf>

as a strong vision and foundation for state spending with funding being based on a priority assessment and performance measurement of state programs.

In order to have the necessary performance data, the Commonwealth should adopt similar practices to the federal Office of Management and Budget to measure program success. This task should be handled by the Independent Fiscal Office. The existence of performance metrics is essential as it will provide tools for General Assembly to strengthen accountability and increase oversight of the taxpayer's money.

In order to ensure the success of these reforms, the Commonwealth should consider adoption of a two-year budget process to provide time for a thorough evaluation of state programs. If adopted, this process would serve to increase the state's financial stability while reducing the Commonwealth's budgeting costs. More importantly, this process would allow the state to utilize the most accurate data for the zero-based budget review in year four.

This hybrid model will serve to reduce the costs of government and will provide and shape funding for the Commonwealth's priorities. In short, this hybrid model empowers the administration and the General Assembly to meet their obligation to be stewards of taxpayer money by ending failing programs, providing financial stability and focusing funding into the priorities of Pennsylvanians.

As we enter the negotiations over the 2016-2017 budget, we must remember that before asking taxpayers to pay higher taxes state government must reform the entire budget process. These reforms ensure greater accountability and efficiency to taxpayers on how their money is currently used. As a result of these reforms, the Commonwealth of Pennsylvania can balance the cyclical deficit in the budget and protect taxpayers without raising taxes.