

Testimony before the Senate Government Management and Cost Study Commission
June 7, 2010

Senator Argall, members of the Commission. I am here this morning representing the Pennsylvania Budget and Policy Center, a non-partisan research and policy organization that focuses on state budget and tax policy. We promote an equitable tax system and a budget that meets the needs of low- and middle income Pennsylvanians. Thank you for the opportunity to speak today.

My testimony today will do three things:

- (1) Provide a big picture view of Pennsylvania's budget and taxes
- (2) Raise a few issues that I hope you will address in your final report
- (3) Identify two areas for study and potential cost savings

I want to applaud your efforts to bring a fresh eye to the budget, to identify ways for government to more efficiently deliver high quality services and control costs. Responsible spending is vital to maintaining public trust in government and its elected officials.

Some of the motivation for examining the budget for cost savings and efficiencies stems from a belief that government spending is too high, is growing too quickly, or is crowding out private sector investment. Although widespread, none of these claims is, in fact, accurate.

I have distributed a copy of PBPC's publication, *the Common Good*, which we developed as a primer on Pennsylvania's budget and tax systems. The data I will share with you this morning can be found in that document where it is presented in more detail.

Pennsylvania is neither a high tax nor a high spending state. Roughly speaking, spending and taxes in Pennsylvania are around the national average. More specifically, in 2007 (the latest for which we have this data), state spending as a share of the economy ranked 32nd in the nation, and state taxes ranked 33rd. The rankings improve slightly from 2005. General expenditures are 12%, just above the national average. Taken together, taxes and spending at the state plus local level are a little higher, ranking 20th and 26st respectively. This means Pennsylvania relies more on local taxes and spending for public services and government.

Many services, including public safety, education, higher education and human services are the joint responsibility of state and local governments. When state government cuts back or spends less local governments often are required to spend more. This is particularly true with local education funding, where Pennsylvania ranks close to the bottom, 46rd in the state share of (state plus local) education spending.

In the *Common Good* (see p. #), we compare taxes and spending to a number of states that the Department of Community and Economic Development has identified as economic competitors. Pennsylvania spends less and taxes less than our competitors. In fact, taxes as a share of the economy

are a half percentage point lower than most of our economic competitors which include North Carolina, Maryland, Delaware, New York, New Jersey, West Virginia, Ohio, Illinois and Michigan.

The Council On State Taxation, a trade group representing 600 of the biggest corporations in the US, released the latest version of *Total state and local business taxes (2009)* in March 2010. Comparing state and local taxes paid by business to private sector Gross State Product, Pennsylvania's effective tax rate was 4.6%, which is lower than the national average. Compared to the most populous states, Pennsylvania was tied with Illinois – lower than Texas and Florida.

The report tries to measure “bang for the buck” for taxes paid by businesses in states. If half of education spending benefits businesses, the report found that Pennsylvania businesses come out roughly even in what they pay in taxes each year - the same as the national average.

Finally, state spending as a share of the economy has been stable over time, averaging around 6.3% for more than 20 years. Public expenditures have grown in tandem with the economy. This point is important to acknowledge because some would argue that public spending has grown as a share of the economy. Others would argue that spending should grow at the rate of inflation. This claim fails to acknowledge that the Consumer Price Index (CPI) measures household expenditures, not government expenditures. Governments buy health care for many of its citizens: the cost of health care has grown much faster than inflation, and will continue to do so, as growth in the 85+ demographic group is particularly robust.

As the work of the Commission comes to a conclusion and you consider your final report, I would ask that you address not only about what government does wrong, but also about what government does right. There is great public cynicism about government writ large. Some of this cynicism is because most people aren't fully aware of how public funds are invested in their communities. *The Common Good* gives some examples of places where public sector spending has made a concrete difference in the lives of Pennsylvania's citizens. The Commonwealth enjoys lower rates of poverty and child poverty and better rates of health insurance coverage than most states and improving public school student performance. Those outcomes are a direct result of public spending and public policies that are, objectively, more effective than other states. As we look for cuts in Pennsylvania public spending that would improve the effectiveness of state government, we want to be careful not to throw the baby out with the bath water. A quick look at the 10 states with the lowest spending and tax levels makes clear very quickly that low spending and tax levels are not an end in themselves—cost-effective spending and high return-on-investment are legitimate goals.

I suspect that one of the questions that the Commission has considered in its deliberations is the proper role of government. I would say there are four:

- (1) Improving the quality of life of citizens and communities
- (2) Protecting the public
- (3) Providing assistance to the vulnerable

(4) Making investments that support economic growth.

I want to underscore the latter. There is a rich body of economic literature on the importance of public expenditures in the past, particularly in transportation, infrastructure and education, to a healthy and growing economy. There is also a very live debate now about the role of the state in stimulating economic development now and in the future—in supporting a 21st century state economic development strategy. As in other areas, if Pennsylvania decided in this time of tight revenues to simply abandon its role in economic development—in creating good jobs and strong industries—we think all Pennsylvanians would come to regret that retreat. Again as in other areas, the question should be what is the *strategic* role for state government and what approaches can maximize return on investment in the form of good jobs and broadly shared prosperity.

Public expenditures play another critical role. The vast majority of state funds, more than 80% go back to local communities in grants and subsidies or institutional expenditures. This isn't Las Vegas: what collected by Harrisburg doesn't stay in Harrisburg. State tax dollars generate jobs and economic growth at home. Moodys.com economist Mark Zandi, using data from the 2001-03 recession, has found that every dollar invested in state fiscal relief to states during the recession returns \$1.41 in economic activity. Direct benefits, like unemployment insurance result in \$1.61 in economic activity. According to Families USA, each dollar spent on Medical Assistance in Pennsylvania generates \$2.77 in local communities, and a report by Cornell University finds that \$2 are circulated for every dollar spent on early childhood education.

There are a few areas that I would urge that you examine to find savings. The first is tax expenditures and tax credit programs. I have attached a few pages from the Commonwealth's Tax Expenditure Analysis, more than 100 pages in the budget book that detail the cost and rationale (a term I use loosely) for tax expenditures. Tax credits in particular are very popular, although there is very little reporting and in many cases research has found tax credit programs subsidize rather than stimulate behavior. Other tax expenditures include exemptions that have been enacted by the General Assembly, in response to a request or argument that a tax exemption, for example a sales tax exemption will create jobs and stimulate investment. Often these are just a race to the bottom, or a giveaway. Pennsylvania enacted a sales tax exemption for helicopters last year and was rewarded for its effort by having Boeing, the intended beneficiary of this credit open a new operation in New Jersey. According to the company, the New Jersey site had lower labor costs and a more appropriate site. The tax code is rife with examples of special tax provisions; emergency beer tax credit, sales tax exemption for gold bullion, candy and baked goods, horses, fish feed, film rentals and wrapping paper.

Long term, with states as well as families, the best way to save money is to spend it, to invest it in the future. A scalpel that helps us achieve efficient and effective government—lean government—is welcome. A hatchet that ushers in “anorexic government” would be a mistake.

General Fund Tax Expenditures

SERVICES

Description: Expenditures for services are not taxable under the sales and use tax except when specifically taxed by law.

Purpose: Because the primary basis for the sales and use tax is tangible personal property, the majority of services are not taxed unless they are related to taxable property. Legislation adopted in 1991 imposed the tax on charges for selected business services. Act 7 of 1997 removed computer services from the list of taxable services.

(Dollar Amounts in Millions)

<i>Estimates:</i>	<u>2008-09</u>	<u>2009-10</u>	<u>2010-11</u>	<u>2011-12</u>	<u>2012-13</u>	<u>2013-14</u>	<u>2014-15</u>
LODGING							
Recreational parks, camps & campgrounds.....	\$ 42.6	\$ 40.5	\$ 41.7	\$ 42.7	\$ 43.7	\$ 44.7	\$ 45.9
PERSONAL SERVICES							
Dry-cleaning & laundry services.....	\$ 38.1	\$ 38.4	\$ 39.6	\$ 41.3	\$ 43.1	\$ 45.0	46.9
Personal care services.....	119.5	121.3	124.6	128.7	133.1	137.6	142.7
Funeral parlors, crematories & death care services....	47.8	48.6	49.9	51.5	53.3	55.1	57.1
Other: personal services.....	43.6	44.2	45.4	47.1	48.7	50.4	52.3
BUSINESS SERVICES							
Advertising, public relations, & related services.....	\$ 670.2	\$ 665.2	\$ 689.3	\$ 728.8	\$ 771.5	\$ 810.9	\$849.9
Services to buildings and dwellings.....	149.4	148.4	153.1	161.0	169.6	177.4	185.0
Consulting (scientific, environmental, & technical).....	305.0	303.5	314.4	332.4	352.1	370.6	388.8
Scientific research & development services.....	212.8	212.8	220.4	233.5	248.1	262.6	277.7
Information services.....	17.4	17.1	17.4	17.9	18.4	19.0	19.8
Administrative services.....	424.7	422.2	436.1	459.3	484.8	508.4	531.5
COMPUTER SERVICES							
Custom programming, design & data processing.....	\$ 316.6	\$ 313.2	\$ 324.0	\$ 342.7	\$ 363.1	\$ 381.9	\$399.9
AUTOMOTIVE SERVICES							
Parking lots & garages.....	\$ 74.5	\$ 75.5	\$ 77.6	\$ 80.3	\$ 83.2	\$ 86.1	\$89.4
RECREATION SERVICES							
Spectator sports admissions (excludes schools).....	\$ 25.4	\$ 27.1	\$ 29.0	\$ 31.0	\$ 33.1	\$ 35.3	\$37.7
Theater, dance, music & performing arts admissions..	15.8	17.3	19.0	20.8	22.8	24.9	27.3
Amusement & recreation industries.....	132.3	134.1	137.7	142.5	147.5	152.7	158.4
Museums, historical sites, zoos & parks.....	10.8	10.6	10.4	10.2	9.9	9.7	9.5
HEALTH SERVICES							
Home health care, nursing care, & other ambulatory health care services.....	\$ 382.6	\$ 396.6	\$ 412.0	\$ 429.8	\$ 447.8	\$ 466.2	\$487.9
Hospitals.....	742.8	770.4	800.8	835.7	871.2	907.3	949.8
Physician & dental services.....	896.4	929.7	966.4	1,008.5	1,051.3	1,094.9	1,146.2
Social assistance including day care.....	149.6	155.2	161.3	168.3	175.5	182.7	191.3
PROFESSIONAL SERVICES							
Legal.....	\$ 548.5	\$ 549.4	\$ 565.9	\$ 591.7	\$ 619.3	\$ 645.3	\$671.5
Architectural, engineering, & related services.....	256.6	247.5	252.7	269.4	288.0	302.5	313.2
Accounting, auditing and bookkeeping services.....	261.4	260.0	268.7	283.0	298.5	312.7	326.5
Specialized design.....	62.9	61.8	63.5	67.0	71.0	74.7	78.2
All other professional and technical services.....	158.1	156.3	161.4	170.1	179.8	188.6	197.1
TRANSPORTATION SERVICES							
Transit & ground transportation.....	\$ 44.0	\$ 43.4	\$ 43.9	\$ 45.2	\$ 47.0	\$ 49.1	\$51.0
Air transportation.....	20.7	20.4	20.6	21.1	22.0	22.9	23.8
Truck transportation.....	49.3	48.5	49.9	52.4	55.3	58.0	60.6
Other transportation.....	1.0	0.9	1.0	1.0	1.1	1.1	1.2
MISCELLANEOUS SERVICES							
Basic television.....	\$ 155.5	\$ 155.7	\$ 156.8	\$ 159.0	\$ 160.6	\$ 161.8	\$164.2
Tuition (college, vocational training & instruction).....	616.9	626.0	642.9	664.6	687.2	710.3	736.5
Electrical, plumbing, heating & AC service fees.....	NA	NA	NA	NA	NA	NA	NA
Veterinary fees.....	43.0	43.6	44.8	46.3	47.9	49.5	51.3
Financial institution fees.....	324.2	332.7	343.3	355.6	371.7	388.2	411.1
Waste management and remediation services.....	121.9	121.7	125.5	131.4	137.7	143.7	149.6

Beneficiaries: Virtually all 4.9 million households and all 304,000 business establishments benefit from one or more of these service tax expenditures.