



## Proposed 2009/10 Budget

Today, the Governor presents his budget proposal for Pennsylvania. His proposal is presented in the midst of a very uncertain economy and with an assumption on federal economic stimulus money that may or may not materialize. As a result, now more than any time in several decades, the General Assembly is presented with a spending plan that may need to change significantly as we better understand our situation. For now, we explain how the Governor proposes to solve the budget gap within current parameters. His plan includes significant pain that could deepen if the economic environment worsens.

The total 2009/10 operating budget for the commonwealth is \$61.7 billion. The following document is a summary of the more significant proposals that focus on:

- the **General Fund**, the largest operating fund (\$26.6 billion after federal stimulus offsets) that addresses the greatest variety of programs;
- the **Motor License Fund** (\$3.6 billion), a fund that supports highway-related programs;
- the **Lottery Fund** (\$166 billion) which supports senior citizens, and
- the **Public Transportation Trust Fund** (\$922 million) which subsidizes mass transportation programs.

### General Fund

In January, the House Appropriations Committee identified a budget gap of at least \$5.6 billion over two years. The anticipated budget gap took into account a reduction in tax revenues and investment earnings, as well as necessary expenditures in larger program areas. This estimate did not include any discretionary increases in program areas or smaller mandated expenditures.

Recognizing a gap between revenues and expenditures, the Governor's proposed budget identifies \$6.3 billion in additional revenue sources for the General Fund over the current (2008/09) and upcoming (2009/10) budget years combined. These funds will be used to support a bare bones budget proposal that reflects a small change in General Fund expenditures, \$266 million in unused expenditures from prior years, and approximately \$557 million in cuts to current appropriations. Proposed appropriations increase by about \$706 million or 2.5% compared with the enacted 2008/09 budget. However, after taking into consideration current year cuts and offsetting federal stimulus money, spending actually declines by almost \$65 million or 0.24%.

<b>Spending Increase</b> <i>(\$s in millions)</i>	<b>2008/09</b>	<b>2009/10</b>	<b>\$ Increase</b>	<b>% Increase</b>
Appropriation	\$ 28,266.9	\$ 28,972.6	\$ 705.7	2.50%
Current Year Lapses (cuts)	(556.8)			
Federal Fiscal Relief	(1,083.0)	(2,410.0)		
<b>Total Spending</b>	<b>26,627.1</b>	<b>26,562.6</b>	<b>\$ (64.5)</b>	<b>-0.24%</b>

The Governor's revenue assumptions rely heavily on the receipt of federal fiscal relief to the states. The proposed budget assumes a total of \$3.5 billion over two years (\$1.1 billion for 2008/09 and \$2.4 billion in 2009/10) will come to Pennsylvania based on the federal stimulus package as passed by the U.S. House of Representatives. The proposals relating to federal stimulus continue to evolve as the package moves through Congress, therefore, the assumptions contained in the proposed budget may or may not be realized.

In addition to the assumed federal stimulus funding stream, the proposed budget includes the following additional revenues in 2008/09 and 2009/10:

- Nearly \$480 million in revenue increases for 2009/10, primarily reflecting new tobacco related taxes, redirection of a portion of the cigarette tax, and a new severance tax on natural gas.
- A total of \$1.1 billion (\$424 million in 2008/09 and \$725 million in 2009/10) in transfers from other funds.
- A total of \$1.2 billion (\$832 million in 2008/09 and \$329 million in 2009/10) in cost containment measures, including budgetary freezes and Medical Assistance (MA) cost containment proposals.

In addition to closing a budget gap, the additional revenue sources allow for increased spending in:

- The Department of Education (PDE),
- The Department of Public Welfare (DPW),
- The newly expanded Department of Aging and Long Term Care,
- PHEAA (due to increased grants to students),
- The Department of Insurance (due to Children's Health Insurance),

- The Department of Revenue (due to technology and process management), and
- The Department of Transportation (due to Rail Freight Assistance).

Smaller increases are reflected in the Departments of General Services, Military and Veterans Affairs, and Health.

## Addressing a \$6.3 billion Gap between Revenues and Expenditures

In order to address a gap in revenues and expenditures, the Governor's proposed budget includes the revenue assumptions outlined in the table below.

### Bridging the Budget Gap

<i>\$s in millions</i>	FY 2008/09	FY 2009/10	TOTAL
<b>TOTAL to bridge the Gap</b>	<b>2,339.8</b>	<b>3,970.0</b>	<b>6,309.8</b>
<b>Revenue Increases Subtotal</b>	<b>-</b>	<b>479.7</b>	<b>479.7</b>
New Other Tobacco Products Tax		37.9	37.9
New Severance Tax -- Natural Gas		107.2	107.2
Increase Cigarette Tax by 10 cents from \$1.35 to \$1.45		60.8	60.8
Redirect 25 Cents of Cigarette Tax from HCPRA		198.9	198.9
Eliminate 1% discount to vendors for collecting Sales and Use Tax		74.9	74.9
<b>Fund Transfers Subtotal</b>	<b>424.0</b>	<b>725.0</b>	<b>1,149.0</b>
Health Care Provider Retention Account (HCPRA)		350.0	350.0
Rainy Day Fund (A \$125m balance will remain)	250.0	375.0	625.0
Oil and Gas Lease Fund	174.0		174.0
<b>Federal Fiscal Relief Subtotal</b>	<b>1,083.0</b>	<b>2,436.2</b>	<b>3,519.2</b>
FMAP (for Medical Assistance)	1,083.0	1,917.0	3,000.0
Fiscal Stabilization Fund/Flexible Portion: public safety and other government services		493.0	493.0
Special Education		20.5	20.5
Child Care		5.7	5.7
<b>Expenditures Subtotal</b>	<b>832.8</b>	<b>329.1</b>	<b>1,161.9</b>
MA Cost Containment		329.1	329.1
Cost Containment from Current Year	566.8		566.8
Cost Containment from Prior Years	266.0		266.0

## Taxes and Revenue Modifications

While the chart above provides a list of the revenue increases assumed in the proposed budget, a few additional facts are worth noting:

- PA is currently the only state that does not tax cigars and smokeless **tobacco**. The proposed rate is 36 cents per ounce of smokeless and loose tobacco and 36 cents per 10 sticks of cigars and cigarillos.

- The **severance tax on natural gas** is aimed at tapping into the vast reserves held within the Marcellus Shale formation. This is expected to generate \$107 million in the General Fund. The proposed rate is five percent of value of the natural gas at the wellhead plus 4.7 cents per thousand cubic feet of natural gas severed (assumed effective October 1, 2009). This is the same rate and rate structure used by West Virginia.
- The **Capitol Stock and Franchise Tax** will continue to be phased out. The rate in 2008 was 2.89 mills. The rate for calendar year 2009 will be 1.89 mills.

### Transfers from Other Funds

The proposed budget transfers a total of \$1.1 billion over two years from other funds to the General Fund in order to help close the gap. For 2008/09, \$250 million from the **Budget Stabilization (Rainy Day) Fund** and \$174 million from the Oil and Gas Lease fund will be transferred to the General Fund. For 2009/10, \$350 million from the **Health Care Provider Retention Account (HCPRA)** and \$375 million from the Budget Stabilization Fund will be transferred to the General Fund.

The current balance in the Budget Stabilization Fund is approximately \$750 million. Even after the proposed transfers to the General Fund, a total of \$625 million over two years, a balance of \$125 million will remain in the Fund.

Due to an improving medical malpractice insurance climate that includes reduced claims paid out of the Medical Care Availability and Reduction of Error (MCARE) fund, the current balance in the HCPRA exceeds \$600 million. The proposed budget transfers a portion of the available balance to the General Fund. In addition, the proposed budget will use the available HCPRA balance to expand enrollment in the adultBasic health insurance program and phase-out the MCARE fund. A more detailed analysis of MCARE and HCPRA proposals included in the Governor's 2009/10 budget can be found later in this document.

The 2008/09 transfer from the **Oil and Gas Lease Fund** reflects the proceeds of the Marcellus Shale base payments.

### Federal Fiscal Relief

The federal stimulus bill moving through Congress includes significant funding to the states in the form of grant programs and increased Medicaid match that would be payable over a three-year period. The proposed budget assumes total federal fiscal relief of \$1.083 billion in 2008/09 and \$2.436 billion in 2009/10, most of which reflects an increase in the federal medical assistance participation (FMAP) to help states maintain their Medicaid program.

The federal government currently reimburses Pennsylvania for approximately 54.5 % of its Medical Assistance costs (Medical Assistance is the name of Pennsylvania's Medicaid program). The federal stimulus bill that passed the U.S.

House increases the federal reimbursement for nine quarters, beginning October 2008 through December 2010. Each state would receive an across-the-board increase in its FMAP of 4.9 percentage points – this would increase the federal reimbursement for Pennsylvania to 59.4%. In addition, states with rising unemployment would receive an additional increase in their FMAP directly related to their unemployment rate. **As a condition of receiving increased federal reimbursement, states cannot restrict their Medicaid eligibility below what was in effect July 1, 2008.**

Depending upon the unemployment rate, Governor Rendell is assuming the federal Medicaid reimbursement to Pennsylvania will be between 62 percent and 66 percent over the next two years, reflecting an FMAP increase between 7.5% and 11.5%. Given this projected increase in Pennsylvania's FMAP, the budget anticipates \$1.083 billion in additional federal Medicaid match for three quarters in the current 2008/09 fiscal year and \$1.917 billion for all four quarters in the 2009/10 fiscal year. Of course, the actual amount of federal match will depend upon the final FMAP provisions enacted by Congress and signed by President Obama. Each one percent increase of FMAP would bring significant funds to Pennsylvania – based on the federal Medicaid funds in the enacted 2008/09 budget, we estimate each one percent is worth approximately \$160 million.

The U.S. House version of fiscal stimulus also establishes a State Fiscal Stabilization Fund (SFSF) that provides grants to states, of which 61 percent is earmarked for education and 39 percent is a flexible grant that can be used for "public safety and other government services." Pennsylvania's allocation of the SFSF grants (which would be released in two equal payments) is expected to total \$1.26 billion each in 2009/10 and 2010/11. The Governor proposes using the flexible portion of the grant, or \$493 million, to offset the rising cost of corrections in the 2009/10 budget. (The education portion of the grant would go directly to school districts as set forth in the federal legislation).

In addition to the SFSF grants, the proposed 2009/10 budget uses two other federal grants that are anticipated in the federal stimulus act: \$20.5 million of IDEA (Individuals with Disabilities Education Act) grants to support special education and \$5.7 million of Child Care Development Block Grant for additional child care assistance for low-income working families.

### **Cost Containment Measures**

The proposed budget includes a total of \$1.2 billion in cost containment measures over two years. This includes about \$823 million in prior year lapses (\$266 million) and budgetary freezes (\$567 million). These cuts include a \$175 million reduction in prior year balances in Legislative appropriations and \$36 million in cuts to current year appropriations for independent agencies.

The Governor's proposal also includes significant cost containment measures for the Medical Assistance program which are expected to save the state \$329 million in 2009/10. The projected savings increase to \$616 million in 2010/11

when the measures are fully implemented. Two initiatives account for the bulk of the proposed savings: a new **two percent assessment on all managed care organizations** to replace the existing assessment that is set to expire September 30, 2009 in accordance with federal law; and a new **Smart Pharmacy program** that carves-out pharmacy from managed care. Other initiatives include reducing supplemental payments to hospitals, increasing behavioral health managed care efficiencies, increasing Access Plus (fee-for-service) efficiencies, reducing fraud and abuse, and expanding third party liability. A more detailed description of the proposed cost containment measures can be found in the Medical Assistance section of this document.

### **A Proposal with Many Variables**

As the Governor's proposed budget is considered, the commonwealth must proceed cautiously. In this economic climate, the projected revenue shortfall of \$2.3 billion may deepen as the current year progresses. In addition, the final federal stimulus package passed by Congress may not include the assumptions around which the Governor's proposal is built.

In addition to monitoring the variables that may affect 2008/09 and 2009/10 revenues, the commonwealth must also consider an out-year structural problem. Under the federal stimulus proposals in Congress, funds available to the states will begin to disappear in 2010/11. The commonwealth will then need to account for this disappearing revenue source. Likewise, any one-time funding sources included in the proposed budget, such as transfers from other funds will need to be accounted for in future years.

In addition, other fiscal issues in future years will place a strain on the commonwealth's budget. An aging baby boom population and health care inflation will continue to drive expenditures. In addition, Act 44 of 2007 assumed an estimated \$473 million would be available in 2010/11 from tolling Interstate 80, which is now not plausible. Another large cost-driver in the out-years will be the anticipated \$2.8 billion needed in 2012/13 to address legally mandated retirement costs relating to public school and state employees. The increase in cost is due to unfavorable investment markets from 2001 to 2003 and the current year as well as the impact of Act 38 of 2002 and Act 40 of 2003. These acts improved retirement benefits and made changes to the way investment gains and losses are recognized.

### **2009/10 Proposed Budget Expenditures**

The Department of Education (PDE) and Department of Public Welfare (DPW) comprise the largest proportion of state General Fund spending, representing 42 percent and 37 percent of state expenditures respectively. The proposed budget includes some increased spending in these areas, as well as for the Department of Corrections (\$164 million) and debt service (\$38 million).

Additionally, the budget proposes to reorganize the Department of Aging by moving three long term living programs currently funded in DPW: Medical

Assistance long term care, attendant care and services to persons with disabilities. This new agency will be called the Department of Aging and Long Term Living and will have a \$5.1 billion total budget (state, federal and other funds).

In general, the proposed 2009/10 budget significantly reduces or eliminates many appropriations when compared to the amounts included in the 2008/09 enacted budget. For many agencies and departments, the proposed budget cuts appropriations that fund payroll and operating expenses, known as General Government Operations, by 5 to 6%. The proposed budget assumes a reduction of 2,600 positions in the state complement, largely due to eliminating vacant positions. The proposed budget also reduces the appropriations for the offices of elected officials, including the General Assembly, row offices and the Judiciary by six percent.

A General Fund printout provides a detailed list of all appropriations and how they change in the proposed budget. A copy of the printout can be found on our website, <http://www.hacd.net>. Highlights regarding major program areas follow.

## Education

Fiscal year 2009/10 marks the second year in the Governor's proposed \$2.6 billion, six-year goal to provide districts with adequate funding as defined in the State Board of Education's "costing-out study". The Governor's 2009/10 budget continues towards that funding goal by including nearly \$5.5 billion for the basic education subsidy payment to the 501 school districts, representing an increase of 5.7% or \$300 million. Because this amount falls short of the original second year subsidy amount necessary to achieve the six year funding goal, an additional year will be required to meet the adequacy target for all districts.

The Pennsylvania Accountability Grants, Education Assistance Program, and Basic Ed Formula Enhancement program, formerly separate line items in the education budget, will be folded into the basic education subsidy payment to districts. The combined amount (\$338 million) for these three programs, reflected in the Basic Education appropriation, is in addition to the \$300 million subsidy increase. The **Accountability Block Grant** was introduced in the 2004/05 budget to provide funding for programs such as pre-kindergarten, full-day kindergarten, and class size reduction. Specialized tutoring programs are provided to academically-challenged school districts and career and technical centers through the **Education Assistance Program**. At the start of the 2007/08 school year, students attending Duquesne High School were transferred to either East Allegheny School District or West Mifflin School District on a tuition basis. The **Basic Ed Formula Enhancement** is designated to support the remaining Duquesne education programs and other miscellaneous administrative expenses.

### ***Early Learning***

For 2009/10, funding for **Pre-K Counts** will increase by more than \$8.6 million, for a total of \$95.1 million. Pre-K Counts provides funding for early childhood learning, focusing on at-risk students. It is anticipated that nearly 13,000 children will participate in this program in 2009/10. **Head Start Supplemental Assistance**, which expands pre-K services to eligible children, remains funded at the 2008/09 level of nearly \$39.5 million. **Early Intervention** funding is geared towards providing services and support for children with developmental delays. The proposed budget includes a \$3.9 million increase, for total funding of \$189 million.

### ***Consolidation Incentives (Shared Services)***

The proposed budget expands Consolidation Incentives by \$1.5 million, for total funding of nearly \$2.5 million. The program is designed to encourage and support group purchase among school districts and consolidation of other services to increase efficiency. When this program was created in 2007/08, it was known as Shared Services.

### ***Proposed Education Initiative: Consolidation***

The governor's proposal would provide incentives to promote consolidation among school districts across the Commonwealth. He proposes a legislative commission to study consolidation and report back within one year.

### ***Special Education***

The proposed budget level funds the Special Education subsidy at \$1.02 billion. Also, the Governor anticipates additional federal relief funds in the amount of \$20.5 million. With the additional money special education programs would receive a two percent increase.

### ***Scranton State School for the Deaf***

The Governor's budget cuts funding for the Scranton State School for the Deaf. The 2008/09 appropriation of \$7.3 million has been eliminated and a Special Education Transition line of \$5.5 million has been established, for a net reduction of \$1.8 million.

### ***Governor's Schools of Excellence***

The Pennsylvania Governor's Schools of Excellence are summer residential programs on eight different college campuses across the Commonwealth. These schools are geared towards the educational needs of artistically or academically talented high school students, including the gifted. The proposed 2009/10 budget eliminates funding for this program. In 2008/09, the program received more than \$3.2 million.

### **Scotland School**

The Governor's budget closes the Scotland School for Veterans' Children effective with the Fall of 2009, saving the Commonwealth over \$10 million. This closing will affect current students, students' families, and the school's faculty and staff. It is expected that most of the current 288 students will attend their local public schools with 31 of the students in the Class of 2009. In the current fiscal year, Scotland employs 138 full-time staff as well as 48 temporary or part time workers. Scotland School is a unique state owned and operated residential school for general elementary and secondary education for children related to veterans. It is the last school of its kind in the United States. Ohio closed their similar school in 1977. The school's 183 acres and 70 buildings/structures will be transferred to Commonwealth's land managers for future disposition which will require legislative approval.

### **Community Colleges**

Community colleges offer two-year programs in the liberal arts, technology, or other areas that lead to an associate degree or certificate. State funding is distributed through a formula that establishes a base funding level for each college, provides a growth supplement, economic development stipends and capital costs.

The commonwealth, the sponsoring school district or county, and students all contribute to fund community colleges. A hold harmless clause guarantees funding of at least the previous year's amount. For 2009/10, the Governor has requested an increase of \$6.8 million, for a total amount of \$287.6 million. Of that amount, Capital Funding would receive \$46.3 million, an increase of \$1.8 million more than the previous year.

The Governor proposes to legalize a limited number of video poker machines at private clubs, taverns and other establishments and dedicate the revenue stream to higher education, including a portion for community colleges.

### **State System of Higher Education**

The State System of Higher Education (SSHE) includes 14 state universities across the Commonwealth. For 2009/10, the Governor has asked for the same amount as the prior year, for a total of \$519 million.

The Governor is proposing to double SSHE's \$65 million capital funding allocation to a total of \$130 million.

As mentioned above, the proposed funding stream for higher education would also benefit SSHE.

### State-Related Universities

Under the proposed budget, the four state-related universities (The Pennsylvania State University, The University of Pittsburgh, Temple University, and Lincoln University) would receive a six percent reduction in state support. Additionally, all lines for each university would be consolidated into a single “General Support” line for each.

University \$millions	2008/09	2009/10	\$ Change	% Change
Pennsylvania State University	\$338.37	\$318.07	(\$20.3)	(6%)
University of Pittsburgh	\$170.73	\$160.49	(\$10.24)	(6%)
Temple University	\$175.50	\$164.97	(\$10.53)	(6%)
Lincoln University	\$14.49	\$13.62	(\$0.87)	(6%)

### Libraries

The proposed budget reduces the public library subsidy by \$1.75 million, or 2.3%, for total funding of \$74 million. The library subsidy supports more than 600 library facilities and 29 district library centers across the commonwealth.

### Pennsylvania Higher Education Assistance Agency (PHEAA)

PHEAA provides higher education grants, scholarships, loan forgiveness, and other financial assistance to students and institutions. The proposed budget includes total funding of \$513.7 million, an increase of nearly 8.6% above the \$472.8 funding level of 2008/09.

Grants to students comprise the largest portion of the PHEAA state appropriation. For 2009/10, a \$45 million increase is proposed, for total funding of \$452.4 million. Of this proposed increase, \$10 million is dedicated towards providing grants to almost 10,000 additional community college students.

The **Institutional Assistance Grants** line, which provides assistance to higher education institutions that do not receive other state funds, would be reduced by \$4.2 million, for total funding of \$37.8 million. Institutions receive this allocation based upon the total number of eligible grant recipients enrolled. For 2008/09, the per capita grant amount was \$1,132; in 2009/10, it is expected that the grant amount will be reduced to \$957.

Remaining lines in the PHEAA budget will be funded at the 2008/09 level.

## Public Television Network

Funding for the Public Television Network has been transferred to the Public Television Technology line in the Executive Office budget. The greatly reduced \$2 million appropriation is designated to support network infrastructure and other public television technologies. In the 2008/09 budget, the Public Television Network received a total appropriation of \$12.3 million, which included \$3.7 million for general operations, \$583,000 for broadcast standards data upgrades, and \$7.9 million in public television station grants.

## Medical Assistance

The state Medical Assistance (MA) appropriations in the Executive Budget reflect the current federal Medicaid reimbursement of approximately 54.5% and do not take into account any increased FMAP (federal medical assistance participation) for Pennsylvania under federal fiscal stimulus. Each additional dollar of federal Medicaid reimbursement that Pennsylvania receives under a higher FMAP will result in a concomitant reduction in the state MA appropriations. Consequently, each of the MA appropriations will ultimately be reduced to reflect the FMAP provisions that are finally enacted in the federal fiscal stimulus bill signed by President Obama.

The 2009/10 budget proposes \$5.8 billion in state General Funds for the five major MA appropriations: Outpatient, Inpatient, Capitation, Long Term Care, and Payment to Federal Government for Medicare Drug Program. This represents a \$549 million (or 10.4%) increase over 2008/09.

Major cost drivers in the 2009/10 MA budget are summarized below:

- Growth in MA caseload and utilization of services accounts for \$130 million of increased spending need. **The number of Pennsylvanians enrolled in MA is expected to reach 2,022,000 during 2009/10**, an increase of 3.2% over the current year.
- Funding certain delayed payments will cost \$220 million. Specifically, the 2008/09 budget funded only 11 monthly payments to managed care organizations that provide physical health care to MA recipients and only 11 monthly payments to the federal government for the cost of MA recipients who receive drug benefits through the Medicare Part D program. The 2009/10 budget reflects the cost of resuming twelve monthly payments to managed care organizations and the federal government.
- Rising health care costs account for \$103 million of the proposed state increase – the requested funds provide for an increase in managed care rates to meet federal requirements for actuarially sound rates. In addition, the mandated state payment to the federal government for Medicare Part D will increase \$41 million, reflecting the federal increase in premium

costs charged to the states. **No funds are budgeted for rate increases for nursing homes or hospitals.**

- The need to replace revenue that was used in 2008/09 to pay for MA, but is no longer available in 2009/10, totals \$405 million. It includes the following non-recurring revenue: county intergovernmental transfer (IGT) funds and state special funds (such as the Lottery Fund and Tobacco Settlement Fund) that helped pay for long term care; unspent state General Funds from prior years that were carried over to pay current year MA bills; and revenue from the managed care assessment that supported the managed care program. The existing managed care assessment will terminate after September 30, 2009 as the result of provisions in the Federal Deficit Reduction Act of 2005 – an alternative assessment is proposed as one of the cost containment measures explained below.

The Executive Budget includes the following initiatives which are anticipated to reduce state costs by \$329 million in 2009/10:

- In response to federal requirements that take effect October 1, 2009, Governor Rendell is proposing to levy a new statewide two percent assessment on all managed care organizations. The existing assessment, first implemented in 2005, applies only to those managed care organizations that are MA providers and finances the rate increases paid to these providers by drawing down additional federal Medicaid matching funds. However, the Federal Deficit Reduction Act imposed new rules that require states to impose the assessment on all managed care plans (not just those that serve MA beneficiaries) in order to earn Medicaid match. The proposed two percent statewide assessment would begin January 2010 and is expected to generate state savings of \$200 million in 2009/10.
- In order to maximize federal drug rebates, Governor Rendell is proposing to implement the Smart Pharmacy Program which would give the Department of Public Welfare responsibility for administering pharmacy benefits currently managed by the HealthChoices managed care providers. The pharmacy carve-out is expected to save the state \$54 million in 2009/10.
- The Governor is proposing \$20 million in across-the-board reductions in the supplemental payments made to hospitals in inpatient, outpatient, medical education and community access funds.
- The proposed budget includes several initiatives aimed at reducing fraud and abuse and expanding third party liability recoveries. These initiatives, which include implementing a Medical Assistance false claims act, are expected to generate state savings of \$15.7 million in 2009/10.

- Finally, the proposed budget includes several initiatives to increase efficiencies in fee-for-service (Access Plus) and managed care. State savings of \$4.4 million are expected in Access Plus by enhancing disease management and pharmacy management. State savings of \$35 million are expected from program modifications in behavioral health managed care which include adjustments to the level of county risk and contingency funds and tightening the treatment of reinvestment funds.

The Executive Budget does not change MA eligibility nor does it change MA benefits. However, it does propose an additional \$9.6 million in Long Term Care to expand home and community based services to 2,000 additional older Pennsylvanians.

To further reduce state General Fund spending for Long Term Care, the Executive Budget proposes to utilize \$298 million from special funds. The 2009/10 budget uses \$175 million from the Lottery Fund, a reduction of \$123.8 million from 2008/09. It also redirects \$123 million from the Tobacco Settlement Fund, a decrease of \$10.8 million from 2008/09.

### Programs for Individuals with Disabilities

Pennsylvania's budget supports programs that provide critical services to individuals with disabilities such as mental illness, mental retardation, autism, and physical disabilities. Many of the state appropriations that fund these services receive federal Medicaid matching funds and will therefore be impacted by any additional federal reimbursement that Pennsylvania receives under federal fiscal stimulus. The Executive Budget request for these state appropriations reflects the current 54.5% federal Medicaid reimbursement and so these appropriations will ultimately be reduced to reflect the FMAP provisions in the fiscal stimulus bill enacted by Congress.

The 2009/10 DPW budget includes \$800.4 million in state General Funds for the commonwealth's mental health system, which is comprised of both state hospitals and community programs operated by the county. This represents an increase of \$19 million from 2008/09. Below are highlights of the proposed mental health budget:

- The Mental Health Services appropriation increases \$11.6 million, primarily to continue the current program and to annualize prior year revisions that provided enhanced services.
- The Behavioral Health Services appropriation increases \$11 million to replace county Intergovernmental Transfer (IGT) funds that are no longer available to help fund services.

The 2009/10 DPW budget includes \$1.25 billion in state General Funds for the commonwealth's mental retardation (MR) system, which is comprised of both

institutional care and community programs. This represents an increase of \$73 million from 2008/09. Most of the increase is for community programs which are now funded through two appropriations: Community MR –Waiver Program (which is an entitlement for enrolled individuals) and Community MR- Base Program. Below are highlights of the proposed MR budget:

- The Community MR Waiver Program increases \$41.7 million in 2009/10. This includes \$15 million to provide services for 793 additional individuals who are expected to require emergency services, including 500 young people leaving the special education system.
- The Community MR Base Program increases \$13.6 million, primarily to continue the current program and to annualize prior year revisions that provided enhanced services.
- Autism and Intervention Services increase \$6.9 million to continue the current program and to increase services for 235 adults.

The 2009/10 budget for the Department of Aging and Long Term Living includes \$231 million in state General Funds for home and community-based programs that serve non-elderly individuals with physical disabilities. These programs are funded through the Attendant Care appropriation and the Services to Persons with Disabilities appropriation. The proposed state appropriations represent a \$45.8 million increase for these programs, a portion of which funds the expansion of services as summarized below:

- Attendant Care increases \$25.16 million, including \$7.2 million to provide home and community based services to 800 additional individuals with disabilities. In addition, \$15.3 million of the increase is requested to replace IGT funds that are no longer available to help fund the program.
- Services to Persons with Disabilities increases \$20.7 million, including \$9.3 million to provide home and community based services to 800 additional individuals with disabilities. In addition, \$9.3 million of the increase is requested to replace IGT funds that are no longer available to help fund the program.

## **Other Health and Human Services**

### ***Medical Care Availability and Reduction of Error (MCARE) Fund and Health Care Provider Retention Account (HCPRA)***

The proposed budget restructures the Medical Care Availability and Reduction of Error (MCARE) Fund. In addition, the proposed budget redirects the balance of the Health Care Provider Retention Account (HCPRA) and the cigarette tax revenue currently deposited into the account for other purposes.

Under Act 13 of 2002, health care providers in Pennsylvania receive medical malpractice insurance coverage for covering claims exceeding \$500,000 per occurrence through the Medical Care Availability and Reduction of Error (MCARE) Fund. For medical malpractice claims up to \$500,000, health care providers must purchase medical malpractice coverage from private insurers. Act 13 of 2002, establishes a phase-out of MCARE coverage, eventually shifting all medical malpractice insurance coverage to private providers.

Since 2003, the MCARE Fund has received the following revenue sources: (1) assessments on health care providers; (2) transfers from the Health Care Provider Retention Account (HCPRA) to cover assessment abatements; (3) revenue related to traffic moving violations via the AutoCAT Fund; and (4) interest earnings on the MCARE Fund.

Provider assessments provide the largest revenue source to the fund. Assessments are calculated based on a formula outlined in the MCARE Act. The formula examines the number of payout claims in the previous calendar year and any projected operating expenses in the current calendar year. The formula also accounts for a ten percent cushion. Due to the nature of the formula, in years where claims are declining, providers pay more into the Fund that is required to cover claim payouts in the current year.

In 2003, the Governor, Legislature and Judiciary took action to address escalating costs in medical malpractice insurance. These reforms included an assessment abatement program funded through a 25 cents per pack tax on cigarettes which is deposited the Health Care Provider Retention Account (HCPRA). As a result of these reforms, the amount of MCARE claim payments has dropped significantly since 2003.

As mentioned above, when claims decline, assessment revenues exceed the amount necessary to fund claim payouts in the current year. Therefore, transfers from the HCPRA only were necessary in 2004 and 2005 in order to cover claim costs. As a result, the HCPRA currently has a balance exceeding \$600 million.

Largely through the availability of HCPRA funds, the proposed budget continues the phase-out of MCARE. MCARE is operated on a “pay-as-you-go” basis. When court judgments and settlements occur, MCARE makes annual payments to cover the obligations. Claim payments often occur years after the alleged incident. As a result, even after the shift to private insurance coverage, MCARE will continue to make claims payments for several decades, known as a “tail.” The proposed budget would “pre-pay” the liability of the MCARE fund through the following sources: (1) \$280 million from the HCPRA; (2) continued dedication of AutoCAT Fund revenues (approximately \$44 million annually); (3) the current balance of the MCARE Fund (approximately \$104 million); and the interest earnings on these contributions.

Please note that the proposed budget uses the remainder of the HCPRA balance toward the expansion of the adultBasic health insurance program and provides another revenue source for General Fund expenditures. Additional information on these components can be found in those relevant sections.

**Expansion of the adultBasic Health Insurance Program**

The adultBasic program currently provides basic health insurance coverage to uninsured adults age 19-65 whose household income is less than 200 percent of the federal poverty level, on a first-come, first served basis. The program currently is funded through a portion of Tobacco Settlement funds and revenue made available through the Community Health Reinvestment (CHR) Agreement with the four blue cross and blue shield organizations in the commonwealth.

The demand for coverage exceeds the availability of funds for the program. Therefore, a waiting list for the program exists. The waiting list had over 165,000 individuals as of January 2009. As of January 2009, enrollment in the program was approximately 45,600 adults.

The proposed budget utilizes additional funding sources to provide coverage to approximately 50,000 more uninsured adults and include prescription drug coverage for all enrollees for the first time. Specifically, the expansion would be funded through a portion of available funds in the Health Care Provider Retention Account (HCPRA), pursuing federal Medicaid dollars and enrollee premiums.

<b>Expansion of the adultBasic Health Insurance Program</b>				
<i>(in thousands)</i>				
	<b>2009/10</b>	<b>2010/2011</b>	<b>2011/12</b>	<b>2012/13</b>
<b>State Funds</b>	<b>\$113,173</b>	<b>\$157,991</b>	<b>\$166,169</b>	<b>\$175,456</b>
<i>Tobacco Settlement</i>	<i>\$29,949</i>	<i>\$28,044</i>	<i>\$24,044</i>	<i>\$19,608</i>
<i>Community Health Reinvestment</i>	<i>\$83,224</i>	<i>\$129,947</i>	<i>\$122,802</i>	<i>\$108,763</i>
<i>Transfer from HCPRA</i>	<i>\$0</i>	<i>\$0</i>	<i>\$19,323</i>	<i>\$47,085</i>
<b>Federal Funds</b>	<b>\$132,855</b>	<b>\$185,467</b>	<b>\$195,067</b>	<b>\$205,970</b>
<b>Individual Enrollee Share</b>	<b>\$5,683</b>	<b>\$8,264</b>	<b>\$8,674</b>	<b>\$9,111</b>
<b>TOTAL FUNDS</b>	<b>\$251,711</b>	<b>\$351,722</b>	<b>\$369,910</b>	<b>\$390,537</b>

**Services for Children**

The proposed Department of Public Welfare (DPW) budget includes an increase of \$9 million for **child welfare services** and \$4 million for **Youth Development Institutions**. As part of the child welfare budget, the proposal includes \$25.5 million for the use of evidence-based in-home services; \$21.7 million for outcomes-based services, known as Pennsylvania Promising Practices; and \$27.3 million for adoption services.

The proposed DPW budget also includes an additional \$20.6 million to provide **child care services** to an additional 6,477 children in 2009/10 and support Keystone STARS providers in improving service quality. The budget also

includes \$8.8 million to allow an additional 1,872 children, from birth through age three to receive early intervention services.

### ***Income Maintenance***

The Department of Public Welfare's (DPW) budget includes funding for needy families as they move from government dependence to self-sufficiency.

The **Cash Grants** appropriation funds time-limited cash assistance and supportive services (transportation, clothing, etc.) to people who meet income and resource guidelines and comply with work activity requirements. The proposed budget includes an additional \$12.8 million due to anticipated caseload increases in the Cash Grants appropriation.

The **New Directions** appropriation funds employment and training supports for individuals receiving cash assistance. The proposed budget includes an additional \$2.1 million for this program.

In addition, the **Supplemental Grants** appropriation provides funding to supplement Federal benefits paid to aged, blind, and disabled recipients under the Supplemental Security Income program. The proposed budget increases this appropriation by \$25.6 million. Only \$1.9 million of this increase is attributed to an increased caseload. Over \$26.8 million is necessary to replace Intergovernmental Transfer funds that are no longer available to support the program. Part of the increase is offset by \$3 million in nonrecurring projects.

### ***Public Safety***

#### ***Pennsylvania State Police***

According to the Governor's budget, a complement of 4,500 troopers will be in place by the end of 2009/10. The State Police can expect an \$8.3 million increase in their budget for a total of \$194.7 million in 2009/10. Please note that funding for the State Police is supported by both the General Fund (27%) and the Motor License Fund (73%).

#### ***Department of Corrections***

This budget proposes a 10 percent increase to Department of Corrections (DOC) taking the Department from \$1.6 billion in 2008/09 to \$1.8 billion in 2009/10.

Pennsylvania's offender population continues to increase. The proposed budget anticipates the DOC will see an **inmate population increase from 43,206 inmates in 2005/06 to an estimated 51,083 inmates in 2009/10**. To address operating capacity issues, the Governor proposes that \$19.6 million of DOC's budget be used for an additional 1,600 beds at 10 different state correctional institutions. This budget also provides for an additional 800 beds in community corrections at a cost of \$12 million.

In 2005/06, cost per inmate per year (including health care) was roughly \$36,000; in 2009/10 cost per inmate per year (including health care) is expected to be almost \$40,000.

### ***Pennsylvania Board of Probation and Parole***

This budget provides for a 6.9% increase for the Pennsylvania Board of Probation and Parole. The Board would receive nearly \$123 million for 2009/10 and an additional \$2 million is included in this budget to provide for additional parole officers to effectively supervise parolees and to avoid repeat victimization after release.

### ***Prison Package***

In September 2008, the Governor signed a comprehensive package of legislation that is expected to reduce recidivism rates and address prison capacity issues related to non-violent offenders. Admission rates for less-serious offenders have increased at a far greater pace over the last eight years than the admission rate of violent offenders. In 2000, less violent offenders made up 28 percent of the prison population, while today that figure is 40 percent.

A projected five-year savings of \$84.5 million is anticipated as a result of this legislation. Savings for both the Department of Corrections and the Board of Probation and Parole as a result of the enacted legislation may have been offset by a recent moratorium on probation and parole. This moratorium resulted in a backlog of inmates in SCIs across the Commonwealth and it included non-violent offenders who were the focus of the recently enacted legislation. On October 20, 2008, the Governor lifted the moratorium for non-violent offenders; the moratorium on violent offenders was lifted on November 30, 2008.

### ***Proposed Legislation***

The Governor has proposed legislation that would change the sentencing structure by establishing flat, determinate sentences for repeat violent offenders who use deadly weapons, followed by a five-year period of post-release supervision. The Governor's proposed changes in sentencing will ensure a longer prison term and end the possibility of parole for these repeat violent offenders. The legislature will have to take into consideration the increased costs associated with longer prison sentences and longer parole supervision when making policy decisions related to sentencing, prison capacity, and public safety.

### ***Economic Development***

The Governor is proposing that the Commonwealth Financing Authority (CFA) leverage existing assets to generate an additional \$100 million for economic development purposes. Sixty million dollars will be used for the **Business in Our Sites** (BIOS) Program to provide loans and grants to local municipalities for the acquisition and development of sites for future use by businesses, and \$40 million will be invested in water and wastewater infrastructure projects.

The **Second Stage Loan Program** (SSLP) offers guarantees for bank loans to second stage (2-7 years old) manufacturers, advanced technology, and life sciences businesses. The SSLP is administered through the Commonwealth Financing Authority (CFA). The Governor proposes dedicating an additional \$100 million to the program, expanding the program to include other fields, and eliminating time limitations.

The **Infrastructure Facilities Improvement Grants Program** provides financial assistance in the form of multiyear grants for debt service that was incurred for the costs of certain infrastructure and facilities improvement projects. The 2009/10 proposed budget includes a \$10 million increase for the Infrastructure Facilities Improvement Grants Program appropriation.

The Governor's 2009/10 proposed budget includes a continued restructuring of the tourism industry in Pennsylvania. As a result of the Governor's regionalized approach to invest in and market the state's tourism, several tourism program appropriations within DCED have been cut. This initiative will result in a total reduction of over \$18.6 million. The affected programs include Tourist Promotion Assistance, Tourism – Accredited Zoos, Marketing to Attract Businesses, Marketing to Attract Tourists, and Tourist Product Development.

The 2009/10 proposed budget includes significant appropriation decreases and the elimination of some programs within DCED. See the 2009/10 budget printout for more details.

### ***Energy and Natural Resources***

The Consumer Energy Program was established via the Alternative Energy Investment Act (Special Session 1, Act 1 of 2008). The program provides loans, grants, reimbursements and rebates to individuals and small businesses for consumer energy conservations projects. The program is administered through the Department of Environmental Protection (DEP). In accordance with the Alternative Energy Investment Act, the proposed appropriation for the Consumer Energy Program for 2009/10 is \$15 million.

### ***Pennsylvania Housing Finance Agency (PHFA)***

The Governor proposes level funding of \$11 million for the Homeowners Emergency Mortgage Assistance Program (HEMAP). His budget does not renew his request for a program to fund early childhood education capital. The current-year budget includes \$1.23 million for this initiative.

### **Infrastructure**

The Governor proposes borrowing an additional \$534.5 million for Rebuild Pennsylvania initiative projects. This includes \$200 million for bridge repairs; an estimated \$190 million for water, sewer, flood control and dam projects; \$100 million for PENNVEST water and waste water projects; \$25 million for rail and aviation projects, \$15 million for rail freight assistance; and \$4.5 million for flood control projects and program support.

The Governor proposes a program that was considered in the House last session. House Bill 2542 passed the House with a vote of 136-58 on June 23, 2008, providing for the Rebuilding Pennsylvania Capital Budget Act. This legislation would have authorized the Commonwealth to issue up to \$240 million in additional debt to pay for capital projects. Project categories included buildings and structures, transportation assistance, flood control, and bridges. The Senate did not consider the legislation.

## Transportation and the Motor License Fund

The Governor is adjusting the current-year official revenue estimate to the unrestricted portion of the Motor License Fund downward by \$149.3 million (-5.5%) to \$2.6 billion. To make up the shortfall, the Governor will lapse \$98.4 million in prior year appropriations and reduce the current year's expenditures by almost \$88 million. For the budget year, the Governor anticipates the revenue will return to about \$2.7 billion, essentially equivalent to the revenue for the fiscal year that ended last June.

<b>Unrestricted Revenue Motor License Fund</b>	
2007/08 Revenue Received	2,667,931,000
2008/09 Official Revenue Estimate	2,732,585,000
<u>Adjustment (Feb. 4, 2009)</u>	<u>-149,275,000</u>
Revised 2008/09 Revenue Estimate	2,583,310,000
2009/10 Estimated Revenue	2,687,550,000

Under the Governor's proposal, the Department of Transportation (PennDOT) will absorb nearly the entire impact of the anticipated revenue reduction. The Governor proposes to increase by 5.1% the Motor License Fund appropriations for the State Police a total \$523.9 million. In addition, he proposes to increase expenditures for the Executive Offices (EO) by \$1.4 million or 6.2% and for the State Treasurer by \$844,000 or 2.3%. The EO increase is for a new \$2.4 million appropriation for Commonwealth Technology Services, and the Treasury Department increase is for additional debt service.

Unrestricted Motor License Fund Expenditures	Available 2008/2009	Proposed 2009/2010	Difference	
	In thousands of dollars			%
Executive Offices	22,968	24,393	1,425	6.2%
Treasury Department	35,982	36,826	844	2.3%
Department of Agriculture	3,089	3,089	0	0.0%
Department of Conservation and Natural Resources	1,000	1,000	0	0.0%
Department of Education	1,130	1,127	-3	-0.3%
Department of Environmental Protection	4,000	4,000	0	0.0%
Department of General Services	12,754	12,754	0	0.0%
Department of Revenue	26,611	26,973	362	1.4%
State Police	498,617	523,896	25,279	5.1%
Department of Transportation	2,221,727	2,087,457	-134,270	-6.0%
Unspecified Reductions (Current Year Lapses)	-87,709			
<b>Total Expenditures</b>	<b>2,740,169</b>	<b>2,721,515</b>	<b>-106,363</b>	<b>-3.9%</b>

The bulk (86%) of the reduction in PennDOT's budget—\$115.4 million—will be for appropriations relating to highway and bridge funding. In addition, the Governor proposes to reduce administrative line items in PennDOT by \$8.1 million (-4.2%) and payments to municipalities by \$10.8 million (-9.0%). The administrative savings include the elimination of 133 positions.

PennDOT Unrestricted Motor License Fund Expenditures	Available 2008/2009	Proposed 2009/2010	Difference	
	In thousands of dollars			%
Administrative Line Items	192,486	184,350	-8,136	-4.2%
State Highway and Bridge Line Items	1,287,990	1,172,607	-115,383	-9.0%
Payments to Municipalities	205,751	195,000	-10,751	-5.2%

In addition to the unrestricted portion of the Motor License Fund, the Governor anticipates receiving \$880 million in statutorily restricted revenue to the Fund. Of these funds, state highway maintenance accounts for roughly 49 percent of the funds that will be spent; grants to local governments, 16 percent; state spending on bridge construction and repair, 13 percent; highway construction, eight percent; debt service, seven percent; payments to the Pennsylvania Turnpike Commission, six percent; and aviation projects and administration, one percent.

The Governor proposes to borrow \$200 million for an estimated 367 bridge projects. With the passage of HB 2522 (Act 54) last year, the General Assembly authorized the Governor to incur debt of \$350 million for bridge projects and \$35 million for highway projects. The anticipated debt service for highway bridges for 2009/10 is \$40.2 million.

Presently the United States Congress is debating a federal fiscal package that may include funds for highway and bridge projects. The version passed by the U.S. House of Representatives included \$29.35 billion for highway and bridge projects of which Pennsylvania would receive an estimated \$1.25 billion.

## Senior Citizens and the Lottery Fund

Lottery Fund revenue in 2009/10 is projected at \$1.852 billion, a \$66 million decrease from 2008/09. The money available to spend includes: the prior year ending balance carried forward to 2009/10 (\$125 million); net Lottery collections after commissions and field prizes (\$1.528 billion); transfers from the Gaming Fund to pay for Property Tax and Rent Rebate program expansion costs under Special Session Act 1 of 2006 (\$196.1 million); and miscellaneous revenue, namely investment earnings (\$2.5 million).

This budget estimates that there will be \$143.4 million for enhanced property tax rent rebates available, which will benefit senior citizens earning up to \$35,000 per year with a rebate of up to \$650. This is new relief which was not available in the previous fiscal year. In addition to this, there will be approximately \$30.6 million available for seniors living in cities with high tax burdens.

The Governor's 2009/10 budget proposes total spending of \$1.64 billion in the Lottery Fund, a \$211 million decrease from 2008/09. This would leave an ending balance in the Lottery Fund of \$110.6 million.

## Mass Transit under the Public Transportation Trust Fund and the Public Transportation Assistance Fund

State support for public transportation comes through two funds: the Public Transportation Trust Fund and the Public Transportation Assistance Fund. The Public Transportation Trust Fund was established by Act 44-2007 to provide dedicated and predictable funding linked to need and performance. The Trust Fund receives revenue from a portion of the state Sales Tax, payments from the Turnpike Commission, and transfers from the Lottery and the Public Transportation Assistance Funds.

The Governor's budget calls for \$710 million in mass transit operating grants, \$51.2 million for programs of statewide significance and \$156.83 million in capital funding for mass transit through the Asset Improvement and Capital Improvement accounts. These increases are made possible primarily by the scheduled \$50 million increase in Turnpike Commission payments under Act 44, along with modest increases in Lottery and PTAF transfers. These increases offset the decline in sales tax revenue predicted over the coming fiscal year. Total disbursements from the fund are expected to be \$922.6 million in 2009/10.

The Public Transportation Assistance Fund, established by Act 26-1991, also disburses grants to transit entities. Grants from this fund are estimated to be \$170.7 million in 2009/10. Capital Budget bond issuance devoted to transit is estimated to be \$125 million, bringing the total support for transit to \$1.21 billion.

## Property Tax Relief Fund

It is expected that homeowners will continue to receive nearly \$200 on average in property tax relief in 2009/10, which is based on a total of \$612.9 million in

gaming revenue from casinos. This is equal to the amount dispersed for property and wage tax relief in 2008/09. It includes wage tax relief for Philadelphia.

Overall there is expected to be \$769 million in total disbursements for property tax, wage tax, and property tax rent rebate relief in 2009/10. This is \$107.6 million more than the amount disbursed in 2008/09.

## Conclusion

The Governor has proposed a budget based on unprecedented assumptions. It is only a first step in the process and we will continue to monitor this spending proposal within the context of a changing economic climate and evolving federal legislation.