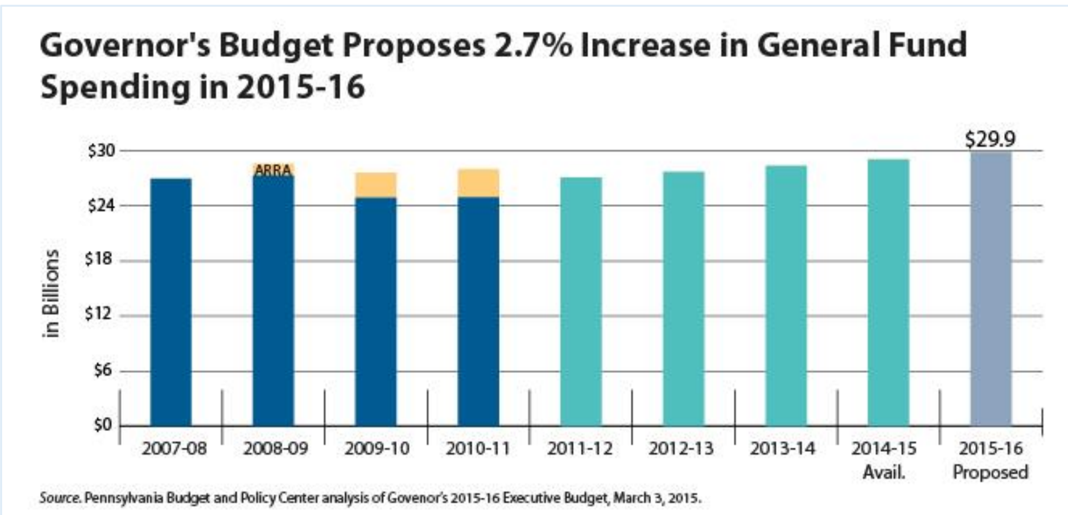
Summary & Highlights of Gov. Wolf's 2015-16 Budget Proposal

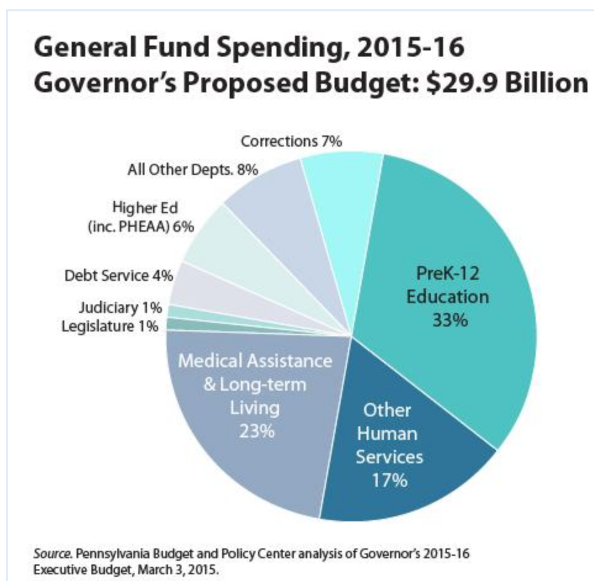
Pennsylvania needs a new direction. For far too long, our commonwealth has been relying on tax cuts as its cure for all ills. It hasn't worked. Our schools are struggling to do more with less, and our economy is recovering more slowly than the nation's (we rank 50th among states in job growth). Austerity has also held back state revenue growth (Pennsylvania ranks 46th in that), and resorting to a series of one-time budget fixes has led to repeated downgrades of the state's bond rating. While the wealthiest Pennsylvanians are doing just fine, too many in the state are struggling to make ends meet.

In his first state budget proposal, Gov. Tom Wolf proposes a $29.9 billion General Fund spending plan for 2015-16 that includes $1 billion for restoring cuts to education funding, a $1.75 billion job growth plan, and a proposal to reduce school property taxes by $3.8 billion beginning in 2016. The budget also fills a $2 billion shortfall between expected revenues and expenditures – an ambitious, but difficult task.



Gov. Wolf proposes a multi-faceted plan to accomplish this feat. His proposal would raise the sales tax 0.6 percentage points and broaden it to include more services, raise the personal income tax 0.7 percentage points, cut some business taxes while eliminating corporate tax loopholes (for a net corporate income tax cut of about one-third), and enact a severance tax on natural gas production.

While there are elements of the proposal we may suggest modifying, it does many important things that we think will move Pennsylvania forward. The plan makes the state a better place to work, increases investment in our schools and colleges, expands access to health care, invests in communities, and helps our most vulnerable citizens (children, seniors, and people coping with disabilities).

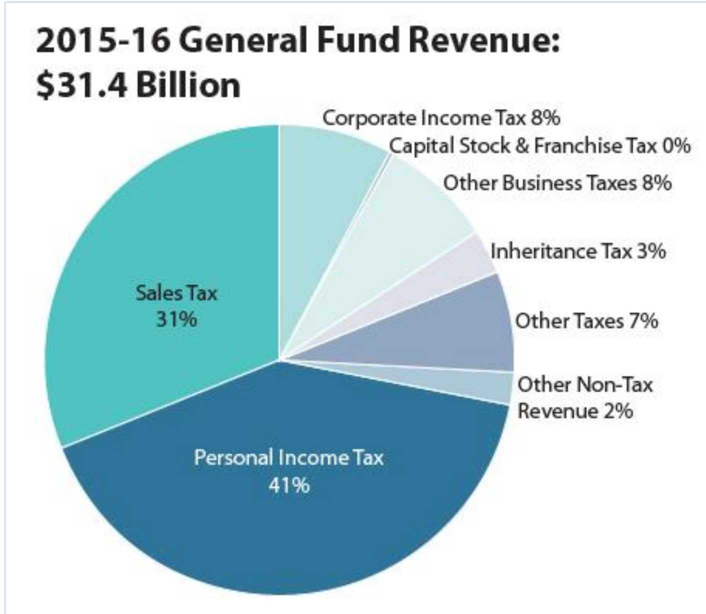


The plan also helps raise revenue to pay for these investments not just in 2015-16, but in future years. One of the governor's priorities is to raise revenue in a way that makes our tax system fairer for struggling communities and middle-income families. We will be evaluating his proposal against that standard as we dig more fully into the details of the budget in the coming weeks and months.

The following is a brief analysis of the basics of the plan. As we learn more, we will update this analysis on our website.

Revenue

Gov. Wolf has proposed an ambitious revenue reform package to fund property tax relief, restoration of education cuts, and other critical needs. This package would provide sustainable revenues for balancing not only the 2015-16 budget, but also budgets in future years. The mix of tax changes incorporates substantial elements of tax proposals aimed at property tax reduction considered by the General Assembly in the prior session.



Source. Pennsylvania Budget and Policy Center analysis of Governor's 2015-16 Executive Budget, March 3, 2015.

Highlights of the reform package include:

- **Enacting a severance tax on natural gas production**, effective 1/1/2016. Pennsylvania is now the second-largest producer of natural gas in the United States and the only major producer without such a tax. The governor proposes a tax equal to 5% of the selling price of natural gas plus a 4.7 cents per thousand cubic feet (MCF) charge. This rate is the same as is in place in neighboring West Virginia. Beginning in 2016, $225 million in severance tax revenue would be distributed the same as the current impact fee. (The impact fee transfers to local governments in 2015-16 will be from fees collected in April 2015 under current law). In 2015-16, the General Fund is projected to receive a net $156 million in severance tax collections. By 2019-20, total severance tax collections are projected to total $1.2 billion, with the portion going to the General Fund equaling $948 million.
- **Fixing the 2013 bank shares tax reform.** A 2013 effort to modernize the bank shares tax triggered an unintended revenue loss for the General Fund. The administration proposes raising the bank shares tax rate from 0.89% to 1.25% retroactively to the 2014 tax year. This is expected to increase bank tax collections in 2015-16 by $339 million but lower amounts (approximately $200 million less) in future years.
- **Closing corporate loopholes, and cutting the corporate net income tax (CNIT) rate.** Beginning in 2016, corporations would use combined reporting, which closes many tax loopholes. At the same time, the corporate tax rate would drop from 9.99% to 5.99%, and would decrease to 4.99% over two years. The net impact of the changes would <u>reduce</u> corporate income tax collections by $249 million in 2015-16. By 2019-20, the 4.99% CNIT is projected to raise $945 million less than in 2014-

15 (an underestimate of the impact of the tax changes because it does not consider the normal growth in CNIT revenues that would have occurred). This amounts to a tax reduction of 35%.

- **Enacting a 40% tax on the wholesale price of other tobacco products and increasing the cigarette tax by $1 a pack**, effective October 1, 2015. Pennsylvania is the only state in the U.S. without an excise tax on smokeless tobacco and one of only two states that do not tax cigars. This proposal would tax cigars, smokeless tobacco, and e-cigarettes and increase the existing tax on cigarettes. This change is projected to generate $443 million in 2015-16.
- **Increasing the personal income tax to fund property tax relief.** The plan calls for increasing the personal income tax from 3.07% to 3.7%, effective 7/1/2015. This increase would largely be used to fund property tax relief – with payments going to homeowners in 2016. The increase is expected to raise $2.376 billion in 2015-16, with $2.14 billion being transferred to an account to be used for making payments to homeowners. In addition, incomes eligible for the commonwealth's long-existing tax forgiveness program would increase by $2,200 per taxpayer (with no change for dependents), reducing collections by $90 million. In total, these changes would increase General Fund collections by $162 million in 2015-16.
- **Increasing the sales tax rate and expanding its base to fund state school employees' retirement payments.** The sales tax base would be expanded to include 42 additional products and services (no specific list is available yet, but the list is said to not include food and clothing), and the overall sales tax rate would be increased from 6% to 6.6%, effective 1/1/2016. This change is projected to generate $1.554 billion in 2015-16. The budget would redirect $1.75 billion of sales tax receipts into a restricted account to pay the state's share of the "employer costs" of the school employees' pension system in 2015-16. These payments currently are made out of General Fund allocations to the Department of Education. The net result would be a reduction of $195 million in sales tax collections available for the General Fund in 2015-16. In future years, where there are 12 months of collections at the higher tax rate and expanded base, this change would likely generate additional revenue for the General Fund, even with the dedication of sales tax receipts to pension payments.

Including the governor's tax plan, the 2015-16 General Fund revenues are projected to total $31.4 billion, an increase of $1.2 billion, or 4.0%, from 2014-15.

Economic and Community Development

- State funds for the Department of Community and Economic Development (DCED) would **increase from $164 million to $242 million**, a restoration to roughly the 2010-11 level (but half the 2007-08 level). The department's funding would include:
    - An increase from $20 million to $45 million for PA First subsidies for job creation
    - $21 million, up from $6 million, for Keystone Communities, including Main Street and Elm Street programs
    - A bump in Infrastructure and Facilities Improvement Grants, from $19 million to $30 million
    - $5 million (reallocated from underperforming tax credits) for Made in Pennsylvania Job Creation – subsidies of up to 5% of payroll for companies that increase payroll by at least $1 million and pay at least the average county wage plus health benefits
    - An increase from $78 million to $97 million in the transfer to the Commonwealth Finance Authority

- $12 million for Industrial Resource Centers, including $5 million for the "IRC Manufacturing Initiative" to partner with research universities to advance manufacturing technology and commercialization
- **$**4 million for marketing – to tourists ($2 million), businesses ($1 million), and foreign investors and markets ($1 million)

- Additional support for community development would be provided through $15 million for a Mixed Use Development Program through the Pennsylvania Housing Finance Agency.
- The governor also proposed **a $675 million economic development bond** paid using a portion of the natural gas severance tax:
    - $100 million for a technology initiative to support entrepreneurs, established companies and manufacturing innovation.
    - $100 million to recapitalize the PIDA low-interest business loan program
    - $250 million to Business in Our Sites brownfield redevelopment
    - $225 million for energy investment, including:
        - $50 million for solar
        - $50 million for energy efficiency
        - $20 million for wind
        - $25 million for "last mile" gas distribution lines
        - $20 million to make farms more energy self-reliant
        - $30 million for the PA Energy Development Authority
        - $30 million for new, on-site heat and power technologies
- The budget also would provide **$1 billion for transportation, and water and sewer infrastructure** including:
    - $500 million in bond-financed transportation investment to supplement revenues from Act 89 of 2013
    - $500 million leverage through revenue bonds issued through PENNVEST

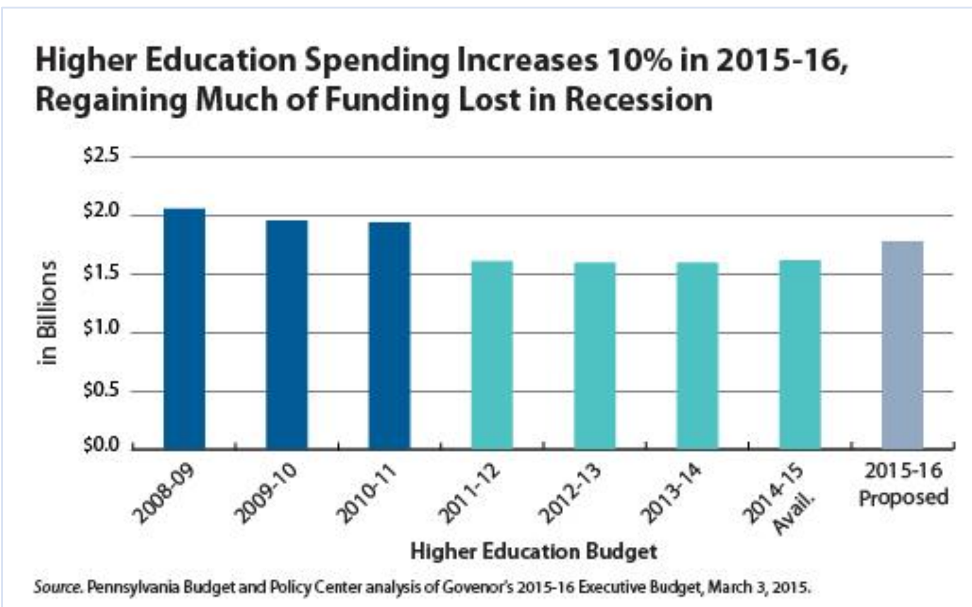
Education: Early Childhood and K-12

- Education funding would be **restored by $1 billion in 2015-16** through increased state funding and cost-saving reforms. This funding restoration is separate from the state share of pensions, which would be paid for by its own revenue account.
- This budget would be the first phase of **a four-year plan to increase pre-K-12 funding by $2 billion** and **return the state's share of education funding to 50%**, which it hasn't been in 40 years. Raising the state's share to 50% depends on property tax relief, which would not start until the 2016-17 school year. The state's current funding share of 35% is one of the lowest in the country. A low state share of education funding shifts the tax burden onto local homeowners and results in funding inequalities between poorer and wealthier districts.
- **The lion's share of an expected $1 billion in annual revenue** from a **5% severance tax** would be invested in education in 2016-17. Revenue from other tax changes would fund increased education spending.
- The state would return to using a **basic education funding formula,** starting in 2016-17, to ensure funding for all school districts is adequate, equitable, predictable, and accountable. Currently, Pennsylvania is one of only three states without a formula.
- **Basic education funding would be increased by $400 million** (7%), and would consolidate the Basic Education Funding subsidy, Accountability Block Grant, Ready to Learn Block Grant, Educational Assistance Program, and Charter Reimbursements.

  - The Accountability Block Grant -- which helps provide funding for proven, effective academic programs -- and Educational Assistance Program funds would be fully restored after enduring previous cuts.
  - School districts would receive a partial restoration of charter reimbursements after having them completely cut since 2010-11. Whereas before, school districts received a 30% reimbursement of their mandatory charter tuition payments, now they would receive about a 10% reimbursement.
- Special education funding would be increased by $100 million (10%), and the formula enacted in 2014 would continue being used.
- Cyber charter school reform that would cap funding would save school districts $162 million.
- Early childhood education funding would be increased by $120 million (88%), with $100 million going to Pre-K Counts and $20 million going to the Head Start Supplemental Assistance Program, both aimed at helping low-income children. This would result in the enrollment of more than 14,000 additional children. Recent years have seen funding for these programs remain largely flat, earning the state a D+ grade and a ranking of 41st in the nation for early childhood education.

Higher Education

- Higher education funding would increase by $159 million (10%) but remain below pre-recession levels.



  - Funding for the 14 “state-owned” Pennsylvania State System of Higher Education (PASSHE) schools would increase by $45 million (11%), restoring about half the 2011-12 cuts.
  - State-related universities would all see funding increases. Penn State would receive about $51 million (22%) more, and the University of Pittsburgh and Temple would both receive about $15 million (11%) more. This $80+ million total is half of the 2010-11 cuts.
  - Community colleges would receive $15 million (7%) more, three quarters of the 2010-11 cuts.

- General Fund support for the Pennsylvania Higher Education Assistance Agency (PHEAA) would increase by $16 million (4%), and PHEAA programs supported by "Other Funds" would increase by $25.5 million. The major PHEAA increases are:
    - $7.5 million for the STEM Scholarship Initiative, to help students pursue careers in Science, Technology, Engineering and Math fields
    - A tripling from $5 million to $15 million in funding for Ready to Succeed Scholarships for middle-class students with good grades
    - $9 million for dual enrollment through which high school students earn college credit

The Environment

A new severance tax on natural gas extraction, using the same rate as West Virginia, would generate approximately $1 billion a year, a portion of which would go to environmental programs:

- $40 million a year to finance a $225 million clean energy bond that would be distributed in the following way:
    - $100 million for alternative energy;
    - $50 million for solar power installation rebates;
    - $50 million for energy efficiency;
    - $25 million for natural gas distribution line development.
- $10 million to the Department of Environmental Protection to beef up oversight of the gas drilling industry.
- $18.8 million increase to DEP's budget.
- $8.3 million increase to the Department of Conservation and Natural Resources' budget.
- Over the last several years, DCNR's budget has been funded almost entirely from royalties from natural gas drilling on public land. The proposed budget would begin to reverse that dependence by increasing the amount provided from the General Fund by $20 million.
- $41.7 million would be available through the Growing Greener Program which provides funding for watershed protection and restoration, parks and forest rehabilitation and community conservation – an increase of $1.16 million.
- $51 million to the Keystone Parks, Recreation and Conservation Fund, an increase of $2.6 million, for local recreation projects, open space conservation, and parks and forest rehabilitation.

Health and Human Services

- The budget would provide $11.9 billion from the General Fund to the Department of Human Services (DHS), an increase of $691 million, or 6%.
- Nearly half of DHS's funding would go to Medical Assistance (MA), which provides health care services for 2.2 million Pennsylvanians -- primarily seniors, children, and adults with disabilities. The General Fund's share of the MA budget is expected to grow by $87 million, or 1.7%, to $5.2 billion.
- The budget would merge MA inpatient and outpatient services into a single system. It also would expand Pennsylvania's Medicaid program under the Affordable Care Act to more than 600,000 adults with incomes up to 138% of the federal poverty line (roughly $33,000 for a family of four). These changes are estimated to save the General Fund more than $500 million next year.
- The budget would put $46 million toward reducing waiting lists and expanding services for Pennsylvanians with physical and intellectual disabilities.
- The budget would expand home- and community-based services to more than 5,500 seniors by allocating an additional $31 million to DHS and $7.3 million to the Department of Aging. For the

first time, more than half of all Pennsylvanians receiving long-term care would be in home or community settings.

- General Fund long-term care costs would increase by $303 million, or 21%, which would include a shift back to the General Fund of $82 million of costs from the Lottery Fund. This would partially reduce the large increase in Lottery Funds used to fund long-term care programs in the 2014-15 budget.
- The budget would allocate $28 million in the first of a three-year restoration of cuts to seven county human service programs that were cut in 2012-13 when the Corbett administration implemented the human services block grant pilot program.
    - The biggest piece of that increase, $18 million, would go for mental health services. Overall, mental health services would see a $55 million increase to $787 million.
    - $4.8 million would go to the Intellectual Disabilities-Community Base Program for a total of $154 million, and $4 million would go for behavioral health services for a total of $47 million.
    - The other four programs benefiting would be county child welfare, Medical Assistance – Fee-for-Service, homeless assistance, and the Human Services Development Fund.
- The budget would level-fund Child Care Services for low-income working families, at $156 million, and Child Care Assistance for Temporary Assistance to Needy Families (TANF) recipients, at $153 million.
- Services for victims of domestic violence would receive a $1.5 million, or 10 %, increase to $16.8 million.
- Funding for rape crisis services would receive a nearly $900,000 increase to $9.6 million.
- Early Intervention, Family Centers, Nurse Family Partnerships, and Legal Services would all be funded at 2014-15 levels.

Pensions

- The governor's budget would fully fund Pennsylvania's two statewide pensions.
- It would dedicate a portion of sales tax revenues ($1.75 billion in 2015-16) to paying the state share of the employer share of PSERS (PA School Employee Retirement System). This recurring revenue source should reassure bond rating agencies that pension debt will be paid.
- New initiatives would lower long-term liability by more than $10 billion, including
    - Reducing excessive management fees now estimated at $700 million annually
    - Using $80 million in liquor modernization profits to reduce school district pension payments in 2015-16
    - Using $185 million in revenues from liquor modernization annually, starting in 2017-18, to pay off a $3 billion bond that pays down pension debt

Public Safety

- Funding for the Pennsylvania State Police—from the Motor License Fund, General Fund and other special funds—would rise by $83 million, or 8%, to $980 million in 2015-16. The budget includes funding for 350 new cadets to complete training.
- The cost of running state prisons would increase by $147 million, or 7%, to nearly $2.3 billion in 2015-16. Most of the increased costs would be for prison operations and medical care, with a smaller increase for inmate education and training. The prison population is expected to drop by nearly 800 inmates, but the state's cost to incarcerate an individual would rise by $3,000 to $45,762 per year.

- Funding for the Board of Probation and Parole would rise by $16 million, or 10%, to $172 million.
- Gov. Wolf is proposing a consolidation of the Board of Probation and Parole with the Department of Corrections. The board would still retain its independent parole-granting authority.

Transportation

- Pennsylvania's bipartisan transportation funding law, Act 89 of 2013, overhauled the state's gas tax, and increased fines and permit, vehicle registration and licensing fees to drive more funding to road and bridge projects.
- In 2015-16, transportation projects would receive $5.5 billion in state, federal and restricted revenues from the Motor License Fund—an increase of $333 million, or 6%.

Workforce Development

- Workforce training funding would be restored to levels comparable to 2009-10, including
  - A $10 million increase for Industry Partnerships, back to about 60% of 2008-09 funding
  - $8 million for the Workforce and Economic Development Network (WEDnetPA)
  - A $5 million increase for Vocational Rehabilitation, drawing down $18.5 million in additional federal funds
  - $37 million to “build a bridge from high school to college and careers” including:
    - $15 million to establish Career and Technical Education partnerships to train students for high-demand occupations with a living wage and career ladders
    - $5 million for Career and Technical Education Equipment grants
    - $8 million for career counselors to develop pathways to high-skill careers
    - $9 million for dual enrollment

Budget hearings begin Monday, March 9, in the House, and Monday, March 16, in the Senate, which should help shed more light on this multi-part proposal.