

CAPITAL NEWS



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Governor Ridge Introduces His 1999-2000 Proposed Budget

Governor Ridge unveiled his proposed budget for the Fiscal Year 1999-2000 on Tuesday, February 2. As in past years, the budget proposal will receive significant attention from a variety of people and interest groups, and with good reason. The Governor's proposal serves as the basic blueprint for government policies for the next year. While the legislature has the opportunity to make changes, the General Assembly has traditionally made relatively few changes when compared to the budget as a whole.

Overview

The table below summarizes the General Fund Financial Statement of 1999-2000.

1999-2000 General Fund Financial Statement

Beginning Balance		\$ 306,926,000
Total Net Revenues	\$18,597,900,000	
Less: Proposed Tax Cuts	<u>257,600,000</u>	
Available Revenues		<u>\$18,340,300,000</u>
Total Available for Spending		\$18,647,226,000
Less: Proposed Spending		<u>\$18,624,705,000</u>
Projected Ending Surplus		\$ 22,521,000
Less: Transfer to Rainy Day Fund		<u>3,378,000</u>
Projected Ending Balance		\$ 19,143,000

Governor Ridge's budget recommends a \$577 million increase in spending from the General Fund to \$18.6 billion, a 2.9% increase in appropriations (excluding transfers to the Rainy Day Fund). Although the total increase exceeds the rate of inflation, it is less than the 4.7% increase projected for this year over 1997-98.

The budget projects revenues to total \$18.3 billion, an increase of 1.4%. This total is net of expected revenues and a tax reduction of \$257.6 million to the General Fund. Additional tax reductions of \$15.4 million will be credited to two other special funds. The Governor projects total revenue collections this year (1998-99) to exceed last year's collection by \$880.4 million or 5.1%. This increase in revenues takes into account tax reductions passed as part of the present year budget.

As is the case in the past several years, spending would exceed revenues. The budget projects spending to be in excess of revenues by \$284.4 million. This difference is funded by an anticipated surplus of \$306.9 million which remains after the statutorily mandated deposit of \$54 million into the Rainy Day Fund. The balance in the Rainy Day Fund will rise to \$785 million or 4% of General fund spending. The Governor's goal for the Rainy Day Fund is 5%. The money in this fund acts as a reserve for future use during more financially difficult times.

The surplus is due in large part to higher than expected revenues of \$270 million by the end of this fiscal year on June 30. The \$270 million is a figure net of receipts from different taxes. The Department of Revenue expects this year's collection of corporation taxes to be below projected levels. The deficit will be more than offset by higher sales tax and personal income tax collections. Higher collections from several smaller tax sources and the return of some unspent dollars will add to the surplus. The potential remains for an even higher surplus should collections exceed these adjusted estimates by the end of this fiscal year. This phenomenon played out with large surpluses in each of the past two years.

Tax Cuts

Governor Ridge's budget proposes to reduce taxes for the sixth year in a row. This year's proposals total \$273 million. Specifically these include:

- The rate of the Capital Stock and Franchise Tax would be lowered from 11.99 mills to 10.99 mills effective January 1, 1999. In addition, the minimum payment would be reduced to \$200 from \$300, a particular benefit to smaller businesses. These measures affect more than 150,000 businesses. Estimated savings - \$ 116.3 million.
- The Gross Receipts tax on sales of natural gas to residential customers would be eliminated. The objective of this tax cut is two fold. First, the elimination of the tax benefits families, an offset to business tax reductions. Second, a major obstacle to natural gas price deregulation will no longer be in place. Estimated savings - \$82.2 million.
- Two changes would be made to the Corporate Net Income Tax. Pennsylvania's cap of \$1 million per year on deductions for net operating losses would be increased to \$2 million. Also, the sales factor used in the apportionment formula is proposed to be weighted 60%, an increase from the current 50%. Estimated savings - \$67 million.
- The Personal Income Tax would be reduced slightly for the working poor. The income eligibility limit for each dependent would be raised from \$6,000 to \$6,500. In effect, a family

of four would not pay income tax if their taxable income was less than \$26,000. This builds on the more significant changes made earlier this year. Estimated savings - \$7.5 million.

There is some controversy surrounding these proposals. The questions concerning tax cuts do not center on whether or not to cut taxes, but how much to cut taxes and who should be the beneficiary of those tax cuts. Past tax cuts benefited the business community and the working poor. Recent legislative rhetoric from both sides of the aisle suggest that it is time for individuals to share in the benefits of a surplus. The Governor's apparent response is the elimination of the gross receipts tax on residential natural gas users and increasing the limit for paying taxes for the working poor. Proposals publicly floated include a .1% reduction in the Personal Income Tax to 2.7% and relief for the elderly through expansion of the lottery's property tax rent and rebate program. The consequence of the former proposal is a high cost, an estimated \$240 million, which would effectively crowd out most other tax reductions, at least within the proposed revenue and spending confines of the budget.

Significant Program Spending Changes

As in past years, the budget proposal includes a number of expenditure increases which are important to specific people or organizations. More important, they paint a bigger picture of what direction the Governor wants to move public policy for 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

Restructuring of the business assistance programs to focus on technology development is the continuing theme for changing the make-up of the Department of Community and Economic Development's budget. Savings from reductions in funding for many of the traditional programs would be reassigned to new initiatives consistent with the Governor's emphasis on rebuilding Pennsylvania's economy through technology.

Technology Industry Promotion

The highlight of the spending plan for the Department of Community and Economic Development (DCED) is the expanded emphasis of building and expanding the technology related industries in Pennsylvania. A new Pennsylvania Technology Investment Authority (PTIA) would be created to meet the financing needs of high technology and knowledge-based companies. The new authority would be capitalized with \$100 million over the next five years. This budget proposes \$18.2 million for the first installment.

The purpose of the new program is to fill a gap in the Department's business assistance arsenal which can be of special benefit to technology firms. Existing programs focus heavily on financing for land and buildings, capital assets which are of less importance to developing technology firms. Specifically, the new program will include the following elements:

- \$10 million for loans, grants and equity investments in high tech firms with facilities on a lease basis;
- \$250,000 for the development of Technology Trade Ports, a mechanism to attract foreign investment;
- \$1 million in E-Commerce grants to encourage existing companies to participate more fully in the digital economy;
- \$1 million for the Digital Main Street Program to assist communities in the development of amenities and services for technology-oriented workers;
- \$750,000 for the Community and Local Government Resource Network to encourage local governments to become part of the new technology age;
- \$200,000 to expand the Assistive Technology Program which provides loan guarantees to people with disabilities;
- \$5 million to integrate university-based technology research and development into business and economic development initiatives.

Workforce Development - Technology

Although not directly contained in the DCED budget, significant new funding to enhance Pennsylvania's technology workforce is proposed. Two new programs to encourage the development and retention of technology-related employees would be created. First, \$14.5 million would be set aside to provide scholarships to qualified students majoring in science or technology-related fields of study. The SciTech Scholars program would be awarded to students enrolled in a Pennsylvania college or university for their second through fourth years. Students must maintain a grade point average of 3.0 or higher, complete an internship with a Pennsylvania company, and work in Pennsylvania following graduation for each year of scholarship received or the scholarship reverts to a loan.

The second program would allocate over \$2 million to a GI Bill for the New Economy. Scholarships of \$1,000 would be awarded to Pennsylvania students and workers enrolled at a Pennsylvania community college or two-year private technical institute. Students must maintain a grade point average of 3.0 or higher, complete their associates degree or the scholarship reverts to a loan.

Marketing and Tourism Promotion

Almost \$10 million in additional funds would be channeled to new and expanded marketing for tourism, international trade, and business attraction. The new money would seed a redirection in the programs.

Traditional Business Assistance Programs

The introduction of new programs promoting technology and other programs comes at a cost to many of DCED's traditional programs. For example, the Pennsylvania Industrial Development Authority (-\$20 million), the Machinery and Equipment Loan Fund (-\$1.5 million), and the Infrastructure Development program (-\$8.8 million) all contribute to this stage of the overhaul of

the Department's business assistance programs. Important programs left untouched are the Customized Job Training Program (\$29.05 million) and the Opportunity Grant Program (\$35 million).

Community Development

Two community development issues are worthy of note in the budget. First, new resources would be directed toward encouraging increased municipal cooperation through a new World Class Community program. This new program combines two existing programs, planning assistance and shared municipal services, into a new more flexible program administered by the Center for Local Government Services. The change was in response to issues raised by the 21st Century Environment Commission. In addition to combining the programs, an additional \$725,000 would be added to the fund.

Second, funding for "Community Revitalization" of \$25 million would be eliminated. Essentially, this program provided funding to a wide variety of community specific projects across the Commonwealth.

Education

Education continues to consume the largest portion of the state budget. Many of the initiatives proposed for 1999-2000 take the next step in the Governor's education plan. Upon closer examination, three major themes surface: promote competition in education, support less affluent school districts, and increase safety in schools.

Competition in Basic Education

The budget includes \$16.8 million for performance incentives for schools to make notable improvements in student achievement and effort. Performance incentives now total \$13.4 million.

The Educational Opportunity Program is back in the budget. A pilot voucher program for lower income parents to choose the best school suited for their children would begin in 1999-2000 and last for five years. The program would be restricted to six counties, seven additional cities and two townships. Income limits for eligible families would increase gradually from \$15,000 in the first year to \$75,000 in the fifth year. First year funding would be \$63.6 million.

Less Affluent School Districts

Basic education funding, the largest state education funding program, would be increased by \$107 million or 3%. However, all schools would not share equally in the new funding. Distribution of the funds would be weighted toward the poorer districts and districts with large enrollment growth. The poorest 125 districts would receive a 4% increase, while all others would get at least 1% more.

A new “Read to Succeed” initiative would provide \$100 million over four years to build strong reading skills in students in grades K-3. The first year installment would be \$35 million.

A 5% or \$33.9 million increase is proposed for special education funding. In addition, the method for distributing the funds is under review in the Administration.

Safety in Schools

The Safe Schools program would receive an additional \$1 million to \$2 million to address the increasing incidents of disruptive and violent behavior in the schools. Another \$500,000 above the present \$5.2 million would go to provide alternative programming for students who behave in a disruptive manner.

Other Initiatives

Incentive grants totaling \$1.5 million would be awarded to local education agencies which consolidate administrative services such as sharing administrative personnel and higher level instructional services. This is \$500,000 more than provided in the current year.

Teacher development programs would be expanded by \$2.8 million. The money will be used to provide technical assistance and training for the upcoming PA School Assessments which are used to measure the new education standards. The money would also establish two Academies for Urban Education.

A program providing higher education technology grants would be funded at \$10 million next year. Funding would be targeted toward workforce development, research and professional development programs as well as infrastructure to connect community networks. The purpose is to provide access to a wide range of educational resources beyond traditional institutions and boundaries.

Environmental Protection

One of the highlights of the budget is a proposed restructuring of significant portions of how state government approaches environmental issues. The changes are inspired by the recommendations of the 20th Century Environment Commission Report. Although the report to the Governor contained numerous recommendations on a variety of environmental topics, it is best known for the considerable discussion it generated on the issues of land use and sprawl. This budget

proposal indicates clearly that Governor Ridge is committed to implementing the principles of the report.

The centerpiece of the overhaul is the establishment of a new Environmental Stewardship Fund. The fund would provide resources to encourage volunteer land use planning reforms, acid mine drainage abatement, watershed restorations, additional water and sewer infrastructure, public lands stewardship, and community conservation. Funding resources would come primarily from a restructuring of existing programs.

Other Agencies

Public Welfare

Proposed state funding for the Department of Public Welfare would increase by \$197.7 million or 1.4%. Proposed spending changes reflect the continuation of the movement to self-sufficiency from traditional welfare programs.

Corrections

Funding for the Department of Corrections continues to grow at a rate higher than inflation and overall growth in the budget. The 3.2% increase is due to continued growth in the state's inmate population.

Department of Transportation

This year's budget news from the Department of Transportation is due to past actions, not proposed new ones. Beginning in the current year, and extending into the future is significantly higher spending on road construction and maintenance. Higher gasoline taxes and vehicle registration fees passed by the General Assembly in 1997 and changes in federal spending will be in full force during this construction season.

Budget Analysis

A key assumption for next year's budget is the rate of growth in Pennsylvania's economy. The health of the economy affects the budget with a double boost. In good economic times, the growing economy pumps up revenues through increased tax collections. At the same time demand for certain state programs, such as public assistance, declines as a larger portion of the population is working. Unfortunately, during poor economic periods, the double boost turns into a one-two punch as revenues decline and program demand increases.

Governor Ridge has enjoyed an expanding economy without experiencing the pains of a contracting one. The coming year will likely continue this string of economic growth years, although not at levels equal to the past few.

The Governor developed his proposals within the context of this economic growth. This allows proposed spending increases higher than the inflation rate and a reduction in taxes at the same time. The tax cuts would be split between the business community and individual taxpayers on a ratio of about 2 to 1 respectively. Business tax reductions continue a longer term trend of incremental reductions without a major one-time impact.

On the spending side of the ledger, Governor Ridge continues his commitment to promoting economic growth through technology and his education proposals emphasize a continuance of policies established earlier in his administration.

The results of past PEL work show up in the budget. A PEL November 1997 study recommended the enactment of a Single Sales Factor Apportionment formula for the Corporate Net Income Tax. The budget proposes a step toward that recommendation as part of the tax reduction package. Also, DCED's initiative to promote electronic commerce in Pennsylvania's small businesses was addressed in a September 1998 PEL report which outlined a strategy for state government to promote electronic commerce.

In summary, the Governor's budget proposal continues his cautious and incremental approach to tax reduction. Spending continues to grow at a rate higher than inflation but less than the growth in revenues. At the same time, the Commonwealth is able to put money into the bank for unanticipated difficult economic times in the future.

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