



**REPORT ON KEY ISSUES FROM THE
HOUSE APPROPRIATIONS COMMITTEE**

BUDGET DAY BRIEFING

DWIGHT EVANS, DEMOCRATIC CHAIRMAN

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Governor proposes Prescription for PA, Energy Independence, and Increased Sales Taxes to Reduce Property Taxes

Budget Overview

Governor Rendell's proposed 2007/08 operating budget for the Commonwealth totals \$59.09 billion compared with last year's \$55.86 billion, an increase of \$3.23 billion or 5.8%. This includes the State

General Fund, Federal Funds, the Motor License Fund, and other Special Funds, such as the Lottery Fund and Tobacco Settlement Fund and other non-state revenues.

A Little Bit of History

Lawmakers face difficult decisions regarding how to mend a gaping hole in the Commonwealth's budget. As we deliberate the 2007/08 budget, the predicament is this -- Do we raise taxes, cut programs, or some combination of the two?

The budget problem is not a new one – it was years in the making. Nor does it come as a surprise – we have been writing about it since 2004.

We have a fiscal problem because the state budget continues to be plagued by significant cost drivers -- such as health care, corrections, and retirement - that are growing much faster than revenues.

This problem is so large and so complex, it is difficult to fix in one shot. Rather, it has been addressed incrementally in past budgets that included very substantial cuts in state government and public programs, and increases in state taxes and fees. However, these budgetary measures have not been enough to fully eradicate the gap between spending and revenues.

Consequently, Pennsylvania has relied heavily on short-term revenue fixes to close the gap. These short-term fixes included using revenue from special funds, one-time windfalls, and other non-recurring revenue to balance the budget.

For six consecutive years (2001/02 through 2006/07), these short-term revenue fixes have averaged \$1.7 billion per year. Some significant examples include: the \$1 billion transfer from the Rainy Day Fund to the General Fund in 2001; the \$851 million in temporary federal fiscal relief funds that Pennsylvania received in 2003; the \$3.6 billion in county Intergovernmental Transfer (IGT) revenue used in the last six budgets to help fund Medical Assistance; and the \$578 million of federal TANF block grant reserves used over four budgets to help fund county child welfare services.

This year, we are running out of short-term revenue fixes. The federal government is phasing out the IGT, which will completely disappear in 2008/09, and the federal TANF reserves were exhausted in 2004/05. Revenue windfalls, such as federal fiscal relief and state General Fund surpluses, are random occurrences. Special funds do not have surpluses that can be raided year after year.

The increase in the combined operating budget is a result of a:

- \$947.9 million increase in General Fund spending;
- \$1.131 billion increase in Special Fund spending; and
- \$1.411 billion increase in Other Funds.

General Fund

The 2007/08 state **General Fund budget** reflects:

- \$27.28 billion in total state money available to spend in 2007/08, an increase of nearly \$913 million or 3.5% from the \$26.37 available in 2006/07.
- \$27.27 billion in total state spending in 2007/08, an increase of nearly \$948 million or 3.6% from the \$26.32 billion in 2006/07.

This leaves a projected \$5.1 million budget surplus at the close of 2007/08, of which \$1.3 million (or 25 percent) would be transferred to the **Rainy Day Fund**. At the close of the 2006/07 budget year, the Governor's budget estimates that nearly \$12.5 million will be transferred to the **Rainy Day Fund** bringing the 2007/08 balance to \$563 million.

Expenditures

The 2007/08 state General Fund budget request is \$27.27 billion, nearly \$948 million or 3.6% above the current year budget which includes a proposed supplemental appropriation of \$211.6 million. The agencies slated to receive additional state funds are led by the Department of Education (\$544 million), followed by the Department of Public Welfare (\$367 million) and Corrections (\$185 million). Part of the Department of Education's budget reflects an increase of \$80 million because the employer contribution rate for the PA **School Employee Retirement System** increased for 2007/08 to 7.13%. There is also a \$23.8 million increase in the Treasury department. The increase in Treasury is driven by a \$24.5 million increase in General Obligation Debt Service. This \$948 million includes \$21.3 million of spending for the new Prescription for Pennsylvania initiative. Not including the Corrections Department, the total complement for all agencies declined by 395 positions.

Most of the \$211.6 million **supplemental request** for 2006/07 is for the Department of Public Welfare (\$201 million) and the Department of Education (\$4.5 million). **The Governor is requesting supplemental state funds for DPW so that the Department can make all payments owed to MA providers in 2006/07**, including June 2007 payments. By using current year revenue to pay the

providers, the Governor is preserving the Rainy Day Fund.

Revenues

The 2007/08 General Fund budget is supported by \$27.28 billion in available state funds, including over \$37 million from a projected surplus for the current fiscal year. Given the solid performance in revenue collections through January, the Administration has **raised the 2006/07 revenue estimate by \$67 million**. This is a modest revision considering that the year-to-date overage through January stands at nearly \$100 million. The Administration's revision leaves room for further upward adjustment after receipts are tallied for March and April, the two most important (and largest) months for tax collections. If General Fund revenues - especially Personal Income and Corporation Tax collections - continue to perform as they have in recent months, 2006/07 could end with a larger surplus which, in turn, will translate into a higher revenue estimate for 2007/08. While we anticipate a larger surplus, we do not anticipate the good fortune experienced last year when the revenue surplus exceeded \$800 million. For 2007/08, the Administration projects revenue growth of 5.7% over the revised 2006/07 estimate.

Taxes

The Governor's 2007/08 budget proposes revenue modifications of \$921.26 million. These modifications include:

- Increases in the Cigarette and Sales and Use Tax rates;
- The creation of a new tax on Other Tobacco Products;
- An increase in the Educational Improvement Tax Credit;
- Compliance Initiatives that focus on the use of abusive tax shelters and;
- Increases in various fees within the Department of Environmental Protection

For more detail on these proposals, refer to the **Revenue Modifications** fact sheet on page 12.

Education

The Governor's budget has proposed a substantial increase to the basic education subsidy for 2006/07. The Governor's proposed basic education subsidy for the 501 districts in the Commonwealth represents an increase of \$166.7 million, or 3.5%.

Basic Education Subsidy

The **Base supplement** of \$48.65 million is divided into a five-tiered allocation based upon four aid ratio

levels of 0.7376, 0.6607, 0.5853 and 0.4158. **As a reminder, the “aid ratio” is a number that indicates the relative wealth of a school district, compared to other districts; the higher the number, the less wealthy the district.**

The **Foundation Supplement** is continued at a total of \$58 million and distributed via a two-tiered formula. Districts that have current expenditures of less than \$9,337 per student are eligible to receive these funds; except, this target is raised to \$11,204 for districts where at least 50 percent of students are eligible for free/reduced lunches. The appropriation is prorated based upon these factors and factoring in equalized millage. **As a reminder, “equalized mills” is a standardized number that takes into account a school district’s property values and total tax collections.**

The **Poverty Supplement** makes \$26 million available to districts where:

- 30 to 40 percent of students are eligible for free/reduced lunches and the district has an aid ratio of at least 0.65 or
- At least 40 percent of students are eligible for free/reduced lunches and the aid ratio for that district is at least 0.45.

The **Tax Burden Supplement** is based upon a qualifying district’s average daily membership (ADM) and aid ratio. The supplement allocates \$3 million to those districts where market value has increased by less than 10 percent during the period 2000 through 2005.

The **Growth Supplement** allocates \$2.5 million to districts where there is a weak local tax base. Districts will qualify for this supplement if: the percent change in market value per ADM is less than 19.5% and the district must have increased its ADM between 2000/01 and 2006/07 by at least five percent.

Small District Assistance is a \$2.4 million supplement designed to target funding for districts with an ADM equal to or less than 1,500 and an aid ratio of at least 0.60.

The **Inflation Index Supplement** makes \$14.2 million available to districts to guarantee that a district’s minimum increase is 3.4% multiplied by its aid ratio. This guarantees that districts with an aid ratio that is approximately higher than the state median will receive a guaranteed increase above the two percent.

The **Minimum Increase Supplement** includes \$4.6 million in funding to ensure that each district has received at least a minimum base increase of two percent.

The **Limited English Proficiency (LEP) Supplement** consists of \$2.7 million for districts with an aid ratio greater than or equal to 0.38 and where LEP student populations represents at least 3.5% of the district’s ADM.

Special Education Subsidy

The appropriation for Special Education is proposed at \$29.4 million, which represents an increase of three percent.

Additional Programs

Accountability Block Grant

The **Accountability Block Grant** was introduced in the 2004/05 budget year with an initial allocation of \$200 million. The purpose of the block grant is to encourage quality education through initiatives such as pre-kindergarten, full-day kindergarten, and class size reduction. In 2006/07, the block grant was increased to \$250 million. For the 2007/08 budget, the governor has requested an increase of \$100 million, for a total request of \$350 million.

This is the third year in the **Dual Enrollment** program, designed to allow students to earn college credits while attending high school. The additional \$2 million in funds allocated in this budget for a total of \$10 million, represents a 25 percent increase in the total appropriation for this budget year.

Early Intervention, designed for children aged three to five, is geared toward minimizing developmental delays and the need for special services. This program is set to receive an increase of 21.7%, for a total requested appropriation of \$173.1 million to provide support services.

In this second year for the **Science: It’s Elementary Program**, the program request has increased from a \$10 million appropriation to \$15 million. This program provides hands-on learning equipment in elementary science classrooms in addition to teacher training. The funding is available to districts committed to improving science curriculum.

Classroom Initiatives – High School

There are several continuing initiatives in the Governor’s budget designed to support and enhance learning at the high school level. One such initiative is **Classrooms for the Future**. This \$90 million appropriation is designed to assist in providing Internet-ready laptop computers on every desk in every core-subject high school classroom over the next five years. Additionally, teachers in these same core subjects (English, math, science, and history) would be provided with multimedia technology and expanded technology professional development opportunities. Last year was the first year for this program which began with a \$20 million appropriation.

Other Initiatives

Rx for PA - Physical and Health Education is an initiative designed to assist elementary teachers in disseminating critical health information to students during health and physical education classes. The requested appropriation for this first-year initiative is \$30,000. Additionally, the **Rx for PA-School Food Services** program makes a first-time appropriation request for \$6.5 million in an effort to improve school nutrition by increasing the breakfasts served to students and providing incentives for school to practice verified nutritional guidelines.

Higher Education

Community Colleges

Community Colleges in the Commonwealth offer two-year programs in liberal arts, technology, or other areas that lead to an associate degree or certificate. The funding formula for Community Colleges considers a variety of factors including base funds, growth supplement monies, an economic growth stipend, and capital costs.

Funding for Community Colleges is shared by sponsoring school districts or counties, student payments, and the Commonwealth. A hold harmless supplement guarantees funding each year that is equal to at least the amount of funding allocated in the previous year.

For fiscal year 2007/2008, the Governor has proposed an increase in the total Community College budget of 3.9%, or \$10.3 million. This increase includes more than \$44.5 million in capital funds; an item that is a continuation of new funding from the 2005/2006 budget year.

State System of Higher Education

The State System of Higher Education includes the general line funding for the 14 state universities. For the 2006/07 budget years, the Governor has requested a 3.5% increase in funding for the universities; bring the total request to \$483.9 million.

| University | \$ Amount (millions) | % Increase |
|-----------------------------------|----------------------|------------|
| The Pennsylvania State University | 263.5 | 2 |
| University of Pittsburgh | 164.5 | 2 |
| Temple University | 172.5 | 2 |
| Lincoln University | 13.8 | 2 |

State-Related Universities

The four state-related universities, Penn State, Temple University, University of Pittsburgh, and Temple University, each received an increase of two percent.

Pennsylvania Higher Education Assistance Agency (PHEAA)

The Pennsylvania Higher Education Assistance Agency (PHEAA) provides financial assistance to students and institutions in higher education. The fiscal year 2007/08 budget contains total funding of \$451.65 million, this is a slight decrease over last year's budget of \$451.35 million.

One significant line in the PHEAA budget is for grants to students. This particular line item remained the same as 2006/07 at almost \$386.2 million. Student grants are allocated based upon a formula that takes into account family income, family size, and institution cost.

Funds available for SciTech Scholarships have almost remained the same as 2006/07 at \$6.8 million.

With the exception of two lines, funding for PHEAA remained stagnant from 2006/07 to this proposed budget for 2007/08. The augmentation of Grants for Students Supplement increased by just \$16 million, for a total of more than \$88.6 million. The Pennsylvania Internship Program was reduced from \$300,000 in 2006/07 to no funding proposed in 2007/08.

Medical Assistance

The Executive Budget proposes \$4.997 billion in state funds for Medical Assistance (MA) in 2007/08. This represents an increase of \$49.8 million from 2006/07, which includes a \$219 million supplemental request. **The Governor is requesting supplemental state funds so that the Department of Public Welfare can make all payments owed to MA providers in 2006/07**, including June 2007 payments.

The number of MA recipients is projected to increase by 62,000 (or three percent), with average monthly enrollment reaching nearly 1,968,000 in 2007/08. **The proposed budget does not change MA eligibility or benefits.** However, the Governor proposes savings initiatives and alternative funding sources as a means to reduce the state General Funds that otherwise would be needed for the MA program. Without these budgetary measures, which are detailed below, state MA funding would have to increase by an additional \$774 million above the Governor's 2007/08 request.

The Governor proposes to generate **\$446 million in state MA savings** by ending the voluntary managed care program, consolidating pharmacy services, changing provider payments, and enhancing third

party liability efforts. These cost containment initiatives impact managed care organizations particularly hard, but also impact nursing homes and hospitals. Specifically, the proposed budget includes the following state savings:

- \$23 million by ending voluntary managed care in the 42 non-HealthChoices counties. (HealthChoices is Pennsylvania's mandatory managed care program in 25 counties.) This initiative means 72,000 individuals who currently choose to receive health care through a managed care organization (MCO) would be shifted to the fee-for-service system, where they would receive enhanced case management and disease management services under the Access Plus program.
- \$45 million by carving out pharmacy from managed care and consolidating all MA pharmacy into the fee-service-system. The "carve-out" means management of the prescription drug benefit for the one million individuals enrolled in HealthChoices would move from the MCOs to the fee-for-service system administered by DPW.
- \$315 million by changing managed care payments. Approximately \$200 million of the savings are associated with switching from the current prepayment system (in which MCOs are paid at the beginning of each month based on projected monthly enrollment) to a retrospective payment system (in which MCOs are paid at the close of the month based on actual enrollment). This proposed change means MCOs would receive their July 2007 payment in August 2007, and so **the state would make only 11 payments in 2007/08**. Approximately \$39 million in savings is associated with implementing additional performance incentives in managed care contracts. These proposed savings represent a portion of the 2007/08 budgeted rate increase that DPW would withhold as an incentive payment (that MCOs must earn by meeting performance standards) and that DPW would then pay to MCOs in 2008/09. Approximately \$72 million in savings are anticipated by claiming federal funds for General Assistance recipients who are enrolled in managed care.
- \$30 million by changing per diem nursing home payments, which are based on the health care needs of nursing home residents. The budget proposes to generate savings by requiring quarterly assessments of residents needs when determining nursing home per diem rates.
- \$9.9 million by changing hospital payments. The budget proposes to stop reimbursing hospitals

for readmissions of patients who have the same diagnosis if such readmission occurs within 30 days of the original hospitalization. It also proposes a 25 percent reduction (\$7.1 million) in Community Access Fund payments to hospitals that serve the uninsured.

- \$23 million by enhancing third party liability efforts to ensure that MA does not pay for hospital bills that should be paid by other health care insurers.

To further reduce state spending on MA long term care, the Governor proposes to utilize **\$328 million from special funds** as follows:

- \$248.8 million from the Lottery Fund; and
- \$79 million from the Tobacco Settlement Fund, reflecting the Administration's proposal to reallocate the annual payments that the Commonwealth receives from tobacco manufacturers.

The Governor's 2007/08 state funding request for MA reflects the following:

- \$29.6 million increase for the statewide expansion of the HealthChoices behavioral health managed care program, including the addition of the 15 remaining counties in July 2007.
- \$245.5 million for provider rate increases. The budget proposes a two percent rate increase for hospitals (\$13.5 million) and nursing facilities (\$33.2 million). The budget includes \$198.8 million for rate increases to managed care organizations; **however**, as explained earlier, the budget proposes that \$38.6 million be held as a performance incentive payment that would not be paid until 2008/09.
- \$11.7 million for additional incentive payments to managed care organizations and outpatient providers. These incentives payments would emphasize prevention by focusing on disease management, preventive interventions, and childhood obesity.
- \$26 million for increased home and community based services as an alternative to nursing facility care. The budget proposes to serve an additional 2,200 seniors through the PDA Waiver program.
- \$13 million reduction in the "clawback" payments that the state must make to the federal government for the Medicare Part D program.

Lottery Fund

The Governor's 2007/08 budget proposes total spending of \$1.8 billion in the Lottery Fund, a \$387 million increase over 2006/07. The largest spending increase is for the Property Tax and Rent Rebate

(PTRR) program in the Department of Revenue. The next largest spending increases are for the PACE and PENNCARE programs in the Department of Aging.

The 2007/08 budget includes \$325 million for **PTRR**, an increase of \$195 million. These additional funds reflect the expansion of the PTRR program under Act 1 of Special Session 1 in 2006. Seven hundred forty thousand (740,000) households are expected to receive property tax or rent assistance in 2007/08.

Lottery Funds for the **PACE** program total \$276 million, an increase of \$74.4 million. Most of this increase (\$60.9 million) reflects the additional costs associated with providing pharmaceutical assistance to an increasing number of PACE enrollees. The 2007/08 budget projects an additional 32,000 seniors will enroll in PACE, bringing the total number of seniors receiving pharmaceutical assistance to 357,725. The balance of the increase (\$13.5 million) replaces Tobacco Settlement Funds which the Governor is proposing to redistribute (see the Tobacco Settlement Fund).

The budget proposes \$243 million for **PENNCARE**, a \$15 million increase. This includes \$6 million for a 3 percent cost-of-living adjustment and \$3 million to provide attendant care services to an additional 346 seniors. It also includes \$5.9 million for a new long-term care initiative to reduce reliance on institutional care and promote growth of quality home and community-based services.

The Governor once again recommends using \$248.8 million of Lottery Funds to help pay for the **Medical Assistance long term care** program in the Department of Public Welfare.

The 2007/08 budget also proposes to transfer the following Department of Aging General Fund expenditures to the Lottery Fund:

- \$8.2 million for **general government operations**; and
- \$12.1 million for the **Family Caregiver** program, which includes a three percent cost-of-living adjustment.

The proposed budget does not include funding for the **Senior Centers**.

Tobacco Settlement Fund

As was done in 2005/06 and 2006/07, the 2007/08 proposed budget continues to use investment earnings on the Fund and the Health Endowment Account, one-eighth of the allocation for the adultBasic health insurance program and one-fourth of the allocation for Tobacco Use Prevention and Cessation to cover Long-Term Care costs which

otherwise would be funded with general funds. Please note that uninsured adults will still receive health coverage through a combination of Community Health Reinvestment funds and new funding under the Governor's Cover All Pennsylvanians proposal.

In addition, the budget proposes using one-fourth of the allocation for Uncompensated Care program to fund Long-Term Care. The Governor's proposal notes that hospitals will benefit from his Prescription for Pennsylvania initiative, no longer needing this level of uncompensated care dollars.

As was proposed 2006/07, the 2007/08 proposed budget recommends securitizing one-half of the allocation for Health Research to create the Jonas Salk Legacy Fund (JSLF). The JSLF will support two major types of investments: (1) Starter Kit grants to renovate, furnish and equip research facilities in hopes of attracting research faculty; and (2) Brick and Mortar Grant Financing to expand, remodel, renovate, alter or construct biomedical research facilities.

The 2007/08 proposed budget also would use half of the allocation for PACENET to fund Biotechnology Commercialization and Health Venture Investment through the Life Sciences Greenhouses.

Prescription for Pennsylvania

The 2007/08 proposed budget includes a multi-agency, comprehensive health care initiative entitled Prescription for Pennsylvania. In order to fund this initiative, the Governor's proposes:

- increasing the cigarette tax by 10 cents per pack;
- introducing a tax on other tobacco products;
- levying a three percent "fair share assessment" on the payrolls of businesses that do not offer health insurance to their employees;
- drawing down additional federal matching funds;
- and, incorporating Tobacco Settlement funds and Community Health Reinvestment funds currently used in the adultBasic health insurance program.

The proposed budget funds the following components for Prescription for Pennsylvania, spread throughout the Department of Education, Department of Health, Insurance Department, Department of Public Welfare, Governor's Office of Health Care Reform, Department of Labor and Industry, and the Pennsylvania Health Care Cost Containment Council:

- \$303.8 million in total funds for a 'Cover All Pennsylvanians' basic health insurance

program for small businesses and uninsured adults. Individuals with household incomes less than 300 percent of the federal income poverty guidelines (FPIG) would have a portion of their health coverage paid by the Commonwealth. Those individuals above 300 percent FPIG may also purchase health coverage through the program for the full price of the premium. Co-payments would vary based on household income. The proposed budget anticipates serving 153,600 adults in 2007/08 through this program.

- \$268,000 to expand the Commonwealth's premium rate review authority to all insurers providing coverage in the individual and small-employer market.
- \$120,000 to develop recommendations and criteria for the review and approval of health care services and facility planning.
- \$810,000 to develop standardized policies and reporting and auditing procedures for non-profit hospitals required to meet community benefit standards.
- \$510,000 to develop and enforce standardized hospital admission criteria and fair billing and collection procedures for uninsured and underinsured patients.
- \$5.4 million to increase access to primary health care in underserved rural areas through community health centers, advance-practice nurses, mobile wellness clinics and a physician loan-forgiveness program.
- \$2.3 million to standardize identification and reporting of hospital-acquired infections by hospitals and to provide training in infection-control best practices.
- \$2.5 million to develop a chronic care information system that tracks patient health information for use by primary care providers and establishes regional collaboratives to promote the use of a comprehensive, evidence-based care model for people with chronic disease.
- \$719,000 to enhance the delivery of health-promotion and risk-reduction messages through an integrated and coordinated approach to health literacy.
- \$1 million to reduce health disparities by increasing the number of health professionals equipped to address the needs of racial and ethnic minorities.

- \$6.5 million to increase the number of school breakfasts served to students and provide incentives for schools that adopt best-practice nutritional guidelines.
- \$30,000 to assist elementary school teachers integrate health living concepts into lesson plans.

Pandemic Preparedness

The 2007/08 proposed budget includes \$14.1 million to purchase and stockpile antiviral medications as part of the Commonwealth's influenza pandemic preparedness planning efforts.

Programs: Health and Human Services

Department of Public Welfare

The 2007/08 budget continues to expand home - and community - based services in the mental health/mental retardation system. Additional state funding is provided to the following programs:

- \$18.9 million for **Mental Health Services** to provide community services for 200 persons who currently reside in the state mental hospitals;
- \$0.5 million for **Mental Health Services** to provide respite care services for 2,000 families of children with mental illness;
- \$28.9 million for **Community Mental Retardation Services** to serve 3,428 additional persons with mental retardation, including 800 young people leaving the special education system; and
- \$2 million for **Autism and Intervention Services** to provide home and community based services to 100 persons with autism.

The budget also continues to expand home and community based services for persons with physical disabilities. Additional state funding is provided to the following programs:

- \$2.9 million for **Services for Persons with Disabilities** to serve an additional 405 individuals who have a severe, chronic disability that is attributable to cerebral palsy, epilepsy or other physical disabilities; and
- \$3.7 million for **Attendant Care** to serve an additional 595 adults with physical disabilities who need assistance with tasks of everyday living such as bathing, dressing, meal preparation, housekeeping, and shopping.

The 2007/08 proposed budget includes a **three percent cost-of-living adjustment** for community mental health and mental retardation programs, as well as for county drug and alcohol programs. The proposed budget also includes a three percent cost-of-living adjustment for in the following social services appropriations: Domestic Violence, Rape Crisis, Breast Cancer Screening, Legal Services, and Homeless Assistance.

In the **Child Support Enforcement** appropriation, the 2007/08 proposed budget includes \$5.7 million in general funds to replace federal funds reduced due to the federal Deficit Reduction Act.

The **Cash Grants** appropriation provides direct money payments and supportive services to eligible individuals enabling them to meet the expenses of everyday living. The 2007/08 proposed budget reduces the appropriation by \$2.7 million to reflect an anticipated decrease in caseloads.

In previous years, the Cash Grants appropriation included funding child care services needed for participants and former participants in the Temporary Assistance for Needy Families (TANF) program. Child care services are crucial to moving individuals from government assistance to work, representing a large portion of that appropriation. The 2007/08 proposed budget transfers child care funding for TANF recipients from Cash Grants into a new appropriation entitled **Child Care Assistance**. The proposed budget funds this appropriation at \$200 million to provide child care assistance to TANF and former-TANF families. This appropriation includes funding to provide a three percent cost-of-living adjustment and to increase child care provider rates.

The **Child Care Services appropriation** provides child care assistance to non-TANF low-income families. The 2007/08 proposed budget increases this appropriation by \$43.3 million including sufficient funding for a three percent cost-of-living adjustment, providing subsidized child care services to 400 additional children, increasing funding for Keystone Stars, and increasing child care provider rates.

Early Intervention is a process that promotes collaboration among parents, service providers, and others significantly involved with infants and toddlers who have, or are at risk of having, a disability and/or developmental delay. The Department of Public Welfare (DPW), Office of Child Development sets policy and allocates funds for the Commonwealth's Early Intervention Program for eligible infants and toddlers, from birth to age three. The 2007/08 proposed budget increases this appropriation by \$14.5 million including sufficient funding for a three percent cost-of-living adjustment and to provide services to an additional 1,529 children.

The **Nurse Family Partnership** is an intensive and comprehensive home visitation program for first-time pregnant teens and young women, starting with prenatal care and continuing through the child's infancy. The program is designed to serve low-income, at-risk pregnant women expecting their first child. Long-term studies have found that such programs reduce child abuse, welfare use, arrests and substance abuse, while improving education and employment rates. The 2007/08 proposed budget includes an increase of \$587,000 to provide services to an additional 184 families in five additional counties.

The **County Child Welfare** appropriation under the Department of Public Welfare (DPW) provides state and federal funds to support county-administered social services programs for children and youth in each of the Commonwealth's 67 counties. Based on the type of services delivered, varying levels of state reimbursement are provided to counties. This is often referred to as a county match on state Act 148 dollars. The proposed budget includes \$947.8 million in state funds, carrying the county match, for child welfare programs. This reflects an increase of \$67 million over 2006/07. The proposed budget also includes \$15 million, half of the amount appropriated in 2006/07, for Child Welfare – TANF Transition, which has not carried the traditional county match in previous years.

In order to alleviate the reduction of Intergovernmental Transfer (IGT) funds under the **Human Services Development Fund**, the 2006/07 enacted budget included an additional \$2.5 million in General Funds. The 2007/08 proposed budget reduces this appropriation by \$2.5 million.

Department of Health

The 2007/08 proposed budget eliminates or reduces funding enacted by the General Assembly in 2006/07 for numerous health research and treatment appropriations in the Department of Health, such as lupus and sickle cell.

The 2007/08 proposed budget includes a three percent cost-of-living adjustment in the **Assistance to Drug and Alcohol** appropriation under the Department of Health.

Insurance Department

The 2007/08 proposed budget includes \$63.5 million in state funds and \$210 million in federal funds to provide health insurance to approximately 175,000 children through the **Children's Health Insurance Program** (CHIP). This reflects a \$16 million or 34 percent increase over 2006/07, largely due to the enactment of "Cover All Kids" in 2006.

Department of Community and Economic Development

Economic Stimulus – Strategic Increases

Infrastructure Facilities Improvement Program provides multi-year grants to pay the debt service on certain infrastructure and building projects. The amount of the grant is limited to the personal income tax, sales tax and hotel tax generated by the project. The Governor proposes \$22.5 million for this program next year – an increase of \$7.5 million.

Housing and Redevelopment Assistance provides grants to communities, redevelopment authorities and nonprofit organizations to improve blighted neighborhoods, to revitalize central business districts and to provide low and moderate income housing. The Governor proposes \$35 million for this program next year – an increase of \$5 million.

Municipal Rightsizing Fund provides new resources for core communities seeking downtown revitalization projects and for communities considering mergers or consolidations. The Governor proposes increasing the Land Use Planning and Technical Assistance appropriation by \$1.9 million to \$5.247 million and a new \$2 million Community Action Team Appropriation for next year to fund these activities.

Keystone Innovation Zones (KIZ) program provides technical support to early-stage companies located in specific areas. The Governor proposes an additional \$2.5 million, transferred to the Ben Franklin Technology Development Authority Fund, to create another four to six economic growth zones. Currently, there are 21 statewide. Total proposed KIZ funding for next year is \$4.5 million.

Film Production Grant Program provides incentives for filmmakers to produce films and television shows in Pennsylvania. The Governor proposes \$20 million for the program next year – an increase of \$10 million.

Department of Environmental Protection

Energy Independence Fund

The **Pennsylvania Energy Development Authority (PEDA)** will issue \$850 million in bonds to fund the programs listed below. The debt service on these bonds will be paid for by securitizing the revenue stream resulting from the imposition of a new Systems Benefit Charge. The **Systems Benefit Charge** is a new one-twentieth of a cent charge per kilowatt hour on electric power sold to residential, commercial and industrial customers. According to

the proposal, residential customers will pay, on average, approximately \$5.40 per year.

Clean Energy Greenhouse will fund “translational” research, incubator support services, an entrepreneur-in-residence program and funding for companies to prepare for first-round venture financing. The Governor proposes \$56 million for these market preparation clean energy research and development endeavors.

Clean Energy Venture Capital program will provide resources to new and existing venture capital firms investing in Pennsylvania energy project companies. The Governor proposes investing \$50 million to help sustain the development of these companies. Investments will range between \$500,000 and \$2 million.

Pennsylvania Energy Development Authority (PEDA) will administer the \$300 million **Clean Energy Grants and Loans** program to stimulate the development of innovative clean energy projects and companies. PEDA will offer low-interest loans up to \$25 million.

Energy Site Preparation program will provide grants and low-interest loans to develop energy business sites for clean energy companies. The Governor proposes \$150 million to help businesses, local governments and economic development organizations undertake clean energy projects.

Energy Capital Assistance Program (EACP) will provide grant funding for the acquisition, construction and improvement of regional energy projects. The Governor proposes \$50 million for this program. This fifty percent match program will leverage other non-state funding sources resulting in total investment of at least \$100 million.

Air Conditioner/Refrigerator (AC/R) Swap program will encourage small business and consumers to swap their old air conditioners and refrigerators with new more energy efficient models. The Governor proposes \$44 million for this program to fund retailer rebates giving small business and consumers an incentive to upgrade their appliances and in turn reduce their energy costs.

Pennsylvania Sunshine program provides incentives to solar manufacturers, small business and consumers to produce and utilize solar energy systems. The Governor proposes \$200 million to provide grants to manufacturers of solar panels or cells to increase market supply and rebates to small business and consumers to increase market demand. The overall goal is to increase the deployment of solar systems and reduce reliance on nonrenewable energy sources.

Hazardous Sites Cleanup Fund

The Hazardous Sites Cleanup Program was established in 1988 to give the Department of Environmental Protection the ability to respond to serious environmental issues, respond to environmental emergencies and promote brownfield redevelopment. The Hazardous Sites Cleanup Fund (HSCF) began teetering on the brink of bankruptcy in 2002 when the annual transfer of one-quarter of a mill in Capital Stock Franchise Tax to the fund was eliminated. During the last two years, the Environmental Stewardship Fund, as part of Growing Greener II, transferred a total of \$50 million to HSCF as a stopgap measure to keep the program operating. For 2007/08, the Governor proposes increasing the solid waste disposal fee by an additional \$2.25 per ton and dedicating that revenue to HSCF. This funding stream should help ensure that the program continues. The fee will generate approximately \$37.7 million in 2007/08 and approximately \$50.2 million thereafter.

Environmental Stewardship Fund

Growing Greener II was authorized by Act 45 of 2005. The legislation authorized the issuance of \$625 million in bonds, as approved by the voters, to support various environmental programs. This year the debt service on the \$210 million issued so far was paid by the General Fund. The debt service cost on these bonds was \$9.4 million. For 2007/08, the Governor proposes paying 100 percent of Growing Greener II debt service from the Environmental Stewardship Fund including reimbursement of the General Fund for debt service paid this year. As part of this initiative, the Governor proposes increasing the solid waste disposal fee by an additional \$0.50 per ton and dedicating that revenue to the Environmental Stewardship Fund. This additional fee is expected to generate approximately \$8.4 million in 2007/08 and approximately \$11.2 million thereafter. For 2007/08, the total debt service cost borne by the Environmental Stewardship Fund will be \$26.987 million - \$9.4 million for 2006/07 and \$17.586 million for 2007/08.

Property Tax Relief Fund – Broad Based Tax Relief

An increase in the sales and use tax rate of one percent to seven percent is proposed for 2007/08. Half of this revenue will be dedicated to further reducing property and wage taxes in 2008/09 and thereafter. Next year, \$420 million in sales tax revenue will be combined with \$223 million in slot machine tax revenue to provide broad based tax relief of \$643 million. This additional revenue not only increases the amount of money available for

statewide tax relief but it accelerates receipt of state funded tax relief to taxpayers. The Governor proposes using the same formula and delivery system contained in the Taxpayer Relief Act, also known as the Special Session Act 1 of 2006.

Property Tax and Rent Rebate – Targeted Property Tax Relief

The expanded Property Tax and Rent Rebate program includes 422,100 new senior citizen participants at a total cost of \$254 million. The expanded program adds 411,600 homeowners who will receive \$223.3 million in additional rebates, and 10,500 renters who will receive \$31.2 million in additional rebates. It is estimated that 155,000 senior citizens will have their school property taxes completely eliminated. Also, nearly 600,000 Pennsylvania seniors will benefit from higher state rebates or will be added to the state rebate program for the first time now that the maximum income limit has been increased to \$35,000 (which excludes half of Social Security income) and the top rebate has been raised to \$650.

These expansions are possible since more than \$250 million of the \$1 billion from gaming revenue is dedicated to go to seniors with incomes under \$35,000 to help them pay their property tax bills. The net result of broad based and targeted tax relief is a combined \$900 million in property tax and wage tax relief next year with seniors being the big winners.

Transportation

In response to the transportation crisis identified by the Governor's Transportation Funding and Reform Commission last November, the Governor proposes investing an additional \$1.725 billion in new transportation funding for 2007/08.

For highways and bridges, the Governor recommends leasing the Pennsylvania Turnpike to a private entity. The Administration estimates that it will bring in an additional \$965 million per year, enabling an unprecedented 133 percent increase in state funds for construction and reconstruction of state-owned highways and bridges. The Governor lists the following objectives to be achieved:

- highway system preservation,
- bridge system preservation,
- capacity management,
- safety enhancement, and
- capacity expansion.

For transit, the Governor recommends a new **Oil Company Gross Profits Tax** in lieu of the Corporate Net Income Tax on oil companies that have realized

record profits “due to creative accounting.” The Budget assumes that these corporations “have been able to shelter much of their profits from Pennsylvania Taxes.” These companies will no longer pay the 9.99% CNI rate on a separate company reporting basis and instead will pay a 6.17% rate on gross profits on a combined reporting basis.

By requiring “combined reporting,” the Administration estimates that it will bring in an additional \$760 million per year, which will be earmarked for transit. This will be a 106 percent increase in state funding of transit, excluding bond-financed capital projects.

Criminal Justice

The number of incarcerated offenders continues to increase. The inmate population has risen 13 percent since 2003/2004, from 40,187 to 45,596. Total costs have grown as well during this time frame, from \$1.3 billion in 2003/04 to an estimated \$1.6 for 2007/08. In just one year, between December 2005 and December 2006, the state prison population rose by five percent.

Due to this increase in inmate population, the Governor is proposing to reopen State Correctional Institution (SCI) Pittsburgh at a cost of \$32 million. SCI Pittsburgh had originally been closed in January 2005. This would allow the Department of Corrections to house an additional 750 inmates, and would provide the capacity for as many as 1,500 inmates. Three hundred seventy four additional jobs will be created to staff the reopened institution.

In addition to the reopening of SCI Pittsburgh, the Department would add modular units at three of its other institutions, which would add a total of 450 new beds by August 2007, and would construct additional housing units in four institutions which would add more than 800 beds by June of 2008. The Governor’s proposed budget also provides \$3.9 million for an additional 250 beds in Pennsylvania’s Community Corrections Centers for technical parole violators.

Several effective crime-reduction strategies are also included in the proposed budget. Drug and alcohol addiction treatment, additional supervision of parolees, and enhanced community re-entry

preparation would all be funded by approximately \$19.6 million.

State Police

The Governor’s budget continues his commitment to maintain the trooper complement at the maximum level allowable by statute. It is projected that by September 2008, there will be 4,660 troopers serving Pennsylvania. Although the Governor is asking for \$22.2 million less from the Motor License Fund and General Fund for 07/08, the current year budget includes \$43.3 million in special enhancements, of which \$34.3 million are nonrecurring expenses.

Volunteer Firefighters

The Governor’s Budget continues the \$25 million appropriation for grants to volunteer fire companies. As with the current fiscal year, this will be funded from gaming revenues.

QUESTIONS AND COMMENTS

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The 2007/08 budget proposes \$921.256 million in revenue modifications. This number combines revenue enhancements, initiatives to increase non-tax revenue and the expansion of the Educational Improvement Tax Credit.

Modifications that effect current programs:

- A proposal to increase the current Sales and Use Tax rate by one percentage point, from six to seven percent. This proposal, excluding the \$420 million dedicated to Property Tax Relief, is expected to generate approximately \$826 million in 2007/08.
- A proposal to increase various fees within the Department of Environmental Protection, effective July 1, 2007. This proposal is estimated to generate \$9.156 million.
- A proposal to increase the Educational Improvement Tax Credit by \$1.4 million, which would take effect July 1, 2007. Currently, the maximum amount of the credit is \$54 million; the Governor's proposal would take the total amount of credits awarded to \$55.4 million.
- The Capital Stock and Franchise Tax rate continues to decline. Effective January 1, 2007 the rate decreased 1 mill to 3.89 mills. This decrease translates to nearly \$190 million in unavailable revenue for 2007/08.¹
- The Solid Waste disposal fee increases by \$2.75 to \$7.00 with \$2.25 dedicated to the Hazardous Sites Cleanup Fund generating \$37.7 million and \$0.50 directed to the Environmental Stewardship Fund generating \$8.4 million to help pay Growing Greener II debt service. The current amount of \$4.25 supports Environmental Stewardship Fund activities. The above amounts do not include the Act 101 \$2.00 recycling fee.

Modifications that effect new programs:

- The Systems Benefit Charge is a new 1/20th of a cent charge per kilowatt hour on electric power sold to residential, commercial and industrial customers. This revenue stream will be securitized to pay the debt service on bonds issued by the Pennsylvania Energy Development Authority (PEDA). The bond proceeds will pay for Energy Independence Fund programs.

Modifications that effect Rx/Prescription for PA:

- A proposal to increase the Cigarette tax by ten cents that will help pay for some of the cost associated with his health care plan. Currently, the tax rate is \$1.35 per pack; this increase is estimated to generate \$49.7 million.
- The creation of a new tax on other tobacco products, namely smokeless tobacco, cigars and cigarillos, and loose tobacco. The rate would equal 36 cents per ounce for smokeless and loose tobacco and the equivalent of 36 cents per ten sticks of cigars and cigarillos. The proposed tax would be effective August 1, 2007 and is expected to generate \$27.8 million in 2007/08.

Modifications that effect Transportation:

- The proposal creates the Oil Company Gross Profits Tax. The tax uses a combined reporting method, in which each firm's total profits are examined, and the portion of those profits that can be attributed to activity in Pennsylvania are subject to Pennsylvania tax. The new tax would be taxing gross profits instead of net income. If enacted, the tax rate would be 6.17%, and corporations subject to this tax would not be subject to the 9.99% Corporate Net Income tax (CNI). This proposal is expected to generate a net revenue increase of \$760 million.²

Other Modifications:

- A proposed compliance initiative designed to focus on the use of abusive tax shelters. This initiative is expected to generate \$10 million.

¹ This \$190 million is not included in the Governor's total proposed tax and revenue modifications number.

² This \$760 million is not included in the Governor's total proposed tax and revenue modifications number.