



Commonwealth of Pennsylvania

December 2007

Commonwealth of Pennsylvania
Governor's Mid-Year
Budget Briefing
December 12, 2007

Edward G. Rendell
Governor

Michael J. Masch
Secretary of the Budget

To find the 2007-08 Mid-Year Briefing slide show on the Web, go to www.budget.state.pa.us

Contents

| <u>Section</u> | <u>Page</u> | <u>Section</u> | <u>Page</u> |
|--|-------------|------------------------------|-------------|
| Budget Highlights and Other Key Facts | 2 | Medical Assistance | 59 |
| Pennsylvania Job Growth | 12 | PACE Plus Medicare | 70 |
| The Potential for Slowing Economic Growth | 15 | Public Safety and Security | 72 |
| Housing Market Conditions | 21 | Transportation Funding | 79 |
| Education | 25 | The Rainy Day Fund | 88 |
| Gaming; Property Tax/Rent Rebate Program | 42 | Business Tax Cuts | 90 |
| Prescription for Pennsylvania | 48 | 2007-08 Unfinished Business | 95 |
| Caring for Pennsylvanians in Need | 53 | Deferred 2007-08 Initiatives | 96 |
| | | Pension Funding Reform | 100 |
| | | Business Tax Reform | 104 |
| | | Commonwealth Debt | 110 |

2007-08 Enacted Budget Highlights

The 2007-08 enacted budget invests in our children, promotes job creation, resolves the public transportation crisis and preserves the social safety net that protects the elderly, people with disabilities and other Pennsylvanians in need.

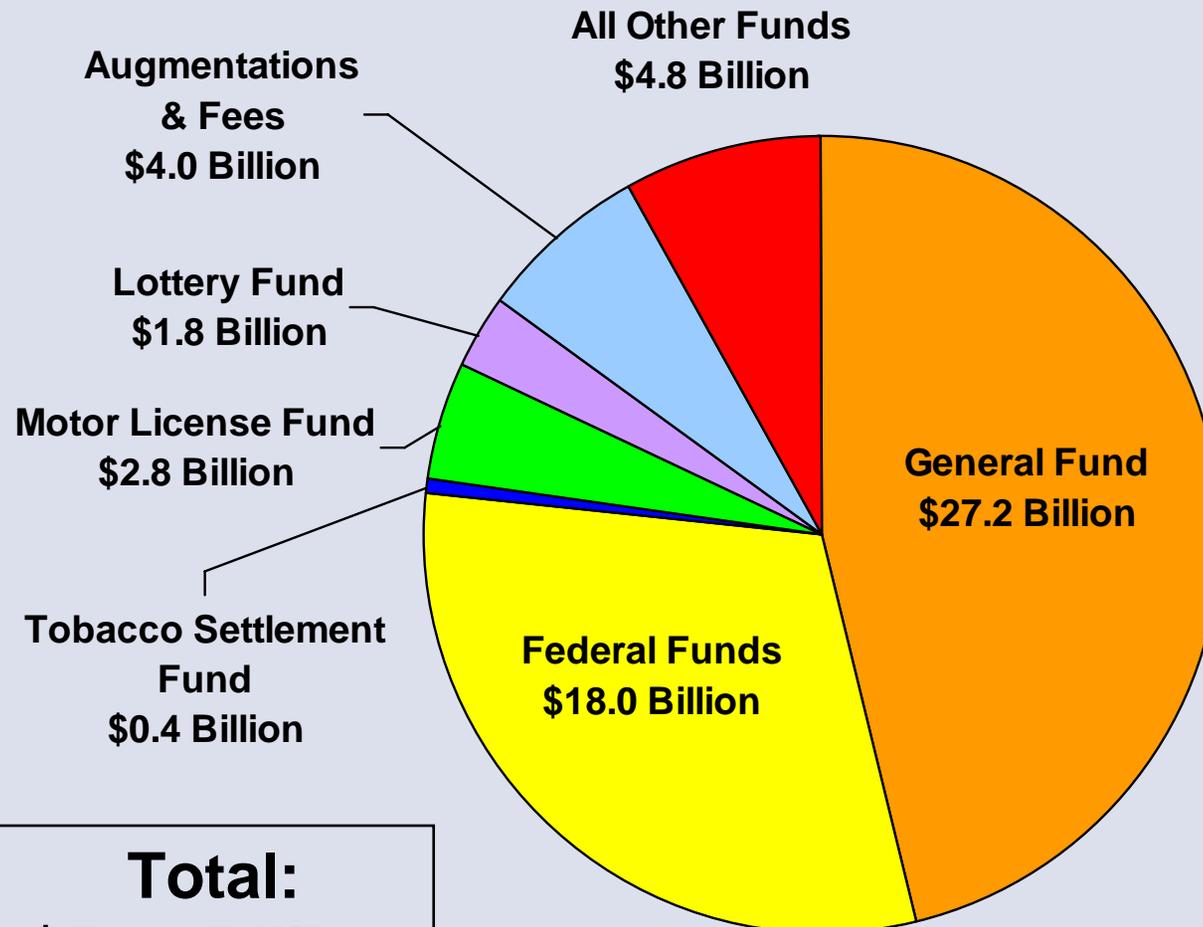
- The enacted 2007-08 General Fund budget is **\$27.2 billion**, an increase of 3.2 percent over 2006-07. In the enacted budget, \$320 million of mass transit funding is shifted to the new Public Transportation Trust Fund. If not for that shift, the enacted budget would have increased by 4.4 percent.
- More than two-thirds of the increase in the General Fund budget, or \$600 million, is for **Education (PreK-12 and Higher Education)**.
- The enacted 2007-08 General Fund budget limits spending growth to less than one percent in all areas other than Education, Public Welfare, Corrections and Probation and Parole, while improving many vital state-supported services.
- The enacted budget contains additional funding to address continuing offender population growth and new resources to reduce the rate of prison re-entry.
- The enacted budget also continues investments to make appropriate options available for long-term living.
- Administrative spending in 2007-08 is 2.3 percent below 2002-03 levels.

2007-08 General Fund Financial Statement

Dollars in Millions

| | <u>2006-07</u> Available | <u>2007-08</u> Budget |
|---------------------------------------|-----------------------------|--------------------------|
| Beginning Balance | \$ 514 | \$ 531 |
| Adjustment to Beginning Balance . . | 8 | |
| Receipts | 26,399 | 26,641 |
| Prior Year Lapses | 85 | |
| Funds Available | <u>\$ 27,006</u> | <u>\$ 27,172</u> |
| Expenditures | \$ - 26,122 | \$ - 27,162 |
| Supplemental Appropriations | - 197 | |
| Current Year Lapses | 21 | |
| Preliminary Balance | <u>\$ 708</u> | <u>\$ 10</u> |
| Transfer to Rainy Day Fund | <u>- 177</u> | <u>- 3</u> |
| Ending Balance | <u><u>\$ 531</u></u> | <u><u>\$ 7</u></u> |

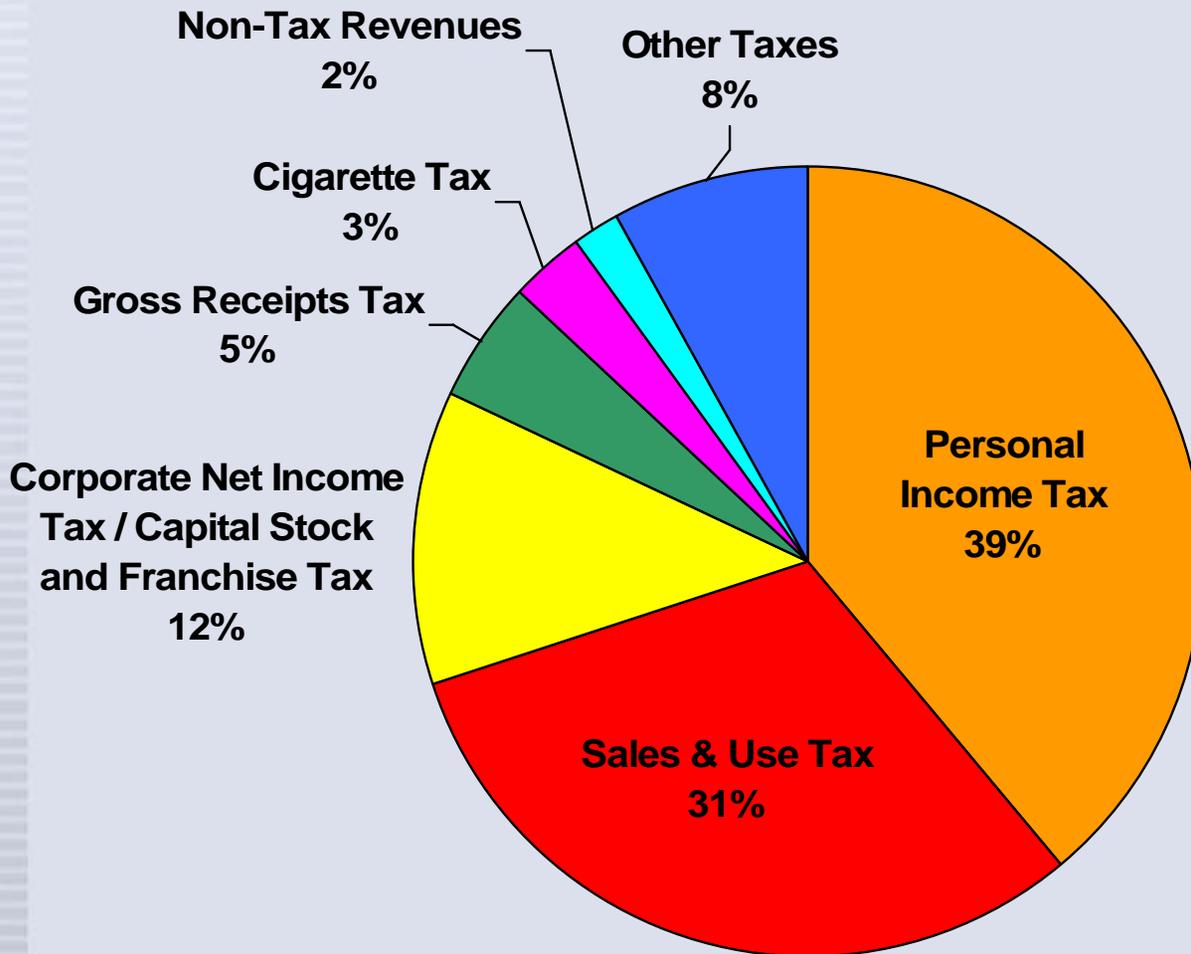
2007-08 Total Operating Budget



The total 2007-08 operating budget, including all commonwealth funds, is \$59.0 billion. The General Fund represents 46 percent of this amount.

**Total:
\$59.0 Billion**

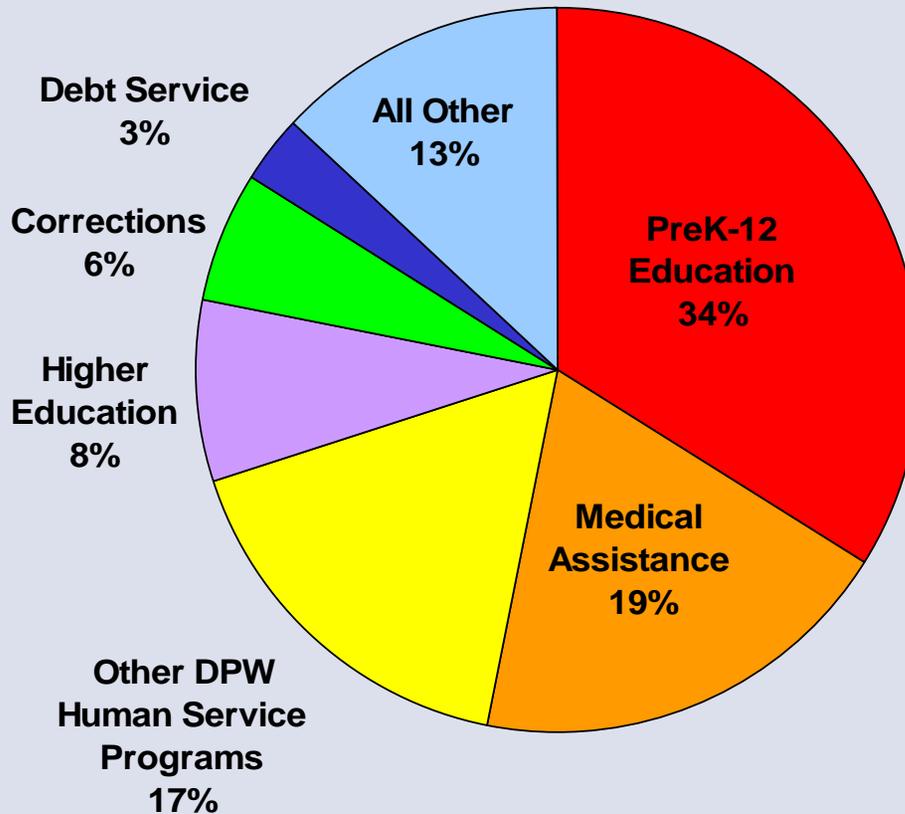
2007-08 General Fund Revenue Sources



More than two-thirds (70 percent) of General Fund revenues are derived from the Personal Income Tax and the Sales & Use Tax.

2007-08 General Fund Expenditures

The 2007-08 General Fund budget is \$27.2 billion – an increase of \$843 million, or 3.2 percent, over 2006-07.



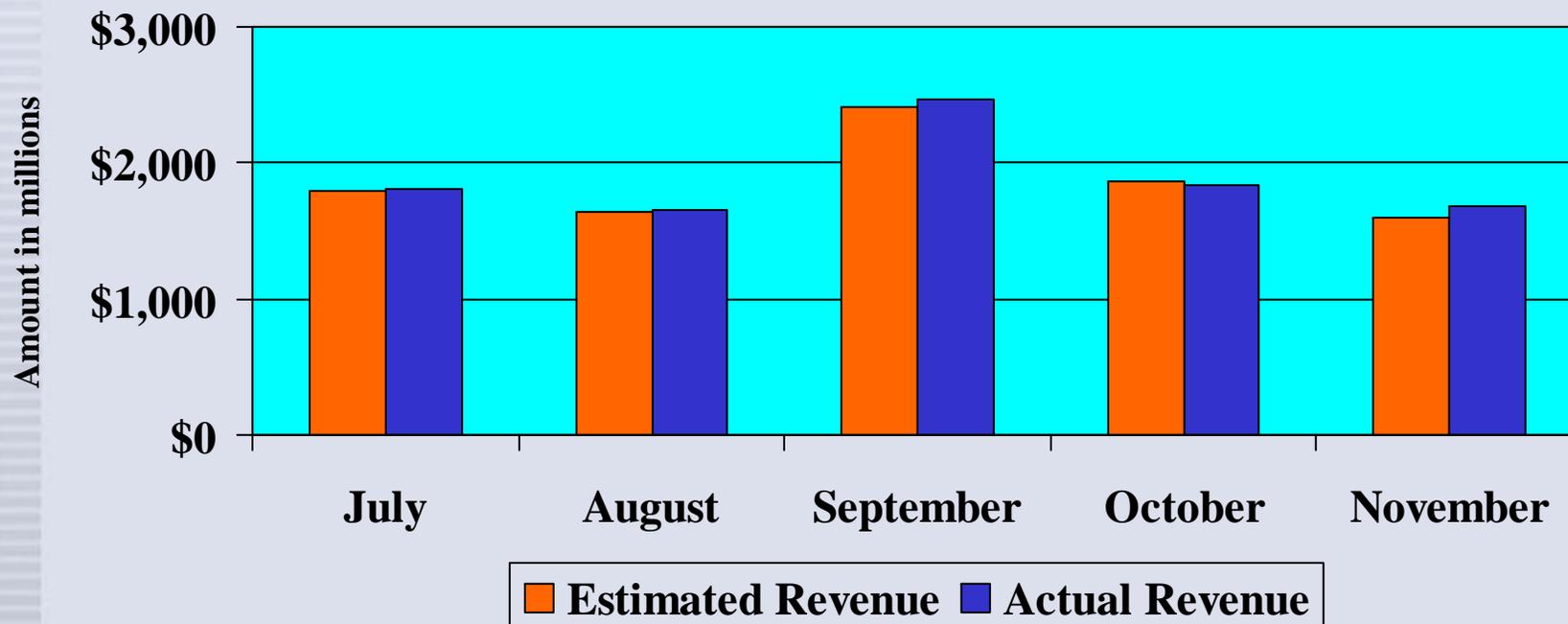
Spending on Education, Medical Assistance, other Department of Public Welfare programs, Corrections and Debt Service comprises 87 percent of total General Fund expenditures.

**Total Expenditures:
\$27.2 Billion**

General Fund Revenues

Estimated versus Actual Revenue Collections

In November, monthly collections were \$89 million higher than projected, causing year-to-date collections to rise to \$136 million or 1.5 percent above estimate. November collections exceeded estimate partly due to two one-time corporate tax settlements totaling \$48 million. Without these two settlements, year-to-date collections would be \$88 million, or 0.9 percent, above estimate.



Year-to-Date General Fund Revenues

Total commonwealth revenues closely tracked the official estimates (1.5 percent over official estimate through November). Virtually all categories of revenues were slightly ahead of the official estimates, with the exception of Sales Tax – Motor Vehicle Sales and All Other Taxes & Revenues. These revenue shortfalls were offset by higher-than-estimated collections in Business/Corporate Taxes, Sales Tax – Non-Motor Vehicles, and Real Estate Transfer Tax.

Year-to-Date - General Fund Revenues

| Revenue Source: | YTD Est. | YTD Actual | \$ Diff | % Diff |
|---------------------------------|---------------------|---------------------|-------------------|-------------|
| Sales Tax - Motor Vehicle Sales | \$ 505,800 | \$ 483,518 | \$ (22,282) | -4.4% |
| All Other Taxes & Revenues | 152,900 | 140,558 | (12,342) | -8.1% |
| Treasury Earnings | 109,500 | 108,721 | (779) | -0.7% |
| Licenses & Fees | 31,200 | 31,195 | (5) | 0.0% |
| Escheats | (2,800) | 6,271 | 9,071 | -324.0% |
| Inheritance Tax | 328,800 | 339,251 | 10,451 | 3.2% |
| Personal Income Tax | 3,659,500 | 3,673,453 | 13,953 | 0.4% |
| Cigarette Tax | 323,200 | 337,200 | 14,000 | 4.3% |
| Real Estate Transfer Tax | 198,800 | 221,390 | 22,590 | 11.4% |
| Sales Tax - Non-Motor Vehicles | 3,076,500 | 3,125,432 | 48,932 | 1.6% |
| Business/Corporate Taxes | 938,900 | 991,167 | 52,267 | 5.6% |
| TOTAL | \$ 9,322,300 | \$ 9,458,156 | \$ 135,856 | 1.5% |

2007-08 Supplemental Appropriations

(Amounts in Thousands)

2007-08 Available

Department of Education

Authority Rentals and Sinking Fund Requirements

Additional School District projects requiring funding

\$ 15,000

Department of Public Welfare

Medical Assistance – Outpatient

Utilization and cost

\$ 10,000

Medical Assistance – Capitation

Utilization and cost

\$ 15,000

Realigns funding to reflect service needs

\$ -15,000

Behavioral Health Services Transition

Realigns funding from MA-Capitation to reflect service needs

\$ 13,000

Mental Health Services

Realigns funding from MA-Capitation to reflect service needs

\$ 2,000

Total Anticipated Supplemental Appropriations

\$ 40,000



2007-08 General Fund

Projected Status

(in millions)

| | |
|---|------------|
| November 30, 2007 Balance | \$10 |
| Revenue Surplus | 136 |
| Additional Lapses | 50 |
| Supplemental Appropriations | <u>-40</u> |
| Preliminary Balance | \$156 |
| Transfer to Budget Stabilization Reserve Fund | <u>-39</u> |
| Projected June 30, 2008 Balance | \$117 |



National Growth in General Fund Budgets

Thirty-six of the 49 other states reported enacted budgets exceeding Pennsylvania's 3.2 percent rate of growth. The average spending increase for all states, compared to the prior year, is 6.2 percent.

All-States Average: 6.2%

| | | | | | |
|----------------|-------|--------------|------|---------------------|-------------|
| Oregon | 31.0% | Arkansas | 7.1% | Arizona | 3.9% |
| Montana | 24.0% | Minnesota | 7.0% | Hawaii | 3.4% |
| Utah | 21.3% | Kentucky | 7.0% | Pennsylvania | 3.2% |
| North Dakota | 17.7% | Missouri | 6.5% | Washington | 2.4% |
| Texas | 14.5% | Nebraska | 5.8% | Maryland | 1.8% |
| Mississippi | 12.8% | South Dakota | 5.8% | Louisiana | 1.2% |
| South Carolina | 12.8% | Rhode Island | 5.7% | Vermont | 0.8% |
| New Hampshire | 12.1% | Connecticut | 5.5% | California | 0.6% |
| West Virginia | 11.7% | Delaware | 5.5% | Oklahoma | 0.0% |
| North Carolina | 10.7% | Wisconsin | 5.5% | Florida | -0.2% |
| Tennessee | 10.2% | Georgia | 5.3% | Wyoming | -0.6% |
| New Jersey | 10.1% | Maine | 5.1% | Massachusetts | -1.3% |
| Idaho | 9.5% | Ohio | 5.1% | Virginia | -1.6% |
| Iowa | 8.6% | Illinois | 4.8% | New Mexico | -3.8% |
| Kansas | 8.5% | Indiana | 4.8% | Nevada | -6.4% |
| Michigan | 8.2% | Colorado | 4.8% | Alaska | -20.9% |
| Alabama | 7.1% | New York | 4.1% | | |

Source: NASBO Fiscal Survey of the States, December, 2007.

Commonwealth of Pennsylvania

December 2007

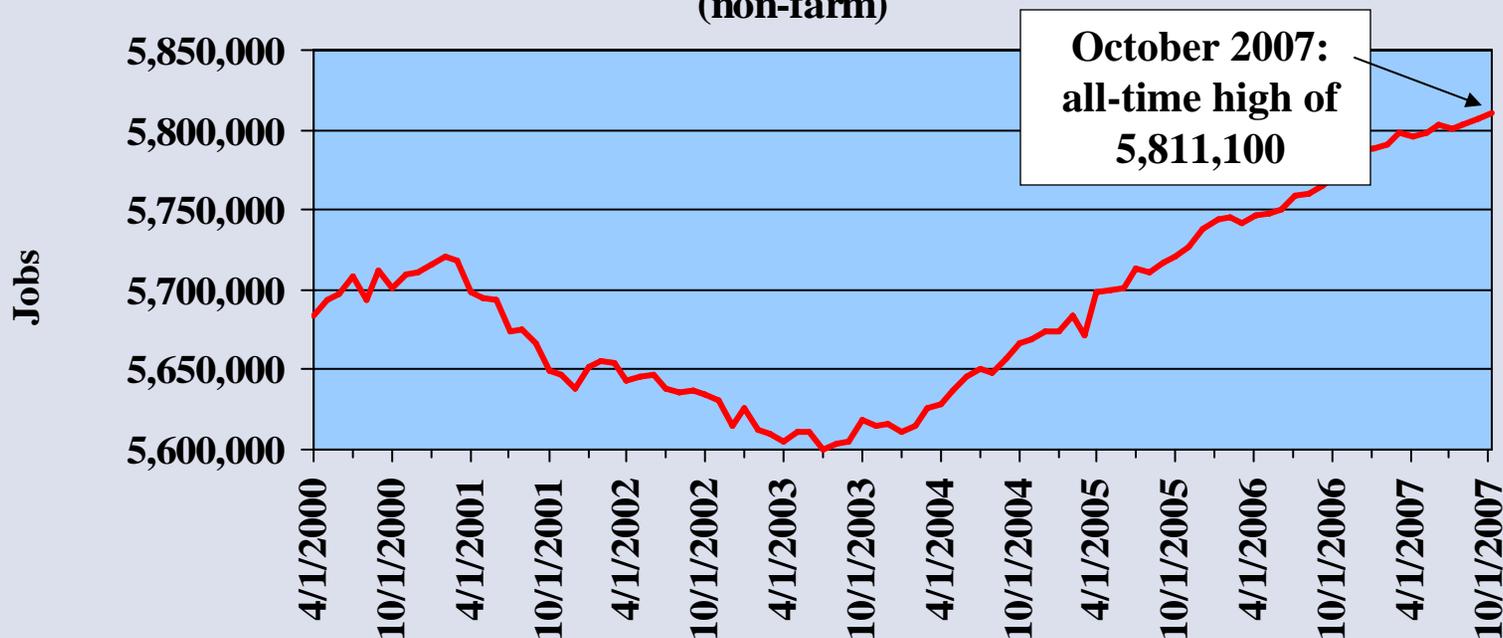
Implementing the 2007-08 Budget

Pennsylvania Job Growth

Pennsylvania Job Growth

Job growth is a key measure of Pennsylvania's improving economy since 2003. In October 2007, Pennsylvania reached a historic high in the number of non-farm jobs, seasonally adjusted. The state's monthly unemployment rate in October was 4.5 percent – marking the ninth consecutive month that the state rate has been below the national rate. Since January 2003, the Pennsylvania economy has generated a net increase of 182,900 jobs. State investments, including the Economic Stimulus program and increased investments in education and workforce development, have been major factors behind the turnaround.

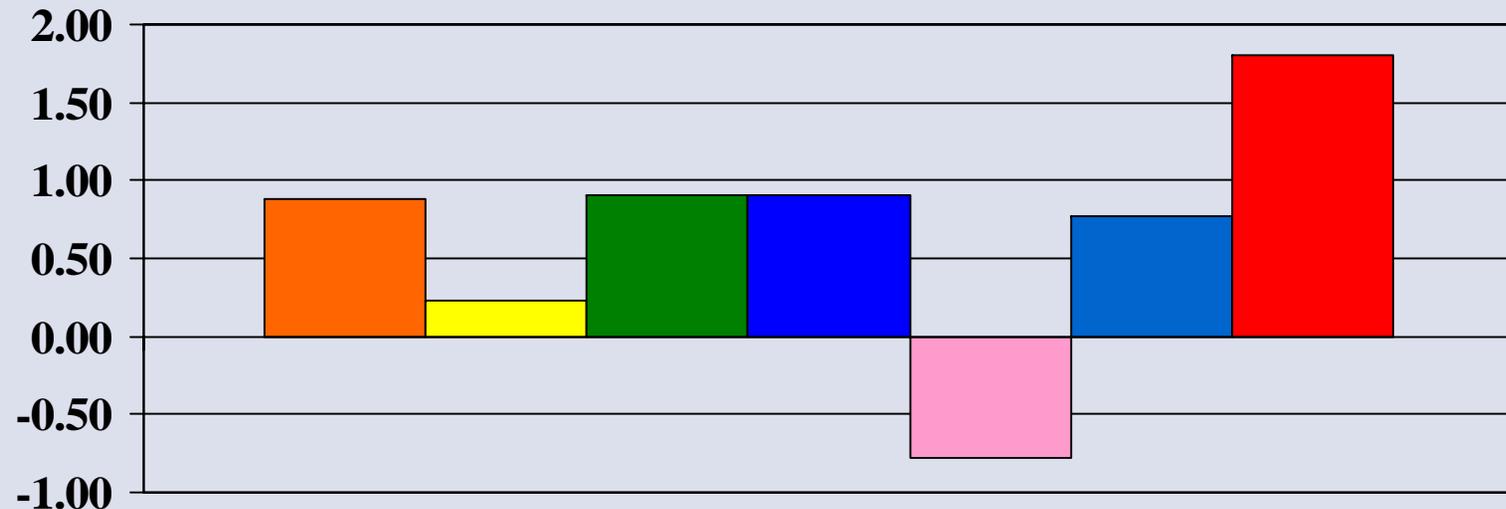
Steady Rise in Pennsylvania Jobs
(non-farm)



PA Job Growth Outperforms Similar States

For Pennsylvania, the general slowing of the U.S. economy has been offset, in part, by relatively strong job growth. Pennsylvania's job growth has routinely outperformed similar states. In 2005 and 2006, Pennsylvania had a higher average job growth rate than that of Ohio, Michigan and New Jersey.

Percent Growth **Two-Year (2005-2006) Average Annual Job Growth Rate**



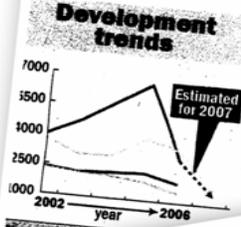
- Pennsylvania
- Ohio
- New York
- Illinois
- Michigan
- New Jersey
- United States

2007-08 Economic Outlook

**The Potential
for
Slowing
Economic
Growth**



Housing slump hurts tax coffers



The downturn could lead to tax increases by school districts and communities.

BY HILARY BENTMAN

STEVEN PEARLSTEIN

when those houses don't materialize, or when fewer existing homes are sold. Revenue is down in some cases by hundreds of thousands of dollars and it could lead to increases in the near future. The situation does not and existing home prices for school districts in several states is down, real estate transactions are flat, and increases in the district's tax base have been in the district's tax base.

Analysts Cut Expectations For Growth

BY EDMUND L. AN

WASHINGTON, The financial turmoil in the seemingly calm market is forcing Wall Street to lower their

broad economy. The "central tendency" of policy makers' individual forecasts calls for economic growth in 2008 of 1.8 percent to 2.5 percent. Growth in 2007 is expected to be 2.4 percent to 2.5 percent. As a group, Fed policy makers expect "subpar" economic growth over the next year. They also predict that unemployment will edge up to as much as 5 percent next year, compared with 4.7 percent today. The new report shows more worried about housing at

It's Not 1929, but It's the Biggest Mess Since

It was Charles Mackay, the 19th-century Scottish journalist, who observed that men go mad in herds but only come to their senses one by one. We are now only at the beginning of the financial world coming to its senses after the bursting of the biggest credit bubble the world has ever seen. Everyone seems to acknowledge now that there will be lots of mortgage foreclosures and that house prices will fall nationally

Depression. Some lenders and hedge funds have failed, while some banks have taken painful write-offs and fired executives. There's even a growing recognition that a recession is over the horizon. But let me assure you, you ain't seen nothing yet. What's important to understand is that, contrary to what you heard from President Bush, this isn't just a mortgage housing crisis. The

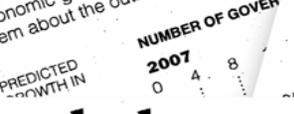
and insured all those subprime mortgages were the same ones, run by the same executives, using the same fee incentives, using the same financial technologies and risk-management systems, who originated, packaged, rated and insured home-equity loans, commercial real estate

The Fed Is Expecting a Slowdown Next Year, Not a Recession

From Page A1
officials and Wall Street over the need to reduce interest rates for the year when the Federal Open Market Committee meets on Dec.

Revised Forecasts

The minutes from the last meeting of the Federal Reserve Board of Governors gives new details on the range of their forecasts for economic growth — and how much disagreement there is among them about the outlook for 2008.



Economic Forecast Index Sees Weakness Into 2008

By Bloomberg News

The economy is expected to continue to decline according to a forecast by the Board of Governors. The index fell 0.5 percent in November, the lowest level since the recession began in 2001. The report shows that the economy is expected to grow at a slower pace than in 2007.

Fuel costs and the housing slump hurt consumer confidence.

Rising fuel costs and the housing slump spurred a drop in the consumer sentiment index in November, the lowest level since October 2005, after the hurricane Katrina. The index fell 1.1 points to 76.1 in November, down from 77.2 in October. The report shows that consumers are becoming more pessimistic about the economy's future.

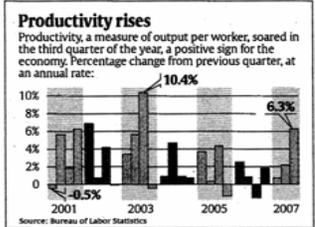
Lawmakers seek strategies to spark the economy

Housing, credit woes overshadow positives

By Sue Kirchhoff USA TODAY

WASHINGTON — The cooling economy is a hot issue on Capitol Hill. Lawmakers are sparring about proposals for new spending or tax cuts to stimulate growth, and House Speaker Nancy Pelosi, D-Calif., holds a forum Friday with noted economists and financial analysts to discuss possible moves.

The heightened concern comes amid mixed data on businesses and consumers. A private report on Wednesday showed the massive services sector slowed in November, with businesses paying sharply



time, the government said factory orders rose a bit in October, though the improvement was due to the

Productivity, a key measure of output per worker, surged at a 6.3% annual rate in the third quarter of the year. But even positive numbers are being overshadowed by a slump in the housing market and a credit crunch in financial markets. Federal Reserve officials have hinted they may have to cut interest rate targets again when they meet next week to keep the economy moving. The Fed has cut a key rate target from 5.25% to 4.5% since September. "If all these reports (Wednesday) came out in the absence of all the credit market gyrations that are occurring, you would probably conclude that the economy is doing pretty darn good," said Ken Mayland of ClearView Economics. At a House Budget Committee hearing Wednesday, the debate was over whether a recession is in the offing. Harvard economist Martin Feldstein suggested that Congress prepare a targeted tax cut to kick in if employment declines by a set amount. Feldstein also said the Fed might have to

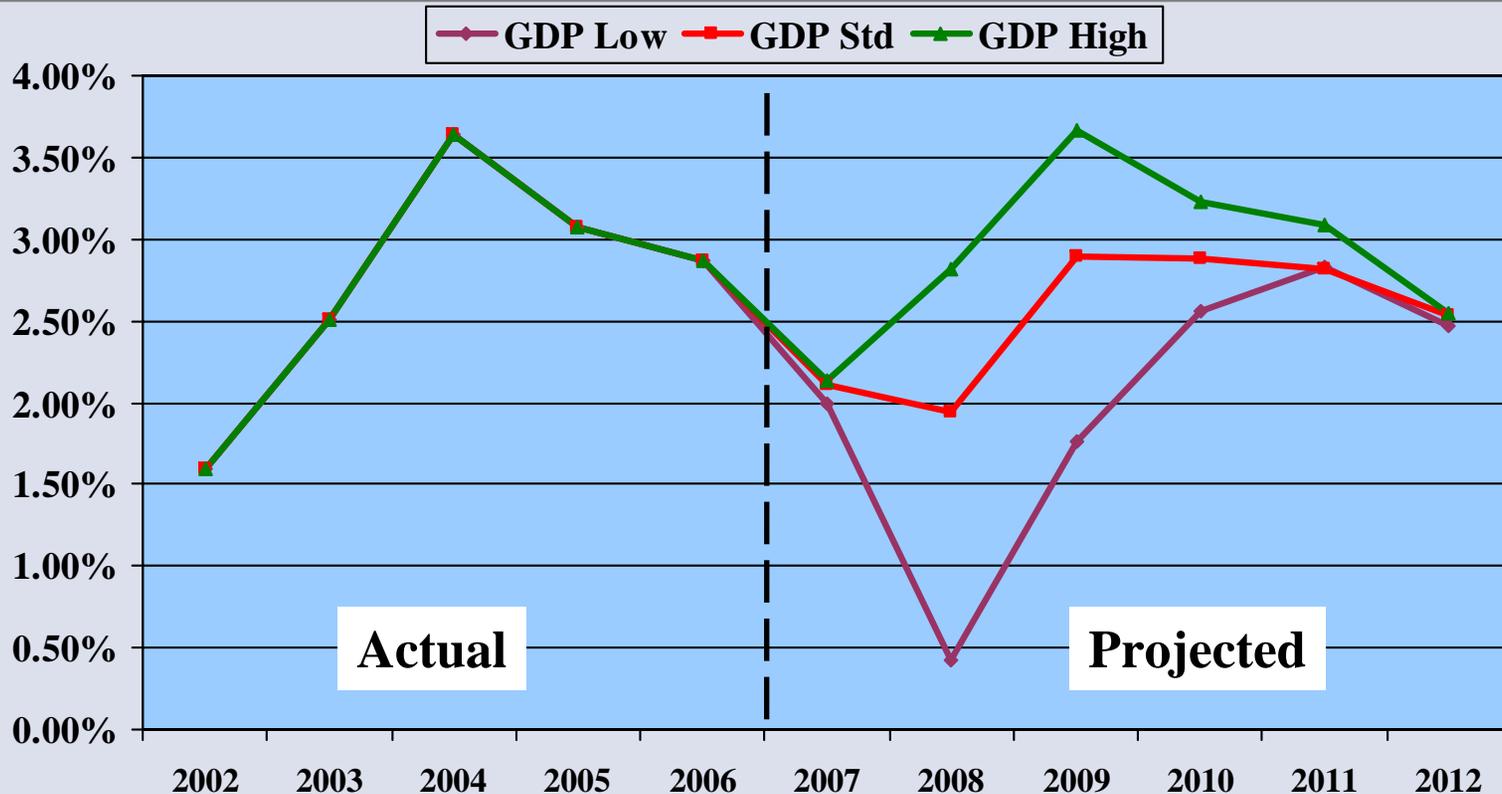
(3% interest rate) is a reasonable thing to do," Feld said, noting that the risks of slower growth outweigh possible threats of higher inflation. The hearing made it clear that Democrats and Republicans are sharply divided on tax cuts. Democrats have proposed that additional tax cuts be offset cuts in spending, for example. Also Wednesday, the U.S. Commerce Dept. issued a new outlook that predicts the economy slow to a tepid 1.9% pace in 2008, but should a recession. The key reason that the nation will sidestep a deep downturn is that factory employment is not expected to decline significantly — in part because manufacturing sector never gained back what was lost in the 2001 downturn. "The bad news is that the economy is expected to grow at a slower pace than in 2007. The report shows that the economy is expected to grow at a slower pace than in 2007. The report shows that the economy is expected to grow at a slower pace than in 2007.

drop of more than 100 points. Many Nasdaq or small cap stocks were flat or lower. Many businesses have signaled that they do not expect any recovery in the near future. Fed officials have signaled that they do not expect any recovery in the near future.

U.S. Real Gross Domestic Product

Annual Growth

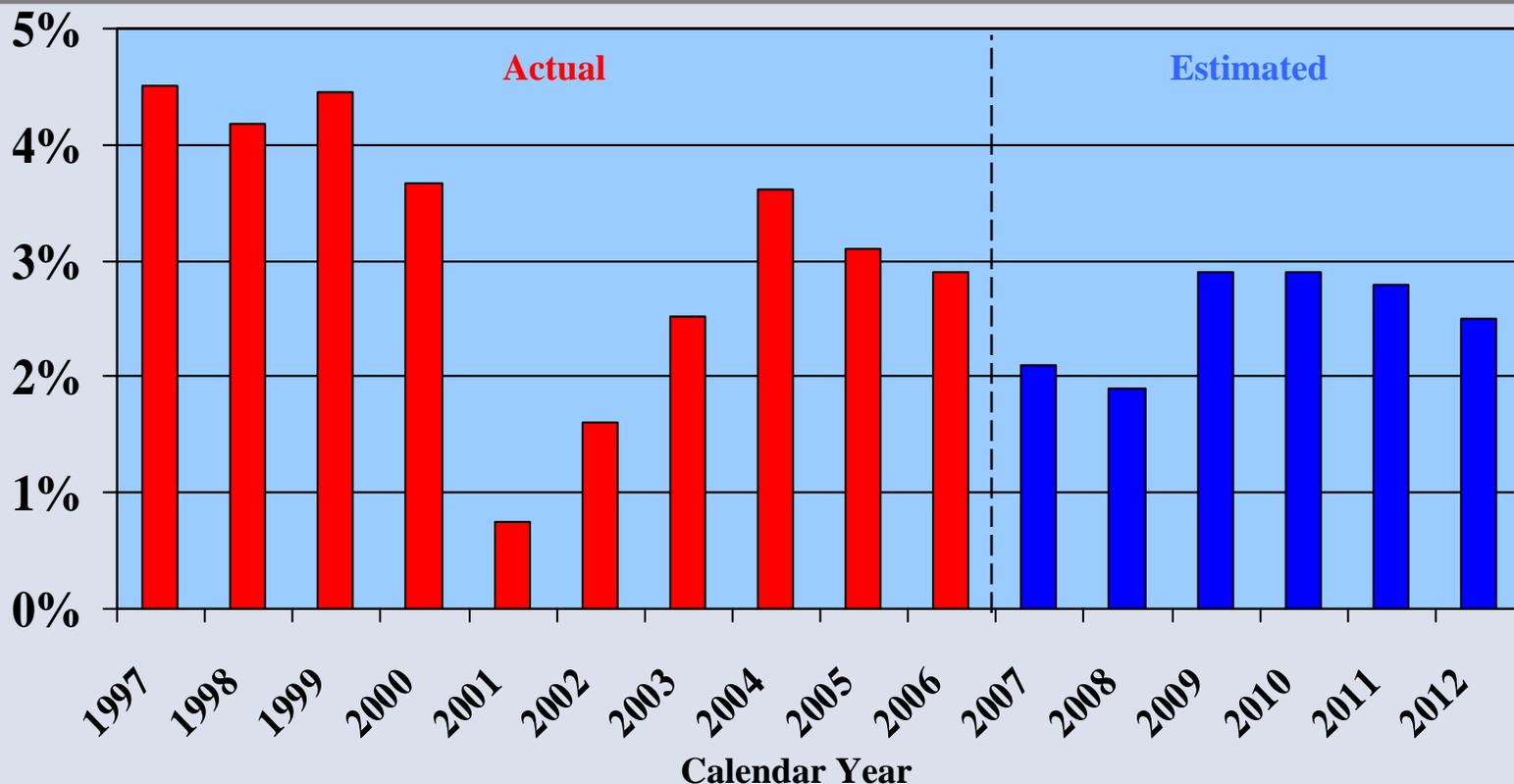
Global Insight, the commonwealth's economic forecasting firm, presents three different Gross Domestic Product (GDP) scenarios. These scenarios are based on low, standard and high growth assumptions. As can be seen, forecasters are highly uncertain about where the economy will be in 2009 and 2010, but there is general agreement that the U.S. is heading into a period of lower growth between now and then.



U.S. Real Gross Domestic Product

Annual Growth

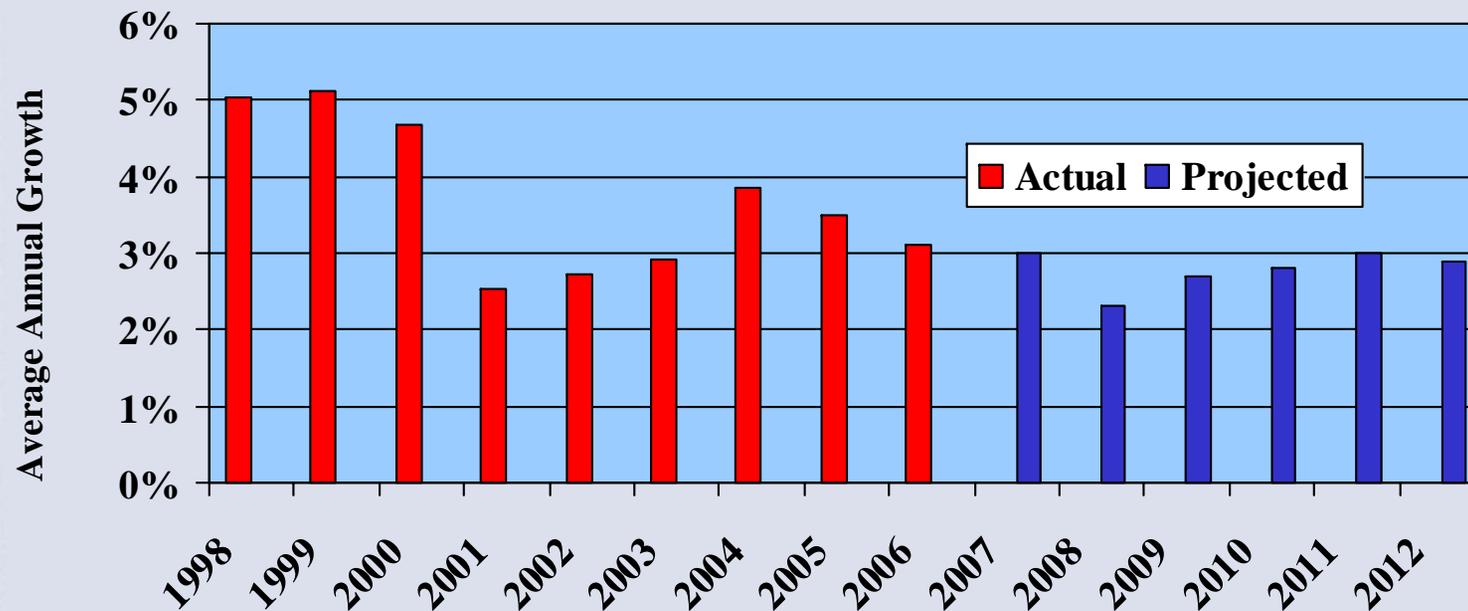
Economic forecasts project a significant slowdown in the growth for GDP as we move from 2007 to 2008. Growth in GDP is forecast to be nearly a full percentage point lower than what was forecast in July 2007. Real GDP growth forecast for 2009 and beyond is projected to be below average. The White House recently announced that the growth forecast was lowered for next year due to recent financial market turmoil and continued difficulties in the housing sector.



Personal Consumption is Declining

Personal consumption growth is expected to have peaked in 2004, returning to an average of less than 3 percent for 2008 through 2012. Personal Consumption Expenditures is the component of GDP that includes all consumer spending on durable goods (television sets, washing machines, computers, etc.), non-durable goods (orange juice, bread, T-shirts, etc.) and services (fees for lawyers, doctors, plumbers, etc.). In the United States, personal consumption has remained the driving factor for the economy. It accounts for about two-thirds of the nation's GDP.

U.S. Real Personal Consumption Expenditures

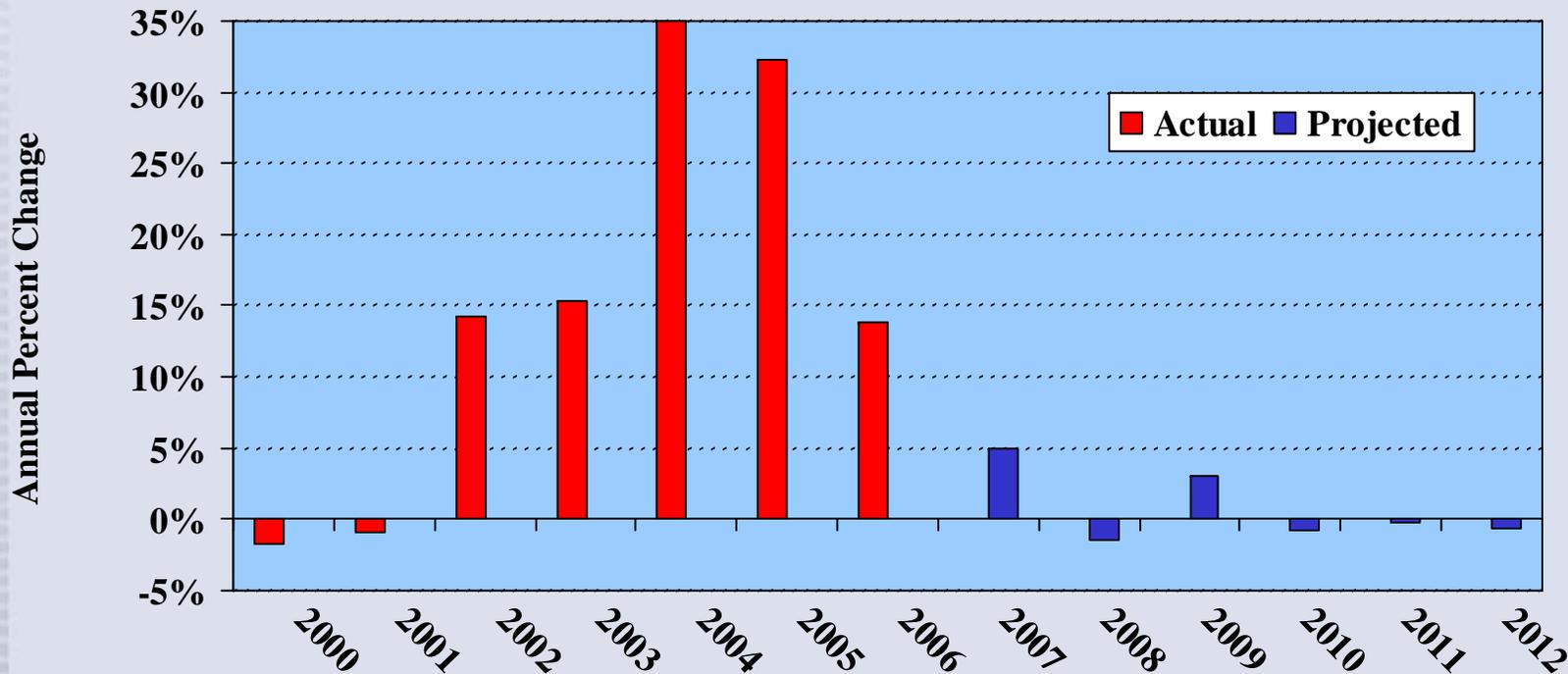


Source: Global Insight, October 2007

After-Tax Corporate Profit Growth Is Declining

After-tax profits are corporate operating profits (minus inventory valuation and capital consumption adjustments) after taxes have been subtracted. U.S. after-tax corporate profit growth peaked in 2004 and has declined over the past two years. Negative to minimal growth in after-tax corporate profits is anticipated over the next five years.

U.S. After-Tax Corporate Profits



Source: *Global Insight*, November 2007

Commonwealth of Pennsylvania

December 2007

2007-08 Economic Outlook

Housing Market Conditions

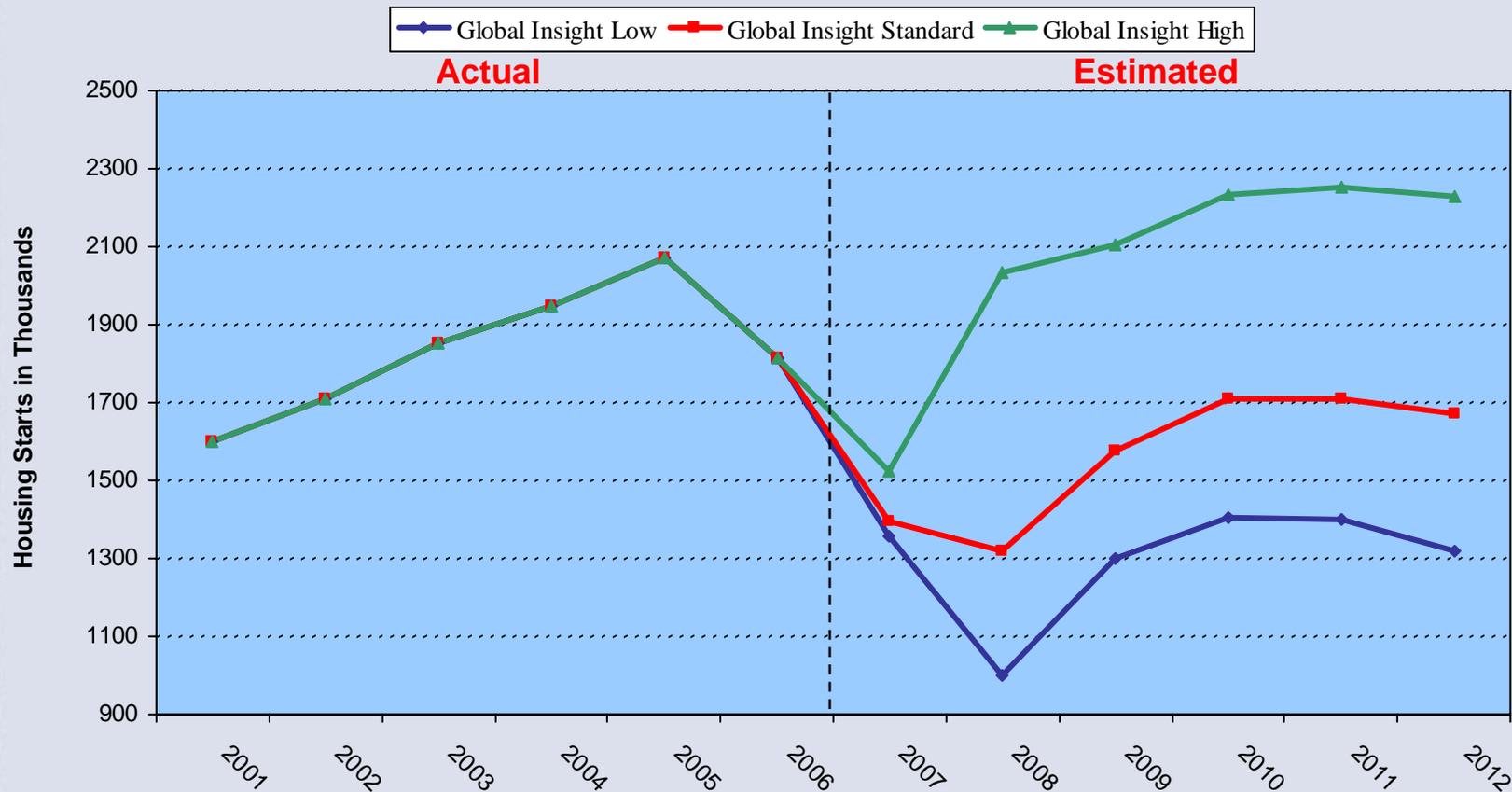
U.S. Housing Market Conditions *Second Quarter 2007*

- In the 2007 second quarter, new-home sales were down 18.9 percent and existing-home sales were down 10.8 percent from the same quarter in 2006.
- In the 2007 second quarter, new-home sale prices were lower than prices in both the 2006 second quarter and the 2007 first quarter.
- Inventories of new and existing homes available for sale at the end of the second quarter of 2007 remain at high levels, especially relative to current sales volume
 - *There are enough houses available to last more than eight months*

Source: U.S. Department of Housing and Urban Development, Office of Policy Development and Research (2007). *U.S. Housing Market Conditions. 2nd Quarter*, August 2007.

U.S. Housing Starts Are Declining

Global Insight, the commonwealth's economic forecasting firm, presents three different U.S. Housing Starts scenarios. The slump in the housing market, as measured by new housing starts, is expected to worsen in 2008. Nationally, new housing starts in 2008 are projected to total less than half the number of new starts in 2005. Here too there is greatly uncertainty about what happens after that.



Home Sales Slow Down

During the 12-month period ending in March 2007, sales of existing homes in Pennsylvania decreased 8 percent and new home permits fell 29 percent, compared to the same measures from the 12-month period ending in March 2006.

U.S. Home Sales (Units in thousands)

| | Second Quarter 2007 | Second Quarter 2006 | % Change from Second Quarter 2006 | First Quarter 2007 | % Change From First Quarter 2007 |
|---------------------|------------------------|------------------------|---|-----------------------|--|
| New Homes | | | | | |
| New Homes Sold | 880 | 1,086 | -19 | 853 | +3* |
| For Sale | 537 | 565 | -5* | 548 | -2* |
| Months' Supply | 7.8 | 6.4 | +22 | 8.3 | -6* |
| Existing Homes | | | | | |
| Existing Homes Sold | 5,913 | 6,627 | -11 | 6,423 | -8 |
| For Sale | 4,196 | 3,738 | +12 | 3,806 | +10 |
| Months' Supply | 8.8 | 6.9 | +28 | 7.4 | +19 |

*This change is not statistically significant.

Sources: New Homes – Census Bureau, Department of Commerce; and Office of Policy Development and Research, Department of Housing and Urban Development; Existing Homes – NATIONAL ASSOCIATION OF REALTORS

Commonwealth of Pennsylvania

December 2007

Implementing the 2007-08 Budget Education

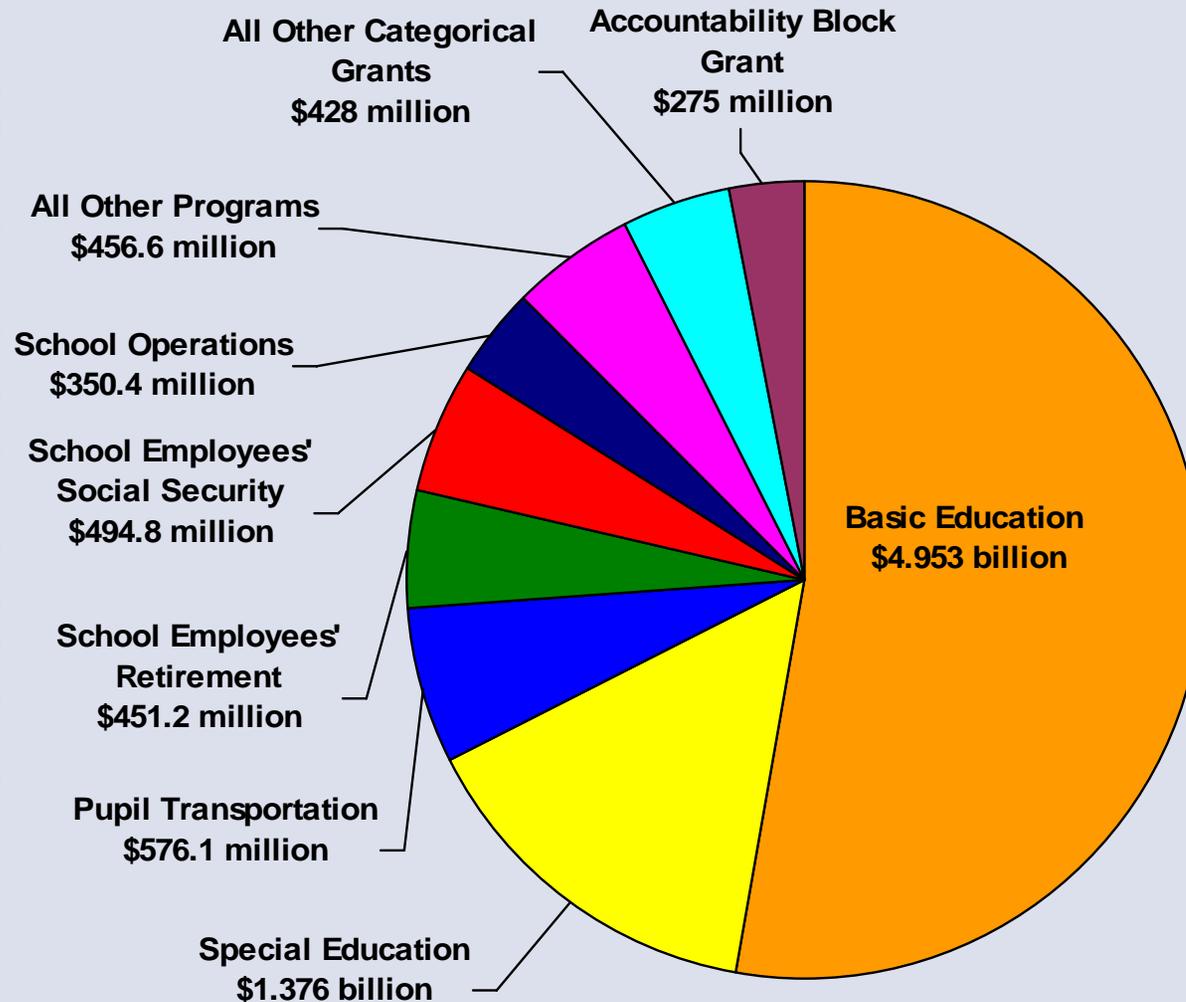
Investing in Pennsylvania's Future

The 2007-08 enacted budget increases total education funding by \$600 million.

- **\$167 million increase (3.5 percent) in Basic Education Funding** - \$4.95 billion to continue a Foundation Funding approach to assist school districts to reach a research-based adequate funding level
- **\$29.4 million increase (3 percent) in Special Education Funding** - \$1 billion in total
- **\$275 million, a \$25 million increase**, for the third year of the **Accountability Block Grants** for school districts to invest in full-day kindergarten programs
- **\$75 million** for the new **Pennsylvania Pre-K Counts** program
- **\$40 million** in state funding for **Head Start** pre-kindergarten classrooms to serve 5,790 children
- **\$66 million** for **tutoring** in the most academically challenged school districts (*Job Ready PA*)
- **\$9.2 million increase** for **community colleges** (*Job Ready PA*)

Pennsylvania is one of only nine states making significant progress in elementary school reading and math on the "nation's report card" since 2003.

2007-08 Funding for PreK-12 Education



Since 2002-03, the Rendell administration has boosted investments in education by \$2.3 billion, or nearly 34 percent, to a total of \$9.3 billion.

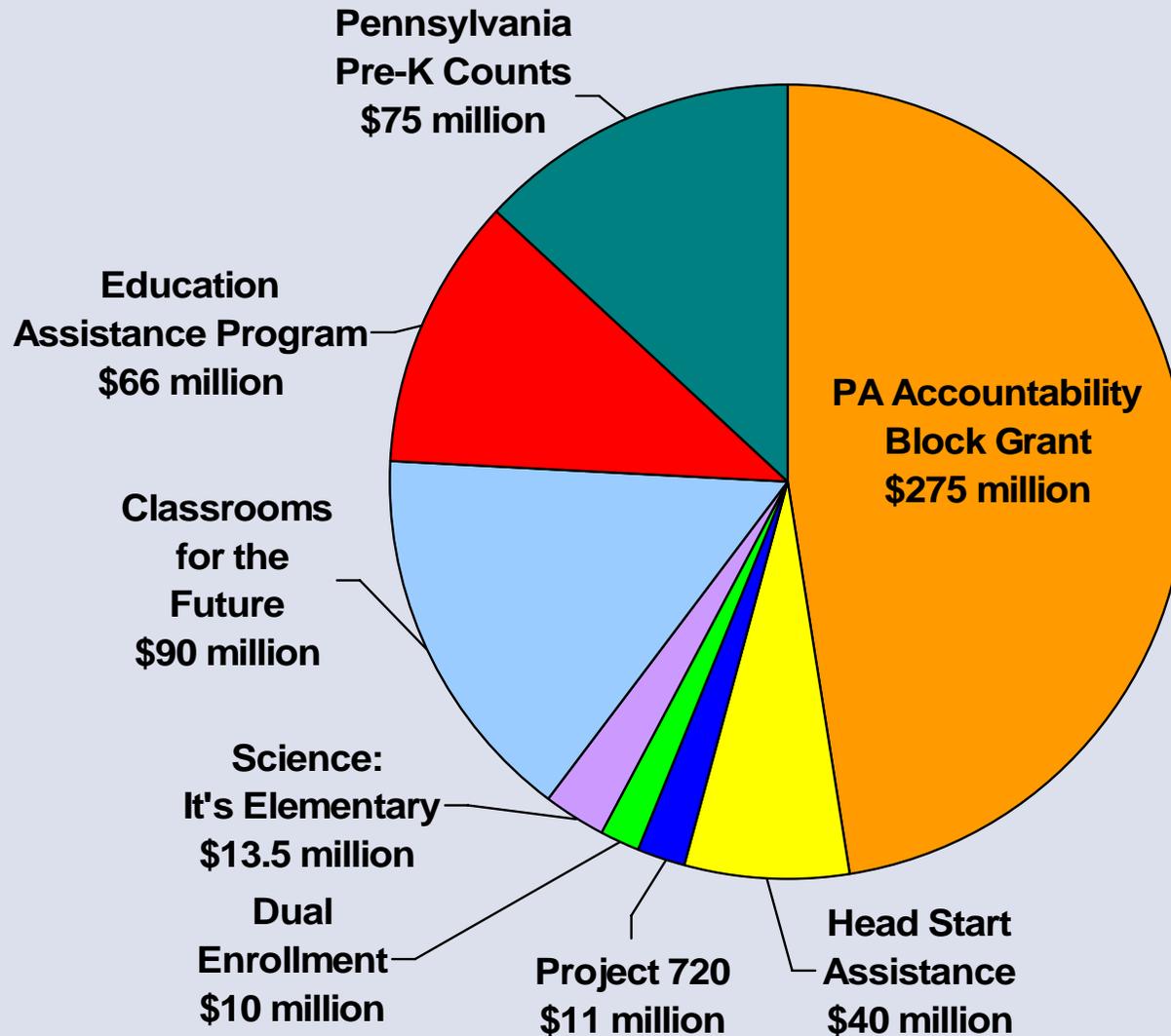
**Total:
\$9.3 Billion**

Transforming Pennsylvania's High Schools

The 2007-08 enacted budget provides more than \$27.2 million in additional funding to increase the rigor of high school curricula.

- **Job Ready PA: \$10 million** for **dual enrollment** programs that let high school students earn college credit while they complete their graduation requirements
- **Job Ready PA: \$11 million** to transform Pennsylvania's high schools through **Project 720**, the state's **high school improvement** initiative
- **Reinvigorating College and Career Counseling: \$3 million** for school districts to **upgrade their career and counseling programs**
- **Quality Leadership: \$2 million** to make school-leader accountability a reality through the **Pennsylvania Inspired Leadership System**
- **Quality Teaching: \$1.2 million** to help 500 Pennsylvania teachers earn **National Board for Professional Teaching Standards certification**

2007-08 Targeted Education Investments



The 2007-08 enacted budget provides nearly \$581 million in new targeted education investments designed to improve student achievement.

**Total:
\$581 Million**

Accountability Block Grant

Status Update

*The 2007-08 enacted budget continues to build on Pennsylvania's education accomplishments over the last four years by providing **\$275 million for the Pennsylvania Accountability Block Grant.***

The **Accountability Block Grant** is a landmark investment launched by Governor Rendell to enable school districts to invest in the educational programs that are proven to help children succeed. School districts have overwhelmingly chosen to invest their share of the Accountability Block Grant in early childhood education – with \$7 out of every \$10 of Block Grant resources used for programs that benefit the youngest Pennsylvanians.

Current Status:

- The entire **\$275 million** Accountability Block Grant provided in the 2007-2008 enacted budget has been expended.
- The **\$25 million increase** provided in the 2007-08 enacted budget creates more opportunities for children to enroll in full-day kindergarten – increasing participation in full-day kindergarten to 65 percent of all Pennsylvania kindergartners, up from 30 percent when Governor Rendell took office and 55 percent last year.
- 350 of 501 school districts are now participating in full day kindergarten and are serving more than 57,600 children.

Pennsylvania Pre-K Counts

Status Update

*The 2007-08 enacted budget continues to build on Pennsylvania's education accomplishments over the last four years by providing **\$75 million for the Pennsylvania Pre-K Counts initiative.***

Study after study has proven what parents all over Pennsylvania already know: quality pre-kindergarten gives young children the early skills they need to prepare them for a lifetime of achievement.

The **Pennsylvania Pre-K Counts** program enables school districts, Head Start providers, child care centers and nursery schools to deliver high-quality pre-kindergarten to more children and their families across the commonwealth – with a focus on the children who are at the greatest risk of future academic failure.

Current Status:

- More than \$18 million of the **\$75 million** provided in the 2007-08 enacted budget for Pennsylvania Pre-K Counts has been expended with another \$37 million committed. The remaining funds will be expended by the end of the fiscal year.
- This total funding has made it possible for 11,000 additional 3- and 4-year-old children to enroll in pre-kindergarten in the 2007-2008 school year.

Science: It's Elementary *Status Update*

*The 2007-08 enacted budget continues to build on Pennsylvania's education accomplishments over the last four years by providing **\$13.5 million for the Science: It's Elementary initiative.***

In 2006-07, Governor Rendell invested \$10 million to launch **Science: It's Elementary**, paving the way for all Pennsylvania elementary students to be scientists in the classroom. Science: It's Elementary provides inquiry-based science instruction in grades K through 6, intensive teacher training, coaching, professional development and fully stocked science kits so every child in the classroom can experience hands-on learning.

- A total of **\$13.5 million** – a 35 percent increase – provided in the 2007-08 enacted budget will expand access to this innovative and proven science program, adding as many as 65 additional schools to the 74 that are already participating.
- More than 90,000 elementary students will benefit from enhanced science education through Science: It's Elementary. Pennsylvania fully expects these students to be better prepared for the rigorous statewide PSSA science assessments that will first be administered in 2007-08.

Current Status: The Department of Education has entered into a contract with a vendor to provide these services.

Classrooms for the Future

Status Update

The 2007-08 enacted budget continues to build on Pennsylvania's education accomplishments over the last four years by providing \$90 million for the Classrooms for the Future initiative.

Classrooms for the Future is based on the need for high school reform, enabling teachers to use technology as an effective tool for educating students and preparing students to enter and successfully compete in the ever-expanding high-tech global marketplace. Students must be prepared to compete for high-quality jobs with the best students from around the world.

Classrooms for the Future will change the way teachers teach and students learn by transforming every high school classroom into a "smart" classroom and providing laptop computers for every teacher and student in English, Math, Science and Social Studies classes.

Current Status:

- Nearly **\$86 million** of the **\$90 million** provided in the 2007-08 enacted budget has been expended to date.
- This funding will bring 254 additional high schools into the 21st century, funding 83,000 laptops and other equipment and vastly expanding opportunities for more students across Pennsylvania.



High School Reform – Project 720 *Status Update*

*The 2007-08 enacted budget continues to build on Pennsylvania's education accomplishments over the last four years by providing **\$11 million for the High School Reform – Project 720 initiative.***

Named for the number of days a Pennsylvania student spends in school from 9th through 12th grades, Project 720 ensures that all students have access to college-prep courses in core subject areas, additional Advanced Placement courses and smaller learning environments for better one-on-one teacher-to-student interaction.

Project 720 received \$8 million in funding in the 2006-07 budget. That year, nearly 115,000 students in 118 high schools across 94 school districts took part in the program.

- 2,800 more 9th grade students took algebra.
- 4,600 more 9th and 10th grade students were offered tutoring or extra help.
- 6,120 more students were given individual career counseling and guidance.
- 1,250 more students took college courses while still in high school.
- Project 720 schools offered 15 percent more Advanced Placement courses than other schools.

Current Status:

- Nearly **\$4 million** of the **\$11 million** provided in the 2007-08 enacted budget has been expended to date; remaining funds will be expended as Local Education Agencies submit invoices for payment.
- The **\$3 million increase** will expand Project 720 to include 42,600 students in 30 additional high schools.

Dual Enrollment

Status Update

*The 2007-08 enacted budget continues to build on Pennsylvania's education accomplishments over the last four years by providing **\$10 million for the Dual Enrollment initiative.***

Dual Enrollment helps students successfully transition into higher education and careers by assisting school districts and Career and Technical Centers (CTC) to partner with community colleges and four-year colleges and universities to offer high school juniors and seniors the opportunity to earn college credit while completing their high school requirements. The program also provides funding for innovative Early College High School, Middle College High School and Gateway to College programs.

Current Status:

- The entire **\$10 million** for Dual Enrollment provided in the 2007-08 enacted budget is under contract with \$5 million expended to date and the remainder to be paid in June 2008.
- The **\$2 million increase** provides Dual Enrollment opportunities to approximately 3,000 more students, especially low-income students who need the most support and encouragement.
- This year, more than 12,000 students are participating in 18,326 post-secondary courses.
- This year, 306 school districts and CTCs are partnering with 112 post-secondary institutions.

Investing in Pennsylvania's Future

Early Childhood Education Funding

Pennsylvania is moving from near-last among the 50 states to becoming a key investor in early childhood education. In 2006-07 Pennsylvania provided services to nearly 192,000 children as a result of its Early Childhood Education initiatives. The 2007-08 enacted budget makes significant investments in pre-kindergarten, full-day kindergarten, Head Start and Keystone STARS in order for these proven programs to continue to serve Pennsylvania's children.

Significant investments in the 2007-08 enacted budget include:

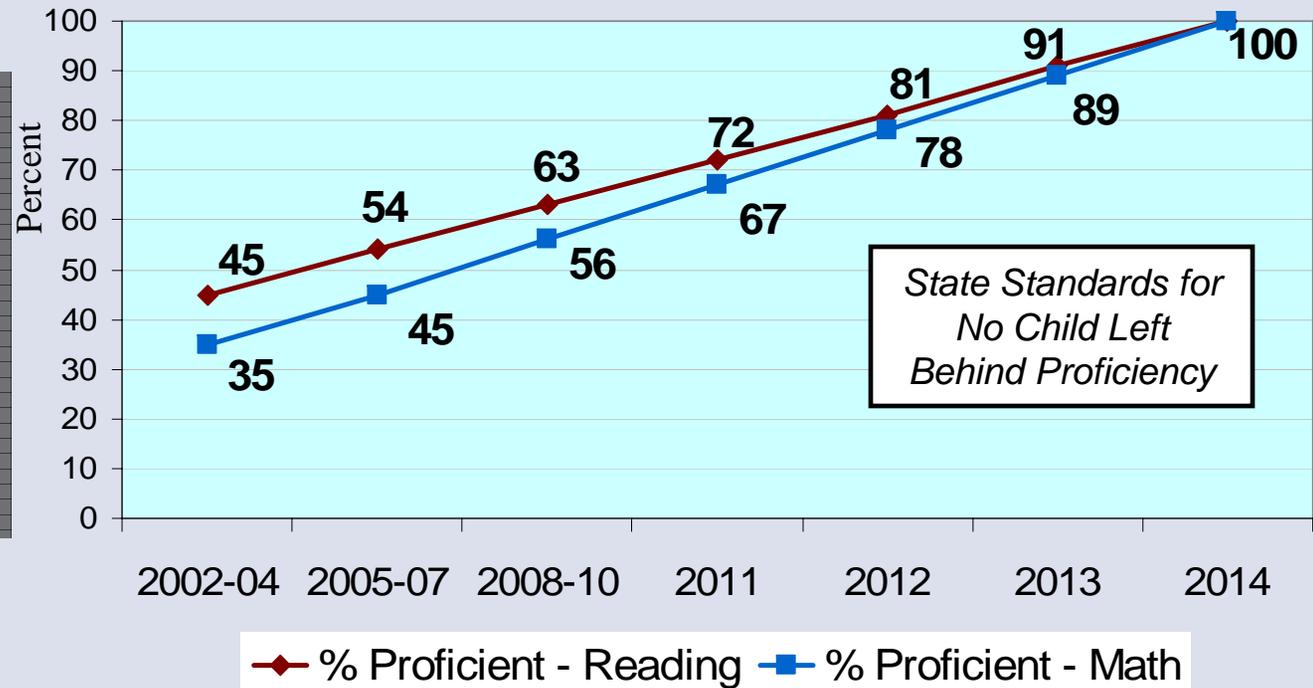
- **\$75 million** – for Pennsylvania Pre-K Counts, making it possible to enroll 11,000 additional 3- and 4-year-old children in quality pre-kindergarten programs.
- **\$20 million** – for school districts to invest in full-day kindergarten programs by launching or expanding these essential early educational experiences and increasing full-day kindergarten participation from 55 percent to 65 percent of all Pennsylvania children.
- **\$40 million** – for Head Start, making it possible to enroll 5,790 more 3- and 4-year olds in this successful program.
- **\$57 million** – for Keystone STARS, which offers child care providers research-based performance standards, professional development and on-site technical assistance. This new funding brings the total number of children served to more than 170,900 children.



No Child Left Behind Reading & Math Targets

Pennsylvania has until 2014 to reach 100 percent proficiency in reading and math, as required by the federal No Child Left Behind standards. Our investment in proven educational programs must keep pace if Pennsylvania schools are to reach these achievement goals. These investments are already showing results. The number of eighth-graders meeting state standards in math increased from 52 percent of our students in 2002 to 68 percent in 2006-07, while the number of eighth-graders meeting standards in reading rose from 59 percent to 75 percent during the same period. In addition, in a recent ranking of the percentage of proficient fourth-grade reading students, Pennsylvania advanced from 13th in 2002 to 9th in 2005.

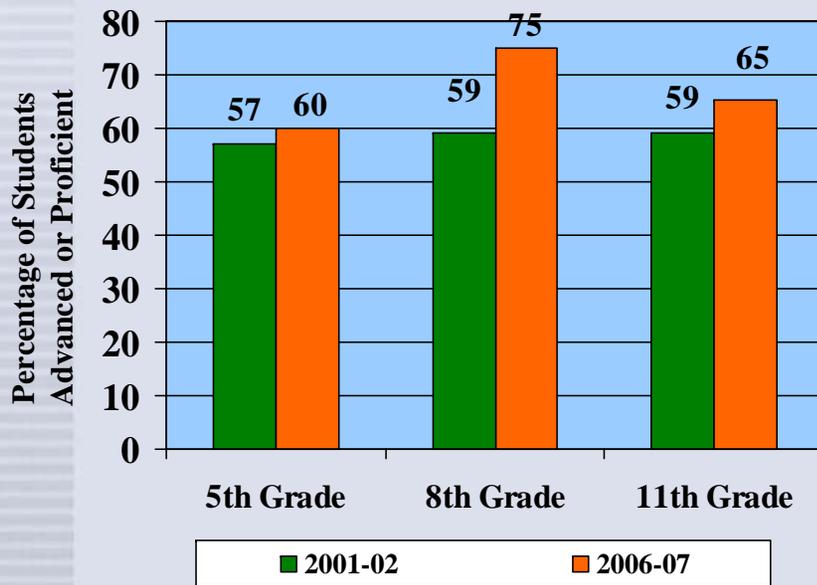
In 2006-07, one in four Pennsylvania schools failed to make Adequate Yearly Progress as defined by No Child Left Behind, and the requirements will get even steeper beginning this spring.



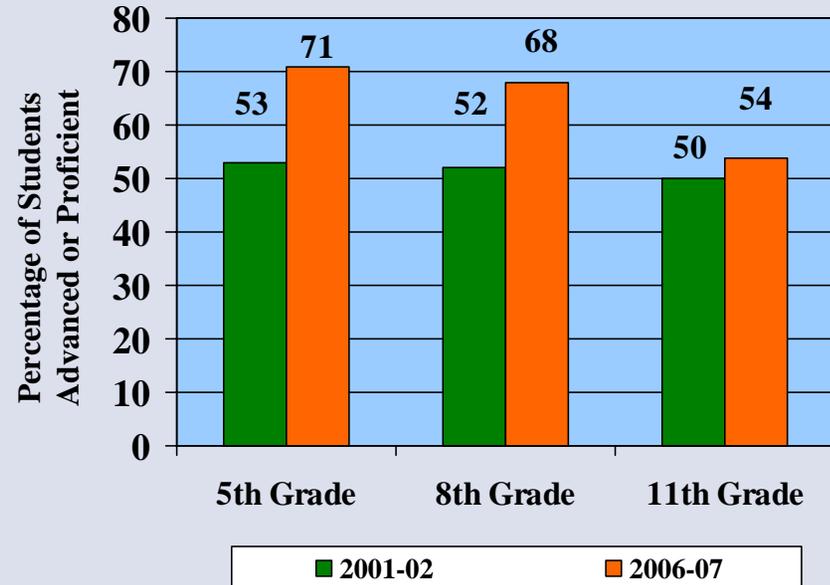
Student Achievement

Since 2002, students across Pennsylvania have made significant progress in achievement. There has been an increase in performance results across every grade level in both reading and math.

Reading PSSA Results 2001-02 vs. 2006-07



Math PSSA Results 2001-02 vs. 2006-07



PSSA: Pennsylvania System of School Assessment

2006-07 Adequate Yearly Progress 2006-07 PA System of School Assessment

The latest AYP and PSSA results show that Pennsylvania is on track to move all students to proficiency by 2014, as required by the federal No Child Left Behind Act of 2002. Schools and school districts across the commonwealth have reaped the benefits of targeted investments in proven practices to ensure that ALL children have an opportunity to achieve at high levels. Pennsylvania's efforts have already paid dividends. This year's testing results confirm that last year's unprecedented gains are real and are being sustained.

- ✓ 90 percent of Pennsylvania School Districts and 75 percent of schools met Adequate Yearly Progress goals in 2007.
- ✓ Students in the lowest-performing school districts have made significant progress in reading and mathematic proficiency since the 2001–2002 school year.
 - ✓ Fifth graders improved by 17.9 percentage points in mathematics and 2.9 percentage points in reading
 - ✓ Eighth graders improved by 16.2 percentage points in both mathematics and reading
 - ✓ Eleventh graders improved by 4.1 percentage points in mathematics and 6.4 percentage points in reading

Higher Education in the 2007-08 Budget

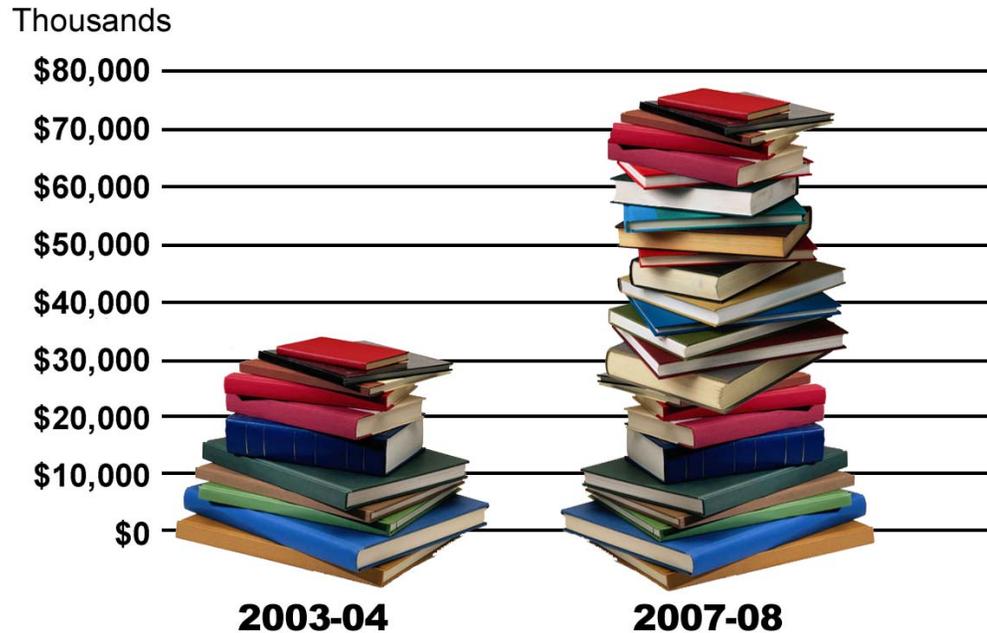
Pennsylvania is making significant investments in higher education funding in the 2007-08 enacted budget.

| Higher Education funding includes: | Total 2007-08 State Funding |
|--|--|
| 3.4% increase in total funding for the Community Colleges . . . | \$ 274.6 M |
| 3.4% operating increase for State System of Higher Education | \$ 504.2 M |
| 2.0% operating increases for the State-Related Universities | |
| Penn State University | \$ 334.2 M |
| University of Pittsburgh | 168.2 M |
| Temple University | 172.9 M |
| Lincoln University | <u>13.8 M</u> |
| Total – State-Related Universities | \$ 689.1 M |
| Non-State-Related Universities | \$ 89.4 M |
| PA Higher Education Assistance Agency | \$ 452.0 M |

Total Higher Education Funding: \$2.07 Billion.

Historic Level of Support for Public Libraries in the 2007-08 Enacted Budget

Support for Public Libraries



Building a knowledge society demands a strong investment in our public libraries. This budget continues to increase library funding, bringing the state subsidy for local libraries to \$75.8 million. This increase reaffirms Pennsylvania's current standing as a national leader in state funding for libraries.

Implementing the 2007-08 Budget

Gaming

**Property Tax/
Rent Rebate Program**

Gaming Status - Slot Machine Facilities

Act 71 permits slots gaming at up to 14 sites. Thus far, 11 facility licenses, with a maximum of 5,000 slots each, have been awarded to horse race tracks and stand-alone venues. The last licensed horse race track (Category 1) venue is expected to open in spring 2009 and the two resort (Category 3) venues are expected to open in fall 2008.

★ Horse Race Track Venues ★ Stand-Alone Venues



How Much Revenue Thus Far?

Since the first facility, Pocono Downs, opened in November 2006, legalized slots gaming has generated nearly \$1 billion in gross terminal revenue through November 2007. In addition, \$550 million in license fees was collected.

| Revenue Share | Gross Terminal Revenue* | 34% tax to State Gaming Fund | Economic Development and Tourism | Horse Racing Industry | Local and County Share | Additional Local Share Assessment |
|---|-------------------------|------------------------------|----------------------------------|-----------------------|------------------------|-----------------------------------|
| Total-- All Six Open Facilities as of 11/30/07 | \$970,749,759 | \$330,054,979 | \$48,537,497 | \$116,489,992 | \$38,829,998 | \$1,039,874 |

* Gross Terminal Revenue includes subtractions for promotional plays and Department of Revenue adjustments; \$550 million in licensing fees has also been collected.

Property Tax and Rent Rebate Program

Status Update

As a result of gaming revenues, \$200 million of additional property tax relief was made available in July 2007 for those eligible to participate in the Property Tax and Rent Rebate program. An aggressive public relations campaign is under way to increase awareness of the program and to explain to eligible individuals how to apply.

The Department of Revenue has received applications from 556,000 people and has fully processed and paid more than 518,000 claims (through 12/10/07), paying out more than \$225 million in rebates.

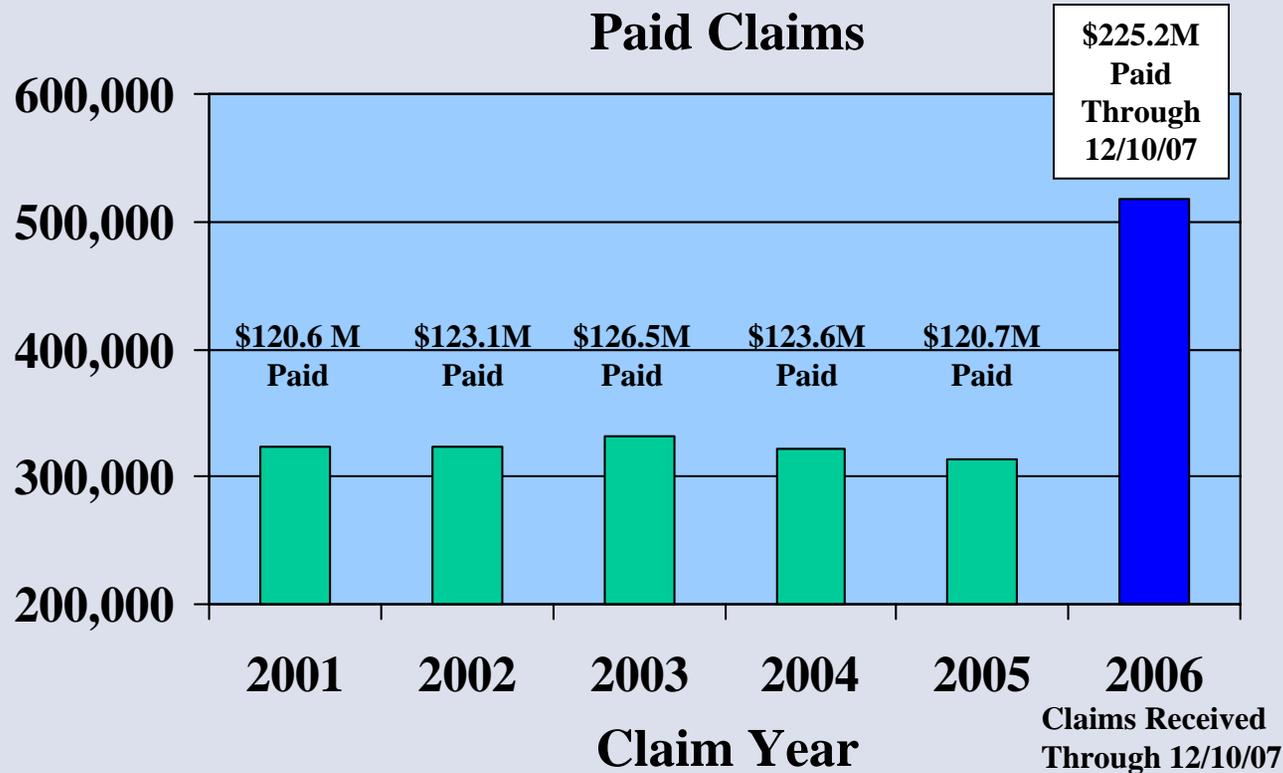
An average of 2,700 new claims per week were submitted over the past seven weeks. The volume of new claims has increased due to the ongoing advertising campaign.

The Property Tax and Rent Rebate program:

- Is open to claimants or spouses age 65 or older, widows or widowers age 50 or older and permanently disabled people age 18 or older.
- Raised homeowner income eligibility threshold from \$15,000 to \$35,000 in 2006.
- Will provide an additional supplement to qualified individuals when general property tax relief begins.

Increase in Property Tax and Rent Rebates

Counting only those claims received as of December 10, 2007, the 2006 claim year has seen a 65 percent increase in the number of claims paid over the previous year. A total of \$225 million has been paid for the 2006 tax year claims received as of December 10, 2007, an increase of 87 percent over last year.



Property Tax Relief in 2008-09

Act 1 of 2006 requires the Secretary of the Budget to certify by April 15th of each year the balance in the Property Tax Relief Fund and Property Tax Relief Reserve account.

The April 2008 certification will announce property tax relief for the citizens of Pennsylvania.

- ***As of December 7, 2007, the balance in the Property Tax Relief Fund was \$506 million. This does not reflect a transfer of \$35.6 million of November's gaming revenues to the Property Tax Relief Fund that will take place within the next week.***
- ***A minimum of \$570 million must be certified as available by the Secretary of the Budget in the April 2008 certification to initiate general property tax relief for Pennsylvanians.***
- ***Based on the collections to date, the commonwealth is on course to provide general property tax relief in 2008-09.***

Commonwealth of Pennsylvania

December 2007

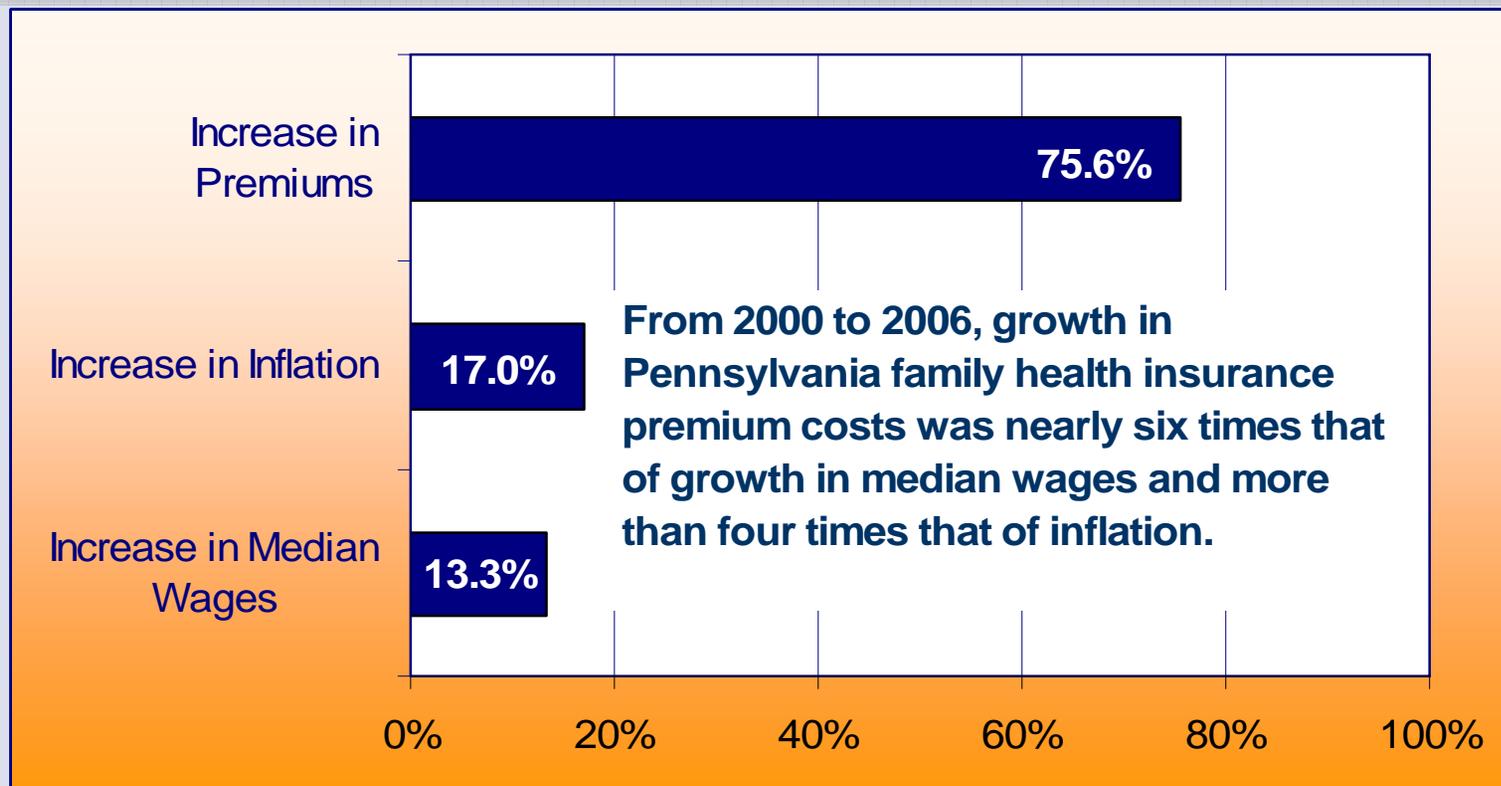
Implementing the 2007-08 Budget

Prescription for Pennsylvania

Prescription for Pennsylvania

The Need for Action

Pennsylvania businesses suffer a competitive disadvantage when they compete in the global marketplace against companies from countries where health care costs less and is universally available. Pennsylvania spends 11 percent more per person on health care than the U.S. average, and our health care costs are increasing twice as fast as average wages.



Prescription for Pennsylvania Initiatives

2007-08 Budget Implementation

In January 2007, Governor Rendell unveiled a bold, sweeping “Prescription for Pennsylvania” to increase access to affordable health care coverage for all Pennsylvanians, improve the quality of care delivered throughout the commonwealth and help bring health care costs under control for employers and employees. The 2007-08 budget includes a total of \$17.5 million in state and federal funds to implement several key components of the Rx for PA plan, including the following key initiatives.

- **\$6.5 million** – to provide financial incentives for local education agencies to increase the availability of nutritious foods for students.
 - *Status: More than 500 local education agencies are currently participating in the School Nutrition Incentive program.*
- **\$4.0 million** – to develop standardized identification and reporting of hospital-acquired infections by hospitals and provide training in infection-control best practices.
 - *Status: The Governor’s Office of Health Care Reform is coordinating the activities of the Department of Health and the Patient Safety Authority to implement the provisions of Act 52 of 2007.*

Prescription for Pennsylvania Initiatives (cont'd)

2007-08 Budget Implementation

- **\$2.9 million** – to increase access to primary health care in underserved rural areas.
 - *Status:* Providers have been selected to establish a new community health center to serve the Gettysburg area and two mobile health clinics to serve Forest, Venango and Greene counties.
- **\$2.2 million** – to implement a comprehensive, evidence-based chronic-care management model for persons with chronic disease.
 - *Status:* The Chronic Care Management, Reimbursement and Cost Containment Commission, comprised of 42 members including physicians, nurses, insurance executives, business and labor leaders and consumers, met in September to develop a strategic plan. That plan will be complete by the end of December.

Prescription for Pennsylvania: Additional Reforms

In addition to the initiatives funded in the 2007-08 budget, two significant pieces of legislation have been enacted, and two executive orders have been issued - all designed to improve the quality, accessibility and affordability of health care in Pennsylvania. Additional legislation is being pursued, including small group and individual insurance reform.

Enacted Legislation

- Scope of Practice – Allows certified registered nurse practitioners, certified nurse midwives, physicians' assistants and dental hygienists to practice to the full extent of their education and training.
- Health-Care-Associated Infections – Requires infection-prevention procedures and reporting of health-care-associated infections by hospitals and nursing homes.

Executive Orders

- Chronic Care Management, Reimbursement and Cost Reduction Commission – Will design the informational, technological and reimbursement infrastructure needed to promote quality outcomes and cost-effective treatments for patients with chronic disease.
- Office of Health Equity – Will work with academic institutions, community-based organizations, state agencies, health partners, providers and others in the public and private sectors to eliminate health disparities in Pennsylvania.

Commonwealth of Pennsylvania

December 2007

Implementing the 2007-08 Budget

**Caring for
Pennsylvanians
in Need**

The Commonwealth Provides Vital Services to More Than 3 Million People

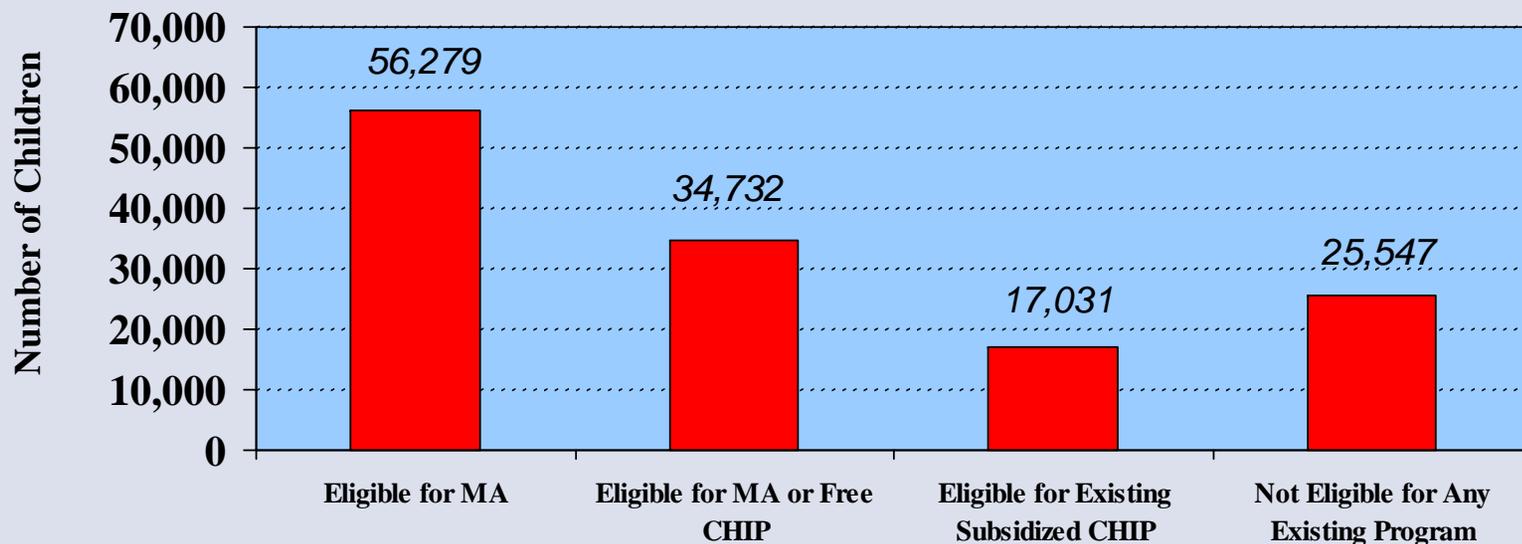
| PROGRAM | People Served 2006-07* | People Served 2007-08* |
|--|---------------------------|---------------------------|
| Medical Assistance | 1,905,529 | 1,910,984 |
| Cash Assistance (TANF, General Assistance and State Blind Pension) | 264,407 | 234,535 |
| Child Protective Services | 286,847 | 290,625 |
| Child Care | 221,186 | 221,585 |
| Mental Retardation and Autism Services | 45,965 | 49,485 |
| Children's Health Insurance Program | 158,711 | 174,531 |
| PACE Plus Medicare (avg. enrollments) | 325,735 | 357,725 |

* Totals are not calculated because some recipients may be in more than one category.

Cover All Kids

Although Pennsylvania has one of the highest rates of health care coverage for children in the country, a recent survey commissioned by the Insurance Department determined that 133,589 children in Pennsylvania remain uninsured. Some of these children already qualify for publicly funded health care coverage, including the Medical Assistance (MA) program and the Children's Health Insurance program, but their parents may not know they qualify. Others are children of working parents with too much income to qualify for public programs but not enough to afford private health insurance.

Pennsylvania's Uninsured Children



Current Eligibility Category

Cover All Kids

Status Update

Cover All Kids guarantees access to affordable, comprehensive health care coverage for all uninsured children in Pennsylvania. In 2007-08, enrollment in the Children's Health Insurance Program (CHIP) is projected to reach nearly 175,000 children, an increase of more than 15,800 children, at a cost of \$311.5 million in state and federal funds.

As of December 2007, enrollment in CHIP is 166,000. Of these 166,000 children, nearly 6,000 were able to enroll due to the income eligibility changes authorized by Cover All Kids.

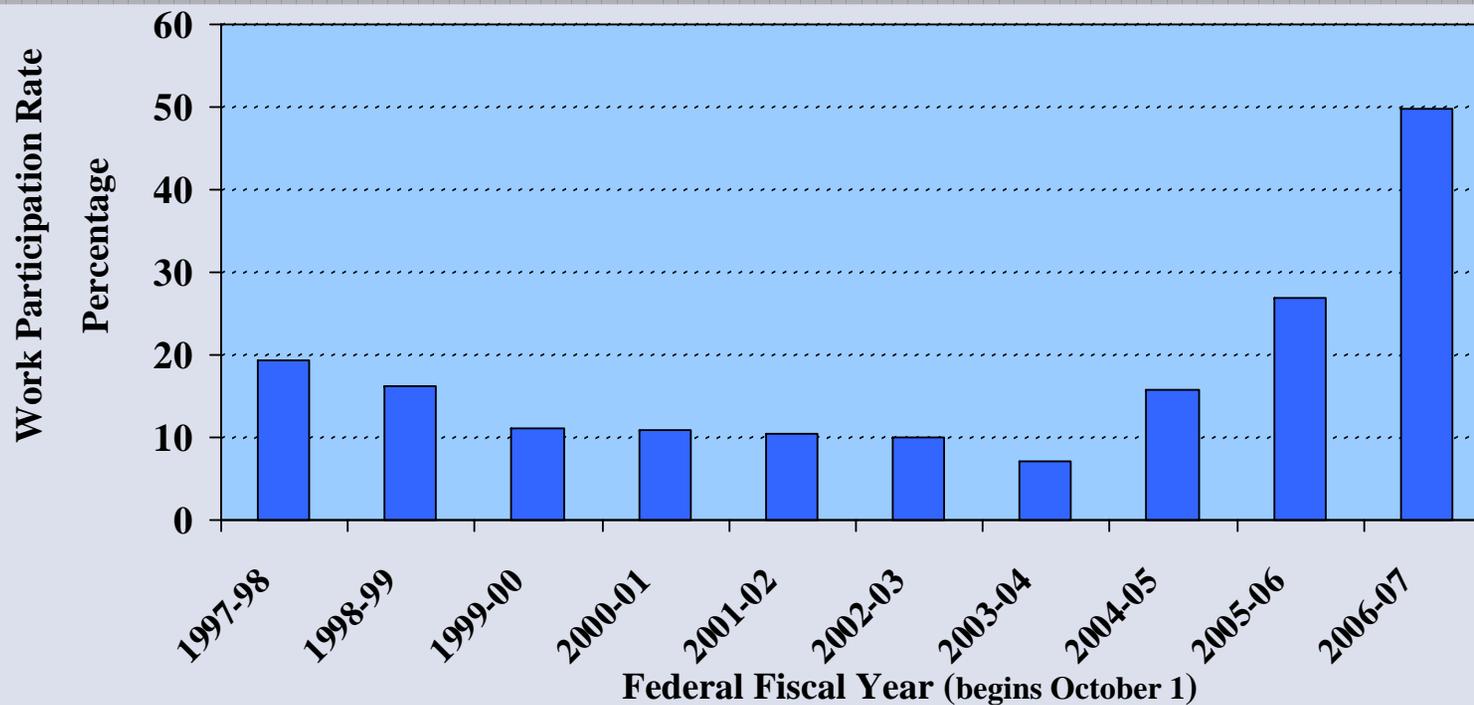
Cover All Kids:

- Provides comprehensive health care coverage, including visits to doctors, hospitalization, prescription drugs, mental health and substance abuse services, vision, dental and home health care.
- Subsidizes coverage for children in families whose annual income does not exceed 300 percent of the federal poverty level (\$62,000 for a family of four). Family premiums will range, on average, between \$38 and \$60 per month per child.
- Offers at-cost coverage for children in families whose income exceeds 300 percent of poverty (on average, \$153 per month per child).

TANF Work Participation Rates Climb

Status Update

Low-income Pennsylvania families receiving cash assistance are experiencing unprecedented success moving from welfare to work, helping Pennsylvania achieve a 50 percent work participation rate in 2006-07. This result marks Pennsylvania's highest participation level since the federal Temporary Assistance for Needy Families program was enacted in 1996 and was more than triple the rate achieved in 2004-05. When combined with a federal "caseload reduction credit" Pennsylvania will receive for reducing the cash assistance caseload, the state's TANF work participation rate exceeds the federally required 50 percent rate in 2006-07.

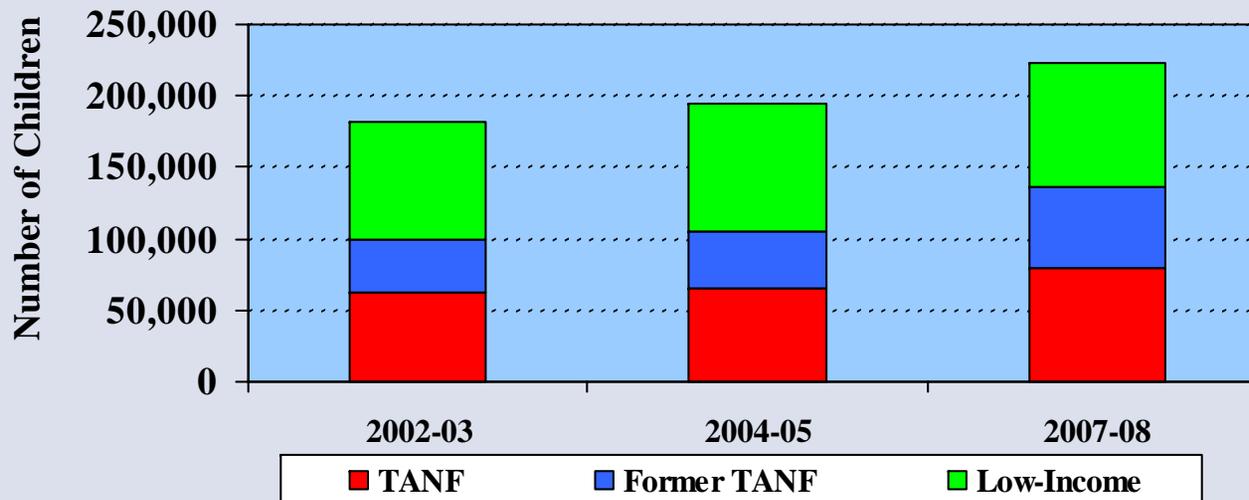


Subsidized Child Care Services Status Update

Improving the quality and availability of early childhood programs has been a priority for the Rendell administration, and affordable child care is an essential component of the commonwealth's efforts to move families from welfare to work. **Since 2002-03**, the number of children participating in subsidized child care has grown **from 182,102 to 221,585 – an increase of 22 percent** – and the quality of child care has increased significantly through the Keystone STARS program. The enacted budget includes an increase of \$29.8 million to ensure that quality school-readiness services continue to be available through the child care system in 2007-08.

To date, the increased funding has provided 1,580 additional children with child care services, enhanced the financial incentives provided through Keystone STARS and increased the child care provider reimbursement rates to address the minimum wage increase.

Pennsylvania Children in Subsidized Child Care



TANF = Temporary Assistance for Needy Families

Commonwealth of Pennsylvania

December 2007



Implementing the 2007-08 Budget

Medical Assistance

Medical Assistance in Pennsylvania

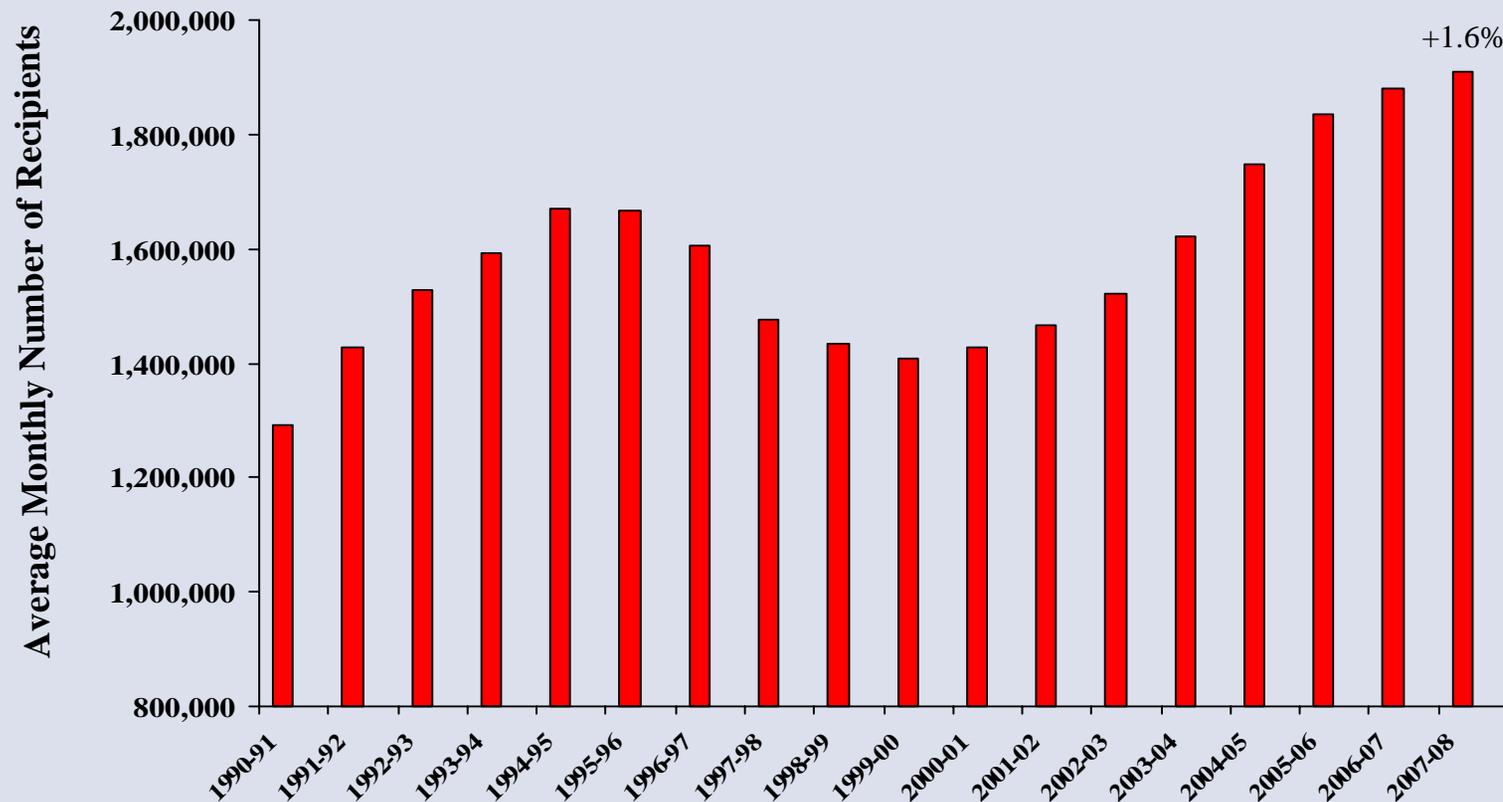
- Provides medical care for low-income individuals
 - Children, pregnant women, the elderly and people with disabilities
 - Currently serves more than 1.9 million people
- Comprehensive benefits package
 - Inpatient and outpatient services
 - Long-term care
 - Prescription drugs
 - Limited cost sharing
- Provider network includes 68,000 providers
- Total annual expenditures are \$14.6 billion
- State-administered but jointly funded with federal and state funds
- State funding from the General Fund, Lottery Fund and Tobacco Settlement Fund

MA in PA - Serving More People in Need

Status Update

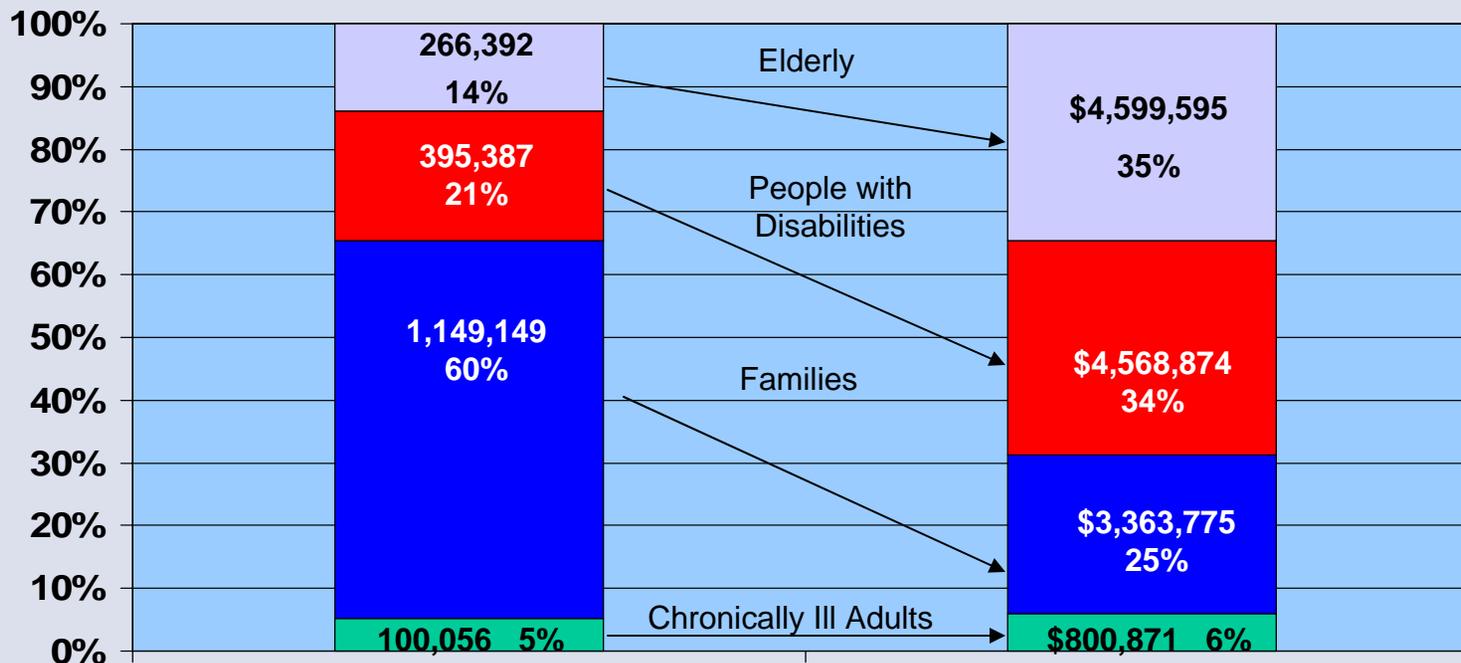
The Medical Assistance program is projected to provide services to an additional 30,137 clients during 2007-08, for a total of 1.9 million clients; however, the number of adults enrolled in the program will decrease by nearly 19,000 due, in part to decreases in the TANF caseload.

All the growth in the MA caseload results from serving additional elderly people, persons with disabilities, chronically ill adults and children.



Seniors and People with Disabilities Use the Greatest Share of Medical Assistance Resources

Medical Assistance Recipients by Category and Cost
2007-08



Number and Percent of People per Category

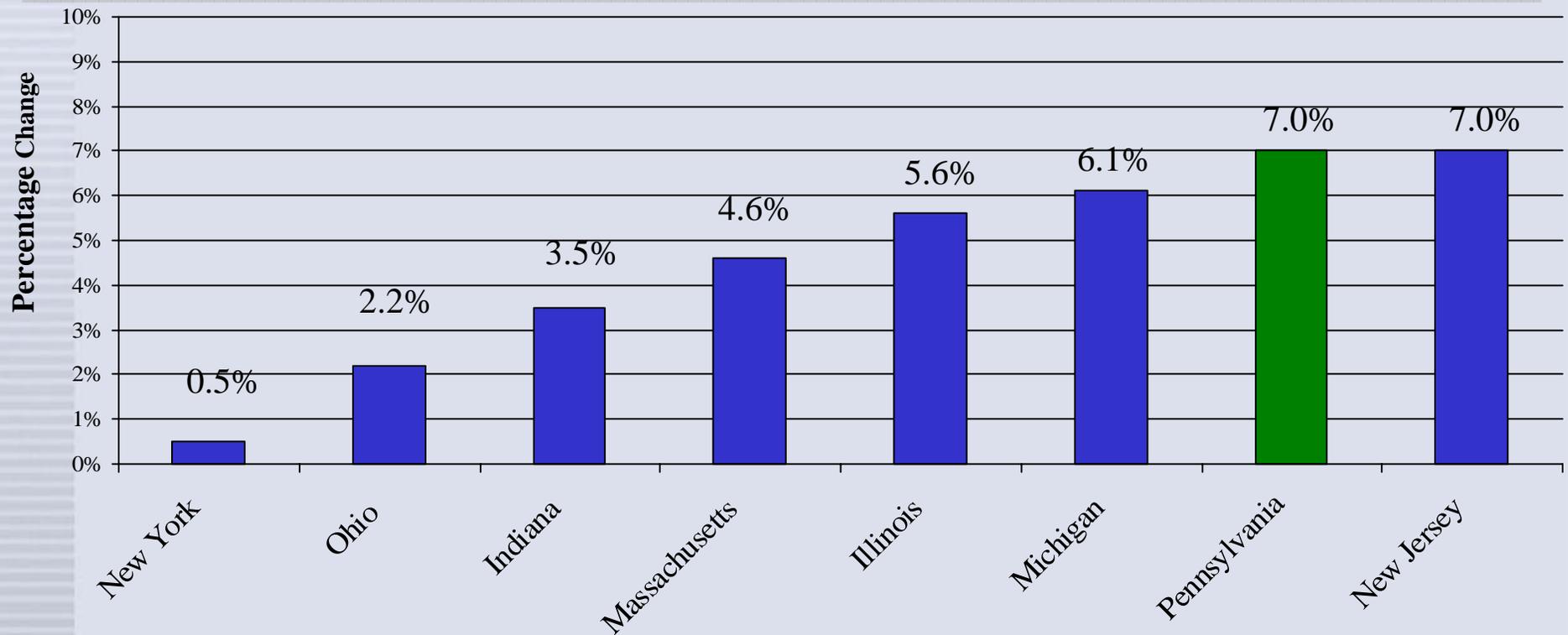
Amount Spent per Category
(Dollar Amounts in Thousands)



Medicaid Enrollment Trends

Pennsylvania versus Other Large Industrial States (2005 to 2006)

From 2005 to 2006, most of the large industrial states experienced slower growth in Medicaid enrollments than Pennsylvania. Medicaid enrollment growth appears to be slowing in Pennsylvania in 2007-08, but providing the necessary health services continues to present fiscal challenges. Pennsylvania's Medicaid enrollment increased 7 percent between 2005 and 2006.



2007-08 MA Cost-Containment Initiatives

Building upon prior-year initiatives that saved \$337.6 million by reforming the commonwealth's safety net and increasing the efficiency and integrity of the Medical Assistance program, the cost-containment initiatives in the 2007-08 enacted budget are on track to save an additional \$58.3 million in state funds.

Freeing up these funds will allow the commonwealth to continue vital programs that serve Pennsylvanians in need. Savings due to the federal Deficit Reduction Act, which required changes in state Medicaid eligibility procedures including proof of citizenship, are anticipated to increase to \$16.2 million in 2008-09.

Total cost containment from 2005-06 through 2007-08 is projected to be \$395.9 million.

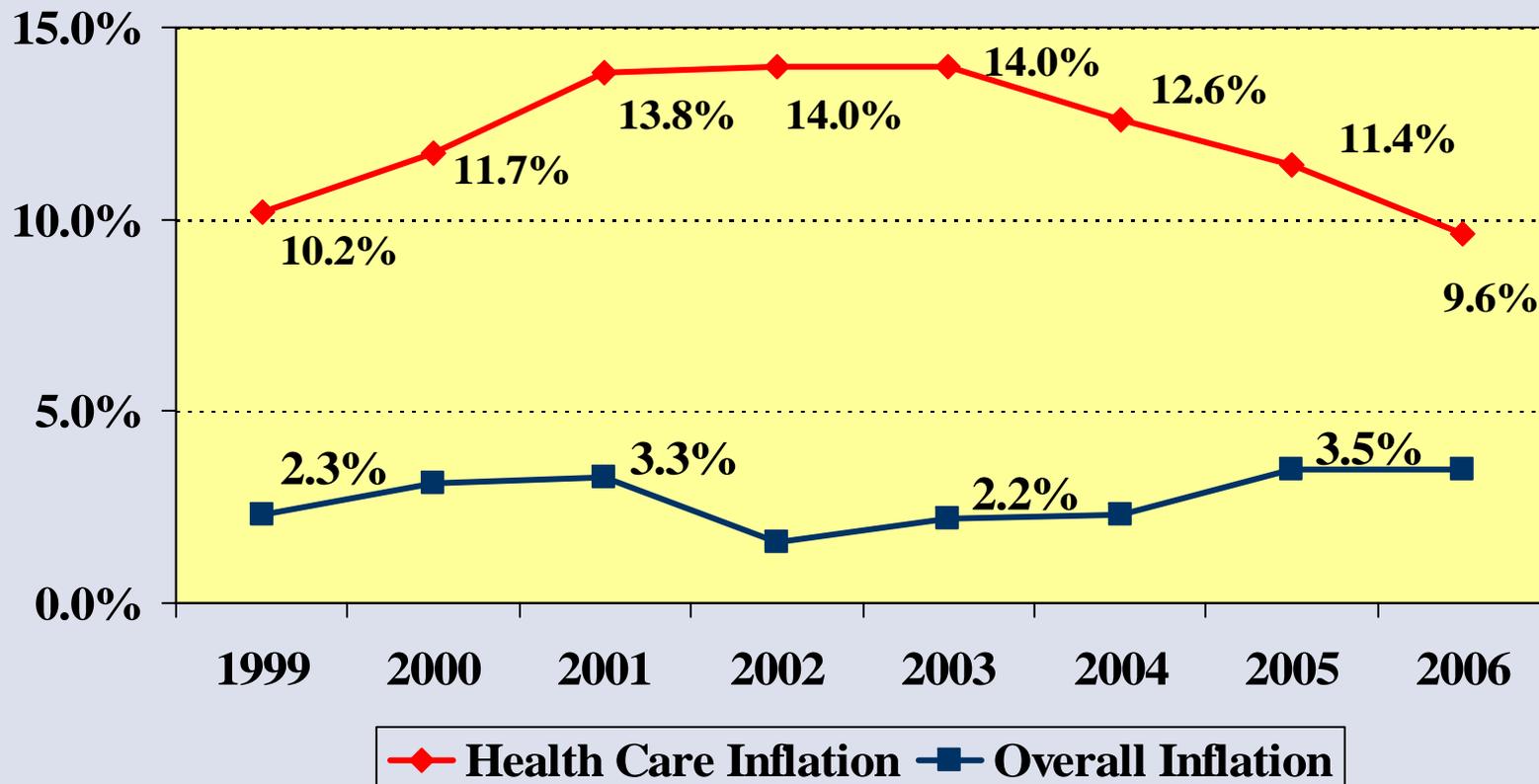
| Initiatives | July Estimate (in millions) | Updated Estimate (in millions) |
|---|--|---|
| Implement managed care performance incentives | \$ 38.6 | \$38.6 |
| Enhance third-party liability initiatives | \$ 13.8 | \$ 15.0 |
| Deficit Reduction Act savings | \$ 16.1 | \$ 4.7 |
| Total Savings | \$ 68.5 | \$ 58.3 |

Managing Medicaid is a National Problem

- Pennsylvania is not alone in its struggle to cope with growing costs for the federal-state Medicaid program. Most states have experienced significant increases in caseloads and costs over the past several years.
- Recent trends suggest that caseload growth is beginning to slow.
- Evidence suggests that states are doing a better job of managing their Medicaid health care costs than the private health care market.
- The commonwealth has successfully reduced Medicaid caseloads and costs; however, cost containment and strong management of the commonwealth's Medicaid program remain a necessity.

Health Care Inflation Is Growing Faster than the Overall Rate of Inflation

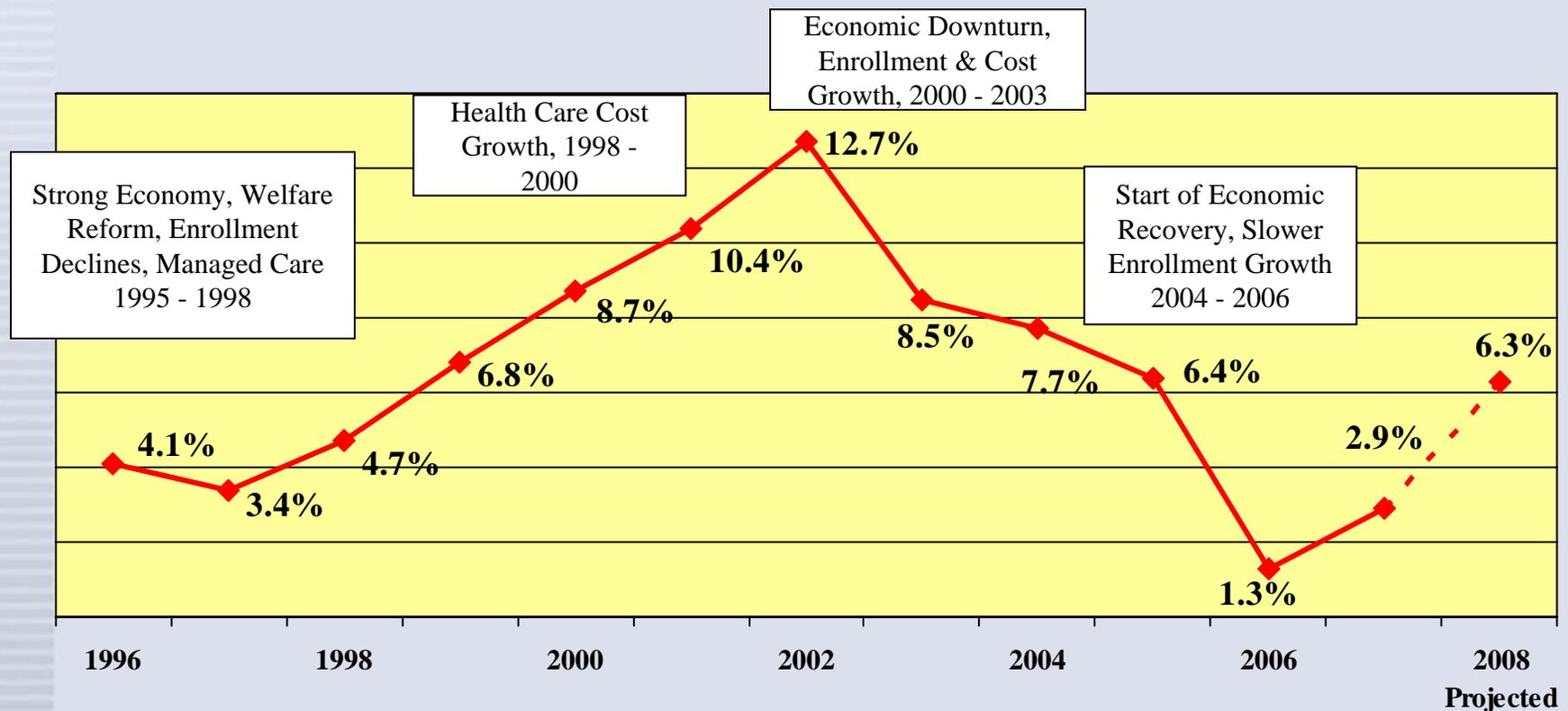
Health care inflation has exceeded overall inflation by a significant margin.



Health care composite inflation rates developed from data provided by Buck Consultants.

National Medicaid Spending Growth 1996 – 2008

MA Spending Growth is Down from the 2002 Peak but Costs are Still Rising

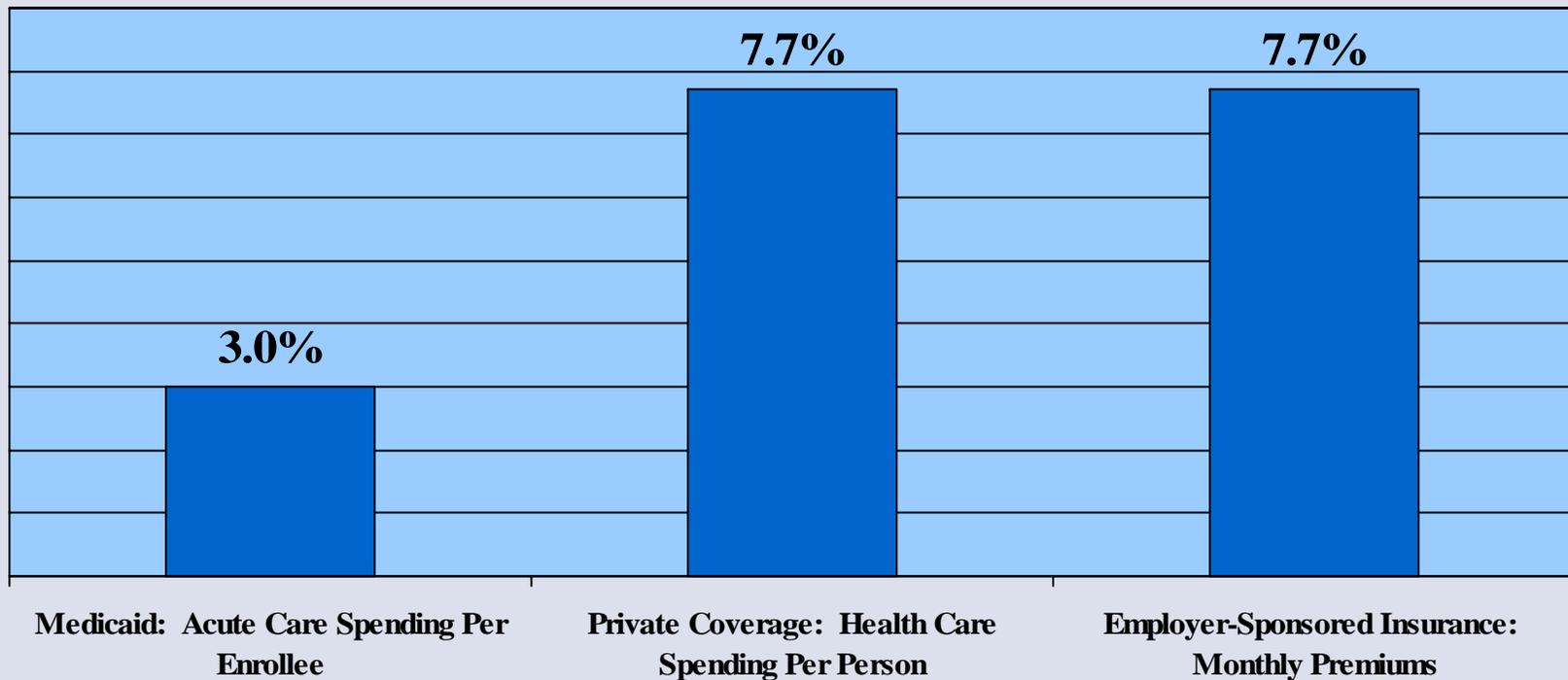


Note: Estimates in State Fiscal Year. Preliminary estimate for 2008.

SOURCE: Kaiser Commission on Medicaid and the Uninsured. "Results from a 50-State Medicaid Budget Survey for State Fiscal Years 2007 and 2008," October 2007.

States Are Managing Medicaid Costs But Growth Continues

*Per Capita Medicaid Spending Growth in the U.S. Compares Favorably to
Growth in Private Health Care Spending 2005 - 2006*

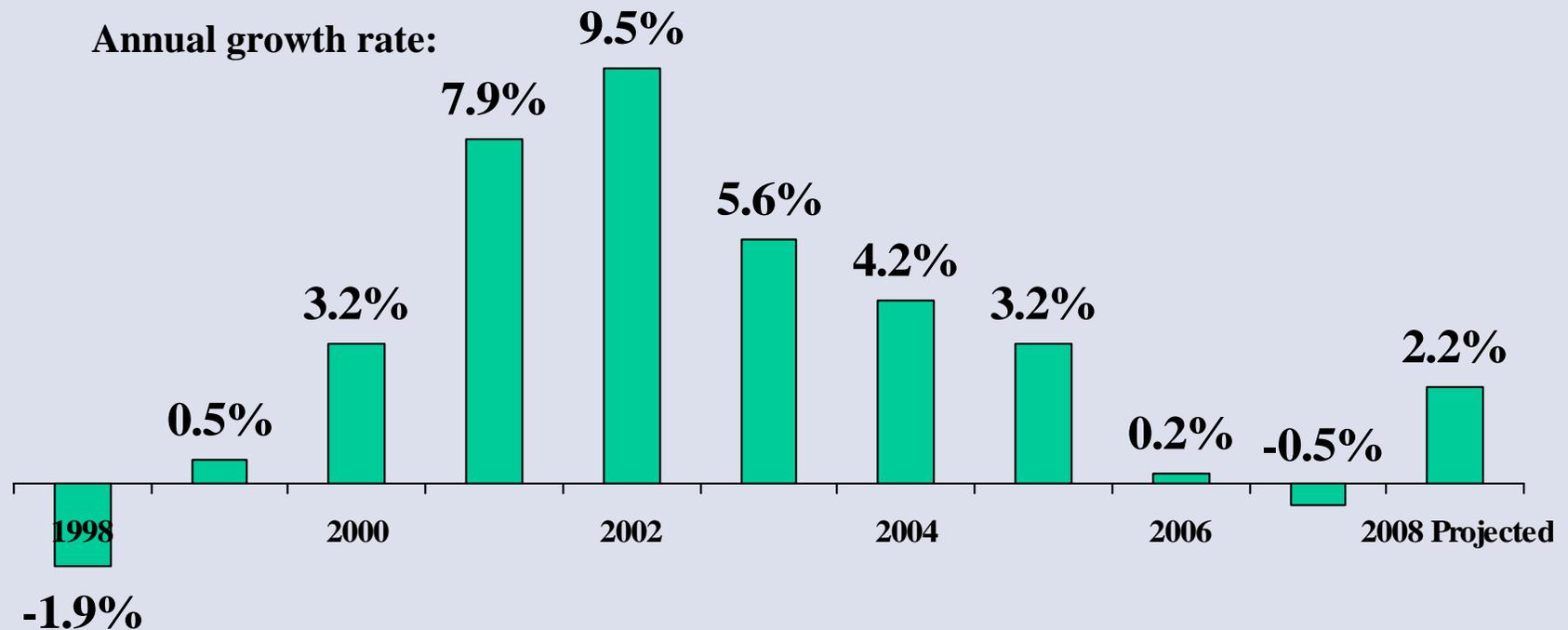


SOURCE: Kaiser Commission on Medicaid and the Uninsured. "Results from a 50-State Medicaid Budget Survey for State Fiscal Years 2007 and 2008," October 2007.

Percent Change in U.S. Medicaid Enrollment

Enrollment Growth Down from the 2002 Peak

But Rolls Expected to Grow in 2008



Note: Percentage changes from June to June of each year.

SOURCE: Kaiser Commission on Medicaid and the Uninsured. "Results from a 50-State Medicaid Budget Survey for State Fiscal Years 2007 and 2008," October 2007.

Commonwealth of Pennsylvania

December 2007

Implementing the 2007-08 Budget

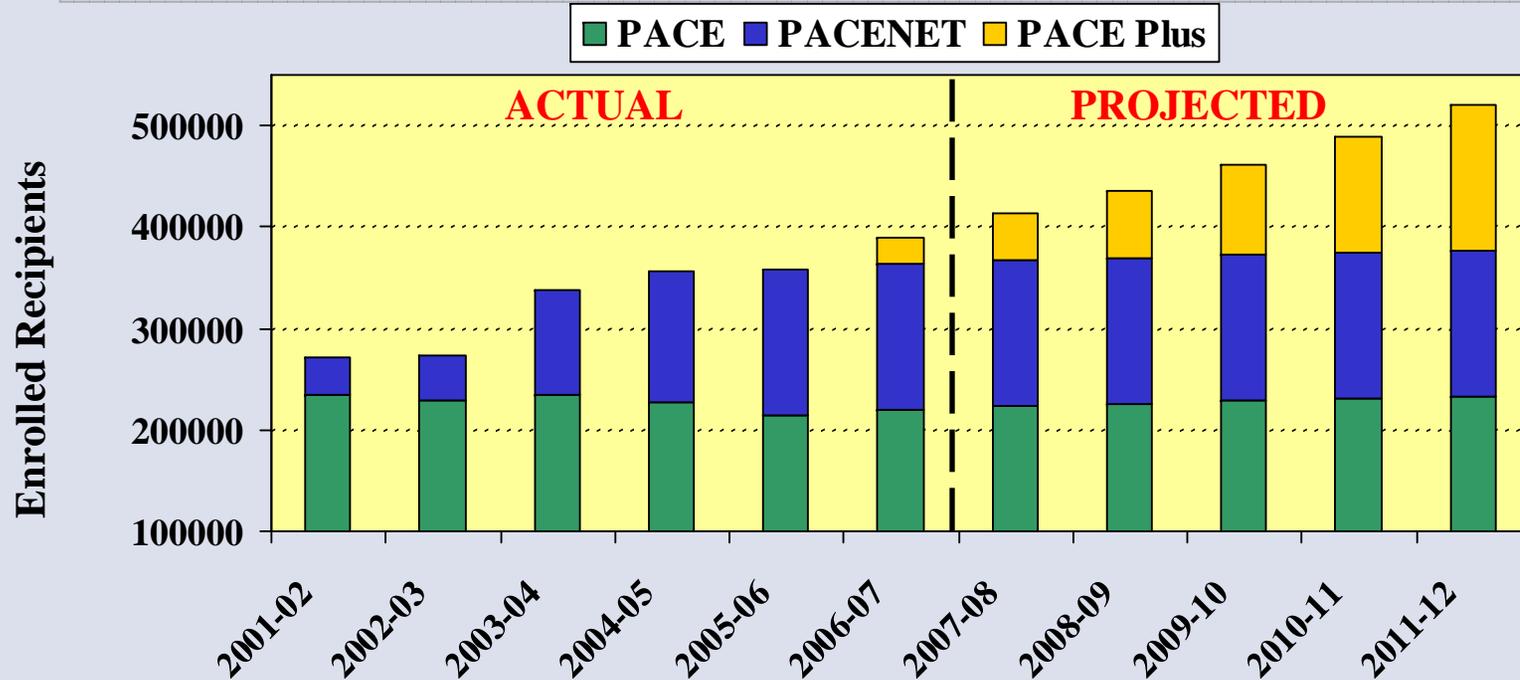
PACE Plus Medicare

**Comprehensive Prescription Drug
Coverage for Older Pennsylvanians**

PACE Plus Medicare Pharmaceutical Assistance Program Enrollment

Status Update

*PACE Plus Medicare provides seamless pharmaceutical benefits to PACE/PACENET enrollees in coordination with the federal Medicare prescription drug program. The 2007-08 enacted budget provides funding to extend PACE/PACENET coverage to an additional 31,990 seniors currently eligible for, but not enrolled in, PACE/PACENET, assisting them with coverage gaps in the federal Medicare prescription drug program. **The 2007-08 total of 357,725 is a 61 percent increase in enrollment since the end of 2002, when only 218,900 Pennsylvania seniors were being served.***



Commonwealth of Pennsylvania

December 2007

Implementing the 2007-08 Budget

**Public Safety
and
Security**

Pennsylvania's Safety and Security – A Commonwealth Priority

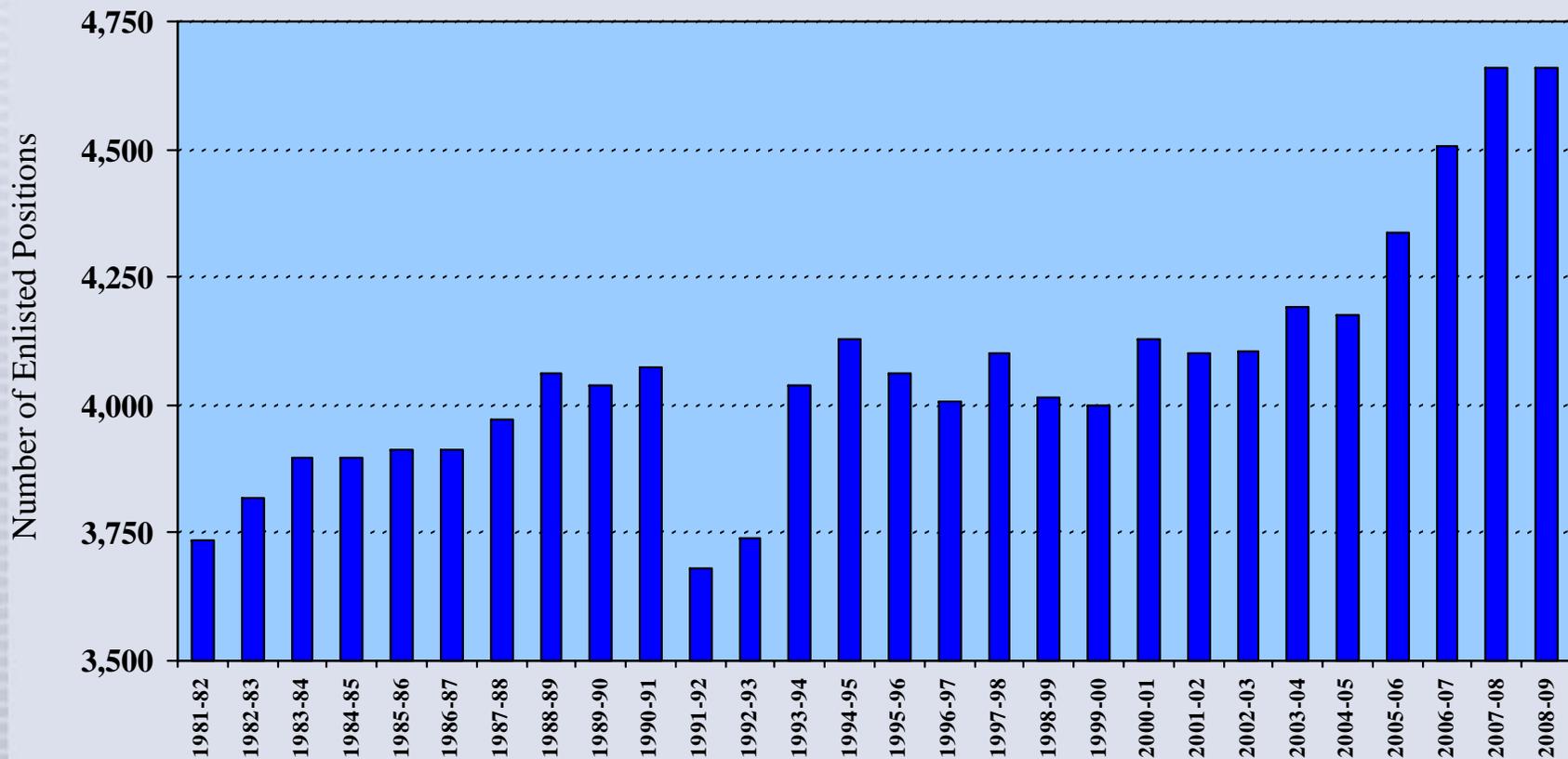
The 2007-08 enacted budget provides additional investments to continue the administration's efforts to increase the security and safety of Pennsylvania's residents and businesses.

- ✓ \$150.0 million in federal funds for **domestic preparedness**
- ✓ \$44 million in state funds to **reopen SCI Pittsburgh**
- ✓ \$27.5 million in total funds for **hazard mitigation**
- ✓ \$25.0 million in state gaming funds for **volunteer company grants**
- ✓ \$14.0 million in federal funds for **pandemic influenza preparedness**
- ✓ \$11.7 million in state funds for **capacity increases at Community Corrections Centers**
- ✓ \$4.0 million in state funds for the **Pennsylvania Map** project
- ✓ \$2.5 million in state funds for **flood mitigation, flood control and flood plain management plans**

Pennsylvania State Police

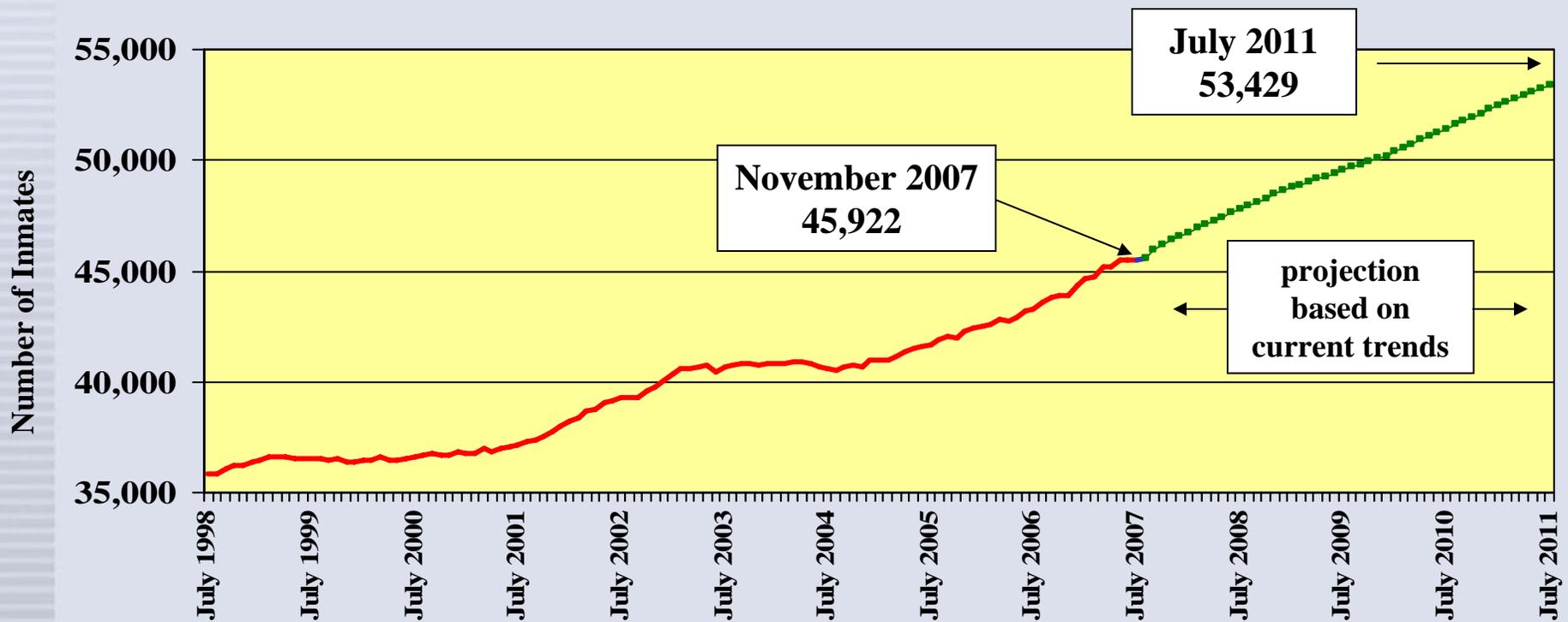
Status Update

The Rendell Administration has supported the greatest increase in State Police trooper strength in recent Pennsylvania history. Recognizing the critical role of the State Police in ensuring public safety, the 2007-08 enacted budget includes funding to raise the trooper level to an all-time high of 4,660 positions by September 2008.



Department of Corrections Inmate Population *Status Update*

Based on current trends, the number of offenders incarcerated in State Correctional Institutions is projected to increase nearly 20 percent, from almost 46,000 inmates in October 2007 to more than 53,000 inmates by July 2011. The 2007-08 annual cost per inmate will be more than \$34,000.



Reducing Prison Re-Entry Rates

The 2007-08 enacted budget provides additional investments to continue the administration's efforts to increase the security and safety of Pennsylvania's residents while saving taxpayer money by reducing recidivism.

- ✓ \$4 million for additional **parole agents, transitional planning coordinators and referral specialists to work with offenders**
- ✓ \$3.2 million to increase **eligible participants in the State Intermediate Punishment program for intensive drug or alcohol treatment**
- ✓ \$2.2 million in additional funding for the **Drug and Alcohol Restrictive Intermediate Punishment program**
- ✓ \$792,000 for the Department of Corrections to **provide addiction counseling, cognitive behavior therapy and psychological assessments to inmates**
- ✓ \$785,000 for the Department of Corrections for **additional vocational education teachers**

New Legislative – Potential Impact on Re-Entry Rates

Controlling the Cost of Incarceration Through Better Offender Management

If enacted, the currently proposed prison legislation will slow the inmate population growth, result in safer citizens and provide a considerable net savings to taxpayers. In addition, this legislative package will delay and even eliminate the need to construct costly new state prisons.

Transfer of inmates:

- Provides for the temporary transfer of inmates who are in the State prison system.
 - *House Bill 5: Introduced July 6, 2007. Currently in House Appropriations*
 - *Senate Bill 1206: Introduced December 7, 2007. Currently on Senate Calendar*

Sentencing Reform:

- Provides authority for new guidelines by the Pennsylvania Commission on Sentencing. Increases access State Intermediate Punishment (SIP) Program and provides for recidivism risk reduction incentive minimum sentencing.
 - *House Bill 4: Introduced August 24, 2007. Currently in House Appropriations*
 - *Senate Bill 1045: Introduced August 2, 2007. Currently on Senate Calendar*

New Legislative – Potential Impact on Re-Entry Rates

Controlling the Cost of Incarceration Through Better Offender Management

If enacted, the currently proposed prison legislation will slow the inmate population growth, result in safer citizens and provide a considerable net savings to taxpayers. In addition, this legislative package will delay and could even eliminate the need to construct costly new state prisons.

Enacting the currently proposed legislation is expected to produce a reduction in the inmate population of 2,687 by December 31, 2012 – the equivalent of nearly one and one half prisons.

Parole Reform:

- Provides for the possibility of administrative parole which requires less supervision. The legislation further provides for “rebuttable parole” for eligible offenders who complete programming and treatment required and certified by the Department of Corrections.
 - *House Bill 6: Introduced August 21, 2007. Currently in House Appropriations*
 - *Senate Bill 1207: Introduced December 7, 2007. Currently on Senate Calendar*

Commonwealth of Pennsylvania

December 2007

Implementing the 2007-08 Budget

Transportation Funding

Act 44 of 2007

The administration, the Turnpike Commission and the legislature crafted a funding solution that protects the public and turnpike workers and generates an historic level of transportation funding.

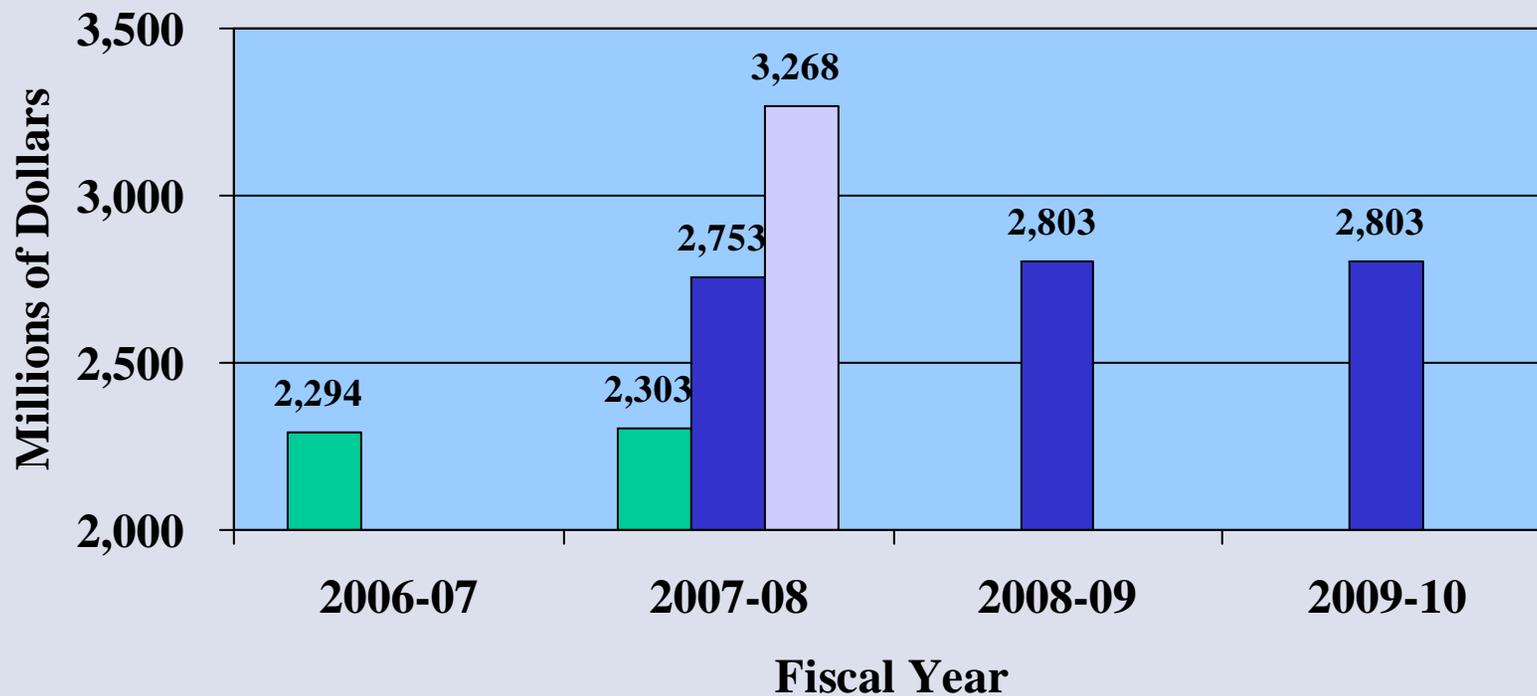
- Act 44 – signed by Governor Rendell on July 18, 2007 – guarantees an average of nearly \$1 billion in new funding per year for highways, bridges and transit over the next ten years:
 - The Turnpike Commission will provide to the commonwealth a yearly average of **\$531 million** for highway and bridge repair and **\$414 million** for 73 transit systems providing more than 400 million rides annually in 67 counties.
 - The Turnpike Commission will:
 - issue \$5 billion in “Special Revenue Bonds” and \$4.1 billion in bonds against tolls on the main line of the Pennsylvania Turnpike;
 - increase tolls 25 percent in 2009 (and as much as required to meet its annual payments thereafter); and
 - toll I-80 beginning in 2011, also issuing bonds against those toll revenues.
 - Act 44 establishes a Public Transportation Trust Fund (PTTF) that:
 - combines old and new transit revenue sources; and
 - dedicates a portion of the state sales tax to transit funding.
 - The dedicated portion of the sales tax replaces the current General Fund appropriation that failed to grow with inflation over the years.

Act 44 of 2007

- Since the law's passage, several concerns have been raised about its approach to providing additional highway, bridge and transit funding:
 - The bipartisan Transportation Funding and Reform Commission recommended investing **\$965 million** in highways and bridges and **\$760 million** for transit annually, considerably higher amounts than provided under Act 44.
 - The Turnpike Commission's required payments to the commonwealth for transportation will drop to only \$450 million annually if the Federal Highway Administration does not approve the I-80 tolling plan. (Highways and bridges would receive \$200 million and public transit \$250 million.)
 - After the conversion of I-80 into a toll road, the Turnpike Commission will debit the commonwealth for the Turnpike Commission's estimate of the annual cost to operate and maintain the roadway (a current estimate of \$100 million, scheduled to grow at 4 percent per year).
 - While under the law, the Turnpike Commission is responsible for payment of debt service on the Special Revenue Bonds, commonwealth Motor License Fund revenues are pledged in case of payment default. The Turnpike Commission is responsible for reimbursing the Motor License Fund in this instance, but this provision could affect the balance of the Motor License Fund, potentially disrupting projects or requiring additional revenue for the fund.

Motor License Fund Revenues

Act 44 provides an additional \$450 million in 2007-08, but the Transportation Funding and Reform Commission recommended a \$965 million annual increase. Even in the next two years, funding levels will remain significantly below the commission's recommendation.



■ Actual/Baseline
 ■ With Act 44 (2007)
 ■ TFRC Recommended

Distribution of New Funds

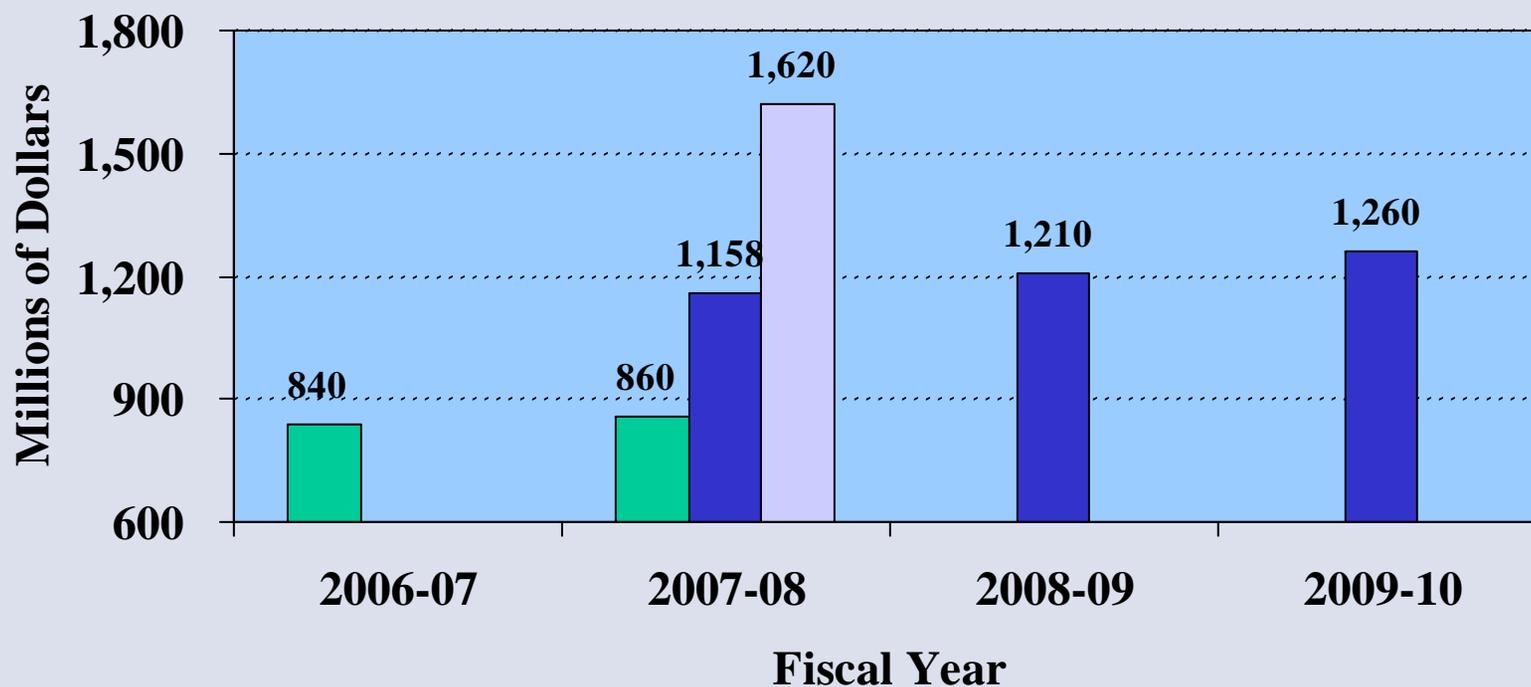
Roads and Bridges

Of the new road and bridge funding, 15 percent is allocated at the discretion of the Transportation Secretary; \$5 million goes to counties, based on the surface area of county-owned bridges; \$30 million is distributed to municipalities by existing formula; and the balance is used for highways and bridges using formulas periodically revised by PennDOT and metropolitan and rural planning organizations.

| How Funds Will Be Distributed | 2007-08 Amount |
|--|-----------------------|
| Needs-Based Formulas – Developed among metropolitan and rural planning organizations and PennDOT | \$347.5 Million |
| Discretion of the Secretary of Transportation (15 percent) | \$67.5 Million |
| Municipal Roads and Bridges (fixed amount) | \$30.0 Million |
| Maintenance and Construction of County Bridges (fixed amount) | \$5.0 Million |
| Total | \$450 Million |

Public Transit Funding

Act 44 provides an additional \$300 million in 2007-08, rising to \$450 million in 2009-10, but the Transportation Funding and Reform Commission recommended a \$760 million annual increase. Even in the next two years, funding levels remain significantly below the commission's recommendation.



■ Actual/Baseline
 ■ With Act 44 (2007)
 ■ TFRC Recommended

Impact of New Transit Funding

- Pennsylvania transit agency operating deficits have been eliminated.
- Rural Transportation for Persons with Disabilities is being implemented in 16 remaining counties and will now be a *statewide program* (excluding Allegheny and Philadelphia).
- **SEPTA** plans to modernize signals, improve switching and acquire paratransit vehicles.
- **Centre Area Transportation Authority** is restoring service.
- **York County Transportation Authority** is evaluating additional service.
- With additional funding, the commonwealth is:
 - supporting service studies at **Cambria County Transit Authority, Altoona Metro Transit, Lehigh and Northampton Transportation Authority, Butler Transit Authority, Port Authority of Allegheny County, Erie Metropolitan Transit Authority, Somerset County and Westmoreland County Transit Authority.**
 - reviewing equipment needs for **Area Transportation Authority of North Central Pennsylvania**, which covers six northern tier counties, and **Washington County Transportation Authority.**
 - providing marketing technical assistance to **County of Lebanon Transit Authority, Berks Area Reading Transportation Authority** and to **Chester County's Transportation Management Association.**
- Work is under way with Public Welfare and Aging on the human services transportation study required by Act 44.
- Systems with more than \$5M in subsidy are now providing reports on the potential for private contracting as required by Act 44.

Act 44 Implementation

- **The Turnpike Commission is pursuing the tolling of I-80 and has:**
 - applied for tolling authority under FHWA *Interstate System Reconstruction and Rehabilitation Pilot Program* (10/13/2007);
 - executed the I-80 lease and funding agreement (10/14/2007); and
 - borrowed \$532 million to fund first three commonwealth payments on 10/25/2007; \$450 million more will be borrowed by 5/1/2008.
 - The Turnpike Commission is studying I-80's traffic and revenue potential, evaluating toll plaza locations, considering operational improvements, and soliciting public input in preparation for submission of further documentation to FHWA by summer 2008.
- **The commonwealth is receiving new transportation funding.**
 - In August 2007 the commonwealth received the Turnpike Commission's initial \$62.5 million payment.
 - In October 2007, it received a second quarter \$229.2 million payment.
 - Two more \$229.2 million payments will complete the Turnpike Commission's 2007-08 obligation.
 - PennDOT is now working with planning organizations statewide to select new highway and bridge projects for funding.

Turnpike Concession Solicitation

- **The administration is reconsidering the policy alternative of leasing the Pennsylvania Turnpike.**
 - Morgan Stanley advised the commonwealth that a long-term lease could fund the entire estimated \$1.725 billion in annual highway and transit needs, significantly more funding than provided by Act 44.
 - A public-private partnership could support not only transportation needs and other priority initiatives of the Governor and legislature.
 - A lease could be structured to provide a large upfront payment, to reduce the credit risk implicit in Act 44 and fund more projects.
- **The administration is pursuing a toll road concession agreement.**
 - Thirty-four firms constituting 14 teams responded to request for qualifications; teams are being finalized and considered for qualification to bid, while conducting due diligence to arrive at appropriate valuations.
 - Commonwealth financial advisors expect to review numerous bids; the Governor will approach General Assembly with a binding bid.
 - Public-Private Partnership legislation and a concession agreement would place the roadway under PennDOT's control and pay off any existing debt secured by tolls, requiring changes to Act 44, which relies on main toll line revenues for annual commonwealth payments.

Commonwealth of Pennsylvania

December 2007

Implementing the 2007-08 Budget

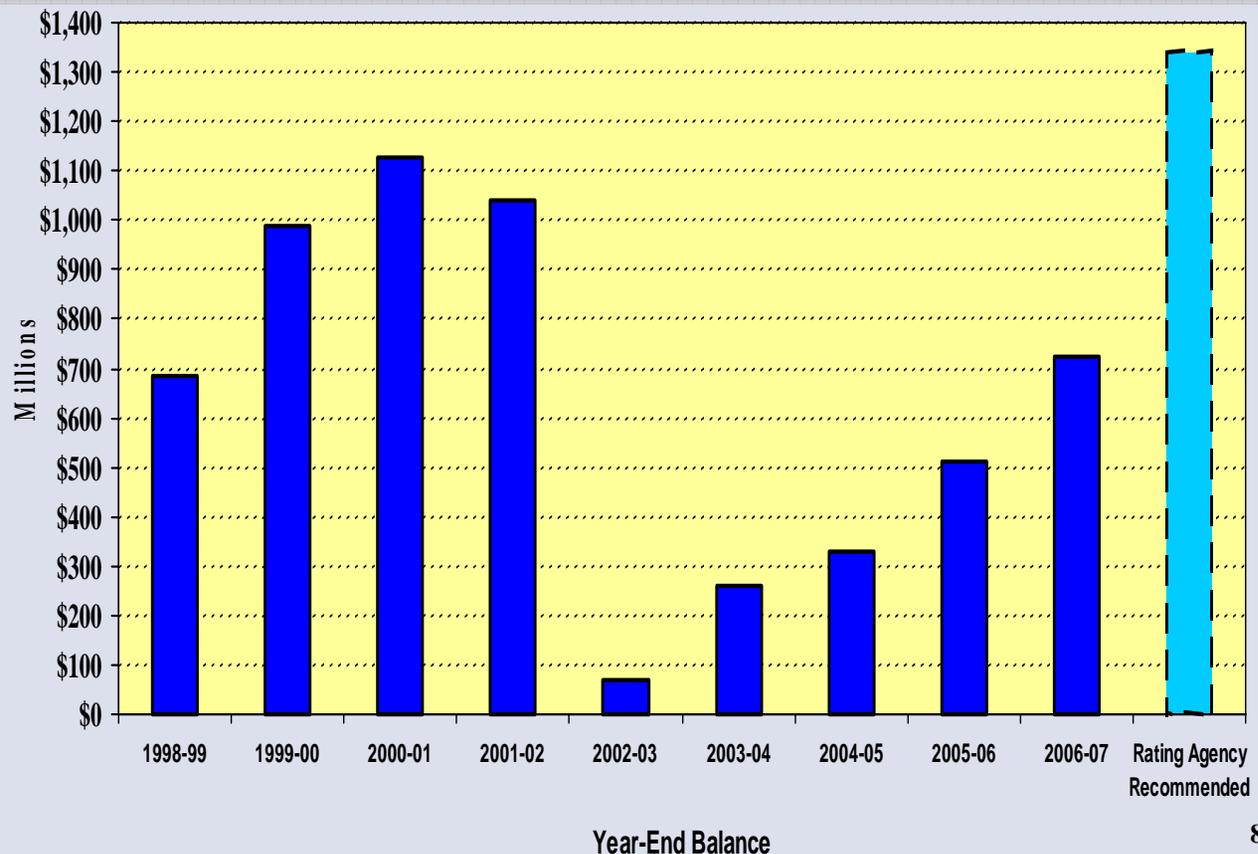
**The
Rainy Day
Fund**

Status of PA's Rainy Day Fund

Pennsylvania Rainy Day Fund balances were built up substantially during the latter part of the 1990s and peaked at more than \$1.1 billion in 2000-01. The Fund was depleted in order to balance the 2001-02 and 2002-03 General Fund budgets. Through disciplined budget administration, the Rendell administration was able to make annual year-end transfers of surpluses that brought the Rainy Day Fund balance to \$726 million by the end of 2006-07.

Rating Agencies recommend that reserves of at least 5 percent of annual revenues be held in a Rainy Day Fund in case of an economic downturn.

To meet this criteria, Pennsylvania would have to increase the Rainy Day Fund balance to \$1.4 billion, an increase of \$664 million.



Commonwealth of Pennsylvania

December 2007



Implementing the 2007-08 Budget
Business Tax Cuts

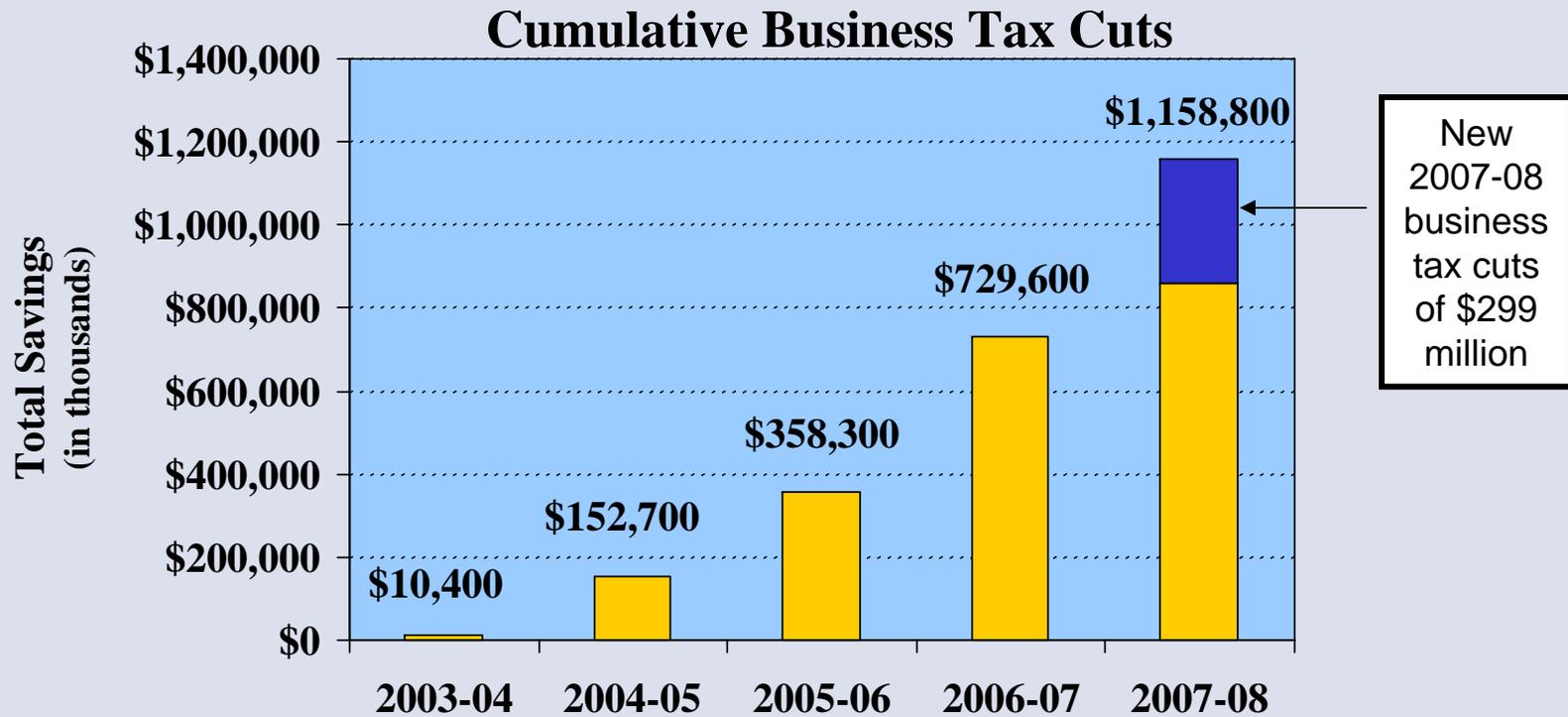
2007-08 Business Tax Cuts

Business taxes will be cut by \$299 million in 2007-08. There has been a cumulative total of \$2.4 billion in business tax cuts from 2003-04 to 2007-08. The 2007-08 cuts include:

- **Capital Stock and Franchise Tax** – continuation of the phase-out by one mill to lower the rate to 3.89 mills, saving businesses a total of \$232 million in 2007-08. In 2007-08, businesses will save more than \$802 million due to the cumulative reductions in the CSFT implemented since 2003.
- **Film Production Tax Credit** – \$75 million
- **Educational Improvement Tax Credit** – \$16 million
- **Goodwill Exemption for Bank Shares Tax** – \$13 million
- **Resource Enhancement & Protection Tax Credit** – \$10 million

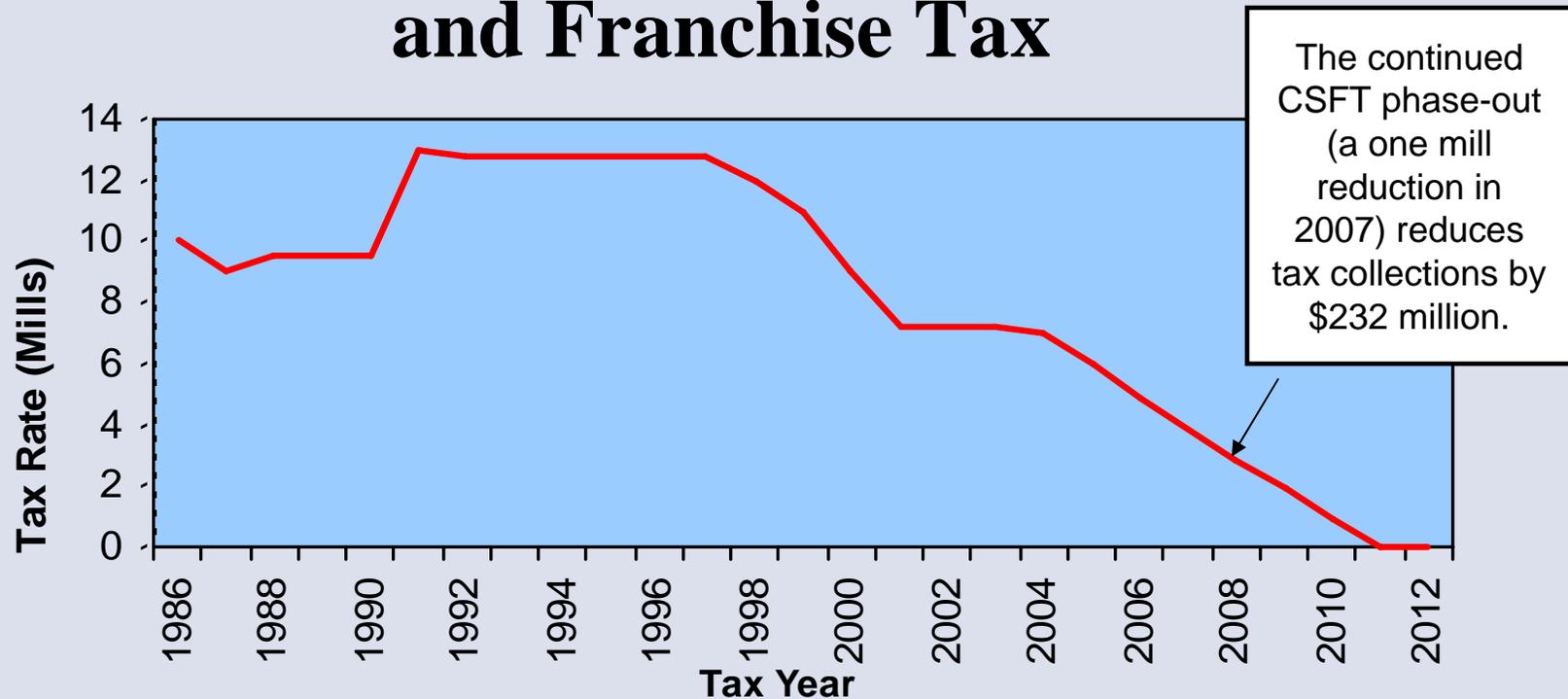
Cumulative Business Tax Cuts 2003-04 through 2007-08

The 2007-08 enacted budget includes \$299 million in new business tax cuts, including \$232 million from the scheduled one mill reduction in the Capital Stock and Franchise Tax. Since 2003, the administration has reduced business taxes by \$2.4 billion, including more than \$1.6 billion in savings from the Capital Stock and Franchise Tax.



CSFT reductions are based on revisions to the rate versus a 7.24 mill base.

Continuing the Phase-Out of the Capital Stock and Franchise Tax



- The Capital Stock and Franchise Tax declines by another one mill to 3.89 mills in 2007, resulting in a \$232 million savings to businesses in 2007-08. The rate will decline by another one mill in 2008.
- Cumulative business tax reductions from major tax savings initiatives for 2003-04 through 2007-08 total nearly \$2.4 billion, including more than \$1.6 billion in cumulative savings from the Capital Stock and Franchise Tax phase-out and acceleration.

Pennsylvania's Business Tax Climate

In its 2008 State Business Tax Climate Index, the non-partisan, business-funded Tax Foundation ranked Pennsylvania's tax structure 28th best among the 50 states. The Tax Foundation praised the commonwealth for its individual income and property taxing systems and cited Pennsylvania as one of the states likely to raise its ranking steadily over the next few years – making the commonwealth even more appealing to businesses.

In particular, the Tax Foundation:

- ✓ Ranked Pennsylvania's taxing system for Personal Income Tax among the best in the nation, an important factor for the increasing number of businesses that report income through the individual income tax code.
- ✓ Highlighted Pennsylvania as one of the states making positive changes to its tax structure, which will continue to improve its business tax climate.
- ✓ Noted that the Capital Stock and Franchise Tax will be phased out with yearly decreases that will completely eliminate the Capital Stock and Franchise Tax by 2011.

Commonwealth of Pennsylvania

December 2007



2007-08 Unfinished Business

Unfinished Business

Deferred 2007-08 Initiatives

During the July enactment, the General Assembly agreed to postpone discussion on several initiatives the Governor included in his 2007-08 budget proposal. These issues are under consideration in the fall legislative session, which began on September 17. Passage of these initiatives is critical to increasing the safety, health and economic competitiveness of Pennsylvania.

- ✓ Energy Independence Strategy
- ✓ Cover All Pennsylvanians – Reducing the Number of Uninsured
- ✓ Hazardous Sites Cleanup Fund
- ✓ Capital Projects Authorization
- ✓ Jonas Salk (Medical Research) Fund
- ✓ Pension Reform
- ✓ Business Tax Reform

Unfinished Business

Deferred 2007-08 Initiatives

Energy Independence Strategy

- Introduced in February, the Governor's Energy Independence Strategy will help consumers manage energy costs, move Pennsylvania toward energy independence and stimulate the state's economy. It will also place Pennsylvania in the top tier of states taking steps to lower consumer energy costs and significantly expand alternative fuel, clean energy and conservation measures.
 - *Various bills pending in both chambers*

Cover All Pennsylvanians

- The Governor's proposal to improve access to health insurance, Cover All Pennsylvanians (CAP) would offer affordable basic health coverage to eligible small businesses and the uninsured through the private insurance market.
 - *House Bill 1870: Introduced October 3, 2007. Currently in House Insurance Committee*
 - *Senate Bill 1117: Introduced October 25, 2007. Currently in Senate Banking and Insurance Committee*

Unfinished Business

Deferred 2007-08 Initiatives

MCARE

- Provides abatements for doctors against their MCARE medical malpractice coverage. The current abatement is set to expire December 31, 2007.
 - *Senate Bill 1137: Introduced October 23, 2007. Currently on House Calendar*
 - *House Bill 1973: Introduced October 25, 2007. Currently in House Appropriations Committee*

Funding for Hazardous Sites Cleanup Fund

- The Hazardous Sites Cleanup program is the Department of Environmental Protection's most important tool to respond quickly and eliminate danger when toxic chemicals or hazardous substances are spilled, leaked or otherwise found in the environment. The HSCF has survived on available balances and transfers from the Environmental Stewardship Fund. The Governor has proposed a tipping fee of \$2.25 per ton on the disposal of municipal solid wastes to provide reliable long-term revenue to the fund. Without a funding solution, HSCF will be bankrupt by January 1, 2008.
 - *Senate Bill 1100: Introduced October 22, 2007. Currently on the House Calendar*



Unfinished Business

Deferred 2007-2008 Initiatives

Capital Budget Itemization and Redevelopment Assistance Debt Ceiling

- The Capital Budget Itemization bill includes an itemized list of projects to be funded by debt of the commonwealth and includes the authority for the commonwealth to incur such debt. The Redevelopment Assistance category within the capital itemization bill has a separate statutory cap on the amount of aggregate debt that can be incurred for such projects.
 - **House Bill 1589:** (*Capital Itemization*) Introduced June 18, 2007. Currently in Senate Appropriations Committee
 - **House Bill 1408:** (*RCAP*) Introduced June 5, 2007. Currently in Senate Finance Committee

Jonas Salk Legacy Fund

- The Jonas Salk Legacy Fund will accelerate investments in research facilities, increase support for biotechnology commercialization and provide increased funding for health venture investments. Fully funded by a portion of Pennsylvania's Tobacco Settlement Fund revenues, the investments made possible by the Jonas Salk Legacy Fund will solidify Pennsylvania's life sciences future.
 - **House Bill 1142:** Introduced May 18, 2007. Currently in Senate Finance Committee

2007-08 Unfinished Business

**Pension
Funding
Reform**

Pension Costs

- The commonwealth contributes funds to the State Employees Retirement System (SERS) for its own employees and to the Public School Employees Retirement System (PSERS) for employees of Pennsylvania school districts.

SERS and PSERS as of 2006

| | Active Members | Assets ¹ | Funded Ratio | Employee Contribution ² |
|--------------------|----------------|---------------------|--------------|------------------------------------|
| SERS ³ | 110,972 | \$28.1 B | 92.7% | 6.2% |
| PSERS ³ | 263,350 | \$52.6 B | 81.2% | 7.2% |

- Actuarial value
- Average employee contribution as a percentage of payroll
- Per most recent published actuarial valuations (2006)

- The commonwealth pays 100 percent of the employer's share of contributions to SERS.
- The commonwealth pays about 55 percent of the employers' share of contributions to PSERS; the remainder is paid by the school districts.

Pension Costs

- Contributions to SERS and PSERS have grown rapidly since 2005, and although rate growth is scheduled to level off in 2008-09 under current law, contributions to both systems are projected to spike in 2012-13.

| | FY2007-08 (\$ millions) | FY2008-09 (\$ millions)* | 2007-08 to 2008-09 % Change | Projected FY2012-13 (\$ millions) * | 2007-08 to 2012-13 % Change |
|--------------|----------------------------|-----------------------------|-----------------------------------|---|-----------------------------------|
| SERS | \$216 | \$225 | 4.2% | \$510 | 136.7% |
| PSERS | \$452 | \$374 | -15.9% | \$799 | 76.8% |
| Total | \$668 | \$599 | -9.4% | \$1,309 | 96.0% |

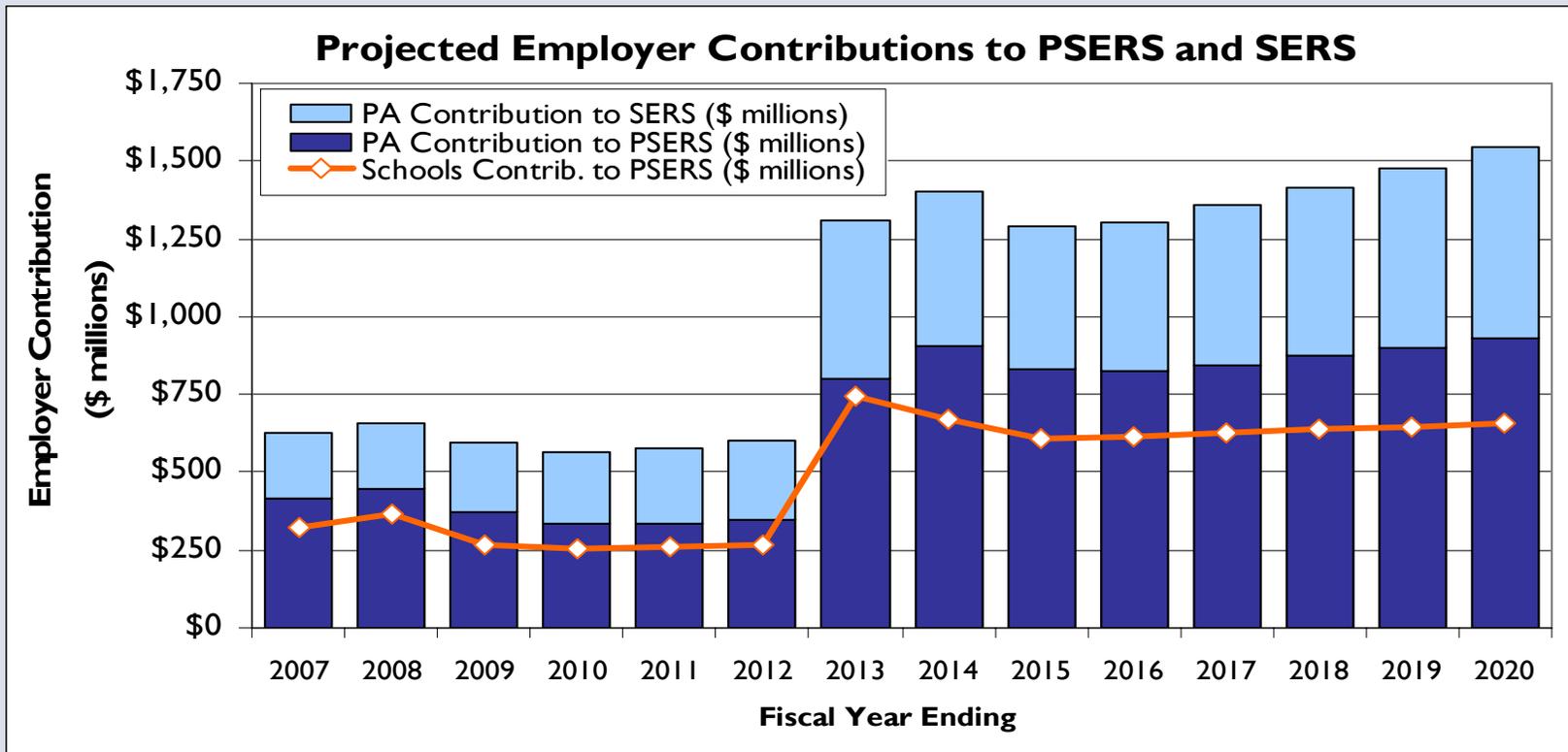
* = Adjusted to include the projected impacts of the PSERS and SERS investment returns as of June 30, 2007

- The dramatic increases in employer contributions in 2012-13 are the result of significant benefit improvements in 2001, reduced stock market returns in the early 2000s, a cost-of-living adjustment to pensions in 2002 and other legislative changes that reduced and delayed contributions.
- Recent legislation and strong investment performances through June 2007 have somewhat reduced the projected 2012-13 increase in contributions. But the commonwealth cannot prudently count on investment returns alone to eliminate these dramatic increases in contribution rates.
- Recent projections that the rate spike will be lower in 2013 than previously expected could be reversed if market performance fails to meet current targets.

Pension Payments

Current and Future Challenges

The strain caused by sudden increases in pension contributions will become far worse. By 2012-13, Governor's Budget Office projections indicate that the state's contribution to SERS and PSERS will reach \$1.31 billion – an increase of 96 percent from 2007-08.



Commonwealth of Pennsylvania

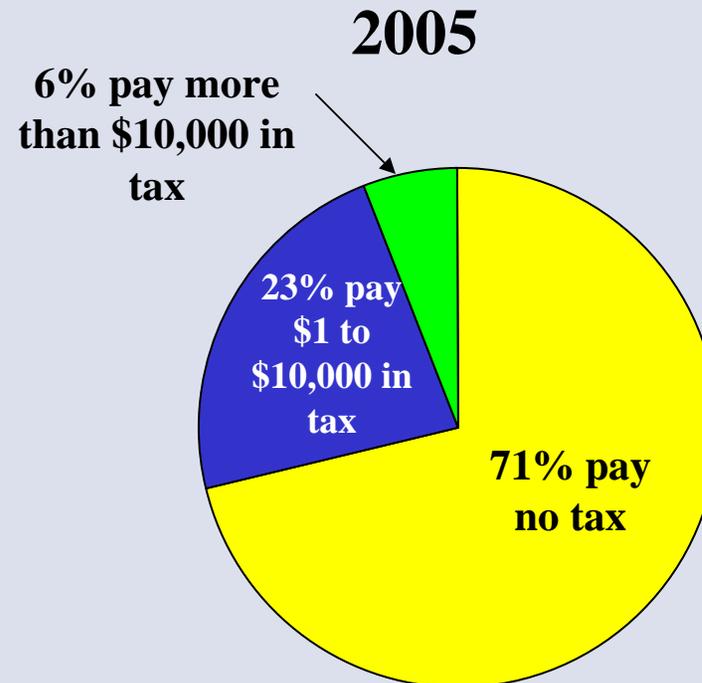
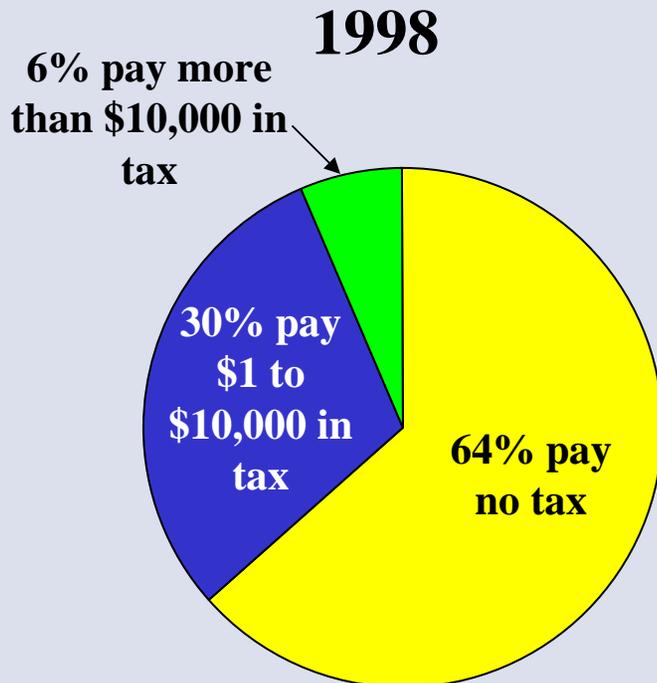
December 2007

2007-08 Unfinished Business

Business Tax Reform

Corporate Net Income Tax

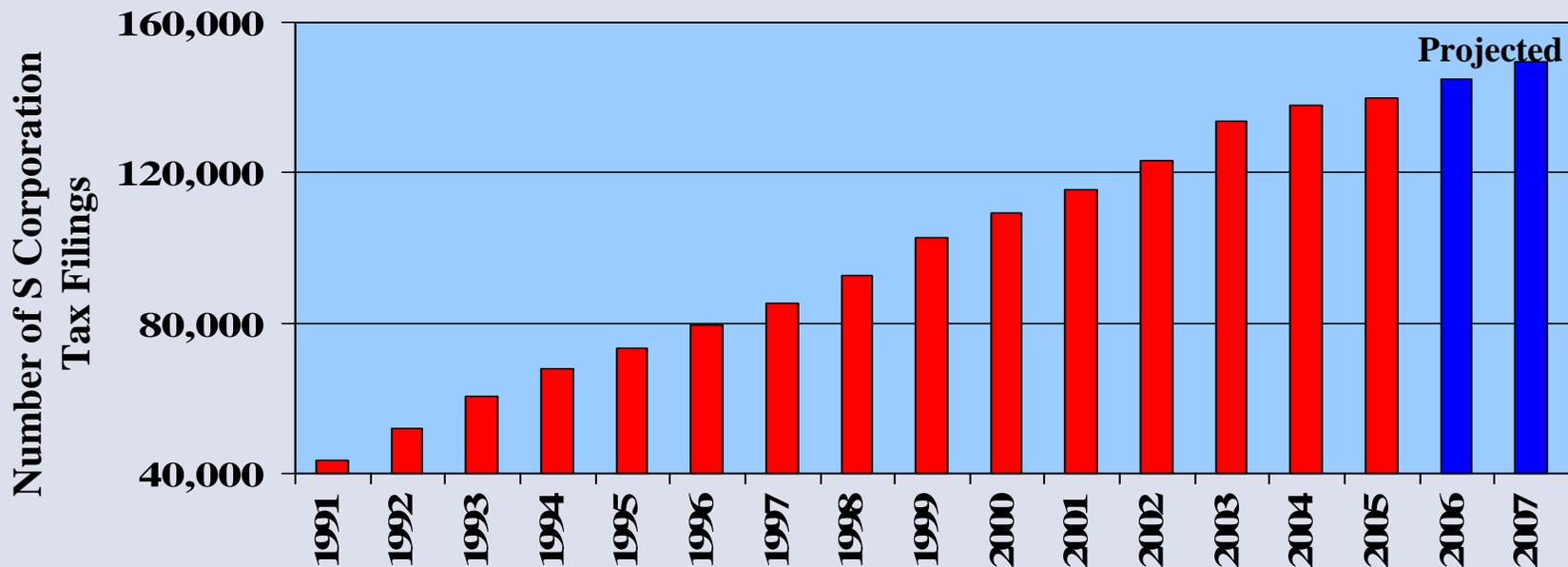
The percentage of Corporate Net Income tax filers with no net income has been steadily increasing – from 64 percent of returns in 1998 to 71 percent of returns in 2005. Nearly 94 percent of all Corporate Net Income Tax filers paid \$10,000 or less in Corporate Net Income taxes during 2005.



Pennsylvania S Corporation Tax Filings

Corporations that elect Pennsylvania "S corporation" status are exempt from the Corporate Net Income Tax. Pennsylvania S corporation shareholders instead include their share of Pennsylvania S corporation income in their Pennsylvania Personal Income Tax filings. This effectively allows corporations to pay their business income tax at the Personal Income Tax rate of 3.07 percent rather than the Corporate Net Income Tax rate of 9.99 percent. In 2007-08, the Department of Revenue estimates that S corporations will pay nearly \$675.4 million less in taxes to Pennsylvania because of this allowance.

From 1991 to 2005, the number of S corporations grew by 221 percent, an average annual growth rate of 15.8 percent.



Pennsylvania S Corporation Tax Filings

Corporations that elect Pennsylvania "S corporation" status are exempt from the Corporate Net Income Tax. Pennsylvania S corporation shareholders instead include their share of Pennsylvania S corporation income in their Pennsylvania Personal Income Tax filings. This effectively allows corporations to pay their business income tax at the Personal Income Tax rate of 3.07 percent rather than the Corporate Net Income Tax rate of 9.99 percent. In 2007-08, the Department of Revenue estimates that S corporations will pay nearly \$675.4 million less in taxes to Pennsylvania because of this allowance.

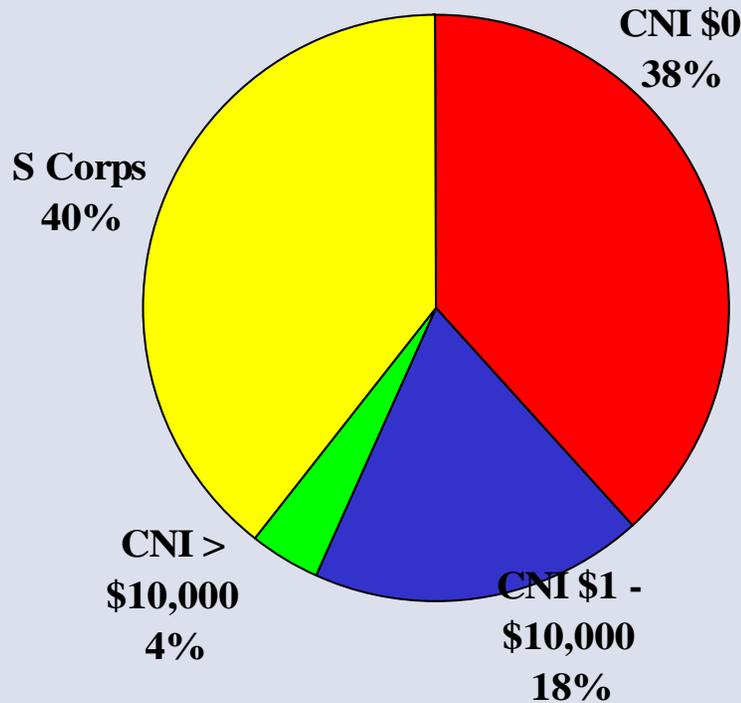
From 1991 to 2005, the number of S corporations grew by 221 percent, an average annual growth rate of 15.8 percent. At the same time the number of S corporations has been increasing, the number of Corporate Net Income Tax filers has decreased.



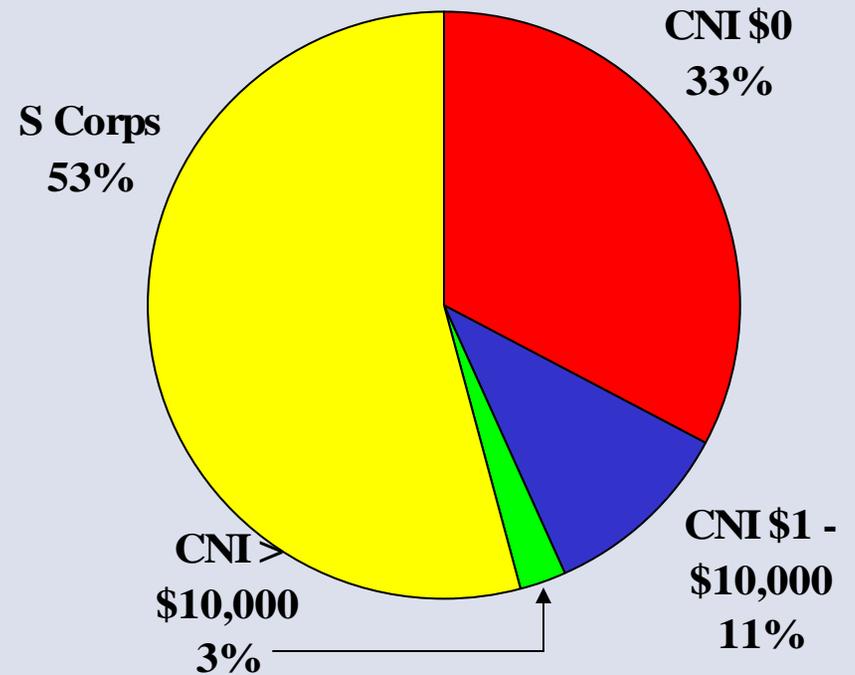
Total Business Tax Filers

An increasing percentage of the commonwealth's business taxpayers are paying their business taxes at the S Corporation rate of 3.07 percent or are paying less Corporate Net Income Tax.

1998



2005



Business Tax Reform – Still Needed

In March 2004, the Governor created the Business Tax Reform Commission to recommend changes to make Pennsylvania's business tax structure more competitive. The Commission made the following unanimous recommendations to improve Pennsylvania's business tax climate.

- ✓ Reduce the Corporate Net Income (CNI) Tax rate to 7.90 percent. **This historic reduction will lower the CNI Tax rate by more than 20 percent from the current 9.99 percent rate.**
- ✓ Eliminate the annual cap on Net Operating Losses.
- ✓ Continue the scheduled phase-out of the Capital Stock and Franchise Tax.
- ✓ Change the weighting of the sales factor of the CNI Tax apportionment formula to 100 percent. **This will encourage employers to locate or expand production in Pennsylvania.**
- ✓ Shift to market-based sourcing in the CNI Tax apportionment formula for the sale of services. **This will encourage growth in service-related industries.**
- ✓ Reform Pennsylvania's tax appeals process and related administrative procedures.
- ✓ Implement a mandatory unitary combined reporting system. **Requires members of a unitary group of businesses to combine income and expenses for tax purposes.**

Commonwealth of Pennsylvania

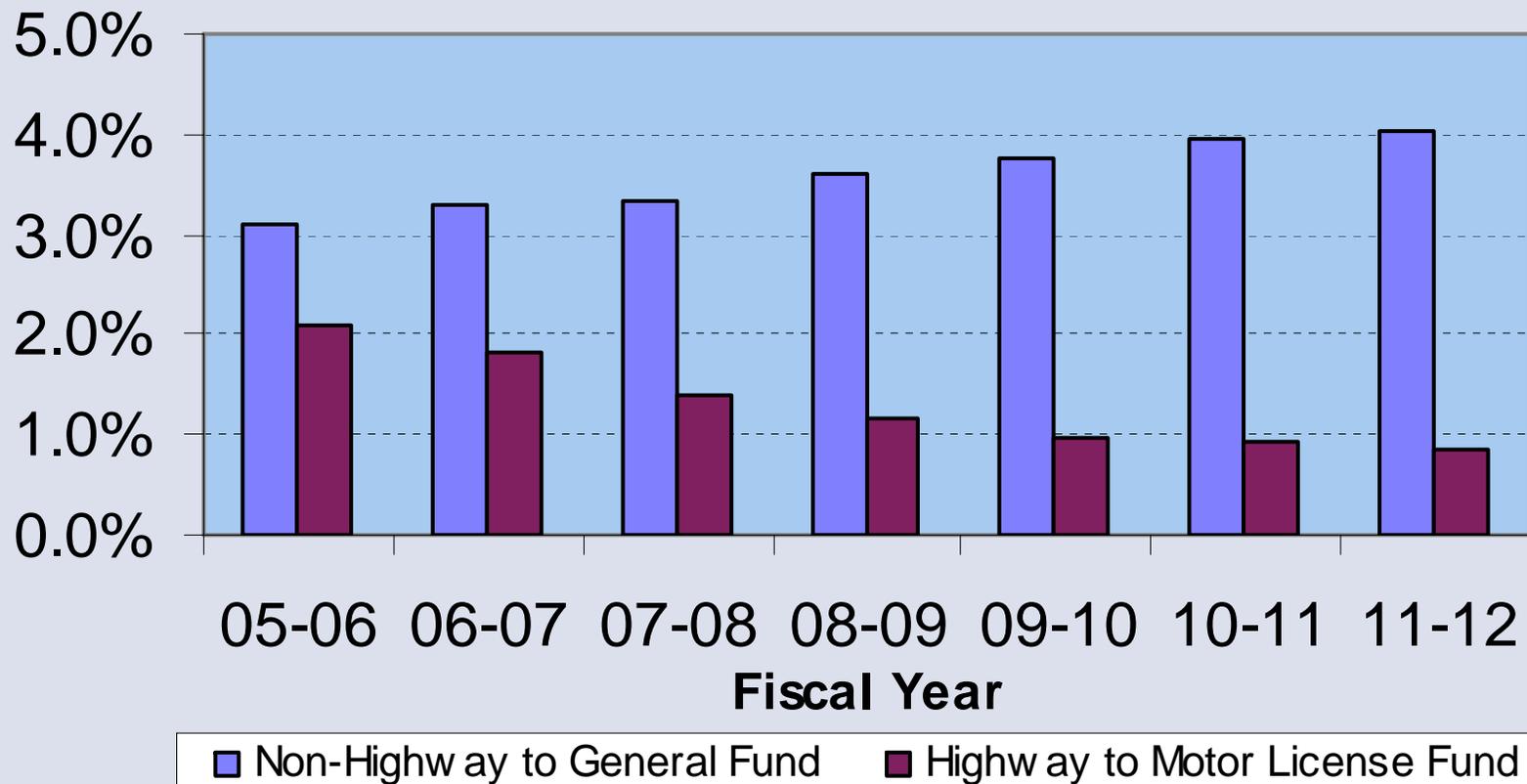
December 2007

Commonwealth Debt

Debt Service As a Percentage of Revenues

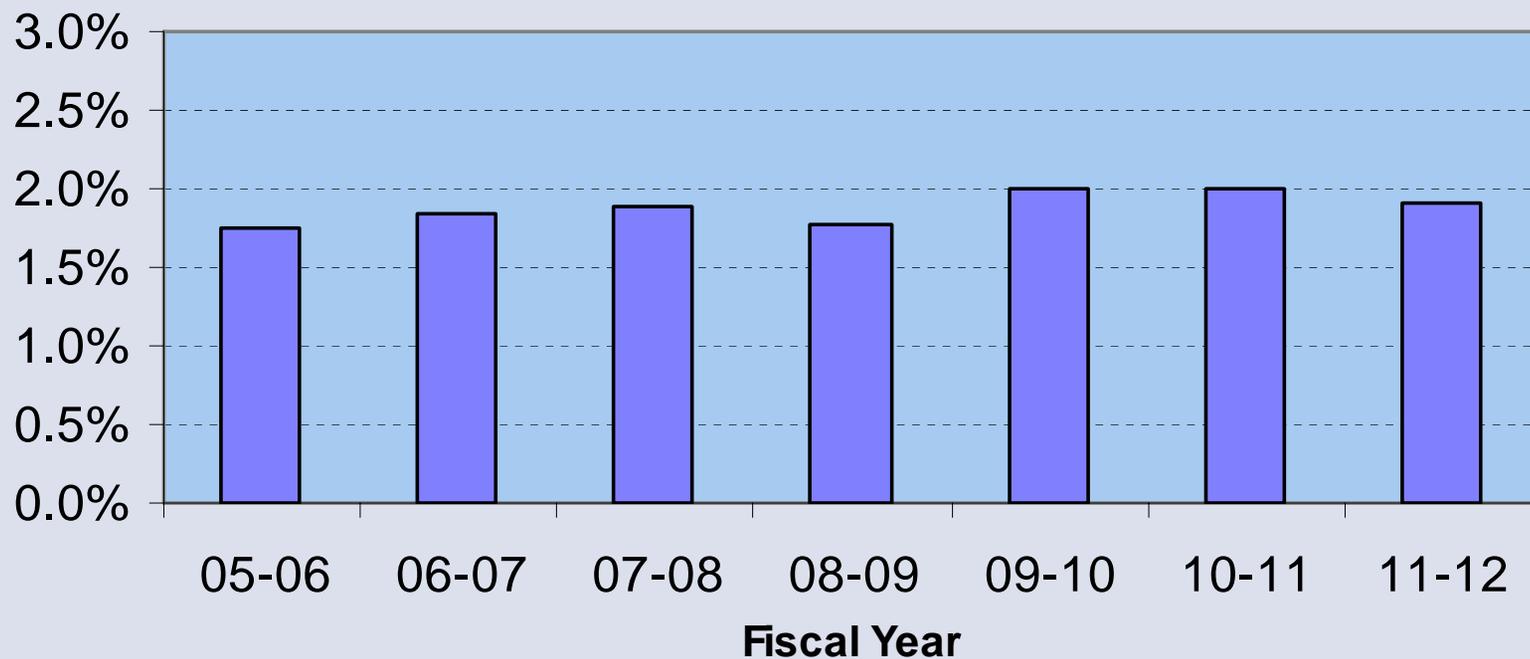
Pennsylvania Has a Low Debt Burden

General Fund debt service as a percent of revenues remains below Standard & Poors criteria of 5 percent for issuers considered to have a "low debt burden."



General Obligation and Lease Rental Debt as a Percentage of Personal Income

Through June 2007, Pennsylvania had only borrowed 14 percent of the level of state indebtedness permitted under the state constitution. According to Moody's, Pennsylvania debts as a percentage of personal income ranked 27th lowest among the 50 states in 2006.





Commonwealth of Pennsylvania

December 2007

Commonwealth of Pennsylvania
Governor's Mid-Year
Budget Briefing
December 12, 2007

Edward G. Rendell
Governor

Michael J. Masch
Secretary of the Budget

To find the 2007-08 Mid-Year Briefing slide show on the Web, go to www.budget.state.pa.us