PA Budget Watch
CURRENT BUDGET ON TRACK BUT FY2011-12 PRESENTS STERN CHALLENGES

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As we begin the second half of Pennsylvania's 2010-11 fiscal year, state revenues seem to be turning the corner - December General Fund revenues exceeded estimate by $176.9 million (8.4%). However, projections of a large structural deficit for 2011-12 continue to call into question whether incoming Governor Corbett will be able to deliver on his 'no tax increase' pledge for the next fiscal year and whether he will be able to implement a number of campaign promises to reduce taxes over the longer haul. Pennsylvania taxpayers should pay close attention as the new Governor and General Assembly target program cuts and consider revenue enhancements for the 2011-12 budget.

Following are some key fiscal 2010-11 revenue statistics, through December 31st, as announced in a Governor's Office press release:

	YTD Variance from Estimate	
	$ (millions)	%
General Fund	**+191.2**	**+1.7%**
- Sales Tax	+102.8	+2.5%
- Personal Income Tax	+16.6	+0.4%
- Corporate Taxes	+91.4	+7.9%
- Realty Transfer Tax	-32.8	-18.0%
- "Other" Taxes	+1.2	+0.2%
- Non-Tax Revenue	+7.0	+2.2%
Motor License Fund	**+163.3**	**+14.4%**

In the out-going Rendell Administration's mid-year budget briefing delivered before Christmas, Governor Rendell and his Secretary of the budget, Mary Soderberg, projected a fiscal 2010-11 General Fund shortfall of $63 million. This took into account: (a) a $280 million shortfall in federal stimulus appropriations; (b) $200 million savings from the Governor's spending freeze; (c) an additional $65 million needed for "safety net" programs; and (d) the Legislature's failure to enact a natural gas severance tax that could have yielded approximately $70 million. However, the better-than-expected December results may erase the Projected $63 million shortfall.

While the 2010-11 fiscal year seems relatively under control, the news for 2011-12 presents stern challenges. The current budget was balanced, in part, with $2.6 billion in federal stimulus funds and $750 million in one-time revenues - funds that will not be available for the 2011-12 budget. In addition, the Commonwealth faces higher costs for pensions, medical assistance and other programs. Although economic growth hopefully will help offset those large shortfalls, out-going Governor Rendell and many other officials have projected at least a $3-4 billion gap to be closed in order to balance the 2011-12 budget.

The fiscal 2011-12 gap constitutes more than 10% of annual General Fund expenditures. Much of the General Fund represents programs which would be difficult to cut, including PreK-12 Education (35.4% of Fund), Corrections (6.7%) and Debt Service (3.5%). The Fund also includes Medical Assistance/Long Term Living (20.8%), other DPW Human Services programs (16.4%) and the ubiquitous "All Other" (10.2%). Incoming Governor Corbett reportedly is looking for substantial savings by cutting waste, abuse and fraud in welfare programs but, while we wish the new administration well in their efforts, it is difficult to believe that this will be sufficient to close the 2011-12 gap.

At the same time, the incoming governor has indicated that he is dead-set against enacting a natural gas severance tax and has pledged not to increase existing taxes. Furthermore, during the recent gubernatorial election, the incoming governor pledged to:

- Complete the phase-out of the Capital Stock and Franchise Tax by 2014.
- Reduce the Corporate Net Income Tax rate from 9.99% to 6.99% over six years.
- Phase-out the Net Operating Loss Cap over a nine-year period.
- Phase-out Pennsylvania's Inheritance Tax over a 15-year period.
- Phase-in Single Sales Factor apportionment for the Corporate Net Income Tax during 2013 and 2014.
- Enhance Research and Development incentives.

Obviously, the upcoming Pennsylvania budget cycle presents a classic confrontation between those supporting what they view as necessary government programs and the new Governor and his political allies seeking to hold the line, or reduce, taxes and "live within our means."

Some combination of cost cutting and revenue enhancement through "fees" and other non-tax alternatives (e.g. selling the state liquor stores) seems the most likely result. However, Pennsylvania taxpayers should pay close attention as they may be significantly impacted by this next budget - whether it includes "taxes" or not.