



# One Step Forward, Two Steps Back

## Historically Late 2009-10 Budget Compromises Many State Services

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On October 9, 101 days after the start of the fiscal year, Governor Rendell signed the 2009-10 state budget. The General Fund budget totals \$27.8 billion, which includes \$25.2 billion in state dollars and \$2.6 billion in federal stimulus funding. Total spending is down \$524 million, or 1.8%, from the amount available in 2008-09.<sup>1</sup> The budget plan uses fewer state dollars than were spent in 2006-07.

Virtually every department sustained cuts. Hundreds of line items were reduced and 142 line items were eliminated entirely, including the Pennsylvania Public Television Network, the Scotland School for Veterans' Children and Classrooms for the Future. Departmental cuts ranged from 7% in the Department of Public Welfare to 54% in the Department of Community and Economic Development.<sup>2</sup>

The budget does include a few bright spots. The spending plan continues progress on the state's education adequacy formula, adding \$300 million to the basic education line. Children's health insurance will grow by \$12 million to meet the current demand for coverage. Funding is included to remove 793 adults from the waiting list for mental retardation services, and provide home and community based services to 300 adults with autism, 900 individuals with severe disabilities and 660 individuals in need of attendant care.

### Federal Stimulus Preserves Services

Federal stimulus funds helped forestall deep cuts in health care and education and freed up state dollars to avoid deeper cuts in other programs and departments. State Fiscal Stabilization Funds (SFSF) totaling \$921.4 million are allocated to the Department of Corrections, public colleges and universities, and to the basic education line item, paying for the \$300 million increase and supplanting an additional \$355 million in state basic education funds. The Department of Public Welfare budget relies on \$1.7 billion in additional federal Medicaid dollars. Unless Congress acts to extend the stimulus, these funding streams will no longer be available as of January 2011.

| 2009-10 General Fund Summary (in \$ thousands) |               |
|--|---------------|
| Source   | Amount        |
| State Funds                                    | \$ 25,178,679 |
| Federal Stimulus Funds (ARRA) <sup>3</sup>     | \$ 2,621,179  |
| Total General Fund                             | \$ 27,799,858 |

### Budget Drains Reserves, Short on Recurring Revenue

The budget relies heavily on one-time funding sources and reserves, as well as speculative revenue sources, such as a tax amnesty program, table games at state casinos and gas leases on public land. The General Assembly opted to transfer balances from a number of special funds, including the Rainy Day Fund, the

<sup>1</sup> This comparison includes state funds and federal stimulus funds that are specifically replacing state dollars (fiscal stabilization and increased federal Medicaid matching (FMAP) funding).

<sup>2</sup> The only departments receiving increases in state General Fund dollars in 2009-10 are Treasury and Revenue. Treasury's budget increased solely due to higher scheduled payments on state debt. Funding for a computerized tax system modernization program in the Department of Revenue increase the agency's overall budget by 1.7%.

<sup>3</sup> American Recovery and Reinvestment Act of 2009 (ARRA).

MCARE fund and the Oil and Gas Lease Fund, into the General Fund. In total, more than \$2.4 billion in temporary and one-time revenue is expected in the current budget.

The General Assembly did not approve most of the recurring revenue measures proposed by the Governor, rejecting a temporary personal income tax increase, a proposed severance tax on natural gas production and an excise tax on cigars and other tobacco products.

Cigarette tax rates were increased by 25 cents per pack and the tax was broadened to include “little cigars.” The capital stock and franchise tax rate was rolled back to its 2008 rate of 2.89 mills through 2011, although that change was offset by modifications to the apportionment formula for the corporate net income tax and by an increase in the net operating loss limits from 12.5% of current year income to 20% in 2010. Both these changes provide a bonus for a small number of large businesses.

### Winners and Losers in the 2009-10 Budget Deal

| WINNERS   | LOSERS  |
|---|---|
| <i>Health care:</i> Federal stimulus dollars prevent cuts to doctors and hospitals, children and pregnant women, seniors and people with disabilities.  | <i>Environment:</i> Environmental Protection and Conservation and Natural Resources funding collectively cut by 24% and Oil and Gas Lease Fund diverted away from environmental uses.                               |
| <i>Schools:</i> Basic Education subsidy is increased by \$300 million, but the increase is partially offset by losses of other education programs.  | <i>Libraries:</i> State funds for public libraries were reduced by 9%, funds to operate statewide electronic catalog eliminated, and funding for access and the state library was cut by 57% and 48%, respectively. |
| <i>Natural gas drillers and cigar wholesalers:</i> Both fended off tax proposals that are common in other states. Pennsylvania remains the only state in the U.S. without an excise tax on cigars and the only major gas-producing state except California without a severance tax. | <i>“Discretionary” programs:</i> Funding was eliminated for a number of economic development programs; substantial reductions in support for museums, colleges, public television stations and research.            |
| <i>Corporations:</i> Businesses traded a temporary increase in the capital stock and franchise tax rate for a permanent corporate net income tax cut.   | <i>Nonprofit service providers:</i> They served clients for months without reimbursement from state. Many had to take out short-term loans; some closed their doors.  |
| <i>Tax Evaders:</i> The state will offer tax amnesty to bring in overdue collections.   | <i>Sustainability:</i> Without additional recurring revenue, it will be difficult for Pennsylvania to meet health care, education and other human service needs over the long-term.                                 |

### Events Last Year Set the Stage for 2009-10 Budget

When the 2008-09 General Fund budget was passed in July 2008, expectations were that the economy would slow and tax revenues would grow by 3% from 2007-08 levels (rather than the robust 6% to 7% growth rate seen from 2002-03 to 2006-07). State spending was budgeted to increase by 4% to a total of \$28.3 billion.<sup>4</sup>

<sup>4</sup> House Appropriations Committee (D), *Budget Briefing: Commonwealth Checkbook July 2008*, July 11, 2008, <http://www.hacd.net/budget/200809/documents/BBCheckbook071108.pdf>.

Almost from the start of the fiscal year, revenue collections dipped below expectations. In October 2008, the General Fund posted a \$144 million loss in short-term investments due to the stock market collapse. Collections of the Commonwealth's two primary taxes, the sales tax and personal income tax, began to fall significantly short of estimates and of prior year collections in December 2008 and January 2009, respectively.

By the end of the fiscal year, tax revenues were \$3.2 billion, or 11.3%, short of estimate. In total, revenues fell by \$2.4 billion, or 10.2%, below 2007-08 collections.

The Governor announced his 2009-10 budget proposal in February 2009, in the midst of significant uncertainty. The economy was clearly struggling and tax revenues were falling. As part of the fiscal stimulus plan to help jump-start the economy, Congress was considering legislation to provide fiscal relief to states hard hit by the recession. Using additional federal dollars, Governor Rendell crafted a budget plan that kept most programs at 2008-09 levels, but increased investments in education, children's services and health care. The original General Fund proposal totaled \$29 billion, comprised of \$26.6 billion in state dollars and \$2.4 billion in federal fiscal stimulus.

As 2008-09 continued, it became clear that the economy was in worse shape than anticipated and that tax revenues for both 2008-09 and 2009-10 were going to be significantly lower than expected. The administration responded by reducing expenditures – by freezing hiring, cutting funds for discretionary programs and ultimately laying off 451 state employees during calendar year 2009.

In May, the Senate passed a budget bill, SB 850, which relied solely on service cuts to close the budget shortfall – rejecting use of reserves or revenue options proposed by the Governor to avoid the worst of the cuts. Given ever-declining revenue, that budget proposal would have had to make almost \$1 billion in additional cuts to remain in balance, and the plan was unacceptable to both House Democrats and House Republicans.

In June, the Governor proposed a temporary one-half-point increase in the state personal income tax, which would raise \$1.5 billion annually, to avoid program cuts and meet growing demand for health care and other services related to the recession. The tax increase would have expired in 2012, when tax revenue is likely to reach pre-recession levels. The plan was rejected by many lawmakers and for more than three months after the start of the fiscal year, the Governor and legislative leaders cast about for a solution.

## **Funding the Budget**

The final budget agreement assumes tax revenue of \$26 billion for the year, a 2.9% increase from 2008-09. Revenue from the state's major taxes, including sales, income and corporate income, will remain essentially unchanged from 2008-09, while \$742 million is expected from changes to the cigarette tax, capital stock and franchise tax and a one-time change in sales tax collections.

Through the first third of 2009-10, actual tax revenue lagged the estimate by \$160 million. That gap is likely to grow through the year, creating the risk that Pennsylvania will end the fiscal year with another revenue shortfall.

Rather than enacting a broad-based tax increase to provide sustainable revenue, the 2009-10 budget includes several minor tax changes, measures to temporarily raise revenue and approximately \$2 billion in one-time revenues. Included in the one-time revenue is between \$392 million and \$750 million of the Rainy Day

Fund. Documentation from the Governor's Office and the Legislature differ on the amount of Rainy Day funding being used in 2009-10.

### **One-Time Revenues: \$2.0 to \$2.3 billion**

- \$211 million from a one-time change in sales tax collections in 2009-10 and \$164 million from a one-time change in personal income tax withholding in 2010-11.
- \$190 million from offering tax amnesty from April 26 to June 18, 2010.<sup>5</sup>
- \$60 million in leases from drilling on state park and forest lands in the Marcellus Shale.<sup>6</sup>
- \$2.3 million in lapsed funds from the Health Care Cost Containment Council (PHC4).
- Transfers from other state-owned accounts and funds, including:
  - \$708 million transfer from the Health Care Provider Retention Account.
  - \$392 million to \$750 million from the Rainy Day Fund.
  - \$168 million from the Tobacco Settlement Endowment Fund.
  - \$143 million from the Oil and Gas Lease Fund.
  - \$100 million from the Medical Care Availability and Reduction of Error (MCARE) Fund.
  - \$18 million from the Keystone Recreation and Conservation Fund.
  - \$11 million from the Higher Education Assistance Fund.
  - \$4 million from the Dog Law Account.

### **Recurring Revenue Increases: \$331 million in 2009-10**

- \$100 million from a cigarette tax rate increase of 25 cents per pack.
- \$16 million from subjecting small cigars, which resemble cigarettes, to the cigarette tax. The federal cigarette tax is assessed on these products.
- \$171 million from redirecting an existing earmark of 25 cents per pack of the cigarette tax from the Health Care Provider Retention Account to the General Fund.<sup>7</sup>
- \$44 million from redirecting surcharges on moving vehicle violations from the MCARE Fund to the General Fund.

### **Recurring Revenue Losses: \$73 million in 2009-10**

- \$73 million in corporate net income tax from increasing the weight of the sales factor in the tax's apportionment formula and increasing the allowance for using net operating losses.<sup>8</sup>
- \$100,000 from a sales tax exemption for helicopter sales and repairs.

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<sup>5</sup> The budget agreement creates a limited time tax amnesty program where people and businesses with delinquent taxes can settle their tax bills with the state and receive a waiver of state penalties and half of the interest that is owed with their tax payments. While expected to bring in money in 2009-10, this program causes collections in future years to be lower as the state would normally settle these taxes over time. Proceeds from such programs are difficult to quantify due to a number of administrative factors. New Jersey recently collected an estimated \$600 million from their program, while Pennsylvania received much less, \$93 million, when it last offered amnesty in 1995-96.

<sup>6</sup> This is a funding target for leasing additional state-owned land for natural gas drilling. The budget agreement does not set a minimum number of acres to be leased.

<sup>7</sup> The HCPRA subsidizes medical malpractice expenses for doctors and hospitals.

<sup>8</sup> The sales weight increases from the current 80% to 83% in tax year 2009 and 90% in tax year 2010 and beyond. This change represents a special interest tax break for a few firms, a tax increase on largely out-of-state firms doing business in Pennsylvania, and provides no benefit to smaller corporations who operate solely within the state. Corporate net income Tax payers with net operating losses from prior years will also be able to offset up to 20% of their current taxable income. Prior to the budget, firms were limited to using the losses to offset 15% of their current income.

### **Temporary Revenue Changes: \$413 million in 2009-10**

- \$374 million in 2009-10 from rolling the capital stock and franchise tax back to the 2008 rate of 2.89 mills. Since 1997, the rate has declined from 12.75 mills to 2.89 in 2008 and was scheduled to decline to 1.89 mills in tax year 2009. The revised schedule uses the 2.89 mill rate through tax year 2011, decreasing to 1.89 mills in 2012, 0.89 mills in 2013, and zero in tax year 2014.
- \$39 million in 2009-10 and \$75 million in 2010-11 from reductions in tax credits. A number of tax credits (Call Center Credit, Employment Incentive Payments, First Class Cities Economic Development Tax Credit, Job Creation Tax Credit, Neighborhood Assistance Program, Research and Development Tax Credit, and the Resource Enhancement and Protection Tax Credit) have been reduced to 50% of their statutory caps in 2009-10 and 45% in 2010-11. The Film Production Tax Credit and Education Improvement Tax Credit programs are also reduced, but not as severely. Alternative Energy Tax Credits, enacted in 2008 but not yet implemented, are eliminated under the budget agreement.

### **Other Revenue Changes in 2009-10**

- The current 2% assessment on Medicaid Managed Care organizations (MMCOs), which was slated to expire on September 30, was replaced with a 5.9% gross receipts tax. This change would draw down an additional \$316 million in federal Medicaid dollars for a total of \$529 million in 2009-10.<sup>9</sup> All funds collected from the managed care organizations (MCOs) and the federal government are returned to the MCOs in the form of increased capitation payments.
- Legislation to introduce table games in casinos, if enacted, could raise up to \$200 million in 2009-10 from license agreements, and up to \$121 million annually in 2010-11.<sup>10</sup>

#### **Education Improvement and Film Production Tax Credits**

Two tax credits that received more modest reductions in 2009-10 than others are the Educational Improvement Tax Credit (EITC) and the Film Production Tax Credit.

The total amount of Film Production Tax Credits to be issued in a single fiscal year has been temporarily reduced from \$75 million to \$42 million in 2009-10, increasing to \$60 million in 2010-11.

The Commonwealth's popular EITC program has been temporarily reduced from its statutory limit of \$75 million to \$60 million in 2009-10 and \$50 million in 2010-11. Even though the budget reduces the amount of credits issued, it also expands the EITC program in a couple of important ways.

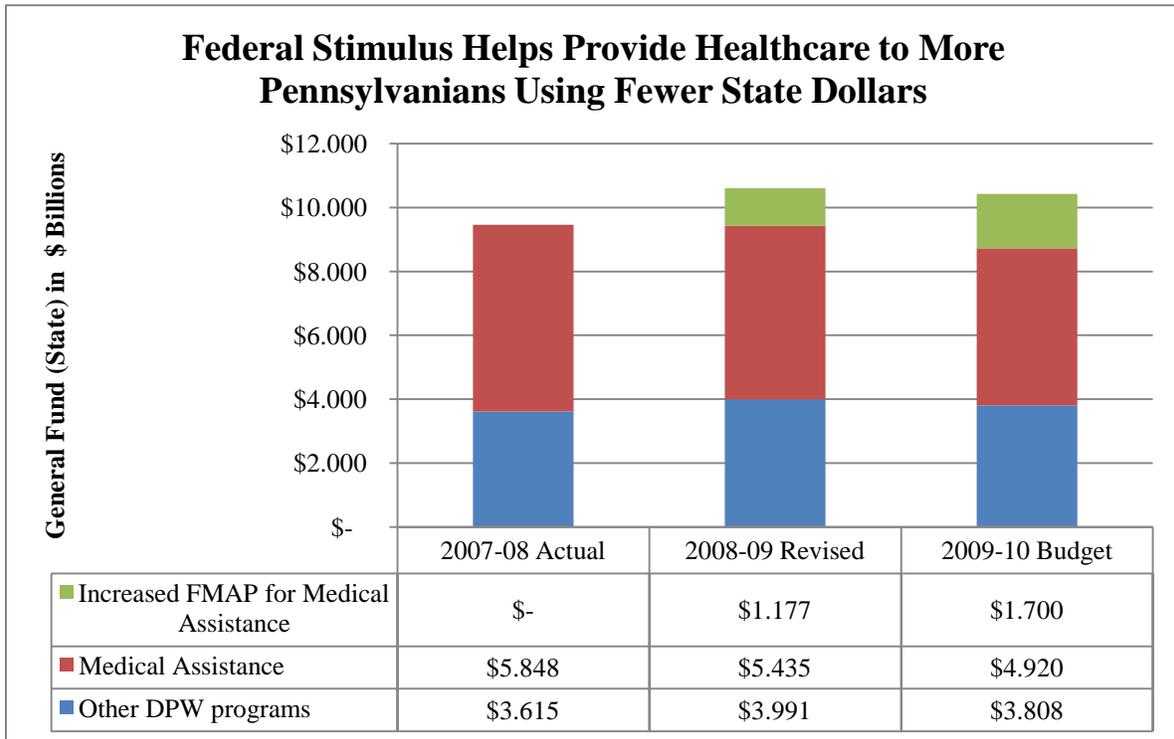
The budget adds schools that offer special education and certain pre-k programs operating over the summer to the EITC program. It also increases the amount of income a family can have and qualify for the tuition scholarships financed by the program. Currently, families are limited to \$50,000 in income, plus \$10,000 for each eligible dependent. Beginning July 1, 2011, the family allowance increases to \$60,000 and the dependent allowance increases to \$12,000. In 2012-13 and beyond, both the family income and dependent allowance will be indexed to inflation. Recognizing the significant costs faced by the families of children with disabilities, the income limits and dependent allowances are increased by a factor of 1.5 or 2.993, depending on the type of disability.

<sup>9</sup> Wendy Lewis, *2009-10 Legislative Session Fiscal Note: House Bill 1531, Printer's Number 2748*, House Committee on Appropriations, October 7, 2009, <http://www.legis.state.pa.us/WU01/LI/BI/FN/2009/0/HB1531P2748.pdf>.

<sup>10</sup> This is an estimate, as the table game legislation has not been enacted.

## Public Welfare

The Department of Public Welfare (DPW), which provides health care and other human services to children, seniors and people with disabilities, receives slightly more than one-third of all state General Fund dollars in the 2009-10 budget. The General Fund appropriation for DPW totals \$10.4 billion in 2009-10 which includes \$1.7 billion in federal stimulus dollars that temporarily replace state dollars. This represents a decrease of \$175 million, or 1.7%, from the available amount in 2008-09<sup>11</sup>.



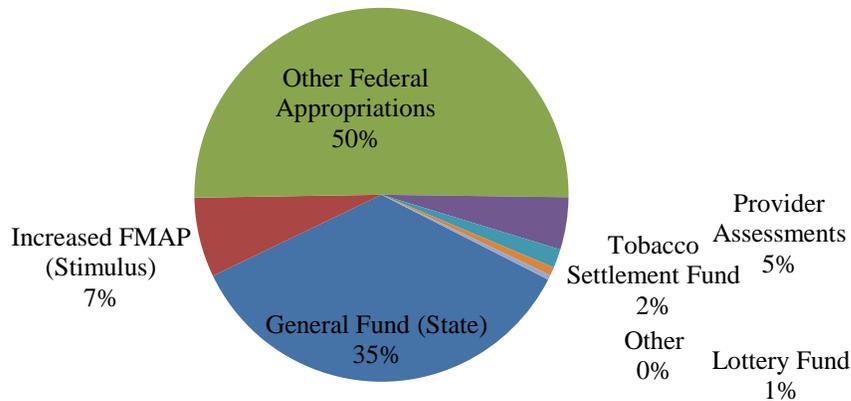
While much of the analysis of the 2009-10 budget focuses on the General Fund, a broader perspective is necessary for reviewing DPW. In fact, the General Fund is the second largest funding source of the department, making up 35% of total DPW funding in 2009-10. More than half of DPW funding comes from the federal government.

### Medical Assistance and FMAP

Providing health coverage for the poor, elderly and people with disabilities through Medical Assistance (the state's Medicaid program) is one of the largest expenditures of state government and the largest expenditure in the Department of Public Welfare. State funds used to pay for Medical Assistance services are matched (at various rates depending on the specific program) by the federal government. More than two million, or roughly one-in-six, Pennsylvanians receive health coverage under Medical Assistance. Enrollment is expected to continue to increase as more Pennsylvanians fall into poverty due to the recession.

<sup>11</sup> State spending would have increased slightly in 2009-10, but \$265 million in Medicaid expenses were rolled back into the 2008-09 budget.

## State General Fund Dollars Make Up One-Third of 2009-10 DPW Budget



Source. Pennsylvania House of Representatives, Appropriations Committee (D).

Under the federal stimulus bill (ARRA), states are eligible to receive a higher Medicaid match rate for nine quarters, from October 2008 to December 2010. In 2008-09, Pennsylvania received \$1.2 billion for three quarters. In 2009-10, the enhanced FMAP will bring in an additional \$1.7 billion to Pennsylvania. These funds ensure that critical health care programs continue and free up state dollars to be used for other General Fund purposes. Without the additional federal funding, Pennsylvania likely would have had to cut services significantly.

The additional funding will end in December 2010. State dollars will be needed to replace FMAP funds beginning January 2011. While tax collections are expected to pick up as the economy recovers, the state still will need to be mindful of its upcoming funding responsibility to provide Medicaid coverage.

### **Managed Care Assessments**

Since 2006, Pennsylvania has collected an assessment from Medicaid Managed Care Organizations to help draw down federal Medicaid matching funds. The Deficit Reduction Act of 2005 prohibited states from collecting assessments limited to Medicaid MCOs after September 30, 2009. Governor Rendell proposed creating a 2% assessment on all managed care organizations (including those that do not provide Medical Assistance services) to comply with the law and replace the revenue. The enacted budget rejected this proposal and instead authorized a 5.9% gross receipts tax on Medicaid managed care contract receipts. If permitted by the federal government, Pennsylvania expects to draw down an additional \$316 million in federal funds in 2009-10. If the federal government does not approve the funding mechanism, a new funding source will have to be found mid-year.

### **Behavioral Health Services**

State grants for community mental health services received a cut of \$3 million, or 2%, as proposed by the Governor in his budget proposal. Behavioral Health Services are increased by \$11.6 million, slightly less than the Governor proposed, to offset the loss of intergovernmental transfer (IGT) funds. Community mental health services received a 2% cut of state funds. This program, which serves non-Medicaid eligible adults using community providers, will not see service cuts from the funding reduction. The cut is an efficiency gained by paying the community providers directly, rather than through the counties.

### **Home- and Community-based Services**

The budget allocates a total of \$96 million (\$33 million in state funds and \$63 million in federal funds) to provide home and community-based services, rather than through nursing homes, to an additional 4,900 elderly Pennsylvanians and people with disabilities.

Overall funding for two programs serving people with disabilities was increased. Services for people with severe disabilities received a \$19 million, or 25%, increase in state funding, along with another \$29 million in federal ARRA funding. The Attendant Care program, which provides funding for caregivers to allow people with disabilities to work and lead independent lives, received a 30% increase in state dollars in 2009-10 and an additional \$17 million in federal stimulus dollars.

State and federal funding for autism services increased by 25% over the revised 2008-09 spending levels, primarily due an increase in federal funds.

### **Child Care**

The Department of Public Welfare provides subsidies to parents needing child care and afterschool care and supports quality improvements in early learning settings through two line items. State funding was cut by \$3.8 million, or 2%, for child care assistance for families receiving cash assistance through the Temporary Assistance for Needy Families (TANF) program and those transitioning from TANF into the workforce. However, federal TANF child care funding increased by \$3 million, as did other federal funding for various child care assistance programs.

The child care services line which assists low-income working parents with child care costs, saw a funding increase of \$5 million, or 3%. Child care services will receive \$22 million in ARRA funds in 2009-10.

### **Cash Assistance**

State funding for TANF cash grants went up by \$10.5 million. Combined state and federal (including ARRA) funding increased by \$74.8 million, or 14%, from 2008-09. After several years of decline, TANF caseloads have begun to rise in 2009, as the recession leads more Pennsylvanians into poverty. Cash grants represent 3.1% of DPW state expenditures.

## **Other Health Care**

### **Aging and Long-Term Living**

The Governor had proposed moving long-term care programs from DPW into a newly created Department of Aging and Long-Term Living. Also included in this new department would be the programs currently operated by the Department of Aging. The Legislature rejected this change and long-term care programs remain within DPW. In 2009-10, no state General Fund dollars are used to fund the Department of Aging. Instead, it is funded through proceeds from the state Lottery.

### **Children's Health Insurance (CHIP)**

Children's Health Insurance Program (CHIP), operated by the Pennsylvania Insurance Department, was one of the few items in the state budget that received additional funding in 2009-10. Governor Rendell had proposed increasing CHIP by \$16.4 million, to provide health coverage for an additional 12,000 children. The amount enacted was slightly smaller, but should allow for an expansion of the program – at a time when more families would likely need it due to continuing loss of employer-sponsored health insurance.

| <b>State Funding For CHIP</b> |                            |                            |                                |                              |
|-------------------------------|----------------------------|----------------------------|--------------------------------|------------------------------|
| <b>2007-08<br/>Actual</b>     | <b>2008-09<br/>Revised</b> | <b>2009-10<br/>Enacted</b> | <b>Change from<br/>2008-09</b> | <b>Percentage<br/>Change</b> |
| \$65.9 million                | \$86.9 million             | \$97.1 million             | \$10.2 million                 | 11.8%                        |

CHIP is also funded using federal matching funds. As the state invests more state funds in CHIP, more federal dollars are received to fund the program. From 2008-09 to 2009-10, the amount of federal dollars used to fund CHIP increased from \$247 million to \$284 million.

### **Prescription for Pennsylvania and Health Care for Adults**

The Governor’s health care reform initiative received minimal funding in the 2009-10 budget. A number of the Governor’s proposed Prescription for Pennsylvania programs, including health literacy, health equity strategies and primary care access, were not included in the final budget plan. Chronic care management and health care information exchange programs received funding, but at lower levels than proposed by Governor Rendell.

The 2009-10 budget includes no expansion of the state’s adultBasic program. Governor Rendell proposed to expand this program, which provides health insurance for adults with incomes up to 200% of poverty, from 40,000 to 90,000 people. The program has a waiting list of 321,191 people as of October, including 48,444 people in Philadelphia.

The final budget does not include funding for this proposal. This reflects both the lack of available funding, and the decision to wait for the outcome of the federal health care reform legislation.

## **Education**

### **Basic Education**

The budget includes some good news for basic education. At risk was the second year of funding for the new education adequacy formula, recommended by the General Assembly’s 2007 Costing Out Study and first adopted in 2008-09. The new budget will increase basic education funding by \$300 million in 2009-10, using federal funds from the stimulus plan (ARRA). ARRA permits states to use allocated federal funds through existing state adequacy formulas, providing key support for state efforts to remain on track with education reform initiatives.

The budget uses a total of \$655 million in federal stimulus funds to support basic education in 2009-10, including the \$300 million increase and \$355 million to replace state funds. The federal funding is, however, a double-edged sword. Federal funds are key to maintaining education funding but will need to be made up with state tax dollars in 2011-12 when funding ends.

|   | <b>2007-08<br/>Actual</b> | <b>2008-09<br/>Revised</b> | <b>2009-10<br/>Enacted</b> | <b>Change from<br/>2008-09</b> | <b>Percent<br/>Change</b> |
|---|---------------------------|----------------------------|----------------------------|--------------------------------|---------------------------|
| <i>Figures in Thousands of Dollars</i>      |                           |                            |                            |                                |                           |
| Basic Education (state)                     | \$5,294,112               | \$5,226,142                | \$4,871,339                | (\$354,803)                    | -6.8%                     |
| ARRA - Fiscal Stabilization Basic Education | 0                         | 0                          | 654,747                    | 654,747                        | NA                        |
| <b>Total Basic Education Subsidy</b>        | <b>\$5,294,112</b>        | <b>\$5,226,142</b>         | <b>\$5,526,086</b>         | <b>\$299,944</b>               | <b>5.7%</b>               |

### **Overall Education Funding**

Total education funding, including both preferred and non-preferred appropriations, will increase by \$47 million, or 0.4%, from \$11.3 billion in 2008-09 to \$11.4 billion in 2009-10.<sup>12</sup> State funding for Pre-K through 12 education, libraries, literacy programs and higher education decreased \$638 million from 2008-09 to 2009-10. Federal ARRA funding makes up the difference, increasing by \$685 million from 2008-09. While certain education programs benefitted from ARRA funds, many other programs were reduced in 2009-10.

|  | <b>2007-08<br/>Actual</b> | <b>2008-09<br/>Revised</b> | <b>2009-10<br/>Enacted</b> | <b>Change from<br/>2008-09</b> | <b>Percent<br/>Change</b> |
|--|---------------------------|----------------------------|----------------------------|--------------------------------|---------------------------|
| <i>Figures in Thousands of Dollars</i>           |                           |                            |                            |                                |                           |
| Pre-K-12 Education <sup>13</sup>                 | \$9,455,613               | \$9,722,155                | \$9,195,505                | (\$526,650)                    | -5.4%                     |
| ARRA - Fiscal Stabilization – Pre K-12 Education | 0                         | 0                          | 654,747                    | 654,747                        | NA                        |
| Higher Education <sup>14</sup>                   | 1,604,055                 | 1,551,322                  | 1,440,167                  | (111,155)                      | -7.2%                     |
| ARRA - Fiscal Stabilization - Higher Education   | 0                         | 62,852                     | 93,226                     | 30,374                         | 48.3%                     |
| <b>Total Education Spending (including ARRA)</b> | <b>\$11,059,668</b>       | <b>\$11,336,329</b>        | <b>\$11,383,645</b>        | <b>\$47,316</b>                | <b>0.4%</b>               |

### **Early Childhood Programs, Special Education & Other Programs**

Early childhood education programs, which were slated to increase in the Governor’s proposed budget, were flat-funded in the final spending plan (Pre-K Counts received \$86.4 million; Head Start, \$39.5 million). Early Intervention funding for 3- to 5-year-olds increased by \$100,000 to \$173.6 million.

State funding remained at the 2008-09 levels for special education (\$1.03 billion) School Improvement Grants and PA Assessments were cut by \$18 million, and Career and Technical Education by \$641,000, or 1.0%, from 2008-09. Funding for teacher professional development declined by \$15 million due to the elimination of the Classrooms for the Future program and the Legislature’s decision not to adopt Graduation Competency Assessments.

Charter school reimbursements to public schools are level-funded at \$227 million, while pupil transportation (public and non-public) increased by 0.3%. The Commonwealth reimburses school districts for 50% of the employer portion of school employee Social Security payments and pension contributions. The state share of Social Security costs increased by \$23.2 million, or 4.6%, in 2009-10, while school employee retirement is funded at \$334 million, \$26 million less than in 2008-09.

### **Laptops in High School, Governor’s Schools & Scotland School**

Initiatives promoted by the Rendell Administration were not spared in the budget. The Classrooms for the Future, the Governor’s initiative to put laptops in high schools, and the Governor’s School of Excellence, a summer enrichment program for high school students, were eliminated entirely. High School Reform and Dual Enrollment payments, which support research-based innovations in public high schools, were both reduced. Funding for the Scotland School for Veterans’ Children (allocated through the Department of Military and Veterans’ Affairs) was also eliminated.

<sup>12</sup> Total education funding in this analysis includes the Department of Education, the State System of Higher Education, and Thaddeus Stevens College of Technology.

<sup>13</sup> Pre-K-12 education also includes state support of libraries.

<sup>14</sup> Higher Education includes community colleges, state-related colleges (Penn State University, University of Pittsburgh, Temple University, and Lincoln University), the State System of Higher Education colleges, Thaddeus Stevens College of Technology, as well as small appropriations for private colleges within Pennsylvania.

**Library & Literacy Programs**

Public library funding took a hit, although not as severely as earlier budget plans. The public library subsidy fell from \$75 million to \$60 million. Funding for the state library was cut nearly in half, from \$4.6 million to \$2.4 million. Adult and Family Literacy programs declined from \$23 million to \$18 million, a cut of \$5 million.

**Higher Education**

Under ARRA, State Fiscal Stabilization Funds could be used to support higher education programs. The General assembly allocated \$52.7 million in ARRA funds to state and state-related institutions. Still, all higher education sectors sustained funding cuts in 2009-10.

Community colleges received \$235.7 million in funding, which includes \$21.5 million in ARRA funding. That is a slight decrease from 2008-09.

Funding for the state-related schools – Penn State, University of Pittsburgh, Temple and Lincoln – all sustain modest reductions in funding, while the non-state-related colleges and institutions saw a 46% cut to their funding.

The State System of Higher Education and the Pennsylvania Higher Education Assistance Agency both saw 4% cuts in funding in 2009-10. The state system is funded at \$503.4 million, which includes \$38.2 million in ARRA funding and is a decrease of \$21 million from 2008-09. For PHEAA, funding is at \$455.2 million – a decrease of \$17.7 million from last year.

**Economic Development**

The Department of Community and Economic Development (DCED), which operates the state’s economic development programs, received the largest reduction of funding in 2009-10 of any of the state’s major departments.

DCED’s 2009-10 budget was cut by \$303 million, or 53%, from 2008-09, falling from \$568 million to \$265 million.

|  | <b>2007-08<br/>Actual</b> | <b>2008-09<br/>Revised</b> | <b>2009-10<br/>Enacted</b> | <b>Change from<br/>2008-09</b> | <b>Percent<br/>Change</b> |
|--|---------------------------|----------------------------|----------------------------|--------------------------------|---------------------------|
| <i>Figures in Thousands of Dollars</i> |                           |                            |                            |                                |                           |
| Community and Economic Development     | \$611,010                 | \$567,519                  | \$264,848                  | (\$302,671)                    | -53.3%                    |

**Program Cuts**

Roughly two-thirds of the budgetary savings resulted from the elimination of state funding for 26 programs, accounting for \$196 million of the total decrease. Of the programs eliminated, the bulk of the funding decrease is attributable to the de-funding of many of the Commonwealth’s traditional “walking around money” programs (or WAMs). State funding for 11 WAM programs operated by DCED was decreased from \$159 million in 2008-09 to \$1 million in the 2009-10 enacted budget. While these programs provided needed funds to many nonprofits, local governments and local emergency service providers, they were viewed as discretionary by lawmakers and unpopular with the public and are eliminated due to the state’s fiscal situation.

**Traditional WAM Program Funding, 2007-08 to 2009-10 (in \$ thousands)**

| <b>Program</b>  | <b>2007-08<br/>Actual</b> | <b>2008-09<br/>Available</b> | <b>2009-10<br/>Budget</b> |
|---|---------------------------|------------------------------|---------------------------|
| Community Conservation and Employment<br>(Community Services Block Grant) | \$44,000                  | \$44,610                     | \$ -                      |
| Community Revitalization  | 40,220                    | 40,200                       | -                         |
| Urban Development   | 20,110                    | 20,500                       | -                         |
| Economic Advancement Program (EAP)  | 18,000                    | 17,800                       | -                         |
| Regional Development Initiative   | 13,500                    | 13,484                       | -                         |
| Economic Growth & Development Assistance                                  | 7,000                     | 6,800                        | -                         |
| Community & Municipal Facilities Assistance                               | 5,800                     | 5,500                        | -                         |
| Cultural Activities   | 4,000                     | 3,832                        | -                         |
| Business Retention & Expansion Program (BREP)                             | 3,226                     | 3,184                        | 1,000                     |
| Community and Business Assistance   | 2,744                     | 2,500                        | -                         |
| Manufacturing and Business Assistance                                     | 1,000                     | 1,000                        | -                         |
| <b>Traditional WAM Program Totals</b>                                     | <b>\$159,600</b>          | <b>\$159,410</b>             | <b>\$1,000</b>            |

Other programs eliminated focused on market promotion and development,<sup>15</sup> infrastructure improvement,<sup>16</sup> providing training and resources,<sup>17</sup> and the Family Savings Account Program. In 2008-09, \$51 million was spent on these 15 programs.

The elimination of the Family Savings Account funding illustrates how deep the cuts were in DCED. This program, which received \$900,000 in state funding in 2008-09, provided matching funds for low-income Pennsylvanians who were able to save up to \$2,000 of their own money and attend financial literacy training. Recipients of the state matching funds were able to use their savings to help purchase or repair a home, pay for college or vocational school tuition, start a business, or purchase a vehicle.

Most of the DCED programs that were funded in 2009-10 received significant cuts. In total, 33 programs were reduced by \$119 million. On average, these programs lost 46% of their 2008-09 funding.

**Funding Increases**

Eight programs received an additional \$12 million in funding in 2009-10 than the previous year, representing an increase of 10%. Notable programs receiving increases include the Office of Open Records (which was created in 2008-09), the Opportunity Grant Program, Infrastructure and Facilities Improvement Grants, and the General Fund subsidy for the Commonwealth Finance Authority.

The result of the 2009-10 budget for DCED is likely a significantly reduced capacity to assist businesses, community groups and local governments – at a time when more help is necessary.

<sup>15</sup> Community and Regional Development, Cultural Exhibitions and Expositions, Keystone Innovation Zones, Market Development, Marketing to Attract Film Business, Regional Marketing Products, and Tourist Product Development.

<sup>16</sup> Base Realignment and Closure, PennPORTS funding for the Delaware River Maritime Council and piers, and the General Fund subsidy for the Industrial Sites Environmental Assessment Fund.

<sup>17</sup> Emergency Responders' Resources and Training, Local Government Resources and Training, PennTAP, and Workforce Leadership Grants.

## Environmental Programs

State environmental programs were also hard hit by budget cuts. State appropriations for the Department of Environmental Protection (DEP) were slashed by \$58.5 million, or 27%, from 2008-09, while funding for the Department of Conservation and Natural Resources (DCNR) was cut by \$21 million, or 18.5%.

|  | <b>2007-08<br/>Actual</b> | <b>2008-09<br/>Revised</b> | <b>2009-10<br/>Enacted</b> | <b>Change from<br/>2008-09</b> | <b>Percent<br/>Change</b> |
|--|---------------------------|----------------------------|----------------------------|--------------------------------|---------------------------|
| <i>Figures in Thousands of Dollars</i> |                           |                            |                            |                                |                           |
| Conservation and Natural Resources     | \$116,486                 | \$113,369                  | \$92,369                   | (\$21,000)                     | -18.5%                    |
| Environmental Protection               | 220,483                   | 217,515                    | 159,056                    | (58,459)                       | -26.9%                    |
| <b>Total Environmental Spending</b>    | <b>\$336,969</b>          | <b>\$330,884</b>           | <b>\$251,425</b>           | <b>(\$79,459)</b>              | <b>-24.0%</b>             |

State funding for DEP is at \$159 million, down from \$217.5 million in 2008-09 (which was a slight decrease from \$220.5 million in 2007-08). Increased federal funding, mostly through the economic stimulus program, boosts overall department funding above 2008-09 levels. One of the biggest components of the stimulus funding is \$184 million for the State Energy Program.

On the state funding side, DEP is seeing decreases in most program funding. Among the biggest cuts are \$13.5 million for environmental protection operations; \$5 million for environmental program management; and \$3.3 million for departmental operations. \$11 million for safe water program was cut entirely. Some loss in DEP's General Fund funding will be made up by recently approved increases in permit fees, which will be applied in particular toward monitoring increasing natural gas production in the Marcellus Shale.

DCNR is funded at \$92 million, down from \$113 million in 2008-09 (which was a slight decrease from \$116.5 million in 2007-08). Unlike DEP, DCNR's budget is not boosted by stimulus funding. The bulk of the state funding cuts impact operational funding for state parks, state forests and forest pest management, as well as general departmental operations. State parks took the biggest dollar hit, with a funding reduction of \$9 million, while forest pest management took the biggest percentage cut – 55% – decreasing funding from \$4.4 million in 2008-09 to nearly \$2 million this year.

The budget also asserts legislative control over the Oil and Gas Lease Fund. This fund, which receives the proceeds of oil and gas leasing on state lands, has been previously used to fund improvements to state owned lands. The budget agreement gives the General Assembly the power to appropriate Oil and Gas Lease Funds as it sees fit, with a provision to allow up to \$50 million in annual spending on conservation, recreation, dams or flood control projects. Previously, the entire fund was used for these purposes.

## Corrections and Public Safety

The Department of Corrections is funded at \$1.8 billion – a \$180 million increase from 2008-09. Most of the increase – \$173 million – is federal stimulus funding.

According to the department's initial budget proposal, about two-thirds of the funding increase was slated to go toward increased salary and benefit costs, the addition of 1,600 new prison beds and 265 new positions, and higher medical costs for treating a larger prison population. Funding for department administration and inmate education decreased slightly from last year.

The state prison population is nearly 50,000 and is projected to rise by 2,000 inmates per year for the next five years, making this department one area that is sure to grow in future budgets.

|  | <b>2007-08<br/>Actual</b> | <b>2008-09<br/>Revised</b> | <b>2009-10<br/>Enacted</b> | <b>Change from<br/>2008-09</b> | <b>Percent<br/>Change</b> |
|--|---------------------------|----------------------------|----------------------------|--------------------------------|---------------------------|
| <i>Figures in Thousands of Dollars</i>       |                           |                            |                            |                                |                           |
| Corrections                                  | \$1,600,181               | \$1,605,505                | \$1,612,329                | \$6,824                        | 0%                        |
| ARRA - Fiscal Stabilization -<br>Corrections | 0                         | 0                          | 172,911                    | 172,911                        | NA                        |
| Attorney General                             | 93,836                    | 94,509                     | 86,522                     | (7,987)                        | -8%                       |
| State Police                                 | 165,230                   | 165,397                    | 182,664                    | 359                            | 0%                        |
| Probation and Parole                         | 109,382                   | 111,605                    | 117,664                    | 6,059                          | 5%                        |
| <b>Total Public Safety Spending</b>          | <b>\$1,968,629</b>        | <b>\$1,977,016</b>         | <b>\$2,172,090</b>         | <b>\$178,166</b>               | <b>9%</b>                 |

State appropriations were approved for most other law enforcement and public safety programs, including the State Police, the Office of the Attorney General, and the Pennsylvania Board of Probation and Parole, in the August bridge budget:

- The State Police received \$183 million from the General Fund. (Most State Police funding – \$519 million in this budget – comes from the Motor License Fund.)
- The Office of the Attorney General was funded at \$86.5 million, nearly \$8 million less than in 2008-09. That funding will be allocated for drug law enforcement, tobacco law enforcement, child predator interception, court costs and other general operations.

The Pennsylvania Board of Probation and Parole was funded at \$118 million, an increase of \$6 million.

## Conclusion

Early in 2009, some lawmakers and advocates argued that Pennsylvania’s budget could be balanced by eliminating waste and by spending cuts that would have little or no impact on citizens or communities. Events have quieted those critics. The payment delays prompted by the budget impasse showed in stark terms that every school district, county, city, hospital, nursing home and community-based group is affected by the state budget. These groups cannot adequately address local needs without adequate state funding.

In the face of a difficult fiscal situation, the 2009-10 budget uses federal stimulus dollars to protect basic education, public safety and safety net programs, while making reductions to most other services. These reductions not only affect those who benefit from the programs but also blunt the stimulative effect of state government spending when it is most needed to offset declining private sector investment.

Lawmakers were charged with the responsibility of addressing a budget shortfall stemming from the worst recession in 50 years. Unable to confront the need for revenue to address the continuing fiscal impact of the recession, lawmakers focused on minor increases to tobacco taxes and temporary business tax increases. Most of the funding gap was filled using \$2.4 billion in one-time and temporary revenues, leaving little in reserve for future years.

The 2009-10 budget agreement contains both short- and long-term risks. In the short-term, continued lagging tax collections could force further mid-year budget cuts. In the long-term, if the national economy does not expand quickly enough to make up for both growing costs (particularly regarding health care) as well as the loss of federal stimulus dollars, the broad-based tax increase lawmakers avoided in 2009-10 will be inevitable.

*For more of the Pennsylvania Budget and Policy Center's research and analyses of the budget, go to <http://pennbpc.org/state-budget-and-tax-policy>.*