



Pennsylvania Governor's Borrowing Proposals Short-Sighted

Testimony Before the Pennsylvania House Republican Policy Committee

by Joseph Henchman

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Good morning. On behalf of the Tax Foundation, I want to thank you for the opportunity to speak today. The Tax Foundation is a non-profit, non-partisan research organization that has monitored fiscal policy at all levels of government since 1937. Our goal is to explain as precisely and as clearly as possible the current state of fiscal policy in light of established tax principles, so that you, the policymakers, can have the information to make informed decisions.

We do the annual "Tax Freedom Day" calculation, which represents the day on which Americans have paid their taxes for the year and can start earning for themselves. We also do the annual *State Business Tax Climate Index*, which ranks the states on 113 variables in five sub-areas. In our 2008 index, Pennsylvania ranked 27th overall—middle of the pack. Now, Pennsylvania has an incredible opportunity, as you are surrounded by many states with poorer business tax climates, such as New Jersey, West Virginia, Ohio, and New York. With a good business tax climate you can draw in jobs and economic activity from those states; with a bad business climate those jobs can go the other way.

For example, Pennsylvania's corporate income tax rate is 9.99 percent, the second highest in the United States. This is not very competitive either at home or internationally, where everyone is cutting corporate tax rates to 25, 20, even 12.5 percent. Businesses doing business in Pennsylvania must pay the 10 percent state tax, plus the 35 percent federal rate. **Any plan that purports to stimulate Pennsylvania's economy and invest in the future which does not cut the corporate income tax rate just isn't serious.**

The Governor's plan is not the right prescription for Pennsylvania's economy, for three reasons.

First, borrowing is expensive. For every \$1.00 of borrowing, you will have to repay about \$1.50 in principal and interest. This debt represents future tax increases. For this reason, many public finance experts say that borrowing should only be done for one-time capital projects, and not to displace ongoing yearly expenses. In the Governor's plan, as one example, he proposes

diverting tobacco settlement money that is paying for current research efforts, and using it to build new facilities. But for every \$1.00 that he uses to borrow for new facilities, you're reducing money going to research by \$1.50.

Two other proposals are especially problematic. These are the venture capital funds, for energy research and the Jonas Salk initiative for health research. Say the Governor's wildest dreams came true, and these initiatives came up with the successor to gasoline and the cure for cancer. These aren't going to stay in Pennsylvania; they'll be enjoyed by everyone the world over. But their development will have been funded entirely by Pennsylvania taxpayers, who would subsidize everyone else. This is why many experts say that this type of research should be left to either private industry or the federal government.

Second, the numbers don't add up. The Governor's plan proposes borrowing \$4.4 billion, which will cost nearly \$7 billion to repay, yet he says that it will only cost \$12 *million* a year. That doesn't pass the smell test, since it would mean an interest rate of something like 0.3 percent. Pennsylvania's credit rating is good, but it's not that good. The real number to remember is the \$7 billion to be repaid, which must come from somewhere. That somewhere is future taxpayers.

The Governor says Pennsylvania can afford to borrow more, because interest rates are low and the debt ceiling hasn't yet been reached. Well, just because you have a credit card with a high credit limit and you haven't maxed it out, doesn't mean you should go out and spend. We usually call that irresponsibility, not responsibility.

Pennsylvania's total state debt is over \$37 billion. Much of that is from regional authorities, and I must warn you of the dangers of going down that path. Many states, including New York and now Virginia, are creating these authorities and giving them dedicated sources of revenue, and that guarantees that they'll be around forever and often not subject to oversight by the voters, certainly not at a statewide level. Establishing these authorities also deprives voters and legislators of the ability to reallocate resources as time goes on, if the authorities are spending their tax revenue on lower priority items.

Pennsylvania may have a balanced budget, but the surplus has been getting smaller each year. In the last few years, that balanced budget has been propped up by over \$3 billion in borrowing. I'm originally from California, and I have to *really* warn you not to go down that path. My state has run consistent annual budget deficits of \$10-\$14 billion, and instead of fixing it, we've just been borrowing each year to paper over it. Eventually, California taxpayers will have to pay for all that. If Pennsylvania borrows another \$7 billion on top of \$37 billion, eventually Pennsylvania taxpayers will have to pay for it.

Third, politicians should not be in the business of picking winners and losers. The Governor's plan would have politicians deciding how to research new energy sources and health care advances. The bottom line is that politicians should not be using taxpayer dollars to play investment banker. If Governor Rendell was great at picking winners and losers, he wouldn't be Governor of Pennsylvania; instead, he'd be working at Goldman Sachs. The enormous risks, and enormous benefits, of such investment decisions should be left to the private sector. Even in

the private sector, investors pick the wrong horse all the time. For every investor who picked Amazon.com, there were a dozen who picked an Internet start-up that didn't succeed. History is littered with failed government investments, and the private sector tends to learn from its mistakes while government almost never does.

Handing out favors to particular industries may be politically popular, but it is problematic for two reasons. First, it sends the message that your tax system is so terrible, that you have to grant exemptions from it to attract businesses to your state. Second, it is unfair to businesses that already exist in Pennsylvania, employing millions of citizens. A tax credit for creating new jobs may sound nice, but it leaves out thousands of businesses that employ millions of Pennsylvanians year after year.

The key to a prosperous economy is a tax system that provides a level playing field for all businesses and all industries. In economics we call this tax neutrality. In other words, business decisions should be made on their economic merits and not based upon tax concerns.

I appreciate having this opportunity to speak with you, and I will be glad to entertain any questions that you may have.

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Tax Foundation
2001 L Street NW, Suite 1050
Washington, DC 20036
Ph: (202) 464-6200
Fax: (202) 464-6201
www.taxfoundation.org