



## Analysis: Governor's Proposed 2010-11 Budget Planning for Future Fiscal Challenges

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The state budget proposed by Governor Ed Rendell for the 2010-11 Fiscal Year, his last in office, is a spare budget with no new initiatives or programs. Spending for many programs would continue at levels below 2008-09, reflecting the ongoing effect of the national recession and a continued decline in state tax revenue.

Most departments will sustain General Fund cuts, while a few areas, including health care, public safety and education, would see modest increases.

Total General Fund spending is proposed at \$29 billion, an increase of \$1.15 billion, or 4%, from the current fiscal year. That includes \$26.3 billion in state funds and \$2.8 billion in funds from the American Recovery and Reinvestment Act (ARRA).

The budget anticipates a \$525 million shortfall in the 2009-10 fiscal year revenue collections – an increase from the \$450 million deficit the Governor projected in December. The 2010-11 budget does not require any additional revenue increases to be balanced, although it is predicated on Congressional action to extend federal fiscal relief through June 2011, as President Obama has proposed in his budget. The Governor's plan does set forth several proposals to raise new revenues; however, those funds would be placed in reserve to be used in 2011-12 when federal recovery funds run out. The additional revenue would also help the state fund increased pension contributions in 2012-13 and beyond.

The proposed revenue measures will raise a total of \$874 million in 2010-11 which would go into the "Stimulus Transition Reserve Fund." (See Revenue section for more details.)

The budget includes mandated increases for health and human services, corrections and public safety, and debt service. Medical Assistance is increasing \$355 million, while correctional institutions will receive an additional \$137 million, including \$13 million for 2,000 new beds at existing prisons. Funding is also allocated to hire 80 people to increase oversight of natural gas drilling.

The budget makes a third year contribution toward the six year equity funding formula adopted by the General Assembly in 2008. It increases the basic education subsidy by \$355 million, or 6%, to \$6.2 billion, but reduces or flat funds many other line items. Higher education funding will remain at 2009-10 levels, which includes \$92 million in federal ARRA funds.

Altogether, education, health and human services, public safety and debt service comprise nearly 87% of total General Fund spending.

Many other programs and services will be cut in this budget, impacting children's programs, agricultural funding, state parks, behavioral health services, job training, and libraries, among other areas.

For the second year in a row, the Governor is proposing to move Long-Term Living programs that are currently operated through the Departments of Public Welfare and Aging into a new Department of Aging and Long-Term Living. This proposal was not included in the enacted 2009-10 budget.

The Governor also called on the Legislature to enact legislation he has championed in recent years, including campaign finance reform, the merit selection of state judges and a phase-in of electricity price increases due to uncapping rates. He also made the case for the following initiatives:

- **Alternative Energy Portfolio Standards:** Current law requires that 18% of all retail electricity sold in Pennsylvania be from clean and renewable resources, but the Governor said other states have enacted higher standards that will make them more attractive for future investments. He called on the Legislature to raise the state's alternative energy requirements to be more competitive with other states.
- **Unified Health Care Plan for School Employees:** The Governor renewed calls for a consolidated health plan for the Commonwealth's school employees to reduce health care costs and save taxpayer money.
- **Unemployment Reforms and Work Sharing:** Governor Rendell called on the Legislature to reform the way wage benefits are calculated under the unemployment compensation system. Under current law, benefits are based on a year's worth of income, but more recent earnings are excluded from the calculation. Taking those more recent earnings into account will allow the state to draw down hundreds of millions of dollars in federal recovery funds. The Governor also called on the Legislature to pass Work Sharing Legislation that would allow employees, whose hours are cut to avoid job layoffs, to receive unemployment benefits for lost hours.

## EDUCATION

Total General Fund education funding, including Pre-k through 12 and higher education, is proposed at \$10.6 billion. This is a \$442 million, or 4.4%, increase over the current year. Most of this increase is in the basic education line item; higher education expenditures are level-funded for the year, with non-state related universities sustaining a 4.9% cut.

Basic education funding will increase by \$355 million, or 6.4%. This increase restores state General Fund spending to the 2008-09 level of \$5.226 billion. With the continuation of \$655 million in federal ARRA funds, basic education spending will total \$6.2 billion in 2010-11.

Special education is level-funded at \$1.03 billion for the third year. ARRA funds distributed directly to school districts pay for some additional costs, but those funds are slated to decline in 2010-11 from \$440 million to \$426 million.

Early Intervention for three- to five-year-olds will increase by \$12.6 million to serve an additional 1,200 children.

#### Early Childhood Education Programs

Funding for Pre-K Counts is reduced slightly from \$86.4 million to \$85.9 million, a 0.5% cut. The Head Start Supplemental Assistance Program is reduced by 2%, from \$39.5 million to \$38.7 million. Pre-K Counts will serve 11,800 students and Head Start will serve 5,734 children.

#### Libraries and Literacy

The state library subsidy is reduced by \$2 million to \$58 million, which is comparable to the 2004-05 appropriation. The State Library, which was cut by 50% in 2009-10, sustains an additional cut of 1% in 2010-11. Adult literacy maintains its 1% budgetary-freeze cut, and is funded at \$17.5 million, down from \$23 million in 2008-09.

#### Other Education Programs

Accountability Block Grants receive the same funding, \$271 million, as in 2009-10, while the Educational Assistance Tutoring program is cut by \$3.8 million to \$55 million. Charter school reimbursements remain unchanged at \$227 million and Career and Technical Education is funded at \$62 million for the second year.

#### Retirement Programs

The budget increases the employer contribution to the school employee retirement system by \$65 million, or 19.5%, for a total of \$400 million. The state, school districts and employees contribute to retirement costs, with employee contributions averaging twice the combined state and school district contribution over the past 10 years.

#### Higher Education

The proposed budget offers no increases in higher education funding from the current year and continues reductions from 2008-09. Community colleges receive \$214 million in state subsidy and \$46 million in capital funds for a total of \$272 million, with ARRA dollars. The 14 schools in the State System of Higher Education will receive \$465 million in General Funds and \$38 million in ARRA funds, while the state-related universities (Penn State, Temple, Pitt, and Lincoln) will receive \$688 million in combined state and ARRA funds. ARRA funding will need to be replaced with state General Fund dollars in 2011-12.

## **CHIP & ADULTBASIC**

#### CHIP

The Children's Health Insurance Program (CHIP), which provides subsidized health insurance for children in families earning up to 300% of the federal poverty level, will increase by \$3 million in state General Funds, from \$97 million to \$100 million, while total spending, including federal SCHIP funds, will increase by \$20 million to \$401 million. The program will serve a total of 208,555 children, an increase of 10,300 children.

#### adultBasic

Funding for adult health insurance does not fare as well under the budget proposal. The adultBasic program receives funding from two main sources, Tobacco Settlement Funds and negotiated

contributions from the state's four Blue Cross/Blue Shield plans. These contributions, known as Community Reinvestment funds, are due to expire in December 2010. Together, these funds are budgeted at \$199 million in 2010-11 to enroll 50,000 participants. The budget would increase Community Reinvestment funds from \$125 million in 2009-10 to \$183 million in 2010-11, and reduce Tobacco Settlement funds from \$38 million in the current year to \$16 million in 2010-11. The budget also assumes premium increases of 80% for individuals purchasing adultBasic at cost, and cost-sharing for current enrollees, would continue.

The share of Tobacco Settlement dollars allocated to adult health insurance has declined through the years, from a high of \$112 million in 2003-04 to just \$16 million in 2010-11. Some of the funds have been redirected to the Medical Assistance for Workers with Disabilities Program (MAWD), which currently enrolls an additional 40,000 people. State MAWD funds are eligible to draw down federal Medical funds, which adultBasic is not, which partly accounts for the shift.

## **PUBLIC WELFARE PROGRAMS**

The proposed budget includes a plan to move Department of Public Welfare (DPW) Long-term Living programs to a new Department of Aging and Long-Term Living. Legislation to effectuate this change was considered but not acted upon by the General Assembly in 2009. This analysis will consider the two budgets separately.

### Total Spending

2010-11 DPW spending will total \$8.3 billion, an increase of \$388 million, or 4.9%, over 2009-10. With ARRA funds, total General Fund spending is projected at \$9.7 billion.

DPW is heavily reliant on federal ARRA funding in the form of a higher Federal Medicaid Matching Rate (FMAP). The budget presumes that the enhanced FMAP rate, which was scheduled to end in December 2010, will continue for two additional quarters through June 2011, generating an additional \$850 million. Funding for this extension is included in President Obama's budget for Federal Fiscal Year 2012 and in health care reform bills pending before Congress.

### Medical Assistance

Medical Assistance (MA) spending is projected to increase to \$5 billion from \$4.6 billion in the current year (combined General Fund and ARRA dollars). MA enrollment is expected to increase by 3% to 2.13 million individuals. Outpatient services would be reduced by \$72 million in General Fund dollars to \$365 million, while Inpatient and Capitation programs would increase by \$20 million and \$363 million, respectively. A number of hospital supplemental payments would be reduced from 2009-10 budgeted levels.

The budget includes increased managed care payment rates, (4% for physical health and 3% for behavioral health), and MCO pay for performance incentives would be restored to 2008-09 levels.

### Cash Assistance

Caseloads for the TANF cash assistance program have risen to almost 218,000 as a result of the continuing recession. The proposed budget would increase funding for cash assistance to \$278 million, an increase of \$10 million. The cuts in SSI supplemental payments to 340,000 elderly, disabled and blind Pennsylvanians, first enacted in 2009, would continue through the 2010-11 fiscal

year. Program funding would decline from \$156 million to \$148 million. The New Directions program, which provides job training, placement and support services to TANF recipients, will decline by \$6 million, or 11%

#### Child Care

Child care subsidies for low-income working families are level-funded at \$172 million; however, \$20 million in increased ARRA funding is allocated to take 11,000 children off the waiting list for child care services. Child Care Assistance for TANF and former TANF recipients is level-funded, although TANF caseloads are expected to rise.

#### Child Welfare

The county child welfare appropriation will increase by \$24 million, or 2.9%, over 2010-11. Federal ARRA funds for child welfare services will decline by \$9 million.

#### Mental Health Services

Funding for mental health services will decline from \$728 million to \$710 million, while the behavioral health services line is level-funded at \$55 million.

#### Mental Retardation

Funding for people with developmental delays will increase under the budget by \$17.5 million. MR base services will increase by \$11.8 million to \$168 million, and waiver services will increase to \$628 million from \$622 million.

#### Other DPW programs

Domestic violence programs were level-funded at \$12.5 million, although date rape programs had a modest decrease. Rape crisis services were also level-funded at \$7.5 million. Legal services programs and homeless assistance are both funded at current year levels, while the Human Services Development Fund sustained a \$4 million cut to \$25.3 million.

## **CORRECTIONS**

The Rendell Administration proposes spending \$1.7 billion in state General Fund dollars for the Department of Corrections in 2010-11. This is an increase over 2009-10 of \$137 million, or 8.5%.

The proposed increase in funding is due in large part to an increasing prison population, which is expected to increase by 4.7%, from 51,000 in 2009-10 to 53,500 in 2010-11, Medical care costs for inmates, like any other segment of the population, are expected to continue to rise, increasing by more than \$17 million, or 8.2%, from 2009-10 levels. Only department administration sees a decrease in funding in 2010-11.

The Governor proposes using \$173 million of federal ARRA funds to help augment prison funding. This is the same amount as was used in the 2009-10 budget. This funding stream is not expected to be available in 2011-12.

## ENVIRONMENTAL PROTECTION AND CONSERVATION

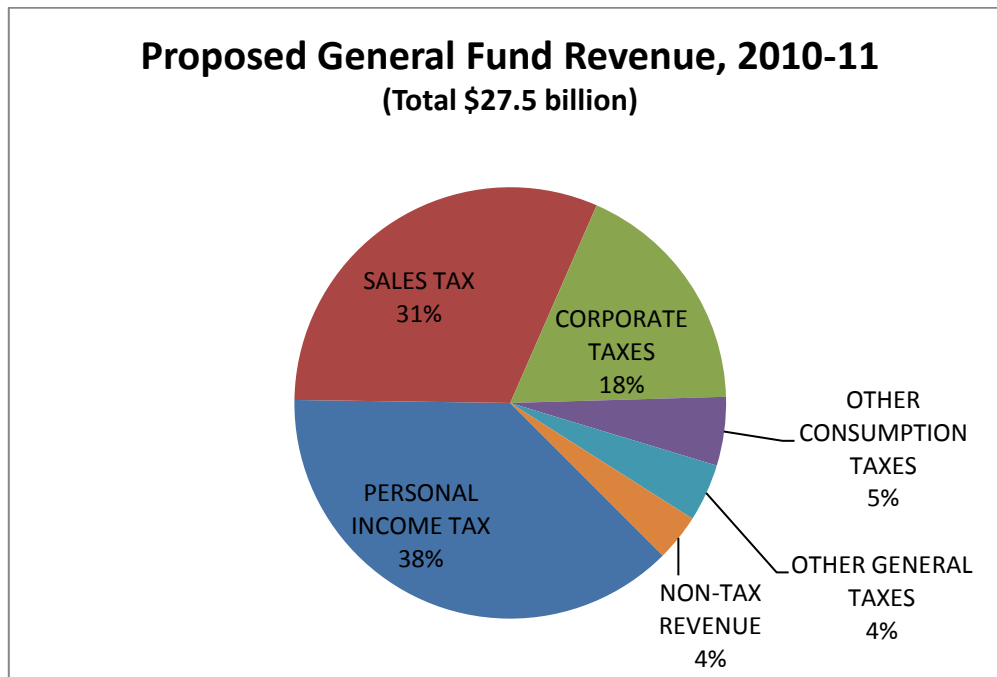
The Departments of Conservation and Natural Resources (DCNR) and Environmental Protection (DEP) will see overall funding reductions in 2010-11.

DCNR will get a General Fund budget reduction of \$1 million, or 1.1%, in 2010-11. These include cuts to state forest and state park operations. Total state funds for the department increase by \$1.5 million, or 0.6%, due to increasing funding from the Keystone Recreation, Park and Conservation Fund, as well as increased timber sales. Like 2009-10, DCNR receives \$10.6 million in funding from the Oil and Gas Lease Fund. Federal funding is reduced significantly in 2010-11, dropping \$24.3 million, or 38%, due to the ending of federal disaster reimbursement for storms in 2005 and 2006. This lowers total funding for the department by \$22.7 million, or 6.8%.

The Governor proposes a General Fund decrease in funding for the DEP of \$3.8 million, or 2.3%, from 2009-10. Funding cuts include environmental protection operations and Black Fly and West Nile Virus control programs. Programs funded using Environmental Stewardship Fund, Growing Greener, and Recycling Fund dollars are reduced, as well. Total funding, including federal funds, for DEP is expected to decrease by \$12.4 million or 2.4%. These reductions come at a time when the natural gas industry is demanding more services so they can develop the Marcellus Shale that underlies much of the state.

## GENERAL FUND REVENUE

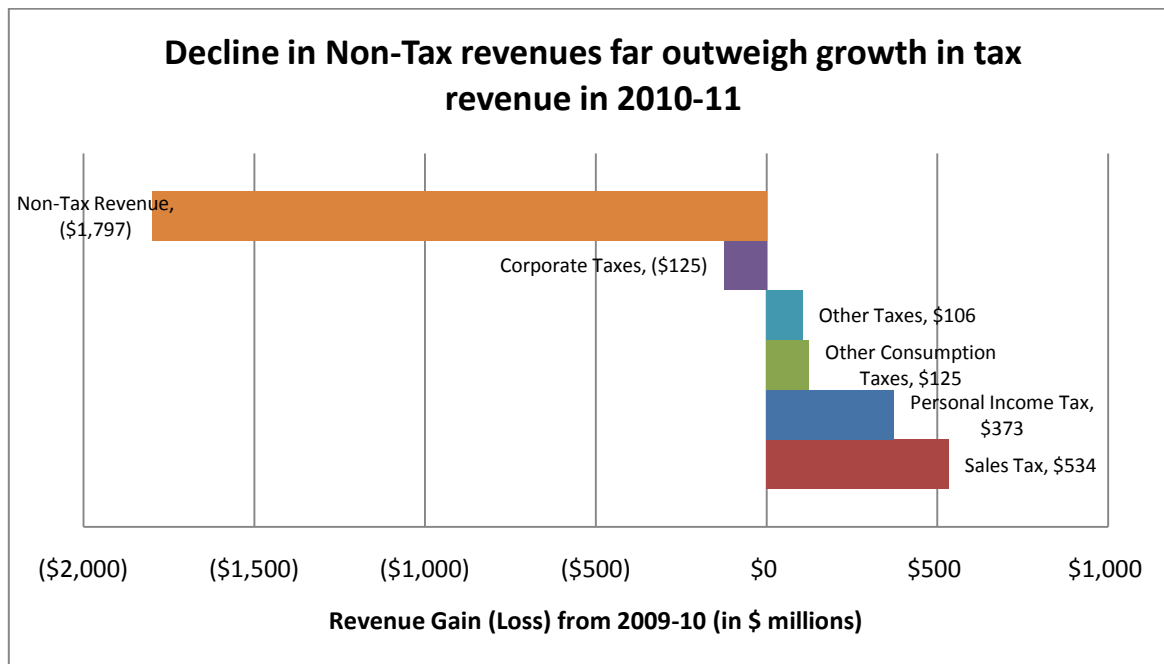
The proposed budget calls for \$27.5 billion in General Fund revenue in 2010-11. This is a decrease of \$785 million, or 2.8%, from estimated revenue for 2009-10. In fact, the total revenue proposed for the 2010-11 budget would be the lowest yearly total since 2006-07.



**General Fund tax growth in 2010-11 is more than offset by declines of non-tax revenue.** Much of the decrease in revenue in 2010-11 is due to the expected decline of non-tax revenues, as more than \$2.1 billion of largely one-time transfers from other funds were used in 2009-10 to balance that year’s budget. In total, non-tax revenues decline \$1.8 billion, or 65%, in 2010-11.

In the wake of the global financial crisis, many businesses saw profits and net worth drop over the last two years, which is reflected in weak corporate tax collections. Corporate taxes are also expected to decline in 2010-11, dropping \$125 million, or 2.5%, from 2009-10. Corporate net income, capital stock and franchise, and bank taxes are projected to drop roughly \$200 million. These are partially offset by a projected increase in gross receipts tax.

The state’s largest two taxes, personal income and sales taxes, are expected to begin to rebound in 2010-11, as the national economy expands. Sales tax receipts are projected to increase \$534 million in 2010-11, or 6.6%. Personal income tax collections are less resilient, increasing \$373 million, or 3.7%. This is likely due to persistently stubborn unemployment rates that are still expected to be increasing through 2010.



**Governor proposes “Stimulus Transition Reserve Fund” to help balance 2011-12.** The Governor proposes a number of tax changes with the new revenue going into a “Stimulus Transition Reserve Fund.” This new fund is expected to collect \$874 million in revenue in 2010-11 that is to be appropriated and used in 2011-12, once the federal ARRA funds have been exhausted.

Included in this new fund are collections from a number of Administration proposals for 2010-11, in particular:

- Enacting a severance tax on the extraction of natural gas (\$161 million in 2010-11)
- Creating an excise tax on other tobacco products, including cigars, smokeless tobacco, and loose tobacco (\$42 million in 2010-11)
- Modernizing the sales tax in three steps (\$605 million)

- Eliminating 74 existing sales tax exemptions, broadening the tax base
- Ending the outdated sales tax vendor discount
- Lowering the tax rate from 6% to 4%
- Closing corporate tax loopholes by enacting combined reporting, while permitting uncapped group net operating losses (\$67 million).

If enacted, these proposed reforms will make the state's tax system fairer, as well as generate additional needed revenue.

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