

Cash Management Loan Interest Payments

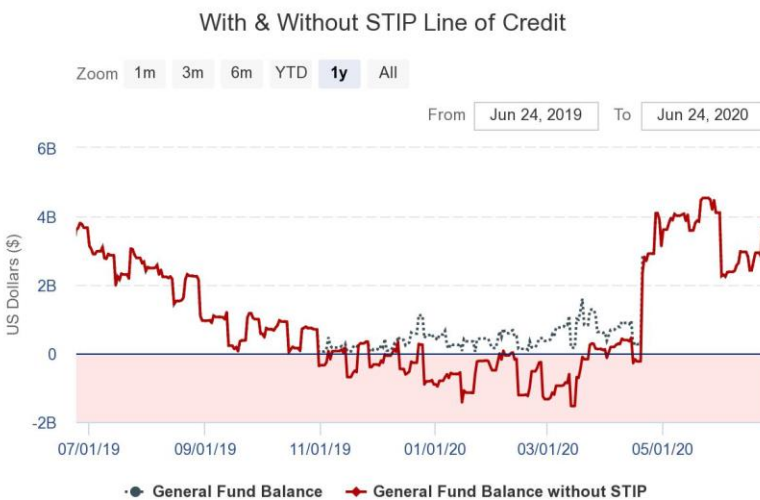
How General Fund Liquidity Reflects on Financial Governance, Wasteful Government Spending, and Insolvency Implications.

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Chairman
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Background on General Fund Liquidity

In Fiscal Year (FY) 2013-14, the Pennsylvania Treasury shifted its cash management loan strategy away from tax anticipation notes to cash management loans or Short-Term Investment Pool (STIP), which borrows cash available in special funds.¹ The strategy of the Commonwealth borrowing funds from itself has reduced costs as the state is receiving lower interest payments.²

Regardless of the strategy in providing cash management loans, the Commonwealth has seen an increase in costs associated with a worsening general fund liquidity.³ As we see from the treasurer's



Transparency Portal, Federal Cares

Act dollars have bolstered the

general fund, providing liquidity

relief starting April 20, 2020. Prior

to the injection of Federal Cares Act

dollars, the general fund was mostly

at a negative balance from October

31, 2019 to April 19, 2020. Twice

the general fund dipped below \$1.5 billion.

Liquidity for many governments is a cyclical event, as governments receive their revenues at different times than payments are due.⁴ The Commonwealth has some big expenses from pension payments to Medicaid payments due throughout the fiscal year. Medicaid payments need to be made prior to receiving reimbursements from the federal government and these payments have frequently been pushed back into the following fiscal year as a budget balancing gimmick. In general, many poor financial

¹ <https://archive.triblive.com/news/pennsylvania-fiscal-officers-say-budget-in-dire-situation/>.

²² https://cumberlink.com/news/local/govt-and-politics/pa-treasurer-loans-m-to-corbett-for-state-projects/article_88d28042-cccec-11e0-9748-001cc4c002e0.html.

³ <https://www.patreasury.gov/newsroom/archive/2020/04-02-COVID-Credit.html>.

⁴ <https://surface.syr.edu/cgi/viewcontent.cgi?article=1950&context=etd>.

decisions have led not only to an increased liquidity problem but also a continuation of annual financial

gimmicks:

- Delayed payments.
- Moving general fund spending to special funds or offline.⁵
- Creating new special funds which utilizes general fund revenue to cover expenses.
- Using one-time revenue sources to pay for recurring expenditures.
- Not completely funding mandated expenditures.
- Executive branch overspending.
- Lack of financial management by the executive branch throughout the fiscal year.

These repetitive decisions reflect a culture of

financial mismanagement and poor budgeting practices in

Pennsylvania. In FY 2017-2018 there were over \$1.4

billion of budget gimmicks used to balance the budget. For three out the last six fiscal years, the

Commonwealth has spent more than what it had in revenues as we look at year to date data from the

Treasurer’s Transparency Portal. While FYs 2017-18 and 2018-19 show a surplus, the surplus is a result

EXPENDITURES	2018/19
General Fund Expenditures Shifted to Special Funds	\$54.9
Increase in MA expenditures funded through Lottery Fund (compared to revised 17/18)	\$54.9
Temporary or One-Time Budget Savings	\$1,210.5
MA expenditures funded with one-time revenue received March 2017 from Managed Care Organization Gross Receipts Tax	\$351.7
MA savings from changes to the payment schedule for managed care organizations	\$120.0
MA savings from one-time revenues pursuant to Tobacco Master Settlement Agreement lawsuit	\$357.0
Department of Human Services expenses funded with one-time surplus from assessment on Philadelphia hospitals	\$54.0
Authority Rentals & Sinking Fund Requirements (PlanCon) reliance on bond	\$215.4
Use of PHEAA resources to reduce General Fund expenditures on higher education - this multi-year support will need to be suspended in 2019/20	\$112.4
Subtotal Expenditures	\$1,265.4
REVENUES	
Transfers to General Fund	\$34.4
Miscellaneous revenues and loan repayments to the General Fund	\$34.4
One-Time Revenue Sources	\$173.8
Gaming Expansion (Act 43) - Interactive gaming (iGaming) license fees at \$10 per license	\$100.0
Gaming Expansion (Act 43) - Interactive gaming (iGaming) license fees at airports	\$3.8
Gaming Expansion (Act 43) - Sports wagering license fees at \$10 million per license	\$70.0
Subtotal Revenues	\$208.2
TOTAL	\$1,473.6

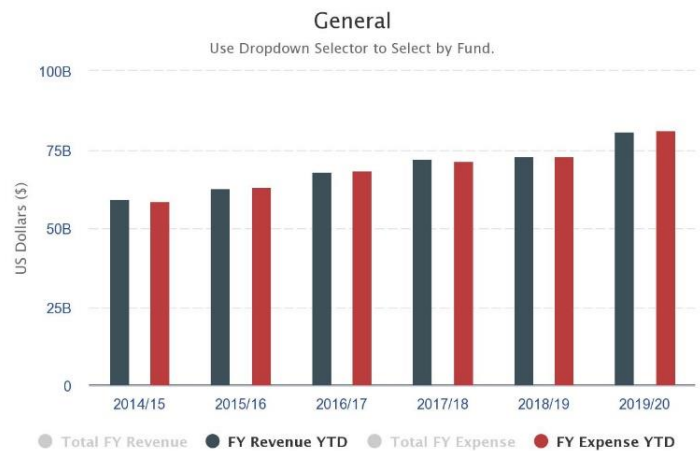
*This chart does not account for additional fund transfers that may occur pending the resolution of outstanding court cases.

https://www.pahouse.com/Files/Documents/Appropriations/series/3044/2018_19_Budget_In_Depth_Final_071018.pdf

of borrowing \$1.7 billion – \$200 million from the

Fiscal Year Revenues vs. Expenditures Year to Date (#'s in millions)				
Fiscal Year	Revenue	Expenditures	Surplus/Deficit	Notes
2014-2015	\$ 59.2	\$ 58.7	\$ 0.5	
2015-2016	\$ 62.7	\$ 63.1	\$ (0.4)	Impasse Budget
2016-2017	\$ 68.2	\$ 68.3	\$ (0.1)	
2017-2018	\$ 72.2	\$ 71.2	\$ 1.0	\$1.7 B in borrowing
2018-2019	\$ 73.0	\$ 72.9	\$ 0.1	
2019-2020	\$ 80.8	\$ 81.0	\$ (0.2)	

Fiscal Year Revenues vs. Expenditures Total (#'s in millions)				
Fiscal Year	Revenue	Expenditures	Surplus/Deficit	Notes
2014-2015	\$ 59.8	\$ 59.3	\$ 0.5	
2015-2016	\$ 63.1	\$ 63.7	\$ (0.6)	Impasse Budget
2016-2017	\$ 68.8	\$ 69.3	\$ (0.5)	
2017-2018	\$ 73.3	\$ 72.1	\$ 1.2	\$1.7 B in borrowing
2018-2019	\$ 73.9	\$ 73.7	\$ 0.2	
2019-2020	\$ -	\$ -	\$ -	



⁵ https://www.pennlive.com/politics/2018/06/gov_wolf_signs_327_budget_for.html.

Farm Show borrowing⁶ and \$1.5 billion from a Tobacco Settlement Bond.⁷ This creates a total of over \$3.1 billion of one-time revenue sources used to balance budgets. The total revenues and expenditures for the same years have this same trend but even more emphasized. Without the FY 2017-2018 borrowing to balance the budget, FY's 2017-2018 and 2018-2019 would have ended in deficits as well. Currently only the impasse budget in FY 2014-2015 truly posts an end of the year surplus.

Further complicating the commonwealth's finances has been the loss of income earners. From 2010 through 2018, Pennsylvania lost \$10.4

Long-Term Recurring Revenue Highlights <i>(Amounts in Millions of Dollars)</i>	
Tax Type	Full Year Recurring Revenue
Cigarette Tax Rate Increase of \$1.00 per Pack	\$ 446.6
Other Tobacco Products	\$ 81.9
Liquor Modernization - Recurring Revenue Portion Only	\$ 75.8
Sales and Use Tax Vendor Discount	\$ 69.2
Digital Downloads and Streaming Video and Audio	\$ 59.2
Sales and Use Tax - Online Marketplace	\$ 50.5
Bank Shares Tax Rate Increase	\$ 24.8
Revenue Maximization - Non-resident Withholding	\$ 24.6
E-Cigarettes - 40% of Wholesale Price	\$ 21.3
Personal Income Tax on Lottery Winnings	\$ 13.6
Sports Wagering Tax	\$ 11.2
Revenue Maximization - Appeals Period, from 90 days to 60 days	\$ 10.0
Fireworks Tax at 12%	\$ 8.7
Total Annualized Collections	\$ 897.4

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https://www.pahouse.com/Files/Documents/Appropriations/series/3044/2018_19_Budget_In_Depth_Final_071018.pdf

billion of revenue or \$1.16 billion per year from out migration of income taxpayers.⁸ From FY 2016-2017 through FY 2018-2019 several attempts were made to increase the personal income tax or sales and use tax.⁹ Ultimately new recurring revenues were adopted totaling \$897.4 million. Even with hundreds of millions in new revenue, over \$1 billion in revenue growth in 2019¹⁰ and spending reductions the general fund continued to show negative balances and deficits.¹¹

⁶ <https://www.cpbj.com/farm-show-complex-lease-back-could-net-200m-for-state-2/>.

⁷ <https://www.inquirer.com/philly/blogs/inq-phillydeals/pennsylvania-tobacco-bonds-extra-millions-low-rated-smoking-penn-pa-20180213.html>.

⁸ https://www.thecentersquare.com/pennsylvania/pennsylvania-lost-10-4-billion-in-gross-income-over-8-years-from-domestic-migration/article_37f33f90-b626-11ea-b0aa-5f3d7d0a7e20.html.

⁹ https://www.pennlive.com/midstate/2015/12/republicans_that_wolf_was_alwa.html.

¹⁰ <http://www.mcall.com/news/pennsylvania/mc-nws-pa-state-tax-revenue-one-billion-dollars-20190705-ogincgyxcvhotiyndphyfcxu3q-story.html>.

¹¹ <http://www.mcall.com/news/pennsylvania/mc-nws-pennsylvania-ifo-economic-outlook-20181115-story.html>.

Cash Management Loan Interest

Since FY 2014-15, the state treasurer has used cash management loans, basically the Commonwealth borrowing from itself, to ensure cash is available in the general fund to pay bills. The Treasury employs a strategy of using motor licensing fund, which is allowed under the Constitution¹², and special funds, which are funds created by statute outside of the general fund. The general fund then reimburses these funds for the loss of interest earnings, which creates a cash management loan interest payment within the general fund. Since FY 2014-15, the enacted amount of cash management loan interest has gone from zero to a record \$15 million for FY 2020-21. In the short-term, we see a massive increase from FY 2018-19 of an actual \$734,000 to a projected \$15 million in the upcoming fiscal year. This is a 1,944% increase in three fiscal years.

Cash Management Loan Interest Historical Trend						
Fiscal Year	Available w/ Supplementals (Actual)	Increase Over Available w/ Supplementals	Available w/ Supplementals Percent Increase	Enacted	Increase Over Available w/ Supplementals	Enacted Percent Increase
2020 - 2021				\$ 15,000,000	\$ 7,685,000	105.10%
2019 - 2020	\$ 7,315,000	\$ 6,581,000	896.59%	\$ 2,500,000	\$ 1,766,000	240.60%
2018 - 2019	\$ 734,000	\$ (1,679,000)	-69.58%	\$ -		-100.00%
2017 - 2018*	\$ 2,413,000	\$ (6,424,000)	-72.69%	\$ 10,000,000	\$ 1,163,000	13.20%
2016 - 2017	\$ 8,837,000	\$ 7,520,000	570.99%	\$ 1,500,000	\$ 183,000	13.90%
2015 - 2016**	\$ 1,317,000	\$ (634,000)	-32.50%	\$ 6,000,000	\$ 4,049,000	207.50%
2014 - 2015	\$ 1,951,000	\$ 951,000	95.10%	\$ -	\$ (1,000,000)	-100.00%
2013 - 2014	\$ 1,000,000					
* Tobacco Settlement Bond of \$1.5 B & Farm Show Borrowing of \$200 M						
** 9-Month Impasse Budget						

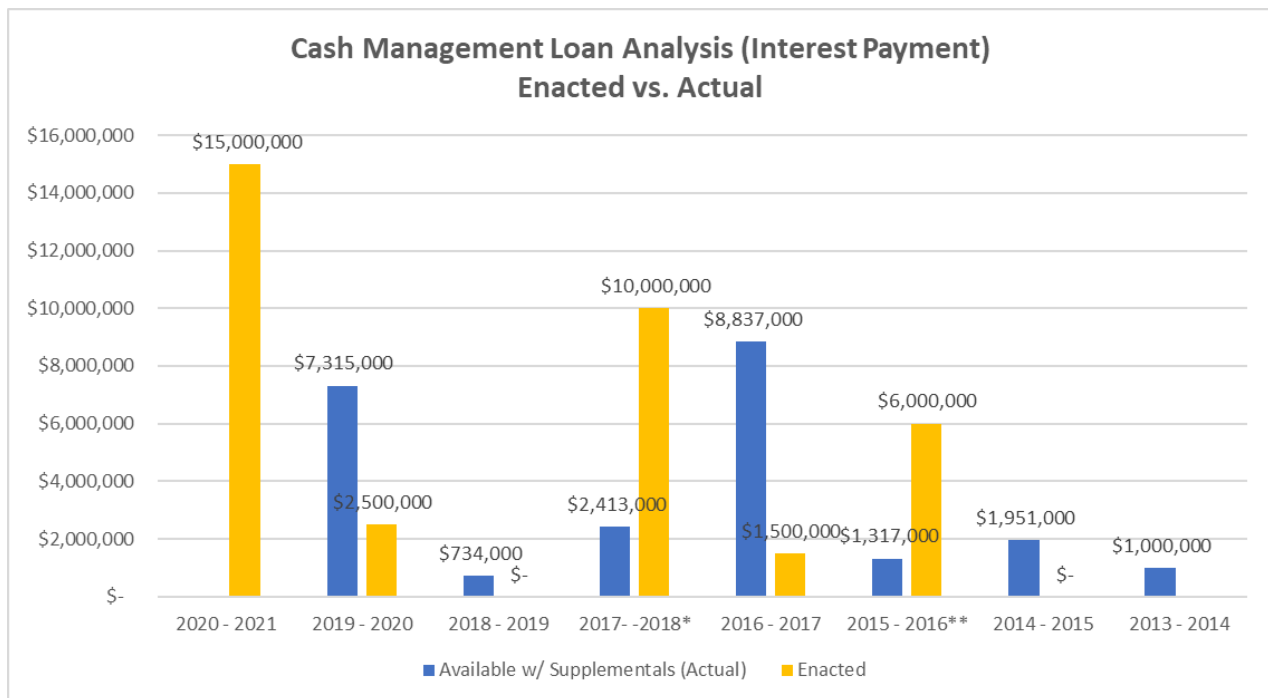
Waste as a verb is defined in *Webster's Ninth New Collegiate Dictionary* as “to spend or use carelessly . . . to allow to be used inefficiently or become dissipated.” Spending \$15 million on interest due to the Commonwealth borrowing from itself is wasteful government spending. It does not add any value to any Pennsylvanian. It does not educate children. It does not fix roads. It does not drive improved outcomes, increased efficiency, or provide better services. It is a cost reflective of a culture of financial

¹² Pennsylvania Constitution. Article VIII, Section 11. Gasoline taxes and motor license fees restricted.
<https://www.legis.state.pa.us/cfdocs/legis/LI/consCheck.cfm?txtType=HTM&ttl=00&div=0&chpt=8&sctn=11&subctn=0>.

mismanagement and poor budgeting practices. 271 or 69% of the appropriations in the available with supplementals FY 2019-2020 budget are \$15 million or less, which means this \$15 million for liquidity could be use more efficiently in over 271 other appropriations.¹³

Insolvency Implications

Cash flow insolvency is when an entity has enough assets to pay what is owed but does not have the appropriate form of payment. In other words, there is not enough of the revenue being collected in the form of cash. As a result, the entity does not have the cash available to meet its short-term debt obligations such as loan payments. An organization can be insolvent without being bankrupt, but you cannot be bankrupt without being insolvent. Cash flow insolvency is the leading cause of business bankruptcy in America.¹⁴



An example is the City of Detroit. Many people believe the problem was their pension liability, but this was only a contributing factor. It was ultimately their cash flow. Detroit had a \$198 million cash

¹³ <https://www.budget.pa.gov/PublicationsAndReports/CommonwealthBudget/Documents/2020-21%20Proposed%20Budget/2020-21%20WEB%20TRACK.pdf>.

¹⁴ <https://www.score.org/blog/1-reason-small-businesses-fail-and-how-avoid-it>.

flow shortfall in FY 2014. This was a result of loss of revenue and increased contractual expenses, such as pension obligations, debt payments and employee contracts. Additionally, Detroit suffered from population loss for decades.¹⁵¹⁶ Property taxes in Detroit were among the highest for large cities, the result of increased expenditures and the loss of taxpaying property owners. Detroit did not have the tax base, nor did it have the capacity to raise taxes to cover its expenses. This created a cash flow crisis resulting in Detroit filing for bankruptcy.

As the Commonwealth has increased the amount of cash management loan interest payments, it is borrowing more over longer periods of time to meet liquidity within the general fund. This is a poor financial position as more dollars are being shifted from mandated expenses to cover short-term loans to make payments throughout the fiscal year. This is reflected in the increases in the cash management loan interest payments. As the Commonwealth continues to see expenses grow faster than revenues and mandated costs like debt, pension payments, entitlement programs and employee contracts increase faster than the rate of revenue growth, the Commonwealth will continue to be on a trajectory much like Detroit. Here is a timeline of the recent STIP loans:

- Nov. 1, 2019: The Treasury issued a \$1.5 billion line of credit to the general fund, and the Wolf administration made an initial \$400 million withdraw at an interest rate of 1.52%.¹⁷
- Jan. 7, 2020: The Wolf administration paid back \$500 million of the \$1.5 billion in principle and \$692,068.39 in interest on the STIP line of credit.¹⁸
- Feb. 4, 2020: The Treasury announced a STIP loan to PHEAA for \$250 million.¹⁹
- Jan.15, 2020: The Wolf administration withdrew another \$650 million.²⁰
- April 2, 2020: The Treasury extended its STIP general fund line of credit to \$2 billion and capped interest at 2% due to the coronavirus pandemic, which resulted in delayed tax collections and a global economic shutdown.²¹

¹⁵ <https://www.demos.org/research/detroit-bankruptcy>.

¹⁶ <https://www.forbes.com/sites/davidmarotta/2013/08/04/detroits-bankruptcy-doesnt-just-happen/#58f27f6b70a3>.

¹⁷ <https://www.patreasury.gov/newsroom/archive/2019/11-01-STIP.html>.

¹⁸ <https://www.patreasury.gov/newsroom/archive/2020/01-10-STIP.html>.

¹⁹ [https://www.patreasury.gov/newsroom/archive/2020/02-04-Treasury-Authorizes-\\$250M-PHEAA.html](https://www.patreasury.gov/newsroom/archive/2020/02-04-Treasury-Authorizes-$250M-PHEAA.html).

²⁰ <https://www.patreasury.gov/newsroom/archive/2020/01-16-Second-Request-Line-Credit.html>.

²¹ <https://www.patreasury.gov/newsroom/archive/2020/04-02-COVID-Credit.html>.

While the \$2 billion extension with caps on interest payments was only extended until June 12, the Commonwealth still has major payments due to managed care organizations in August because of delayed payments from previous budget decisions.

Further, the implications of the FY 2015-16 budget impasse and the \$1.7 billion of bonding approved in FY 2017-18, there are significant reductions in cash management loan interest payments with a resulting spike in the ensuing fiscal year. The budget impasse, resulted in an approved budget lower than the governor’s proposed budget, resulting in less need to for cash management loans. The following year, an elections year budget, resulted in much higher spending and tax increases to fund the FY 2018-19 budget. The increased taxes were cigarette taxes, which depreciate over time. Funding recurring and increasing spending with depreciating taxes is a poor financial decision. The \$1.7 billion in bonding, \$1.5 billion from the Tobacco Settlement Bond and \$200 million for the Farm Show borrowing, results in an influx of cash in the general fund. As

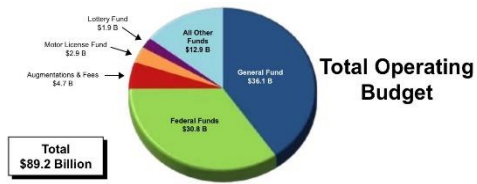
Cigarette Tax Revenue		
Year	Revenue	Year Over Year
		Growth/Loss
2000	\$272.42	
2001	\$269.34	(\$3.08)
2002	\$266.79	(\$2.54)
2003	\$826.74	\$559.95
2004	\$856.44	\$29.70
2005	\$784.37	(\$72.07)
2006	\$792.12	\$7.75
2007	\$778.58	(\$13.54)
2008	\$784.05	\$5.47
2009	\$754.16	(\$29.90)
2010	\$976.06	\$221.90
2011	\$1,075.37	\$99.31
2012	\$1,069.91	(\$5.46)
2013	\$1,024.08	(\$45.83)
2014	\$976.91	(\$47.17)
2015	\$927.21	(\$49.70)
2016	\$911.51	(\$15.69)
2017	\$1,261.57	\$350.06
2018	\$1,198.25	(\$63.32)
2019	\$1,118.76	(\$79.49)

3 Numbers in millions.

you can see it took two fiscal years for those dollars to be spent, resulting in another spike in cash management loan interest payments starting in FY 2018-19 with \$734,000 and a projected \$15 million in FY 2020-21. Due to delayed tax payments and an economic shutdown due to COVID-19, the projected \$15 million in cash management loan interest payments might be the floor rather than a ceiling of potential payments.

Solutions

While \$15 million is a fraction of the \$89.2 billion total operating budget of the Commonwealth,



it highlights the underlying poor finances of the Commonwealth. Dealing with our liquidity issues now is far less costly and provides many more options rather than waiting and allowing this negative trend to continue into a crisis. The following recommendations will increase the general fund liquidity, eliminate wasteful government spending, and

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<https://www.budget.pa.gov/PublicationsAndReports/CommonwealthBudget/Documents/2020-21%20Proposed%20Budget/2020-21%20Budget%20in%20Brief.pdf>

improve the financial condition of the Commonwealth:

- Governor’s Budget Office and Treasury should continue to review payment schedules to maximize liquidity within the general fund.
- Ensure recurring expenses are paid for by recurring revenues.
- Ensure budgets do not spend more than what is available in revenues.
- Move special funds back into the general fund.
- Do not move current line items in the general fund out, to create more special funds.
- Build Budget Stabilization Fund deposits into the general appropriations act.
- One-time revenues should be deposited into the Budget Stabilization Fund.

Impact of Using Special Funds to Mitigate Short-Term Cash Flow Insolvency

The Treasury has provided a cash flow report of the general fund with the inclusion of the following sixteen special funds. These special funds would continue to provide funding based on their stated goals, but their funds and balances will be transferred to the general fund:

- Hazardous Sites Cleanup
- Environmental Stewardship
- Recycling Fund
- State Treasury Armory
- Historical Preservation
- Minority Business Development
- Agriculture Conservation
- Environmental Education
- Keystone Recreation, Park and Conservation
- Industrial Sites Cleanup
- Small Business First



- Substance Abuse Education
- Property Tax Relief Fund
- Job Training Fund
- Conservation District Fund
- Multimodal Fund

These funds represent a fraction of the overall special funds the Commonwealth has created. Combined,

Date	General Fund Balance
1/15/2020	(\$431,789,137.78)
1/16/2020	(\$17,830,621.76)
1/17/2020	(\$88,930,570.95)
1/21/2020	(\$97,977,138.61)

5 General Fund Negative Balances Using Special Funds

these special funds reduced the negative balances within the general fund to four dates between July 1, 2019 and March 22, 2020 and limited the highest negative balance to \$431.7 million. The treasury could, just from the utilization of these sixteen special funds limit cash flow borrowing to the Motor Licensing Fund and eliminate

STIP loans all together. According to data from the Treasurer’s Transparency Portal, the total days the general fund was at negative balance during the same period was 119 days.

Bringing special funds back into the general fund provides significant positive financial results:

- Solvency to the general fund.
- Improved financial controls in the budget process.
- More transparency to taxpayers.
- Honest accounting of revenue and expenditures.

Conclusion

General fund cash flow solvency has plagued governments at every level since their inception. But this is not a reason to ensure government does not need to borrow to make its payments throughout the fiscal year. By focusing on financial management policies, governments can eliminate wasteful cash management loans, which do not benefit residents. Smart management means bringing innovation and challenging the status quo method of doing business as usual. Cash flow management is a great example of doing things the old way versus driving innovation to reduce costs and improve services. Status quo in the financial management of the Commonwealth has been its Achilles Heels and has limited the Pennsylvania’s opportunities for greater economic success.

In 2018, 2019 and early 2020, prior to the global pandemic, the United States economy was growing at 5.4% in 2018 and 4.1% in 2019 (nominal GDP).²² In 2018 and 2019, Pennsylvania still suffered from tight budgets as expenditures continued to eclipse revenues.^{23 24 25} This is a direct result of incremental budgeting and poor financial management decisions. The commonwealth has raised taxes, borrowed and made program cuts to balance budgets, but we continue to see economic stagnation and annual budget crisis. Until the executive and legislative branches decide to follow a new path in financial management, the Commonwealth's economy and its taxpayers will continue to suffer under archaic budgeting culture and practices, which needlessly drive up costs.

²² <https://www.budget.pa.gov/PublicationsAndReports/CommonwealthBudget/Documents/2020-21%20Proposed%20Budget/2020-21%20Executive%20Budget%20Book%20-%20Web%20Version.pdf>.

²³ <https://www.goerie.com/news/20190609/gov-wolf-gop-at-odds-over-spending-new-programs>.

²⁴ <https://www.pennlive.com/news/2019/06/pa-budget-battles-loom-over-raising-minimum-wage-spending-increases.html>.

²⁵ <https://www.penncapital-star.com/government-politics/what-are-supplemental-appropriations-the-pa-budget-battle-youre-not-hearing-about/>.