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The Governor's Odd View of Fiscal Management

In a response to calls for cuts in Pennsylvania's business and income taxes, the Governor said, "now is not the time", alluding to the slowing economy and his proposed "tight" budget. This statement, short though it may be, concisely summarizes the disingenuous nature of self-serving official statements.

First of all the budget is not tight. A 4.2 percent rise in overall spending is hardly the stuff of penny pinching, especially on the heels of five years of increases totaling 30 percent—far higher than the inflation rate. Nor would a tight budget include a near 6 percent jump in education spending and a 7 percent increase in general fund welfare expenditures. These are two categories of spending that never go down. Indeed, state law prevents year to year reductions in the education budget. Thus, the recent increases lock the state's single largest expenditure item on a rapidly rising trajectory regardless of whether the money is truly needed or the spending justified.

Then there is the \$130 million in "tax rebates" for families that are eligible for 100 percent forgiveness of taxes already, i.e. families of four with incomes at \$32,000 or less. In other words, folks who are not required to pay income taxes to the Commonwealth under the state's tax forgiveness program will qualify for \$400 rebates. Moreover, under the Governor's plan, a family with income of \$34,251 would not only forgo a rebate; they would have to pay 100 percent of the state personal income tax rate on their full earnings, or \$1,051. Thus, the net benefit of earning the additional \$2,251 above the \$32,000 qualifying income for full tax forgiveness is only \$1,200. That represents an effective marginal tax rate of 47 percent on those earnings. Amazingly, those who earn \$32,000 will end up with a net of \$32,400 (ignoring any local or federal obligations) while those earning \$34,251 will have a net after state tax income of \$33,200, only \$800 more in net income even though they earned \$2,251 more. Where is the equity in that?

At the same time, isn't it fascinating that no tax cuts can be considered for Pennsylvanians who make more than \$32,000 a year and no meaningful reduction in business taxes will be forthcoming? The argument seems to be that with a slowing economy it is fiscally imprudent to roll back tax rates for fear that falling incomes and profits will lead to serious revenue declines. That is a defensible argument only for those who insist on increasing state spending going into an economic slowdown. However, there is a darker side to the Governor's position. If the state cannot cut taxes during a

slowdown and it raised taxes during a period of growth in order to fund a massive expansion of government spending that continues largely unabated, when can taxes ever be cut? In this administration's tax and spend view of governing that would be never.

Many reports and analyses have pointed out the need for Pennsylvania to restructure its business taxes by lowering the corporate net income tax rate, allowing full net loss carry forward, creating more generous R and D allowances, shifting to a Single Sales Factor formula to determine tax liability in the state. Moreover, a roll back to pre-2003 personal tax rates is highly desirable as well.

The government needs to ask itself, "How is that after spending some \$3 billion to assist in economic development over the last five years, many regions of the state continue to languish economically and job growth is anemic or non-existent?"

And at the same time, the corollary question would be, "What if we had cut taxes each year by the amount of the increased debt service being incurred as result of all the borrowing to fund the various "grant" programs?" Note that since the last pre-Rendell budget, the state's general obligation debt service payments have climbed by \$555 million per year and are continuing to move higher. Upwards of half of that increase can be traced to the borrowing for development purposes. Business tax cuts approaching \$300 million per year would almost certainly have had a greater stimulative effect on overall sustainable business activity than the massive handout approach has been able to achieve. What's worse, the increased debt service obligations will be with us for many years, constraining tax cut opportunities far into the future—the pain that won't go away.

Further, to the degree the subsidy programs fail to deliver the promised job and output gains the money has been absolutely wasted. But the most sinister impact is that the handout programs create an entitlement mentality among many members of the business community, who begin to depend on taxpayers to become unwitting investors with no claims on any profits the business might produce.

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