

CAPITAL NEWS



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Governor Ridge Proposes a “Good News” Budget

Governor Ridge unveiled his proposed budget for the fiscal year beginning July 1, 2000 on Tuesday, February 8. The budget proposal will be the center of attention for the legislature and a large number of interest groups and individuals. In addition to being a tax and spending blueprint, the document provides considerable insight into policy priorities in a number of areas. This *Capital News* summarizes the issues in the budget proposal of concern and interest to PEL members and staff.

Overview

The Commonwealth’s budget proposal for the fiscal year 2000-01 would allocate over \$40 billion from all sources including state funds, federal funds and other revenues. This review and analysis concentrates on revenues and spending from the General Fund. The General Fund receives most of your taxes and pays for most of your state services. The table below summarizes the General Fund Financial Statement for the coming fiscal year.

2000-2001 General Fund Financial Statement

Beginning Balance		\$ 443,879,000
Total Net Revenues	\$19,897,700,000	
Less: Proposed Tax Cuts	<u>\$ 643,500,000</u>	
Available Revenues		<u>\$19,254,200,000</u>
Total Available for Spending		\$19,698,079,000
Less: Proposed Spending		<u>\$19,678,087,000</u>
Projected Ending Surplus		\$ 19,992,000
Less: Transfer to Rainy Day Fund		\$ <u>2,999,000</u>
Projected Ending Balance		\$ 16,993,000

Governor Ridge's budget recommends a \$399 million increase in spending for next year. This is a 2.1% increase in appropriations over last year (excluding transfers to the Rainy Day Fund), which brings General Fund spending to \$19.7 billion.

The budget projects revenues to total \$19.3 billion, an increase of .5%. This total is net of a tax reduction of \$643.5 million. Without the proposed tax cuts, revenue collections for the next budget year would exceed the present year's projections by \$880.4 million or 3.8%.

As has been the case in the past several years, spending would exceed revenues in the governor's budget. The plan projects spending to exceed revenues by \$423.9 million. This difference is funded by an anticipated surplus of \$443.9 million from this year that would remain after the statutorily mandated deposit of \$54 million into the Rainy Day Fund. The balance in the Rainy Day Fund will rise to \$1.1 billion or 5% of General Fund spending. The money in this Fund acts as a reserve for future use during more financially difficult times. The governor proposed and the General Assembly enacted extra payments into the Fund as part of the budget in the past few years to reach the 5% goal.

The surplus is due in large part to higher than expected revenues of \$463.8 million in the current year. The large increase over the original estimates comes from higher receipts from the largest revenue producers – Corporate Net Income Tax, +\$150 million; Sales and Use Tax, +\$180 million; and the Personal Income Tax, + 110 million. The potential remains for an even higher surplus should collections exceed these adjusted estimates by the end of this fiscal year, as has been the case for the past few years.

Tax Cuts

Governor Ridge's budget proposes to reduce taxes for the seventh year in a row with tax cuts totaling \$643.5 million. Specifically these include:

- The rate of the Capital Stock and Franchise Tax would be reduced from 10.99 mills to 8.99 mills effective January 1, 2000. In addition, the existing minimum payment of \$200 would be eliminated - a particular benefit to smaller businesses. The entire tax would be phased out over the following nine years at a rate of one mill per year. Estimated savings - \$289 million this year.
- A one-time 100% rebate of school property taxes (maximum of \$100) would be distributed to each homeowner. An additional \$6 million can be found in the budget of the Department of Community and Economic Development for processing the rebate data. Estimated rebate - \$330 million.
- Computer buyers would benefit from two sales tax-free weeks next fiscal year. During a week in early August and one in February around Presidents Day, no sales tax would be charged on the purchase of new computers. The holiday would apply to non-business use computers only. Estimated savings - \$8.3 million.
- The number of people eligible for exemption from the Personal Income Tax would increase for the third time in the last three years. The income eligibility limit for each dependent

would be raised from \$6,500 to \$7,500. In effect, a family of four would not pay income tax if their taxable income were less than \$28,000. Estimated savings - \$16.2 million.

There appears to be a convergence of philosophy this year on tax cuts. For the first time, the governor's proposal includes a significant reduction for individual taxpayers (one-time property tax rebate) in addition to business tax reductions. Prior to the governor's proposal, the Democratic Caucus of the House of Representatives proposed a package of business tax reductions, a major departure from past proposals that focused on tax reductions for individuals. These new policy positions set up a new dynamic for dealing with the pending budget surplus. This year the debate will focus on how much tax relief individuals and businesses receive, rather than on which class of taxpayer will benefit.

Significant Program Spending Changes

As in past years, the budget proposal includes a number of expenditure increases that are meaningful to specific people or organizations. More important, they paint a bigger picture of the direction the Governor wants to move public policy during his second term of office. The following reviews the most significant changes proposed in the budget of interest to PEL members and staff.

Economic and Community Development

State funding for the Department of Community and Economic Development would actually decrease by \$17.5 million in the next year when compared to the present year. However, this is not a clear indicator of the budget priorities. The net reduction is due to a significant number of "nonrecurring" projects and programs and other one-time expenditures. These include a nearly \$50 million reduction in the community revitalization program (an amount likely to be restored, at least in large part, by the General Assembly) and \$23 million less in funding for two revolving loan fund programs that received heavy one-time capitalization in this year's budget.

Programs benefiting from large increases are concentrated in the following three areas of economic development:

- The nurturing and promotion of technology and technology companies remains at the head of the line. Budgets of the past two years established and expanded technology-related programs. This budget reinforces the trend by providing significant new resources to the Pennsylvania Technology Investment Authority, Technology Trade Ports, Customized Job Training, the Ben Franklin and Industrial Research Centers, and the SciTech Scholars programs.
- Direct investment in job creation will benefit by an increase of \$28 million for the Opportunity Grant Program and \$4 million for machinery and equipment loans.
- Finally, a variety of the Department's marketing programs will receive a significant boost. Marketing funds benefit business and tourism attraction at the state and regional levels.

Most community development programs would continue to be funded at current levels. The exception is proposed new funding for planning assistance. The initiative is in response to the work of the 21st Century Environment Commission. The program would provide an additional \$3.1 million for planning assistance on a multi-municipality basis and would train communities on the requirements of the new economy.

Education

Education continues to consume the largest portion of the state budget. The focus of this year's budget continues many of the initiatives proposed and enacted for fiscal year 1999-2000. These include three major themes: basic education funding, school accountability and performance, and education technology. School vouchers do not reappear in this budget proposal.

Highlights of the education budget include:

- Increasing basic education funding of \$110 million or 3%. All school districts would be guaranteed a 1% increase and less wealthy school districts could receive up to a 4% increase.
- Creating a new Education Empowerment Act designed to turn around poorly performing schools. The issue surfaced this past year; however, this \$20 million version is without the voucher component that caused a stir previously.
- Doubling of the performance incentive grants to \$33.5 million. These grants reward improvement in academic achievement and effort on a competitive basis.
- Revising the special education funding formula and providing for a \$46.9 million increase. The proposed change moves the funding formula toward school districts with moderate to low levels of local wealth.
- Increasing funds for financial aid for higher education by \$28.6 million or 10%. Smaller percentage increases are in store for higher education institutions. This reflects the continuing philosophy of funding following the student rather than being tied to the institution.

Environmental Protection and Conservation

One issue dominates the budget proposal for environmental programs. The Growing Greener initiative's second year would be funded at \$135 million. The authorizing legislation allocates the money as follows:

- \$20 million to the Department of Agriculture for farmland preservation;
- \$50.5 million to the Department of Environmental Protection for watershed and restoration projects;
- \$32.5 million to the Department of Conservation and Natural Resources for upgrading state parks and forests and conservation activities in communities;
- \$32 million to the Pennsylvania Infrastructure Investment Authority (PENNVEST) for water and sewer projects.

Budget Analysis

Pennsylvania's budget continues to grow in step with the state, national and global economies. This growth is reflected in the increase in size by more than \$4 billion, or 25% since 1994-95, to \$19.7 billion. This budget, for the first time in several years, would increase spending at less than the rate of inflation. Also, the content of the spending plans over the past several years has been changing. Social services, while continuing to grow, now receive a smaller portion of the total spending. Technology-related issues in economic development, education and many other areas now dominate the budget proposal headlines.

On the revenue side of the ledger, the business community is slated for a tax cut for the seventh straight year. The tax reduction initiative recognizes that Pennsylvania's business tax structure is not competitive and seeks to remedy the situation. However, business tax cuts to date have been incremental. Based on a PEL study published last year, these cuts have served to maintain Pennsylvania's competitive position in relation to other states. Unfortunately, we have maintained our position among the least competitive states. The governor's proposal to phase out the Capital Stock and Franchise Tax over ten years will gradually improve Pennsylvania's competitive position, assuming that other states do not take similar actions.

The governor's proposal to rebate \$100 to homeowners is welcome news to legislators who have concerns over property taxes. This proposal is only one-time, although it may set a precedent for future budget surplus years. The rebate must be put into perspective. Because the property tax is the largest revenue generator for all local governments – school districts, municipalities and counties – a \$100 rebate would barely make a dent in the average homeowner's tax liability. For example, the median school real estate tax bill for residential property owners is \$1,136. The rebate amounts to 8.8% of that amount. This excludes county and municipal property taxes, which if taken into account, would likely lower this percentage to about 6% of total property taxes.

Overall, the large expected surplus for this year will again set the stage for a budget that can provide a little something for everybody. The governor continues to solidify his gains on policy issues consistent with his philosophies on education and economic development through targeted increases in spending. On the revenue side, a change in priorities emerged. For the first time, significant tax cuts would be directed toward individuals and would be combined with a long-term commitment to business tax reduction.

The Harrisburg Office of PEL will continue to follow the debate as it unfolds and report on its final passage.