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Pennsylvania Overhaul Plan Boosts Taxes for Schools: Muni Credit

(Bloomberg) — Tom Wolf, the only Democrat to beat an incumbent Republican governor in November, wants to extend his disruptive streak by upending Pennsylvania's taxes.

Wolf, a businessman in his first elected office, proposed a new tax on natural-gas drilling, the state's first sales-levy increase in almost a half-century and a boost in the income tax to a record. The plan, released March 3 as part of his budget, would generate \$4.7 billion, enough to close a projected deficit, reduce property taxes and fulfill a campaign pledge to raise education funding.

The 66-year-old took the helm as the state deals with mounting pension costs. Pennsylvania had its credit grade cut by each of the three biggest rating companies last year, to two steps below the average for U.S. states. Credit analysts pointed to one-time fixes used to balance this year's budget.

The latest proposal differs from previous plans that were "piecing things together with duct tape," said Chris Borick, director of the Muhlenberg College Institute of Public Opinion in Allentown. "His shooting for a big move is pretty important because we haven't seen it in a while."

'More Palatable'

Wolf joins about 10 governors considering tax increases, according to the National Association of State Budget Officers. The levies often are tied to particular needs, such as infrastructure or education, said Norton Francis, senior research associate at the Tax Policy Center in Washington.

"It makes it more palatable when you can say we're raising taxes for this express purpose," Francis said.

Wolf beat Tom Corbett, the first Pennsylvania governor to lose re-election since 1968, even as Republican victories gave the party 31 governorships, the most since 1999.

Corbett kept residents' taxes flat, lowered some business levies and cut funding for education and other programs. He failed to push through changes to public pensions, which are consuming a growing portion of the general fund, and a sale of the state's wholesale and retail alcohol operations.

Pennsylvania ranked last in job growth from January 2011, when Corbett took office, to December 2014, according to data compiled by Bloomberg. As expenses swelled, lawmakers balanced the \$29 billion budget for the year through June with \$2 billion of one-time measures.

Buyers' Demand

Investors have taken note, demanding 0.41 percentage point of extra yield to own 10-year Pennsylvania securities instead of benchmark municipal debt, data compiled by Bloomberg show. The difference is the most since at least January 2013 and is greater than the spread on California bonds, which carry a Standard & Poor's grade one step lower, at A+.

S&P, Moody's Investors Service and Fitch Ratings give Pennsylvania their fourth-highest marks. Wolf's use of tax increases is a "clear departure" from his predecessor, said Eric Kim, Fitch's director of U.S. public finance in New York.

Wolf, who was chairman of a family-owned business that supplies kitchen cabinets, told voters he'd boost education funding through a severance tax on natural-gas production, a move that Corbett opposed. Jobs in the industry almost doubled in the four years through June 2014, according to the Department of Labor and Industry.

Wolf's campaign received money from Michael Bloomberg, founder and majority owner of Bloomberg News parent Bloomberg LP.

Wolf's Shift

The governor's \$29.9 billion budget would also shift education funding from property taxes to the sales and income levies. He'd increase the sales tax to 6.6 percent from 6 percent, where it's been since 1968, and the income tax to 3.7 percent from 3.07 percent, while reducing a business-income levy. Average homeowners' property-tax bills would drop by half, or \$1,000.

"To create jobs that pay, schools that teach and government that works, we have to do things differently," Wolf said in his budget address.

Jeff Sheridan, a Wolf spokesman, said previous Republican bills to reduce property taxes form the basis for the governor's proposal.

The governor also called for raising the minimum wage and creating incentives for manufacturing jobs, highlighting national Democratic goals in a state that will host the party's 2016 presidential convention.

'Bad Plan'

Republicans, who control both legislative chambers, still expressed skepticism.

"It really is a very, very bad plan, put very simply, for all of Pennsylvania," Senate President Pro Tempore Joe Scarnati told reporters after Wolf's speech.

Republicans, and even some Democrats, would find it difficult to vote for tax increases because of the risk of primary challenges, said Ryan Shafik, founder of Rockwood Strategies, a Harrisburg consulting firm that works with Republican candidates.

Yet Wolf's victory by 10 percentage points showed voters consider schools a priority, said Thomas Baldino, who teaches politics at Wilkes University in Wilkes-Barre.

"If Republicans want to demonstrate that they are hearing what the public wants, they need to work with Wolf on things like education funding," he said.

Bloomberg Muni Credit

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March 11, 2015

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