

Commonwealth of Pennsylvania

2010-11 Mid-Year Briefing

Edward G. Rendell
Governor

Mary A. Soderberg
Secretary of the Budget

December 16, 2010

“It looks like many states have sort of turned the corner on the worst of the revenue downturn. (But) it’s going to be a pretty sluggish recovery.”

Corina Eckl
National Conference of State Legislatures
The Wall Street Journal
December 8, 2010

2010-11 Enacted Budget

2010-11 Enacted Budget Highlights

The 2010-11 enacted budget makes additional key investments in education and public safety programs, while maintaining funding to protect the social safety net for Pennsylvania's most vulnerable citizens.

- The enacted 2010-11 General Fund budget is \$28.03 billion.
- Spending in the 2010-11 budget is \$290 million lower than in the 2008-09 enacted General Fund budget, and is only \$200 million, or 0.7 percent, higher than in 2009-10.
- The 2010-11 enacted budget assumed \$2.8 billion of federal fiscal relief that will expire this year and nearly \$750 million of one-time revenues.

2010-11 Enacted Budget Highlights

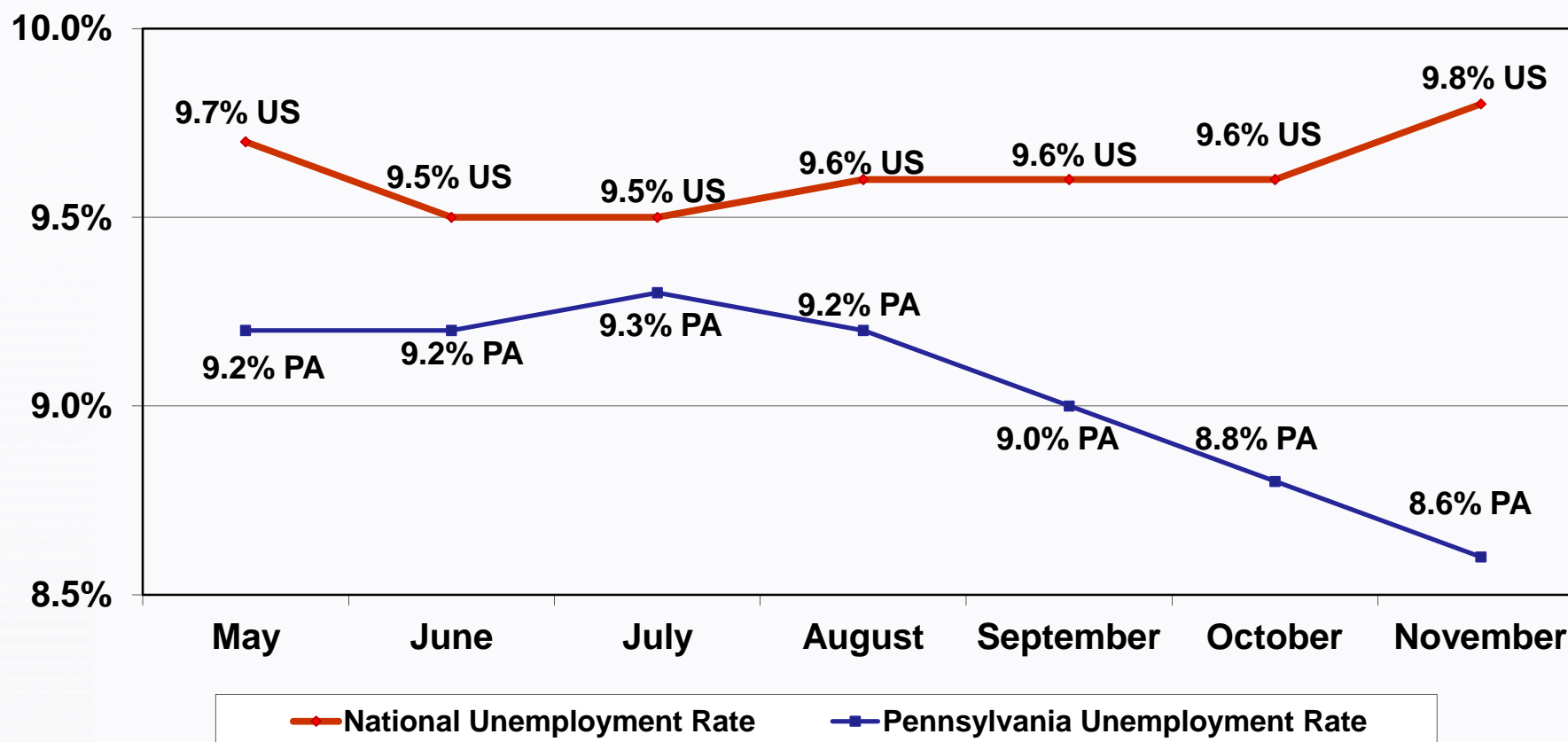
- The 2010-11 budget provided \$5.8 billion in total funds for the basic education subsidy – a \$250 million, or 4.5 percent, increase to avoid property tax hikes and continue phasing in the school funding formula.
- The 2010-11 budget continues funding for key economic development programs designed to strengthen business development and stimulate the creation of new jobs.
- The 2010-11 budget contains \$21.6 million to provide for a skilled workforce for the commonwealth's most competitive business sectors and job training opportunities for Pennsylvania's citizens.
- The 2010-11 budget includes funding for health care and other vital social services for more than 2.1 million of Pennsylvania's most vulnerable citizens.

Economic and Revenue Update

- Economists predict growth in U.S. Gross Domestic Product in 2011.
- Retail sales rose 0.8 percent nationally in November, a sign of improving consumer confidence.
- In Pennsylvania, November 2010 Sales and Use Tax revenues were \$52 million, or 8.6 percent, higher than collections in November 2009. Through November 2010, year-to-date Sales and Use Tax collections are \$71 million, or 2.1 percent, ahead of the official estimate.
- Corporate tax revenue is up in many states, consistent with the rise in business profits nationally. In Pennsylvania, year-to-date corporate tax revenue was \$56 million over the official estimate through November – or 8 percent – ahead of estimate.
- Personal incomes in the commonwealth remain stagnant, however, which has led to lower-than-expected Personal Income Tax revenues.

National and State Jobless Rates, 2010

Pennsylvania's unemployment rate has begun to fall as job growth increases; it has been below the national unemployment rate for 92 of the last 95 months.



Source: PA Department of Labor and Industry, Monthly Seasonally Adjusted Labor Force Data.

Status of the 2010-11 Budget

Reduced Federal Funding Required a Change in the Enacted Budget

- The General Fund Budget was enacted in early July, but Congress did not approve states' enhanced FMAP allocations until August. Pennsylvania's share was \$280 million less than planned.
- This lower allocation required a \$280 million solution; the Governor proposed:
 - \$212 million in mid-year budget cuts and
 - \$70 million in severance tax revenue from natural gas drilling in the Marcellus shale.

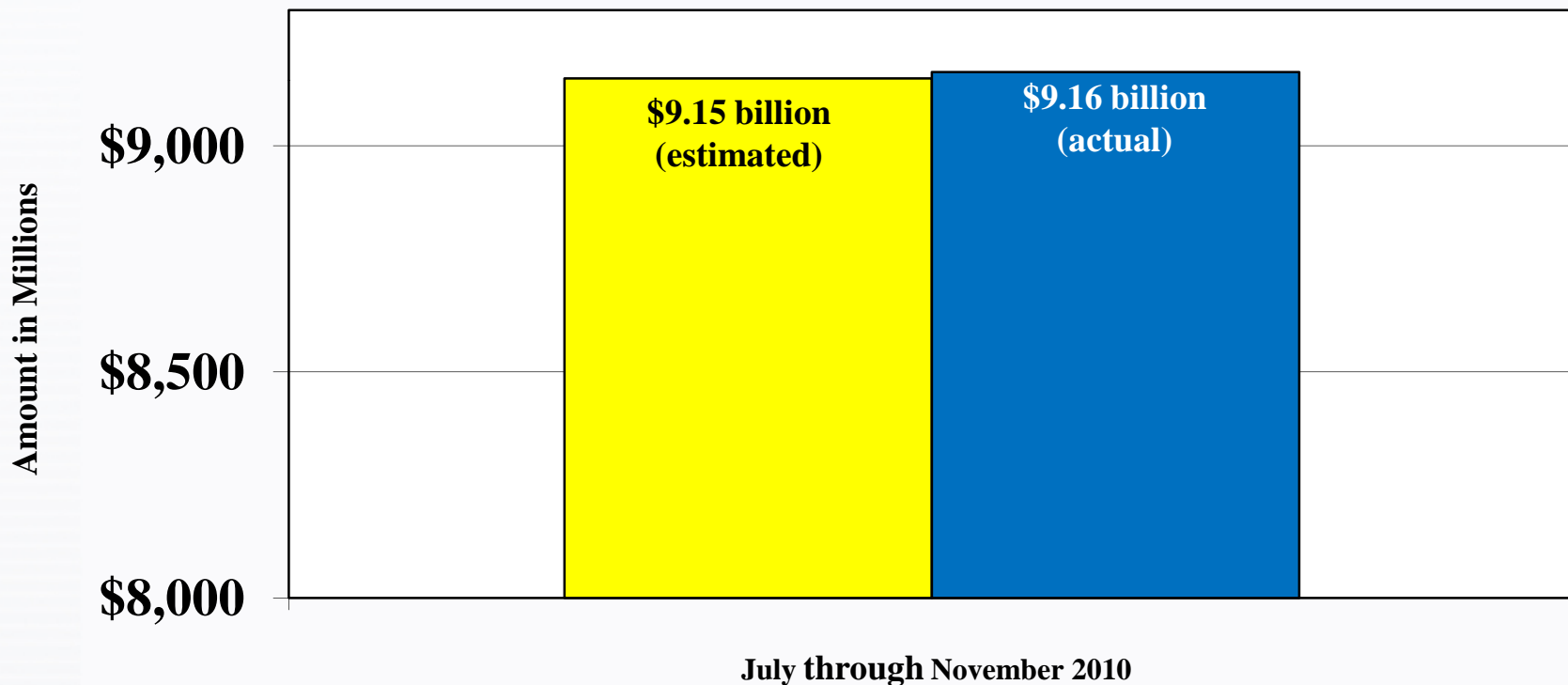
2010-11 Budget Update

- Federal budgetary relief was reduced by \$280 million to \$2.6 billion.
- \$200 million of the \$212 million proposed spending cuts were frozen based upon the Governor's request.
- The \$70 million severance tax was not enacted.
- Revenues are slightly above projection through November.
- The effects of the recession continue to increase demand for safety net programs.
- Congress enacted the Education Jobs Fund (\$387 million allocation for Pennsylvania).

Revenues are on Target for 2010-11

Estimated versus Actual Revenue Collections, July – November 2010

General Fund revenue collections in the first five months of 2010-11 were \$14 million, or 0.15 percent, above estimate.



2010-11 General Fund Revenues by Tax Type

In the first five months of 2010-11, revenues were \$14 million above estimate. Corporate and Sales Tax collections were above estimate. Shortfalls in Personal Income Tax and Realty Transfer Tax collections accounted for most of the negative impact on otherwise improved General Fund revenues.

Tax Type	Estimated	Actual	\$ Difference	% Difference
		(in millions)		
Corporation Taxes	\$ 713.3	\$ 769.1	\$ 55.8	7.8%
Consumption Taxes	4,003.2	4,082.3	79.1	2.0%
Sales & Use	3,421.9	3,493.2	71.3	2.1%
All Other	581.3	589.1	7.8	1.3%
Other Taxes	4,149.9	4,034.7	- 115.2	-2.8%
PIT Withholding	3,143	3,137.1	- 5.9	-0.2%
PIT Non-Withholding	508.9	437.1	- 71.8	-14.1%
All Other – inc. Realty Transfer	498	460.5	- 37.5	-7.5%
Non-Tax Revenue	282.4	276.7	- 5.7	-2.0%
Total	\$ 9,148.8	\$9,162.8	\$ 14.0	0.15%

Summary of General Fund Financial Position

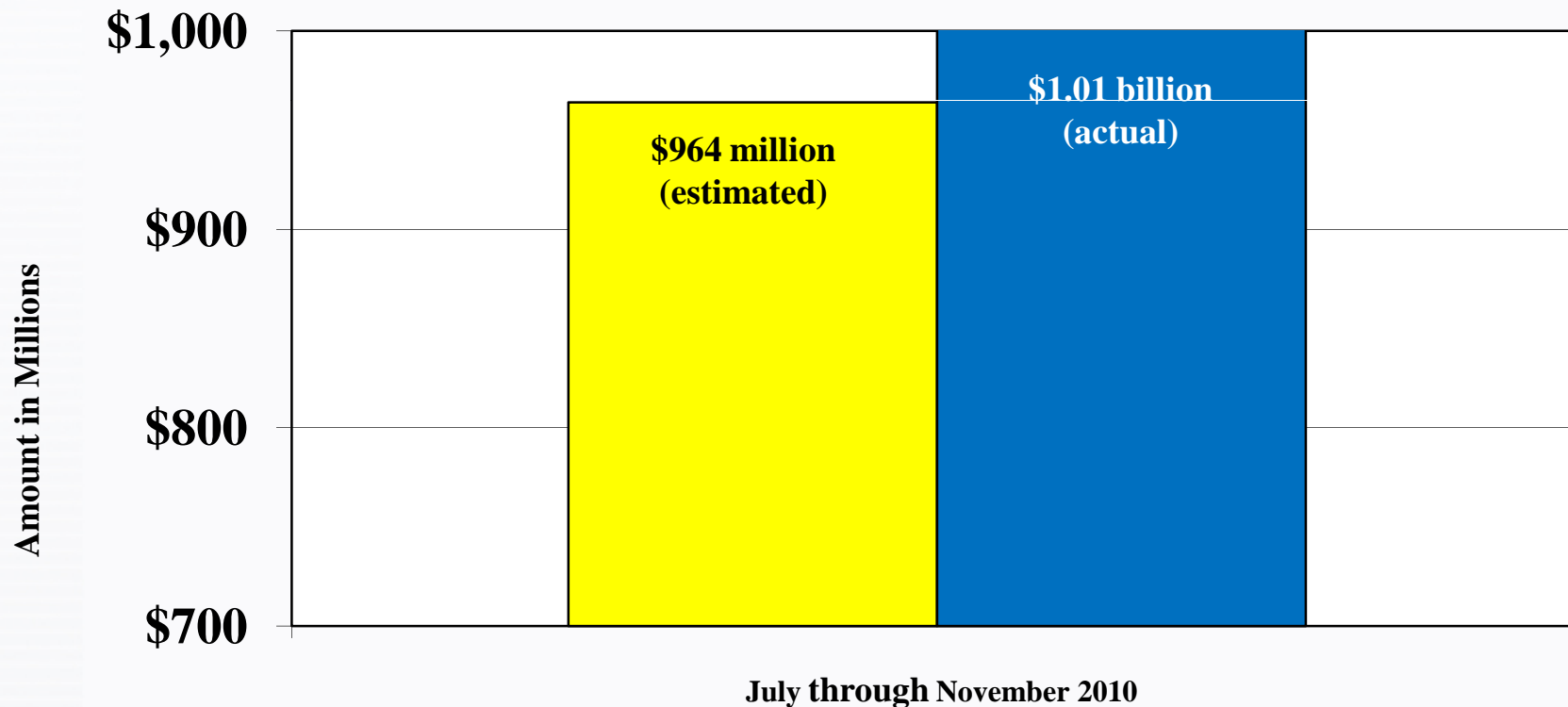
The current fiscal year would be projected to end in balance if the severance tax had been enacted as agreed to in state law.

	(in millions)
Surplus at the Beginning of the Fiscal Year	\$ 12
Impact of Lower Federal Stimulus Than in Enacted Budget . . .	- 280
Governor’s Spending Freeze	200
Estimated Additional Dollars Needed Due to Increased Enrollment in Safety Net Programs	- 65
Adjustment to Revenue Estimate	0
Prior-Year Appropriation Balances to Help Address Shortfall . .	70
Revised Ending Balance	\$ - 63

2010-11 Motor License Fund Revenues

Estimated versus Actual Revenue Collections, July – November 2010

In the first five months of 2010-11, revenue collections were \$43.5 million above estimate. The Department of Revenue estimates Motor License Fund collections will exceed estimate by approximately \$55 million on June 30.



Managing in Tough Times

We Have Cut the Cost of Administering State Government by 14 Percent Since 2002-03

- Compared to 2002-03, spending in administrative line items is 14 percent lower in 2010-11.
- The administration has achieved \$1.75 billion in ongoing annual savings from management and productivity initiatives.

Cost Containment

- 4,875 fewer employees than in 2002-03
- 988, or 19 percent, fewer passenger vehicles since 2002-03
- \$140 million in savings from freezing salaries through 2010-11
- \$47 million in savings by restricting travel through 2010-11

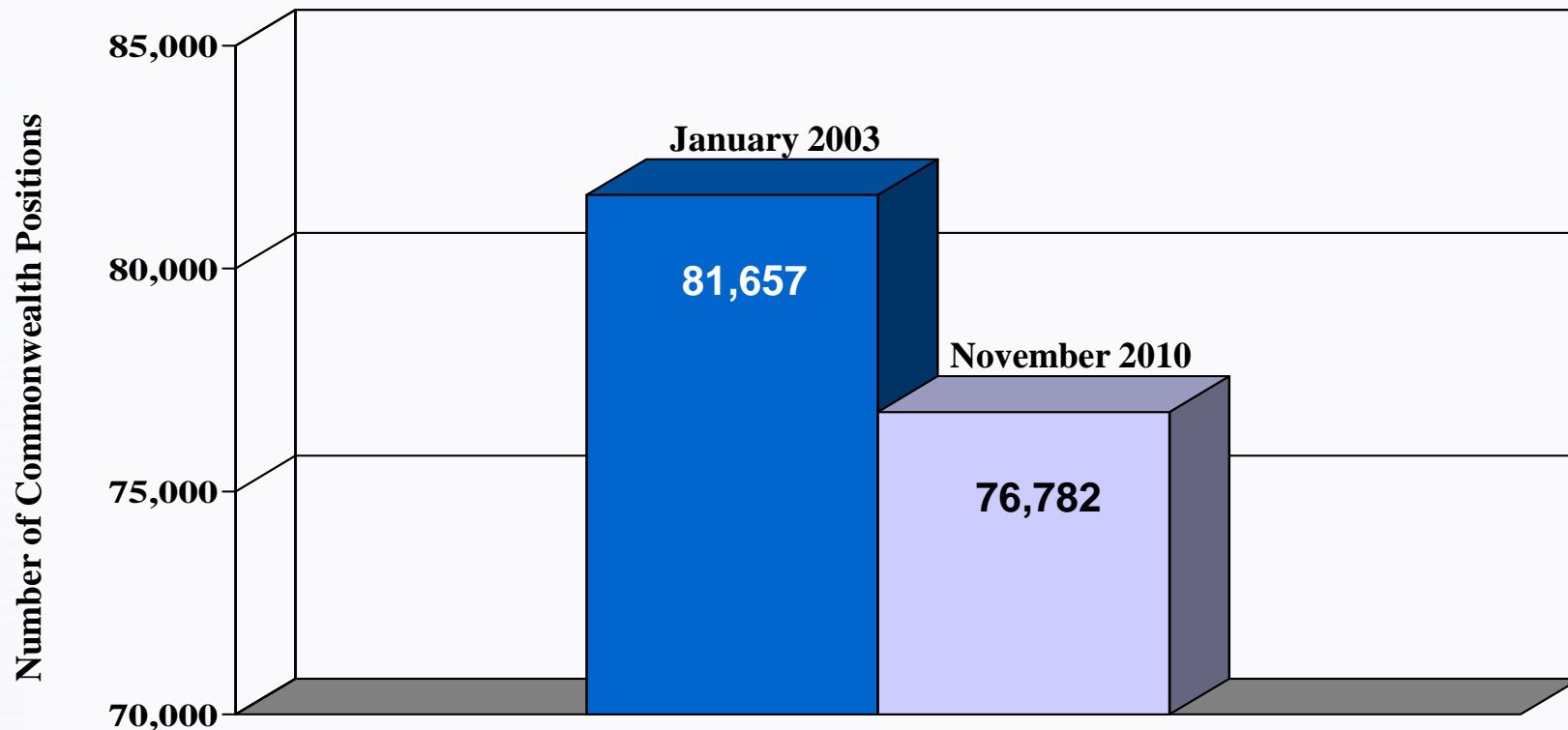
Taxpayers are Saving \$1.75 Billion Annually Through Better Management and Efficiency

Since January 2003, the Governor has directed agencies to contain their spending growth. This emphasis on lowering the costs of government has resulted in annual savings of more than \$1.75 billion.

- \$ 639 million – Administrative & Operational Cost Controls
- \$ 382 million – Program Efficiencies
- \$ 317 million – Procurement Practices
- \$ 255 million – Complement Control and Related Expenses
- \$ 161 million – Revenue Collection and Generation
- \$1.754 billion – Total**

State Government Has Nearly 4,900 Fewer Employees Than in 2003

Between January 2003 and November 2010, the size of the commonwealth workforce declined by 6 percent, or 4,875 positions. This reduction has been part of the Governor's emphasis on lowering the administrative costs of government.



Pennsylvania Retains Double-A Bond Rating

The commonwealth's credit rating remains a solid double-A. Moody's and Fitch upgraded the commonwealth's double-A credit rating, which is the second-highest level of credit. Moody's changed its rating for the commonwealth from Aa2 to Aa1 and Fitch Ratings changed its rating from AA to AA+. These upgrades were in conjunction with the movement toward a global rating scale at each firm.

According to Moody's, the commonwealth's credit strengths include:

- **An established record of good financial management, reflected in strong actions to preserve budget balance in recent years.**
- **A state debt position that is moderate and well-controlled, with tax-supported debt ratios close to national average levels and a well-funded state pension system.**
- **Per capita wealth levels that are close to the national average.**

Meeting Our Ongoing Challenges

➤ Pensions

Act 120 of 2010 enacted pension reform measures that include reduced pension benefits and an increase in vesting years and retirement age for all new employees. These and other reforms provided in the legislation are projected to save more than \$16 billion over the next 25 years. In addition, the legislation ensures a predictable employer contribution schedule.

➤ Medical Assistance

Cost containment initiatives, including implementing significant efficiencies in the pharmaceutical program together with enhanced fraud and abuse enforcement and third-party liability collections, have saved the commonwealth more than \$2.1 billion since 2002-03. In addition, revenue-generating initiatives provided \$784 million.

➤ Corrections

The administration has emphasized prisoner reentry to society. In addition, the enactment of a 2008 legislative package will save taxpayers money through sentencing and parole reform. Recently passed legislation (SB 1161) will encourage offenders with short minimum sentences to finish required programs while on parole, ultimately easing growth in Corrections' prison population.

Remaining Challenges

- **Loss of federal stimulus funds – \$2.6 billion**
- **Loss of one-time revenues – \$750 million**
- **Mandated costs**
 - Pensions
 - Medical Assistance
 - Contractual Salary Increases
 - Debt Service
 - Prisons

“Although a recovering national economy is helping to stabilize state revenues in fiscal year 2011, serious budget challenges await state lawmakers in the New Year. This largely stems from fewer federal stimulus funds available for next year’s budgets. And while state revenues are starting to pick up, the growth is unlikely to be sufficient to replace expiring ARRA funds or cover projected increases in program areas such as Medicaid and K-12 education. This means another round of budget gaps, certainly in FY 2012, but even beyond in many states.”

– National Conference of State Legislatures
State Budget Update
December 7, 2010