

A Long, Hot Summer in Pennsylvania

by Billy Hamilton



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In this article, Hamilton discusses the state budget proposed by Pennsylvania Gov. Tom Wolf (D) and its resounding 193-0 defeat by the General Assembly.

A recent article in *Governing* surveyed the states and found that with just a week left in most state fiscal years, which generally end on June 30, more than a dozen states still hadn't adopted a budget for the new year.¹ Given that the economic recovery has been in progress for several years and that many states are reporting healthy budget surpluses, this is surprising — and possibly a preview of things to come. “This year we've seen a plethora of states where it's been an intractable situation moving forward with their budgets,” Sujit CanagaRetna, a senior fiscal analyst with the Council of State Governments, told *Governing*. “It's overall been a bit of a mess, to put it mildly. And I think we're going to see more of this going forward.”

The states without budgets as of June 25 included Alabama, Connecticut, Delaware, Illinois, Massachusetts, New Hampshire, New Jersey, North Carolina, Oregon, Pennsylvania, South Carolina, Washington, and Wisconsin. Looking at the list, it's hard to see a particular pattern. The states are spread all over the country, from east to west and north to south. Some have a history of budget problems, but others don't. Some are dominated by Democrats, while in others, Republicans have the majority. What in the world is happening to stall what is the most basic of legislative processes in so many states?

¹Liz Farmer, “What's Holding Up So Many State Budgets?” *Governing*, June 25, 2015.

The *Governing* article identifies three possible explanations. First, in some states, there are disagreements over policy — mainly over cutting taxes or restoring services cut in past years. Second, some states are “struggling under the weight of a systemic financial imbalance that prior budgets have papered over with one-time fixes.” And third, some states, despite the economic recovery, are simply confronting unforeseen budget deficits.

In several of the states, the basic budget woes are complicated by sharp disagreements between Republicans and Democrats over how to fix the problem. In that sense, CanagaRetna is onto something with his final point. As the political divide between Democrats and Republicans widens in the states and becomes more intractable, this could become, if not the norm, then certainly more common.

A good illustration of this problem can be found in Pennsylvania, where Gov. Tom Wolf (D) and the legislature are deadlocked over both spending and taxes. In this case, the state fits two of *Governing's* categories. The state has a large structural deficit, and there is a wide gap between the approaches taken by Wolf, who unseated Republican Tom Corbett in last November's election, and the Republican-controlled legislature. The two branches are so far apart ideologically that with the new fiscal year just days away, it appeared that both sides had given up on reaching a timely compromise. “It's looking like a long budget summer,” said Rep. Patty Kim (D) after attending a dinner with Wolf.

The divide is so sharp between Wolf and lawmakers that it almost transcends the partisan divide, a point made on June 1 when the House rejected the governor's tax plan by the unheard-of margin of 193 to 0. In case you don't follow state legislative politics, this is an astounding result for any proposal that gets to the House or Senate floor for debate. In almost all states, even a motion to make the buzzard the state bird probably would get a few affirmative votes.

This isn't the first time a budget deadlock in Pennsylvania has spilled over into the new fiscal year. Unlike some states, the failure to pass a budget in Pennsylvania doesn't trigger a government shutdown — and therefore pressure for compromise. Even without a budget in place at the start of fiscal 2016, the state can coast for a time on its reserves before running out of money. This breathing room isn't entirely helpful because it removes a sense of urgency. Add to that some significant structural problems and mix in some politics, and you get Pennsylvania's situation, in which the budget deadline has been missed several times over the last

dozen years. When he was governor, Ed Rendell, a Democrat like Wolf, vetoed part of his first budget in 2003 and fought with Republican lawmakers until reaching a budget deal in late December. It wasn't the last deadline that Rendell missed.

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Obviously, the situation in the Keystone State is complicated, and to unravel it, I turned to Bob Strauss, a professor at Carnegie Mellon University in Pittsburgh and a longtime observer of the state's legislative follies. Well, not only is he an observer, he's also a contributor, he told me, since several of his former students hold important staff positions in the legislature and the administration. Strauss has also researched and written about Pennsylvania's taxes and spending plans over the years, as well as served on various tax reform commissions. He reported that tempers are fraying already, and much depends on "how long the governor is willing to wait and do nothing." He predicted that the impasse won't be resolved until Labor Day. It's going to be a long, hot summer in Harrisburg.

At the heart of this year's deadlock is a major budget shortfall. When Wolf released his budget in March, the 2016 shortfall was projected to be \$2.3 billion. That, at least, has improved. On June 15, lawmakers were informed that the budget gap had been cut to \$1.2 billion in part because of better-than-expected revenue growth. The state's Independent Fiscal Office predicted that revenue this year should end up well ahead of Wolf's initial expectations.²

However, even as the good news spread across the Capitol, administration officials were urging caution, saying the gap between revenue and spending would soar past \$2 billion in fiscal 2017 because of growth in spending demands and the fact that some one-time factors affecting next year's growth won't continue. "We need to look at our structural budget deficit long-term," Wolf's press secretary, Jeff Sheridan, told *PennLive*. "Even with updated revenue projections and some one-time revenues, the bottom line is that Pennsylvania is facing a structural budget deficit of more than \$2 billion in year two [fiscal year 2016-17]." Still, \$1.2 billion is the problem that must be solved immediately. The question is how.

In his March budget plan, Wolf, a political novice in his first year of office, offered his vision, which he described as an effort to rebuild the middle class by investing in schools, attracting solid jobs, and making government more efficient. Wolf proposed a \$29.8 billion general fund budget. At

first blush, the spending plan is about 3 percent higher than the \$29 billion fiscal 2015 budget; however, that's because it doesn't account for nearly \$2.1 billion that the governor plans to transfer into a special fund for property tax relief, as well as \$1.7 billion he wants moved to another fund for public school employee pension costs. If that money is taken into account, Wolf's budget would increase spending by 16 percent over 2015.

To finance the budget and pay for the \$2 billion shortfall that was being predicted at the time, Wolf's plan called for \$4.6 billion in new taxes, equal to about 15 percent of the governor's proposed general fund spending plan for next year.³ The budget proposes increasing the state's personal income tax from 3.07 percent to 3.7 percent, a 20 percent increase that would raise \$2.38 billion. On the business tax side, the governor wants to lower the corporate net income tax rate from 9.99 percent to 5.99 percent at a cost of \$249 million next year, but increase the bank share tax from 0.89 percent to 1.25 percent, netting \$339.2 million. He also wants to move from separate to combined reporting. The plan would also increase the sales tax rate from 6 percent to 6.6 percent and expand the base to a slew of new goods and services, bringing in about \$1.55 billion next year.

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Among the items that would be added to the sales tax base are newspapers, candy, and personal hygiene products. He also wants to tax several services, including cable television, amusement, and recreation services such as fitness centers and golf courses, as well as "social assistance," such as child care services. The cigarette tax would be increased \$1 per pack, and the state would begin taxing all other tobacco products, including e-cigarettes. And finally, the plan includes a controversial severance tax of 5 percent plus 4.7 cents per thousand cubic feet of volume on natural gas extraction on Marcellus Shale production, which Wolf originally proposed in February. The new taxes would replace the impact fee that natural gas companies now pay to the state and to local governments based on the number of wells they drill.

Much of the money raised by the tax hikes would go toward funding Wolf's proposed property tax relief plan, worth \$3.8 billion, covering Pennsylvania's 500 school districts. Under his plan, Wolf said in his budget address, the state's share of public education funding would increase to 50 percent for the first time in four decades. It would also reduce the reliance of local school districts on property tax increases to make ends meet. Payments to school districts

²Charles Thompson, "Budget Negotiators Have Defined Pennsylvania's 'Structural Deficit' at \$1.2 Billion," *PennLive*, June 16, 2015.

³Wolf, "2015-16 Pennsylvania Executive Budget" (Mar. 3, 2015).

would be gin in 2016 and would favor high-tax, high-poverty districts. The administration estimates more than a 50 percent average reduction for homeowners from the property tax reductions.

In addition to the property tax relief, Wolf also proposes expanding school funding by about \$2 billion over four years, and he wants additional funding for various jobs programs. Reform of the state's abysmal pension system is also on his list. Wolf wants to take out a \$3 billion bond to fix the state's growing employee pension debt; officials called this approach "refinancing." The governor's budget secretary said a plan to modernize, but not privatize, state liquor stores would generate increased alcohol revenue to help pay off the bond.

Early on, the budget received fairly positive reviews from the public, and even recent polling has shown that voters continue to approve pieces of Wolf's plan, including the Marcellus Shale gas tax and the proposed property tax relief. The plan's political viability, though, is another matter. "There is no doubt this is by far the most ambitious agenda that any governor has had in recent history, because of the comprehensive nature of it," said Terry Madonna, a Franklin & Marshall College professor and pollster. "The difficulty with it is it's a package. If you start to pull it apart, then can it sustain?"

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Comments from the Republican-controlled legislature suggest it can't sustain. When the plan was released, the legislative leadership dismissed it as too large and unrealistic. Senate President Pro Tempore Joe Scarnati (R) called it "the most massive tax-and-spend plan in recent history of the Commonwealth." Senate Majority Leader Jake Corman (R) said, "The problem with this budget is it's not based in reality."

It's been downhill since then. In April, House Republicans proposed a \$4.9 billion property tax relief plan that's larger and targeted to benefit a different set of taxpayers. The plan would provide two-tiered tax relief: It would funnel increased funding to local school boards reduced the millage rates on which property taxes for homeowners and businesses are based, and it would use additional funding to expand the homestead exemption that reduces homeowners' taxes. Unlike the governor's plan, the House's plan wouldn't provide extra help for the state's poorest school districts, nor would it provide tax relief for renters, as Wolf's does. Instead, its main effect would be to reduce taxes in the richest districts. "We tried to drive [property tax relief] to the areas that had the highest property taxes, but in a way that helps everyone," House Appropriations Committee member Seth Grove (R) explained.

To finance the property tax relief, the House plan proposes increasing the state personal income and sales taxes, as

well as using casino revenue, to provide nearly \$5 billion in tax relief. Under the plan, the state sales tax rate would increase from 6 percent to 7 percent, compared with the rate increase from 6 percent to 6.6 percent under Wolf's plan. Both plans would also raise the state's income tax from 3.07 percent to 3.7 percent. The House plan would add \$600 million in casino revenue to the total.

Even the lawmakers who supported it said they didn't view the plan as a finished product but as the start of a "long overdue" conversation. House Majority Leader Dave Reed (R) said House passage of the plan puts the issue front and center in the budget discussion, along with liquor privatization, which the House passed in February, and pension reform, which the Senate also passed in May. "Now that we kind of know how the table is set, we're going to have to discuss what that final table is going to look like at the end of June," Reed said. Even Wolf praised the willingness of House Republican and Democratic leaders to work together on the plan, even as he took credit for starting the discussion of property tax relief. "Democrats and Republicans did Pennsylvania a great service, and that's sort of getting this budget season off to a great start," the governor said after the bill passed.

Well started, perhaps, but not well finished. The air of harmony began to unravel when neither side was able to make much progress on a compromise tax and spending plan. Then came June 1, when the House leadership called for a vote on the governor's full tax plan as a single package in one of those complicated procedural maneuvers that only state legislatures seem capable of concocting.⁴

After the House adopted several amendments to HB 1192 that provide the basic framework for the budget, the legislation was temporarily held over after Rep. Joe Markosek (D) moved to suspend the rules so that a late-filed amendment could be considered that would amend the bill to add the governor's spending — but not revenue — priorities. While the legislation was held over, the chamber took up another bill that would exempt from sales tax the purchase of gun locks and safes. This otherwise trivial bill quickly became contentious when Grove — a Republican, remember — offered an amendment that was basically the governor's tax plan in full.

House Minority Leader Frank Dermody (D) called the move "a political stunt" and said that the amendment "does not accurately reflect the governor's proposal." He said House Democrats would vote against the amendment until such a time when all four caucuses in the House and Senate could sit down and negotiate a final budget plan. Republicans countered that they were hampered in representing the governor's tax proposal for an up-or-down vote by the absence of any gubernatorially proposed statutory language.

⁴Jason Gottesman, "Gov. Wolf's Tax Plan Gets House Floor Vote, Democrats Said Move Was a Political Stunt," *The PLS Reporter*, June 1, 2015.

Reed chided the Democrats: "This is your opportunity to have that which you have been crying for, not only for the last six months, but the last four years." He said Democrats have to put up the votes to make sure the revenue exists for the governor's spending plan. "It's a constitutional mandate," he said. "If we are going to be forced to vote on a spending plan that does not have revenue attached to it, we are going to make sure we have the revenue first."

Both sides stuck to their guns, and the amendment failed 193 to 0.

Upon returning to HB 1192, Markosek claimed that his amendment would provide for "a real budget" with the revenue to come. "This puts Pennsylvania where we need to be; there's no gimmicks in front of us," he said. Reed called the attempted amendment "smoke and mirrors," and eventually the House failed to suspend the rules to allow the late amendment to be considered, and it died.

That went well.

I asked Strauss for his interpretation of what happened. His explanation was a little more nuanced than the news reports. "The House Democrats didn't really like the governor's tax plan," he said. "They're particularly uneasy with the shale gas tax because of falling gas prices. They're worried about driving the industry [to] shutting down production." He said the vote was a matter of the Democrats going along with the Republican procedural move so everyone — and that means every single House member — could go on record as voting against a large tax bill. The result, he later said, "is likely a new national record for state legislative expressions of disapproval of gubernatorially proposed tax policy. I was really surprised at their taking a record vote. In early April, I publicly suggested they resort to a voice vote to give everyone political cover."⁵

Since then, parallel negotiations have been going on in the Capitol without much apparent movement as the clock ticked down on the legislative session. "From what I've heard," Strauss said, "two rooms are being used. The House and Senate meet in one room then go to the other one to meet with the governor's staff or the governor himself."

This is the result Strauss had warned his former students about months ago — to no avail. "All listened respectfully to my rantings about the desirability of *not* revisiting the 1991 meltdown of negotiations," he said. "Back then, one former student working for the Senate [minority] Democrats, and another slacker who worked for the House [minority] Democrats, and who didn't take any courses from me, fashioned a purposefully anti-business tax package which the Republicans ultimately adopted because they got so angry at business interests who didn't want to share any of the pain in paying higher taxes to close the recession-induced budget shortfall." There was, he said, "a kind of

⁵Brad Bumstead, "Can the Pa. Budget Process Be Fixed?" *Pittsburgh Tribune-Review*, Apr. 5, 2015.

gleeful perversity in raising our corporate net income tax rate into the stratosphere, where it remains as a stubborn reminder that it's rather easy for Keystone politicians to go en masse to the wrong goal line. I continue to pound away at former students that a repetition of that debacle will ensure that high-paying, nearby jobs for our children and grandchildren will never happen. My former students listen politely, and just like our own adult children, they go about their ways as if I said and they heard nothing!"

Whether anybody really pays attention and heeds Strauss's warning is an open question. He said that after the 193-0 drubbing, Wolf appeared surprised by the outcome. Following the House session, the governor called a news conference to voice his displeasure with what some were characterizing as a conversation starter on the first day of the final month of the fiscal year when budget talks start to really heat up. "It's a funny way to start a conversation. I think we could do a better job of it," Wolf said.

Strauss takes a longer view. "Our General Assembly generally trains a new governor this way," he said. "We have a great tradition of craziness in a governor's first year, and this applies equally to Republican and Democratic governors." He also said he didn't expect a Hail Mary to save the day in this case. "My forecast is Labor Day to finish the budget if people begin to feel pressure from Wall Street. The state is almost certain to have its debt downgraded when it fails to pass the budget this coming Tuesday, and I'm not sure anyone is too worried at this point." He said his rough calculation is that a downgrade would cost the state an additional \$15 million a year in higher interest costs — "small potatoes in a \$30 billion budget." Strauss continued, "Moreover, no elected judge in Pennsylvania would give a negligence complaint any standing."

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For Wolf, the next few months will be important, particularly after several political stumbles in his first legislative session, going beyond the tax plan fiasco. The legislature will shape the budget, but the governor may take a lot of the blame from voters if things drag on through the summer.

To improve his political fortunes, Wolf in June announced a new political action committee — Rebuild Pennsylvania — to sell his agenda, including higher taxes and more spending on schools, to the state's voters and to support other candidates for office. Wolf, who made a fortune in the kitchen cabinet business, also sold his shares in the family business and will use some of his own money to start the PAC.

From what Strauss told me, a PAC to trumpet Wolf's agenda is a good idea. However, Strauss said he wasn't sure the governor or his agenda are as popular as Wolf seems to

imagine, even though he beat Corbett handily. "Whether or not Governor Wolf still believes that he cracked a 50-year pattern of sitting Pennsylvania governors always winning a second term by beating Tom Corbett because Wolf was so popular remains to be seen." It might be a case of Corbett being so unpopular, he said. "After all, Corbett, while attorney general, put Republican and Democratic members of the House and Senate in jail for corruption, and then had really bad bipartisan relations with those he didn't put in jail. Corbett's active criticism of Joe Paterno in the Sandusky affair probably sealed his fate." It remains to be seen if the coming summer will seal Wolf's.

A few days before the legislative session ended, I asked Strauss what would happen next. First, he said, the legislature will pass a budget largely along party lines, without a severance tax or the large school funding increase Wolf wants, and send it to the governor for signature. Second, he said, "the governor will veto the budget and go on vacation." Strauss said that "July will be a continuation of the discussions in different rooms by the Republicans, Democrats, and governor's staff. And there will be recriminations in the media all around." Finally, he said, the state's bond rating will be reduced, and with pressure presumably building and patience running out, lawmakers will finally reach some sort of watered-down compromise budget by the end of summer or early September. "In the end, I think what you'll wind up with is pretty much the status quo, except that the General Assembly will privatize liquor sales and take some steps to fix the state's pension problem," he said.

I asked if he thought any major tax plan would be adopted. He said he doesn't think so. "Property tax relief is too expensive, and no one wants to raise the sales and income taxes." The other problem, he said, is that taking over an expanded share of school funding would have large, ongoing consequences for the state's finances, which are

already shaky and could get worse. "The growing healthcare cost pressures of adding 1 million seniors over the next 10 years to a stagnant 12.5 million population, coupled with tax expenditures today of \$2.4 billion, rising to around \$7 billion in 10 years, from not taxing any retirement income, will continue to increase the structural deficit," he predicted. But still . . . no new taxes? I asked. "No new taxes," he said.

True to prediction, on June 27 the House adopted a \$30.1 billion budget over strong Democratic opposition and sent it to the Senate, which scrambled to pass it before the end of the legislative session. The budget would increase state spending by about \$1 billion, mostly for pension obligations and healthcare, while holding the line on taxes but privatizing liquor sales.

The Senate passed the bill on the evening of June 30, the final day of the fiscal year. Democrats claimed it was crammed with more than \$1.5 billion in one-time measures, compounding the structural deficit, but they didn't have the votes to stop its passage. The GOP plan largely ignores the increases in public school aid sought by Wolf, and the governor said he would veto it regardless of the consequences.

Not long after he received the budget from the legislature, the governor was as good as his word and vetoed the budget. "It's what I feared. This is a budget that actually doesn't work," Wolf said at a news conference. "It simply doesn't work. The math doesn't work. It's not balanced and it doesn't address the challenges Pennsylvanians face."

The next day he vetoed the liquor privatization bill, which the Senate had also passed to him as the final day of the fiscal year wound down. And then he rested. Not really. But Wolf did take off for the Fourth of July weekend, promising to be back at work the following Monday. It could be a long, hot summer in Harrisburg. ✧