Let's Not Put Cranky Uncle Mike in Charge of the State Budget: Why We Shouldn't Raid Special Funds to Balance the General Fund

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By Marc Stier August 29, 2017

Know-nothings in American Politics

Last November we elected a President who reminds many of us of a cranky uncle who sits at the far end of the Thanksgiving or Christmas table, muttering under his breath about the "damn government" and "wasted taxes" and, quite often, "those people who cause all the trouble." When you try to engage him in discussion, you find that he has a ready – and extremely simplistic – answer to every question, one that is lacking in any detailed understanding of what government actually does and that assumes that "it's very simple to do x or y" if not for conniving politicians. And if you try to point out to him that government is not quite so simple, he is quick to point to some over the top blog post or email that assures them that, yes, it is all very simple

Right now, some Republican members of the House of Representatives, with the support of outside advocates, are readying a plan to borrow massively, perhaps up to more than $2 billion, from many of the 100 or so special funds that, along with the General Fund, are part of the state budget. Their justification for doing so is that, at the end of each year, many of these funds have a surplus. So it seems easy enough to shift those surpluses – money they are quick to say is "just sitting there not doing anything" – into the General Fund. Voila, the state's budget deficit is solved, and we don't have to raise taxes.

And if you doubt that this plan makes sense, they can point you to a blog post or two that gives some assurance about it. Indeed, those posts egg them on by calling those special funds the "shadow budget," as if there are places where large sums of money are being hidden by our politicians.

This plan, however, is one more example of the know-nothing politics that from time to time overtakes both parties in American politics, but today especially afflicts Republicans. This idea appears to be coming from supporters of Speaker of the House Mike Turzai who is determined never to raise taxes under any circumstances and believes that there is some "simple solution" that will make it possible to avoid a tax increase this year.

In this paper, we examine this plan, first from a theoretical point of view and then by looking at a few of those state funds. We conclude that is it is largely based on a misunderstanding of how government works in Pennsylvania and elsewhere.

Governments, Businesses, Households

Comparing government budgets and household budgets is sometimes misleading, especially when talking about the federal government, because the federal budget need not be, and according to most economists should not always be, balanced.

But there are certain basic principles of budgeting that apply across the board.

1. If your business or household income has been reduced, you eventually have to reduce your spending. While you can keep your spending up by dipping into your reserves, at some point you run out of those reserves. Then you either must increase your income or cut your spending.

2. If your business has contracted with a customer to carry out a special project, you may seek advanced payments for that project in order, for example, to be able to purchase the supplies you need to carry out the project. Similarly, if a household wants to set aside money for a special project – say remodeling a home – you must keep that money separate. A business can only use advance payments for special projects, which are often kept in an escrow account for that project in question. If it borrows from the special project fund, it has to pay the money back with interest. A business that co-mingles the money contractually set aside for special projects with its general business funds may be guilty of fraud. A household can borrow from a special project fund without legal consequence, but at the cost of not being able to carry out its project.

These two principles are clear to anyone who runs a business or a household. Yet it is exactly those principles that some House Republicans want the state to violate to balance this year's budget. They claim that the state should raid the positive balances of the 100 or so special funds that the state has set up to receive dedicated funds for special purposes. Yet:

1. This is only a short-term fix. It might be possible to fund the state budget for one year by these maneuvers, but eventually the reserves run out.

2. Money accumulates in these funds for a reason. The money raided from these funds almost always must be repaid with interest. Thus, the state budget deficit will get deeper in future years.

3. Borrowing from these reserves can significantly undermine the ability of these special funds to carry out their purposes, because the fund balances play a critical role in ensuring that sufficient funds are available in emergencies or when bills come due.

4. Co-mingling the money from the state's various special funds with the General Fund is a kind of fraud in that it takes money raised from bond issues approved by the voters or dedicated by the General Assembly for specific purposes.

5. In many cases these special funds are set up to ensure that some purposes of government are paid for not by the general public but the people who especially benefit from them. (This, by the way, is a principle often proposed by conservatives who seek to privatize government services or the funding for them.)

Some Examples

We can see all these principles at work in a series of examples.

Take the **Coal and Clay Mine Subsidence Insurance Fund**. It receives revenues from premiums paid by policyholders for subsidence insurance and it makes payments to homeowners in mining areas whose homes have been damaged by subsidence. Setting up this fund was meant, among other things, to embrace the conservative principle that the burden for covering subsidence damage should fall on those most at risk for it, not the general public. Like any other insurance program, the

fund keeps a balance so that it will have the funds to cover large losses in any year. If the $105 million accumulating in the fund – and earning interest – is used to balance the General Fund budget, monies paid by homeowners for this insurance won't be available to pay for a major disaster.

Or take the **Fish Fund,** which receives revenues from fishing licenses and fines and the occasional federal contribution. The state promised to use those license fees to administer state fishing programs and to sustain aquatic life in the state. And, again, by drawing revenue for the fund mostly from those who fish, the general public does not have to pay for programs that benefit a much smaller group. The Fish Fund has a balance at the end of the year of about $60 million in part because expenditures take place in the summer months, early in the fiscal year before receipt of funds for that year. In addition, the costs of these programs vary from year to year depending upon weather and other conditions. It's not right to take money that is dedicated for this purpose and use it to balance the General Fund and then not have it available if, say, fish stocks are suddenly depleted.

Or take the **Growing Greener Bond Fund,** which was established to receive $625 million in bond sales authorized by a vote of Pennsylvanians. Those funds are dedicated to various environmental projects such as watershed preservation, mine drainage remediation, flood control projects, brownfield remediation, and improvements in state parks. The fund's balance is gradually being drawn down and now stands at $21 million, although it was far higher a few years ago. Bond funds like this one often have a high balance initial as bonds before the projects they are meant to fund are planned and competed. Raiding these funds inappropriately takes money dedicated to one purpose and uses it for another. And since these raids must be repaid with interest, they deepen the General Fund deficit.

Or take the **Persian Gulf Conflict Veterans' Compensation Bond Fund**, which was established to distribute funds from a $20 million bond fund approved by the voters of Pennsylvania to compensate Persian Gulf Veterans. If this fund is raided to support the General Fund, money may not be available to Persian Gulf Veterans this year.

Or how about one of the funds with a large end-of-year balance, the **Property Tax Relief Fund,** which receives revenue from casinos and distributes the money to reduce local property taxes (and wage taxes in Philadelphia). At the start of the fiscal year, it has a balance of almost $500 million. Why shouldn't that "surplus money" be transferred to the General Fund? Well, the balance is kept so that the fund can makes payments in August and October each year to local governments and school districts before revenues are received from the casinos. If the General Assembly raids this fund to balance the General Fund, payments to local school may be delayed.

And, finally, consider the **Public Transportation Trust Fund**, which provides dedicated funding for public transportation systems all over the state – not only the big transit systems in Philadelphia and Pittsburgh, but the smaller ones in 12 other cities. The Public Transportation Trust Fund receives revenues from a portion of Pennsylvania Turnpike Tolls, motor vehicle funds, vehicle code fees, and other sources. And it provides both operating support – that is subsidies to make public transit more affordable – and capital funds for such things as new buses, new transit cars, and track upgrades. Over the course of a year, about $1.5 billion flows into and out of the fund and, at the end of the fiscal year, it keeps a balance of about $250 million. (While the monies for this fund come from

drivers, not public transit users, they do benefit because public transit reduces traffic on roads in our major and small cities.)

Why does the Public Transportation Trust Fund need to keep a balance? In part for the same reason as the Property Tax Relief Fund, to ensure that payments can be made early in the fiscal year before receipts come in. And, in part, because the fund pays for large capital projects. Thus, it makes sense to keep a balance that allows it to support the purchase of new assets for transit systems when it makes financial sense to pay for them and / or when the bills come due. What will we tell transportation agencies around the state when a bill comes due for new buses and there is no money to pay for them?

Conclusion

There are many other state funds, most of which are quite small, and many of which are basically just bank accounts to receive and pay out funds for specific purposes. If one were to go through the larger funds one by one, you would find one or another good reason that they keep a positive balance in their account. We've seen many of those reasons in reviewing these funds:

- To ensure that funds from bond issues or taxes dedicated to specific purposes only goes to those purposes.
- To ensure that certain government activities are paid for not by (or not mainly by) the public as a whole, but by those who most benefit from them.
- To have a reserve to make payments for specific purposes before the revenues dedicated to those purposes for that fiscal year are received.
- To keep a reserve in case extraordinary expenses arise in one year.
- To hold funds for major capital expenses – which do not come due at fixed intervals – until they are needed.

It's possible that some of these funds maintain larger balances than they need to. But there is no reason to think that this is a general practice or that there is anything nefarious in the practice of keeping balances in these funds any more than there is something nefarious in the state as a whole – or a business or a household – in keeping a substantial enough bank balance to cover day to day expenses, possible emergencies, or to set aside money received for, or designated for college, retirement, or other special purposes.

We can see the difficulties that running a fund down creates for managing the finances of the state in the current crisis as the State Treasurer Torsella has to scramble to lend the General Fund, which fell into the red early this month and will do so again soon, money to pay bills coming due. It makes no sense to solve the problems of the General Fund by replicating them in many special funds.

While calling these funds part of the "shadow budget" is a nice rhetorical move to convince people that politicians in Harrisburg have done something wrong in creating them, it's also entirely misleading claim that puts the workings of these special funds – whose existence is known to everyone in Harrisburg and which are documented in some detail in the Governor's annual budget document – unjustly in the shade.

So the plan to raid the "shadow budget" is based on a false understanding of how the state special funds work. And, more importantly, it is an attempt to do on steroids what Harrisburg has done far too often in the last decade, balance the General Fund budget by borrowing money from these funds. And, as in the past, the result will be putting off the necessary decision to raise recurring revenues while worsening the structural deficit since borrowing must be repaid.

Our cranky uncles are sometimes entertaining, especially when we are young. Their iconoclasm can be bracing and thought provoking. But as we get older, most of us conclude that they are far too cynical and uniformed to be taken seriously. Their simple solutions are almost always based on false premises and a lack of information. Most of us would never dream of turning our government over to our cranky, blustering, know-nothing uncles.

It sometimes seems to both Democrats and Republicans that we did that in electing the current president of the United States. And that's one more good reason to be cautious in turning over our state budget to cranky Uncle Mike Turzai and his simple-minded solution for our current budget crisis.