

What the Hell Is Going on in Pennsylvania?

by Billy Hamilton



Billy Hamilton

Accounts from 1990 until he retired in 2006. He is also a private consultant, advising on numerous state tax matters.

In this article, Hamilton recounts Pennsylvania's ills, especially the commonwealth's struggle to pass not one but two fiscal year budgets.

Billy Hamilton is the executive vice chancellor and CFO of the Texas A&M University System. In 2015 Hamilton led Texas Republican Gov. Greg Abbott's Strike Force on the Health and Human Services Commission to complete a management analysis of the agency. Before that, Hamilton was the deputy comptroller for the Texas Office of the Comptroller of Public

If states had nervous breakdowns, Pennsylvania would be in the throes of one right now. Entering its eighth month without a budget, the state also has an attorney general facing criminal charges, a convicted state treasurer, and assorted Supreme Court scandals. Its school boards are suing the state over funding, and it faces a crippling burden from its underfunded public pensions. California in its darkest days in the early 2000s never suffered so many tribulations in a single year.

My expert on all things Pennsylvania, Robert Strauss, a professor of economics and public policy at Carnegie Mellon University and a veteran of the state's policy wars, calls the current situation a "four-ring circus," featuring the House, Senate, executive branch, and courts. "This is worse than Illinois," he said recently. "We're talking about all three branches of government. People who travel to other states are constantly asked, 'What the hell is going on in Pennsylvania?' Woody Allen would have a great time starring in a movie: Pennsylvania, the latest banana republic."¹

At the center of the four-ring circus is Gov. Tom Wolf (D), who has been battling the Republican-controlled legislature for months over the shape of the budget, a situation

I have written about before.² The impasse has been stoked by a perfect storm of underlying causes, including political polarization, a 2009 court decision from the last lengthy impasse, and Wolf's controversial tax proposals.

At the heart of the budget issue are profound differences between the governor and legislature on both spending and taxes. Wolf favors additional funds for education and property tax relief; Republican lawmakers, who control both legislative houses, bitterly oppose increasing taxes to pay for what the governor wants.

Although the problem was months (if not years) in the making, it came to a head last June. On June 1 the House crushed Wolf's tax plan in a test vote, 193 to 0. Wolf's plan included billions of dollars in tax shifting to reduce property taxes and increase state spending. Wolf proposed major increases in the sales and personal income taxes and a new tax on the extraction of natural gas from the Marcellus Shale formation. He also proposed raising the cigarette tax and taxing other tobacco products such as cigars and snuff. Opponents called it a \$4.7 billion tax increase encompassing "everything from the cradle to the grave," as the president of the Pennsylvania Chamber of Business and Industry put it.³

Wolf soon evened the score. On June 30 he vetoed the entire budget sent to him by the legislature, rather than line-item vetoing the portions he didn't agree with, a more normal course for a governor. Had he vetoed only the parts he disliked, there would have been more of a framework for negotiations. Instead, Wolf wiped the slate clean, and any hope of quick compromise disappeared. The two sides settled into a war of attrition, alternately fighting over the budget and staring at one another in icy silence.

In the fall, Wolf again put forward a budget plan that included a scaled-down \$1.3 billion tax package that featured an increase in the personal income tax rate for all wage earners from 3.07 percent to 3.57 percent, the shale gas tax, and property tax relief for seniors and the disabled. In early October, the House again rejected the governor's proposal.

Ironically, the standoff may have been enabled by the last budget stalemate in 2009. During that deadlock, the state

²Hamilton, "State Tax Merry-Go-Round: A Long, Hot Summer in Pennsylvania," *State Tax Notes*, July 13, 2015, p. 173.

³Bumsted, "Pa. House Says No, 193-0, to Gov. Wolf's Tax Plan," *TribLive*, June 1, 2015.

¹Brad Bumsted, "Woes Across Government Branches Tarnish Pa.'s Image, Experts Say," *TribLive*, Jan. 24, 2016.

supreme court ruled that state employees who work must be paid with or without a budget, a decision that many believe removed some of the pressure legislators faced in past stalemates from angry unpaid state workers. This time around, state workers have continued on the job despite the lack of a budget. “I think that pushed the pressure points back several months,” Senate Minority Leader Jay Costa (D) said recently.⁴

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Finally, when they aren’t disagreeing with the governor, the House and Senate sometimes disagree with one another. Beyond taxes and spending, this year’s budget debate in the legislature has revolved around two other contentious issues — liquor privatization, backed by House Republicans, and public pension reform, which Senate Republicans want. Neither chamber is willing to give the other what it wants, further complicating the situation.

What’s developed over the months of squabbling is more than simply a budget debate. It’s budget civil war. “There’s one primary factor — divided government, in the form of a Democratic governor, and a House and Senate controlled by Republican majorities,” wrote Kate Giammarise last year.⁵ “But the two sides arguably aren’t just from different parties — they have completely divergent visions of what state government and a state budget should do.”

Pollster Terry Madonna of Franklin & Marshall College said political polarization is the key to understanding the issue. “We now have the most conservative legislature in modern history,” he said, noting that many Republican lawmakers were elected on no-tax pledges. Wolf, on the other hand, leans liberal and wants to make investments in education and other areas of the budget. That’s the main reason for the deadlock, Madonna said.

After months of wrangling, there was a brief window at the end of last year when it appeared that the budget impasse might finally break. In November legislative leaders unveiled a budget “framework” that would have provided school property tax relief coupled with increases in public school and higher education funding. Under the plan, the sales tax rate would have been raised from 6 percent to 7.25 percent to create a fund for property tax relief, and taxes collected from the state’s 12 casinos that currently go to property tax reduction would have been redirected to help cover the state’s growing pension problem. The shift in casino money would have also freed up dollars that could have been used for public and higher education funding. As

part of the framework, Wolf committed to try to negotiate with the Republican leadership on reform of the state’s pension system and what to do about the state liquor monopoly.

It wasn’t to be. The fragile budget deal fractured a month later when House Republicans abandoned the framework — and their own leadership — saying they couldn’t support the roughly \$2 billion in new taxes that were part of the plan. “From my perspective, our battle was always on taxes,” said Rep. Seth Grove (R). “I didn’t run on saying: ‘We’re going to get a deal to increase taxes for liquor and pensions.’ It was always about [keeping] the taxes [down] for me, and I think a lot of my colleagues felt the same way.”⁶

The legislature instead passed an alternative plan with less spending, no taxes, and no property tax relief. With pressure mounting to keep schools open and the government limping along, Wolf eventually signed a partial \$24 billion state budget, vetoing parts of the legislative plan and leaving \$8 billion in proposed spending unresolved. Taxes were once again swept off the table.

As I write this, Wolf is about to introduce his 2016-2017 budget while attempting to negotiate a finish to the *current* budget. The state can’t simply take a pass on dealing with the 2015-2016 budget and move on to next year. According to state budget experts, funding for schools and state prisons won’t last through June 30, the end of the fiscal year. There’s also no fiscal code and no agreement on funding state universities. Not surprisingly, all parties are taking a beating in opinion polls, which recently showed that most Pennsylvanians blame the legislature but only feel marginally better about Wolf.

Be that as it may, I thought surely this mess couldn’t go on forever, so I called Strauss for an update. From his standpoint, the outlook for a quick fix isn’t promising. The problem has gone beyond philosophy and budget math into the realm of pure fatigue. “People are worn out,” he said. “They get cynical and make mistakes. Then they get angry and won’t talk. They’re talking past each other.”

“Right now, seven months into fiscal year 2015-16, something like 87 percent of the broadly agreed upon state budget has been appropriated,” Strauss said. While some Republican legislators say no more needs to be done and that they’ve effectively cut spending by 13 percent, Strauss agrees with those who argue that’s unrealistic. “Funding for things like the state universities remains in doubt,” he said. Public education funding is also a problem. “The appropriations bill is described by both recipients and those in the process as lacking sufficient guidance to the executive branch on how to dole out things like the basic education subsidy for public education.” He said “tax revenues continue to flow in from indefinitely enacted taxes, but the

⁴Kate Giammarise, “The Pennsylvania State Budget Mess: How It Came to This,” *Pittsburgh Post-Gazette*, Dec. 20, 2015.

⁵*Id.*

⁶Charles Thompson, “Pennsylvania’s State Budget Framework Rattles Apart Over Tax and Spending Issues,” *PennLive*, Dec. 9, 2015.

fiscal code portion of the budget hasn't been agreed to by the House and Senate." By the end of January, Wolf had delayed introducing his 2016-2017 budget for unknown reasons, Strauss noted. "Nobody in the General Assembly admits to knowing what he's going to do" about either fiscal year, he said. "Maybe the governor doesn't either," he said.

In the meantime, there's a lot of finger-pointing. "Everybody is pointing to the House Republican caucus as being unreliable, because the leadership agreed to a deal and then found they didn't have the votes to deliver," Strauss said. "I anticipated this situation months ago when I publicly recommended through a newspaper interview that they simply resort to voice votes on the really hard problems and declare the compromise achieved. The chair could ignore anybody asking for a record vote through a point of order. Worse things have happened in state legislatures over the decades as well as in Congress."

Strauss said that finding a compromise is complicated by Wolf's political style. "The biggest criticism of Wolf is that he and the people around him have never left campaign mode," he said. "He's been out beating the drum for his program, criticizing the legislature, and really annoying the House and Senate. This really is more than a microcosm of Washington, D.C. It's an amplification."

Here's an example of what he means. Recently, Wolf spokesman Jeffrey Sheridan said the governor "inherited a multibillion-dollar deficit and schools that have been decimated, both as a result of the failed status quo and irresponsible budgets passed by the Republican-controlled Legislature. That same Republican-controlled Legislature recently sent the governor an irresponsible budget that was unbalanced by \$500 million, would have grown the already multibillion-dollar deficit and made a \$95 million cut to education."

Strauss also says the governor and his advisers aren't paying enough attention to the realities of the legislature. "Wolf's people are still talking about a shale tax," he said. He said Wolf has unrealistic expectations for the tax. The administration continues to talk about an estimate from last summer that pegged the tax generating about \$1 billion a year in new revenue, which appears wildly optimistic now with oil and gas prices falling to levels unprecedented in recent history. "The number of wells being drilled has collapsed," Strauss said. "My back-of-the-envelope estimate is that the tax wouldn't generate more than \$250 million — even assuming it could get any traction in the legislature."

Strauss offered one additional point as an example of just how dysfunctional the situation has become: By October 2015, the budget stalemate had dragged on for so long that all four legislative caucuses had exhausted their reserves and were forced to come up with alternative funding to keep the legislative branch open for business. The Senate borrowed \$9 million from PNC Bank at an interest rate of 3 percent. The House Republican caucus secured a \$30 million line of credit from five banks and promptly drew down \$5 million. A spokesman said the 3.25 percent interest rate would climb

to 4.25 percent in January. House Democrats received advances from the state Treasury.⁷

This sort of borrowing isn't common for any legislature, including Pennsylvania's. "There is no shame on the part of the General Assembly being paid on borrowed money," Strauss said. "One of my former students, who is a senior manager at PNC, simply says that as long as they pay their 3 percent in a timely manner, PNC is proud to extend credit to them. Of course, this is a kind of Ponzi scheme, especially as interest rates edge upwards, but nobody seems to notice, let alone care."

Strauss said the budget mess has stained the state's financial reputation and that the state's fiscal woes won't end even if the budget deadlock does. "Even if a budget is passed soon, the damage from doing nothing for seven months is horrible," he said. The state's credit rating was lowered last October because of the budget impasse. Moreover, he said that whatever the governor and legislature work out, they still will be far from solving the biggest elephant in the room: the state's ailing pension system. The system is in horrible condition because of years of "overpromising and underfunding," he said. "No one wants to talk about the tax increase it will take to fix that problem," he said.

Strauss also said that the budget is only one piece of a much larger story of government dysfunction that's fallen over the state like a rancid blanket, with problems and scandals almost everywhere you look.

Last year, former state Treasurer Rob McCord pleaded guilty to shaking down contractors for campaign money.

Attorney General Kathleen Kane, a Democrat, is awaiting trial on charges that she illegally leaked secret grand jury material and lied under oath. Her law license has been under temporary, indefinite suspension since October, and it's unclear when it might be restored. No trial date has been set.

Strauss described the weird farce swirling around Kane. "Wolf asked her to resign, but she declined," he said. "The Senate and recently the House have prepared different mechanisms to either remove the attorney general from office or impeach her. Both approaches await the decision about whether she committed a felony by leaking grand jury materials to the newspapers." He said that Kane has declined to testify at various legislative hearings about her predicament but has sent prepared statements. "Meanwhile, she's hired the former attorney general of Maryland to help defend her against various accusations and is paying him with public funds."

"To complicate things further," Strauss said, "the composition of the Supreme Court, which earlier had a Republican majority when it voted to suspend her law license and

⁷Jan Murphy, "Pennsylvania, Your State Legislature Is Out of Money," *PennLive*, Oct. 27, 2015.

possibly render her unable to hold her office, now is controlled by a Democratic majority, and she is asking that her case be retried because of the change in composition of the Supreme Court.”

One reason for the change in the court’s composition is Kane. After taking office in 2013, she began an internal investigation into how the attorney general’s office handled the controversial child molestation investigation at Penn State University before she was elected. The investigation opened a Pandora’s box of dubious behavior by state officials, mostly unrelated to the Penn State investigation. Kane discovered that for years her office had been a hub for the exchange of sexually explicit and offensive emails. Over the past year she has released a stream of emails that reveal state officials and employees trading pornographic, racist, and misogynistic messages. There are jokes about rape and sexual assault, photos mocking minorities, and insults leveled at people because of their weight, sexual orientation, or their religion.⁸ The scandal, inevitably, has been labeled “Porngate.”

The revelations have brought down two Supreme Court justices. In 2014 former Justice Seamus McCaffery, a Democrat, retired after his colleagues suspended him for sending hundreds of lewd emails, and in December of last year, Justice Michael Eakin, a Republican, was suspended after a three-judge panel of the Court of Judicial Discipline found that he, too, had sent emails that were insensitive and inappropriate regarding gender, race, sexual orientation, and ethnicity.

The email scandal was only the latest taint on the high court, which has been dealing with the fallout of a 2013 conviction of former Justice Joan Orié Melvin. Melvin was found guilty of using legislative and judicial staff to perform campaign work and sentenced to three years of house arrest and community service. Her two sisters, one a state senator, had been convicted earlier on similar charges.

Amid all these distractions, Wolf is proposing a new budget whose passage will be, at best, “exceptionally difficult,” Strauss said. The state isn’t accustomed to handling two budgets at once, and lawmakers are unlikely to increase taxes in an election year that will determine the composition of the entire House and half of the Senate. “There are a lot of topics on the public agenda right now but not enough votes to carry them out,” Strauss said. He said the collapse of the budget framework in December was telling because it showed that the leadership can’t get the votes they need to act. This is particularly problematic in the House, he said. Of the 118 House Republicans, 30 to 35 are associated with the Tea Party and are unwilling to compromise with the governor under any circumstances, he said. “We’re going to have a neutered governor like we’ve never seen before,” he said.

⁸Natalie Pompilio, “Pornographic Email Scandal Roils Pennsylvania Politics,” *The Washington Post*, Dec. 26, 2015.

Strauss has his own plan for ending the stalemate. It’s based on the need to find a budget plan that can unite non-Tea Party House Republicans and at least some Democrats to overcome Tea Party resistance. He thinks the key lies with Democratic lawmakers from Philadelphia. “It’s possible the Philadelphia delegation can be brought in — but at a cost,” he said, although he admits it’s a long shot and hasn’t gotten much traction when he has floated it with legislative staffers. “Statewide, 500 school districts have their own tax bases and control over their own budgets. The one exception is Philadelphia,” he said. Rather than having their own tax base, the city’s schools are tied to the city budget and must therefore compete with city departments for funding.

“It’s possible that the Philadelphia House delegation, largely Democrats, would like to see the school district have its own tax base and be freed from city control,” Strauss said. “That’s the possible trade that would get the delegation to go along with a compromise they might not otherwise support.” The other thing that might work as a carrot, he said, would be to help the city with the cost of charter schools and special education, which suck more than a billion dollars annually out of public school funding in the city. “It’s the one possibility I can think of,” Strauss said. “The governor and the Senate are much more amenable to finalizing the 2015-16 budget, so Senate Republicans would agree with their Democratic counterparts in the Senate to broker a deal of freedom to tax and spend for the school district, add to it at least \$100 million in financial relief, convince Philadelphia House Democrats to ally with the House leadership — somehow — and get some kind of budget done for 2015-6. Do a voice vote if it’s close!” Sounds simple enough.

I asked what the prospect for any new taxes was, although I suspected I knew the answer. He said Republican lawmakers were so entrenched in their opposition to new taxes that it was unlikely, although that position may have to change whenever the state is forced to deal with the pension problem. When the time comes, the likely solution, if one is possible, is broadening the sales tax base. “Nationally, states are moving to more taxes on consumption to get at the elderly,” he said. “A handful of states, including Pennsylvania, entirely exempt retirement income from taxation and can’t tax it politically. Raising revenue through consumption taxes is all that’s left.”

The last time I talked to Strauss at any length about Pennsylvania’s travails was last summer. At the time he predicted the budget crisis wouldn’t be solved before Labor Day, now long past. I asked if he had a new prediction. He doesn’t. The budget impasse may have tainted the state’s reputation nationally, but the general public hasn’t gotten too worked up over it yet. “There’s not a lot of commentary on the crisis,” he said ruefully. “You don’t hear the state’s economic leaders saying this needs to be fixed. But it’s bad for the commonwealth, and it’s going to cost us economically. Some parts of the country are just more agile and willing to make hard decisions.” ☆