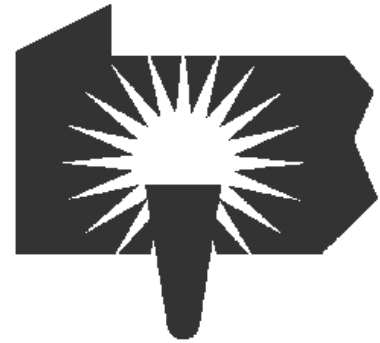


CAPITAL NEWS



NEWS AND VIEWS FROM THE PENNSYLVANIA ECONOMY LEAGUE - CAPITAL DIVISION
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Where Does the Money Go? Pennsylvania's 1999-2000 Budget

Cementing what has become a trend in recent years, the General Assembly passed another early state budget, approving the Fiscal 1999-2000 spending plan last Wednesday, May 5. The author of this trend is yet another surplus of approximately \$630 million. With that much money on the table, budget negotiations focused on how to divide the pot - the result is some to the Rainy Day Fund, some to increased spending, as well as significant tax cuts. Major elements of these three categories are described below.

Rainy Day Fund

The Rainy Day Fund received its statutory transfer of 15% of the closing balance or \$94.4 million, plus an additional \$150 million for a total contribution of \$244.4 million. This brings the state's nest egg to 5% of the General Fund, meeting the Governor's goal and the recommendations of various fiscal experts and rating agencies.

Revenues and Tax Cuts

Revenue forecasters are predicting revenue growth during the next fiscal year of .94%. While this is a modest increase, it is calculated after accounting for significant tax cuts. Those cuts total nearly \$400 million with 72% of the tax savings directed at business taxpayers, 27% to individuals, and 1% to a miscellaneous category. The highlights include:

- A reduction in the rate of the **Capital Stock and Franchise Tax** from 11.99 mills to 10.99 mills as well as a \$100 reduction in the minimum tax payment to \$200. Estimated savings - \$124.7 million.
- The **Corporate Net Income Tax** will be reduced for many companies through two structural changes. The cap of \$1 million per year on the Net Operating Loss deduction will increase to \$2 million and the sales factor used in the apportionment formula will increase from 50% to 60%. Estimated savings - \$67 million.

PEL played a role in the changing apportionment formula. We have long advocated movement towards a 100% sales factor apportionment formula both in a 1997

research study highlighting the potential economic benefits as well as in marketing efforts aimed at legislators and the Governor's Office.

- **S-corporation** eligibility will expand to more closely match Federal rules. Estimated savings - \$11.2 million.
- The **Public Utility Realty Tax** will be restructured in the wake of utility deregulation to reduce the tax burden by an estimated \$54.6 million.
- The **Gross Receipts Tax** on natural gas will be repealed should the deregulation of the gas utility industry occur. Estimated savings - \$78.8 million.
- **Personal Income Tax** forgiveness will be expanded from \$6,000 to \$6,500 per person so that the income threshold at which a family of four owes income tax increases from \$25,000 to \$26,000. Estimated savings - \$7.5 million.

In addition to the tax cut package described above, senior citizens will benefit from an expanded **Property Tax/Rent Rebate** program when authorizing legislation is passed by the General Assembly. This change is expected to save older Pennsylvanians an estimated \$96.8 million by exempting from eligible income one-half of Social Security benefits. The program is and will continue to be funded by lottery proceeds.

Significant Program Spending Changes

Total General Fund spending of slightly more than \$19 billion represents an increase of \$700 million or 3.8% according to Budget Office calculations. This is considerably more than the Governor's proposed 2.9% increase and represents a departure from the budgets of the previous five years which, on average, expanded spending by 3%. Some of the more significant expenditures, particularly those related to the PEL mission, are highlighted below.

Community and Economic Development

The Department of Community and Economic Development (DCED) will see a significant budget increase of 22% or \$77.6 million. Last year, the focus of agency spending was workforce development. This year, technology development is very clearly the primary goal of new spending. Secondary and often related objectives are business and tourism development as well as community development.

Technology and Economic Development

A number of new programs fall into this category, including:

- The **Pennsylvania Technology Investment Authority** which will meet the financing needs of high-tech and knowledge-based companies. The new authority will be funded with \$18.2 million in this budget and will be capitalized by a recommended \$91 million over five years.

This program includes funding for Electronic Commerce grants to encourage existing companies to participate more fully in the digital economy. This was a major recommendation in a 1998 Pennsylvania Economy League study outlining a strategy for state government to promote e-commerce.

- **Regional Marketing Partnerships** is a \$5 million program designed to coordinate and allocate regional efforts to promote tourism.
- **Cyberstart** is a \$1.6 million budget item which will provide Internet access to daycare centers.

New and reallocated spending will also expand a number of existing programs, including:

- **Interactive Marketing** funded by an additional \$4 million will support expanded Internet marketing efforts to develop Pennsylvania tourism and business development. The marketing program will also focus on attraction and retention of tech students and knowledge workers.
- Capitalization of the **Small Business First Fund** will be expanded from \$2 million in 1998-99 to \$25 million to support the capital needs of smaller businesses. This is significantly higher than the Governor's \$8 million recommendation.

Community Development

There are also a number of new efforts to strengthen Pennsylvania's communities.

- The **World Class Communities** program is a new \$475,000 effort to help communities develop strategies for economic development, growth management, and environmental protection. It will enhance the activities of more traditional programs like the Planning Assistance and Shared Municipal Service programs which are both funded at under \$1 million.
- **Community Revitalization** funding was almost doubled to \$84.6 million in spite of the Governor's recommendations to cut this program. Funds in this appropriation are used for "special" projects that meet certain general criteria. Insiders often refer to this appropriation as the successor to "Walking Around Money" (WAMS).

Workforce Development

While workforce development is not at the top of the agenda at DCED and other agencies, it is still an important issue. Significant efforts include:

- Continued funding for **Customized Job Training** at \$29 million, and \$2 million for a **Career Marketplace System** to improve the delivery of job training services.
- \$17.2 million to establish **SciTech** and **GI Bill Scholarships** for students pursuing science or technology-related fields of study. While promoting workforce development, this program also relates to efforts to expand technology-based sectors of the economy.

Education

Education continues to consume the largest portion of the state's budget and both new and expanded programs reveal a number of important themes: basic education; a continuation of the Governor's policy promoting competition in education; incremental movement toward more equal funding for school districts, and; a resumption of efforts to increase safety in schools. Items of particular interest in each category are outlined below.

Basic Education

- The **Basic Education Subsidy** for the state's local school districts increased by 3% to \$3.7 billion.
- **Special Education** funding grew by \$42 million or 6.2%.
- The new **Read to Succeed** program is funded with \$35 million to ensure students can read by grade 3. This is the first installment of a four-year, \$100 million program.

Competition in Education

- \$63.6 million is budgeted for the **Educational Opportunity Program**, the Governor's much publicized pilot school voucher proposal. Enabling legislation must be passed in the General Assembly before the funds can be spent.
- A 25% increase to \$16.8 million for the **School Performance Incentives** program to reward schools for improved academic achievement.

Equitable Education Funding

- Distribution of the **Basic Education Subsidy** is weighted to less affluent school districts. According to Budget Office calculations, 23% of the subsidy goes to the poorest 125 districts, while 13% goes to the wealthiest 125 districts.

Safe Schools

- Funding for **Safe Schools** increases dramatically from \$1 to \$22 million.

Higher Education will receive an additional \$57 million for State-Owned and Related Universities and Community Colleges. Additionally, state grants to higher education students will increase by \$18.7 million or 7%, resounding the theme of competition in education by allowing students to choose the college or university they consider best.

Environmental Protection

The budget of the Department of Environmental Protection increases more than 12% with both new and expanded programs reflecting the recommendations of the 21st Century Environment Commission and particularly their focus on land use and sprawl. New programs include:

- The **Environmental Stewardship Fund** which is capitalized with \$8.7 million in new spending to encourage and fund acid mine drainage abatement, pollution reduction, new sewer and water infrastructure, and community conservation. This program was originally an \$85 million vehicle for the Governor’s Growing Greener proposals. Much of that funding would have been reallocated from existing programs, primarily from the municipal sewer operating grants. The program still needs authorizing legislation before the money can be spent.
- A \$2 million **Environmental Education Fund** to encourage local government land use planning to inhibit “sprawl.”

Another \$43 million is dedicated to the purchase of additional easements on agricultural land to ensure its continued use for agricultural purposes. This appropriation supplements \$21 million already dedicated to this purpose through a special fund.

Budget Analysis

For the 7th year in a row, Pennsylvania’s economy produced a healthy surplus of revenues for use in the state budget. The immediate result is the passage of the spending and revenue plan nearly two months before the Constitutional deadline of July 1. Negotiations between the Governor and leaders in the General Assembly created a satisfactory product for all.

Savers saw the Rainy Day Fund account balance reach \$982 million. This total accomplishes the Governor’s goal of 5% of spending in reserve.

Tax cut proponents will receive reductions of nearly \$400 million benefiting both individuals and the business community. Although the weighting of the reductions is toward the business community for the fifth year in a row, individuals will benefit from tax reductions as well. It should be noted that as in past years, the amount of reduction continues to be incremental without major change in any one tax.

Advocates for higher spending will experience a 3.8% increase in overall spending - a rate more than twice inflation and the highest percentage increase during this Administration. In addition to keeping almost all of the Governor’s recommendations intact, the General Assembly was able to use the larger surplus to selectively fund several of its priorities not present in the Governor’s proposal.

PEL will continue to monitor implementation of the revenue and spending plan as it unfolds throughout the year. Many of the items in the budget have significant implications for PEL priorities at both the state and regional levels.