

**Commonwealth of Pennsylvania**

**2009-10 Mid-Year Briefing**

**Edward G. Rendell**  
*Governor*

**Mary A. Soderberg**  
*Secretary of the Budget*

**December 15, 2009**

“States are currently facing one of the worst, if not the worst, fiscal periods since the Great Depression.”

– **The Fiscal Survey of the States**  
**December 2009**  
**National Governors Association/  
National Association of State Budget Officers**

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## Managing in Tough Times

## Pennsylvania Retains Double-A Bond Rating

*Before Pennsylvania's August 2009 General Obligation bond sale, the top Wall Street credit rating agencies – Moody's, Standard & Poor's and Fitch – all reaffirmed the commonwealth's double-A credit rating, which is the second-highest level of credit. At the same time, Moody's changed its rating outlook for the commonwealth from stable to negative, in part because of the state's declining fund balances and the challenges it faces in rebuilding those balances.*

**According to Moody's, the commonwealth's credit strengths include:**

- **An established record of good financial management, reflected in strong actions to preserve budget balance in recent years.**
- **A state debt position that is moderate and well-controlled, with tax-supported debt ratios close to national average levels and a well-funded state pension system.**
- **Per capita wealth levels that are close to the national average.**

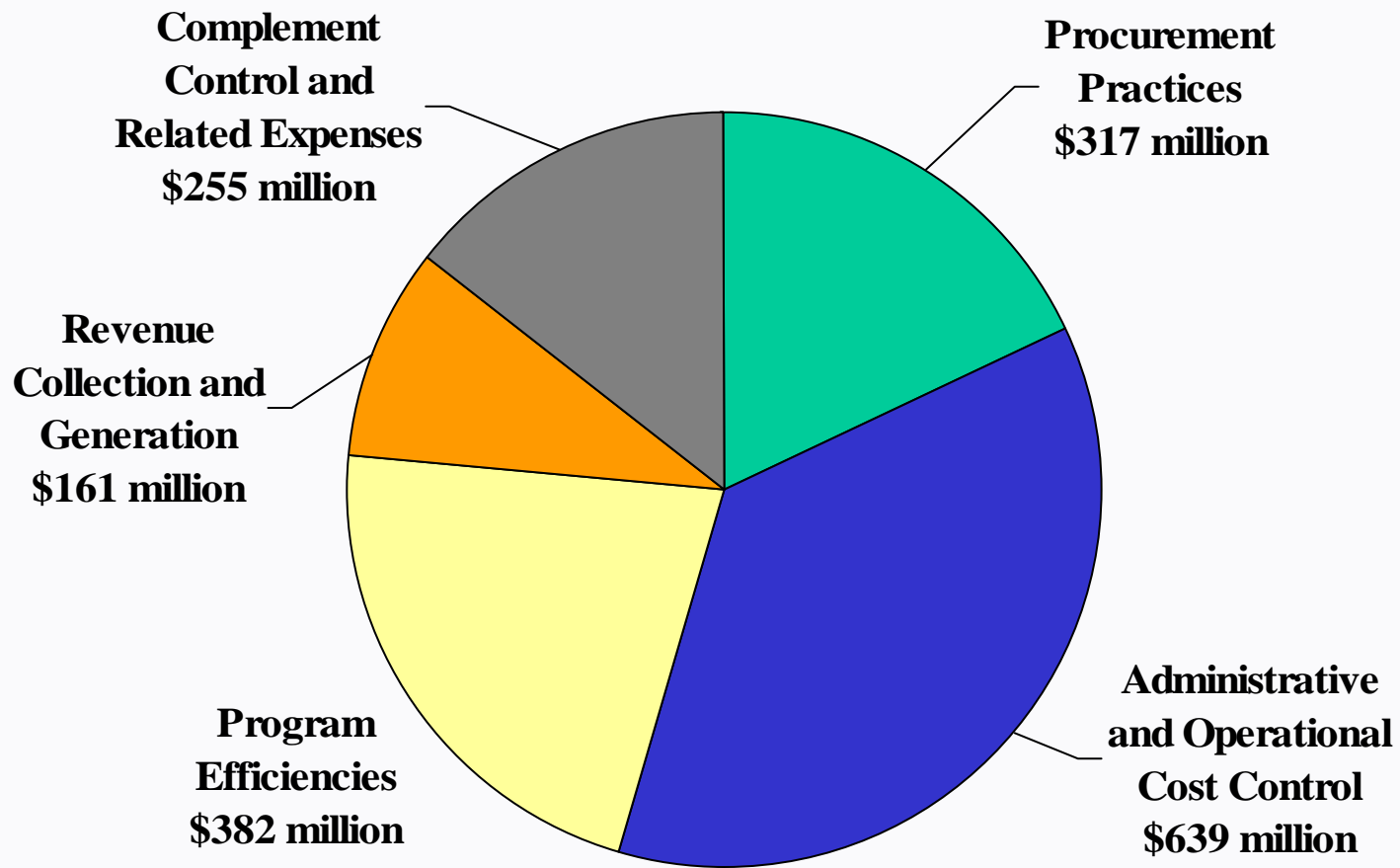
## Ongoing Cost Containment

*In addition to directing agencies to contain their spending growth, the Governor has taken decisive action to reduce administrative spending. These initiatives were put into place in the fall of 2008 and remain in effect today.*

- **A general hiring freeze, followed by employee layoffs in August and December of this year**
  - These actions, along with other actions taken before 2008-09, reduced the workforce by 4.8 percent between January 2003 and December 2009.
  - As of December 2009, there have been 721 layoffs in 2009-10.
- **Out-of-state travel restrictions: Trips must be pre-approved by the Governor's Office.**
  - Reducing out-of-state-travel saved the commonwealth \$14.1 million since the restriction on out-of-state travel was put into place – a 27 percent reduction in out-of-state travel costs in one year.
- **A ban on the purchase of new vehicles. Today there are 500 fewer vehicles in the commonwealth's fleet than last year.**
- **A freeze on cabinet and non-union employees' salaries, saving a total of \$87.3 million from January 2009 to June 2010**

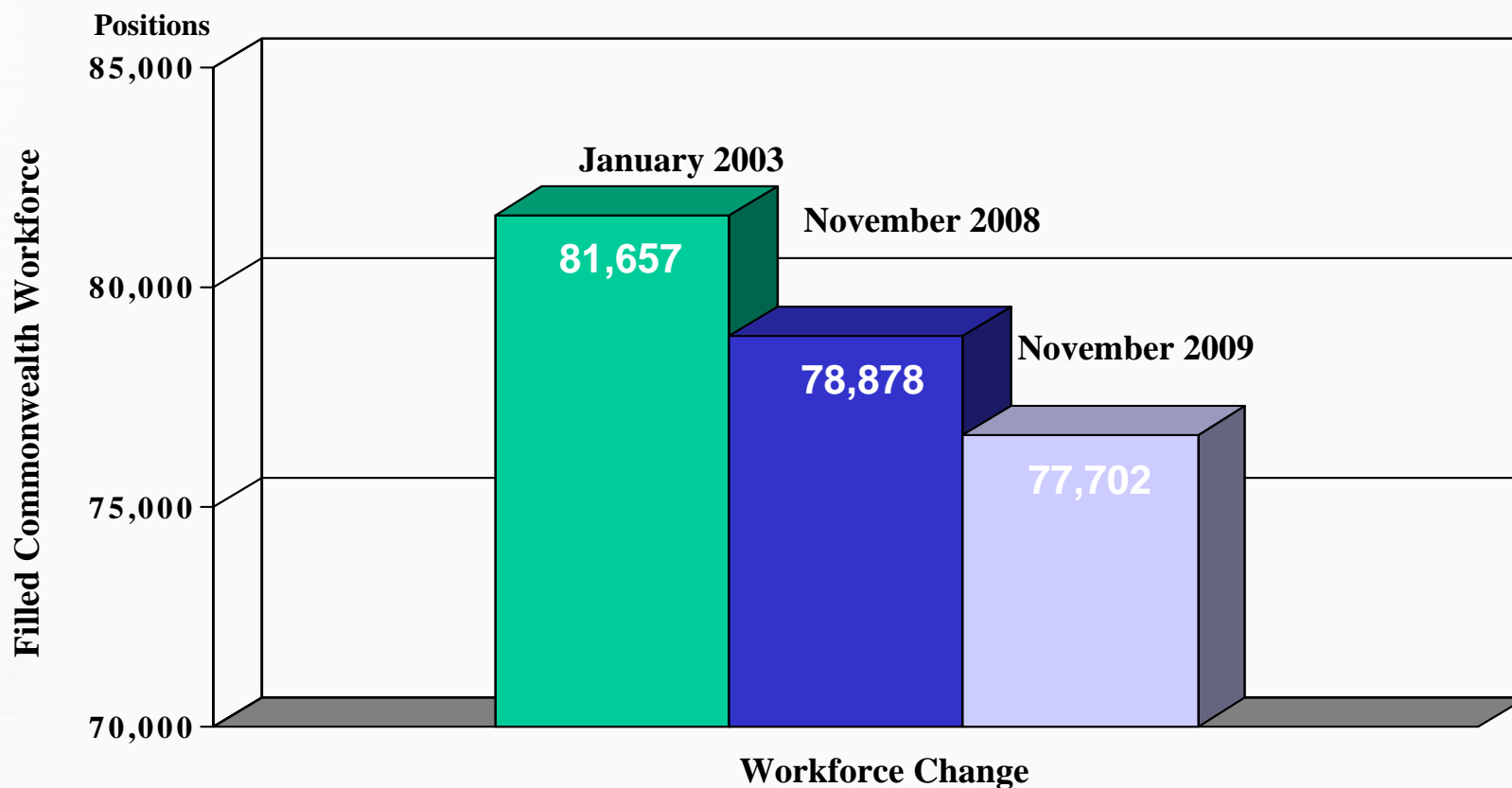
# Components of the \$1.75 Billion in Management and Productivity Savings for 2008-09

*Dollars in Millions*



## Reduction in Filled Staffing Levels *2002-03 versus 2009-10*

*Between January 2003 and November 2009, the size of the workforce declined by 4.8 percent – or nearly 4,000 positions.*



## States Will Recover Slowly from the Current Recession

**“Many economists are optimistic that America’s Great Recession may be turning the corner. States, however, are not celebrating. Plagued by record-setting revenue losses, the housing bust and credit crisis, high unemployment and a host of other challenges, states have struggled through nearly two years of budgetary pain – and are bracing for more.”**

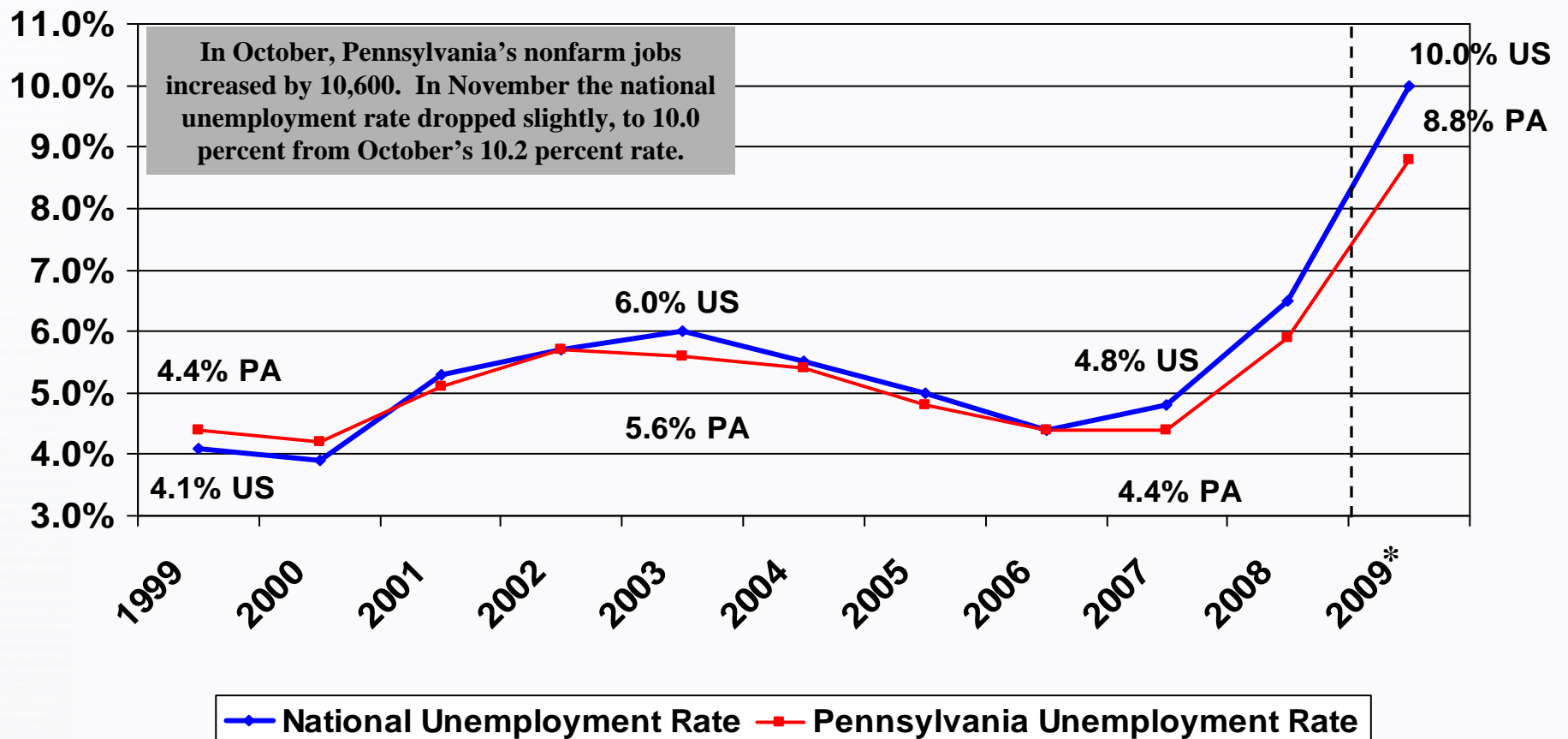
**– Susan Urahn  
Managing Director  
Pew Center on the States  
In releasing the Pew report  
“Beyond California: States in Fiscal Peril”**



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## National and State Jobless Rates, 1999-2009

*Pennsylvania's Unemployment Rate Has Remained Below the National Rate Since the Recession Began in Late 2007*



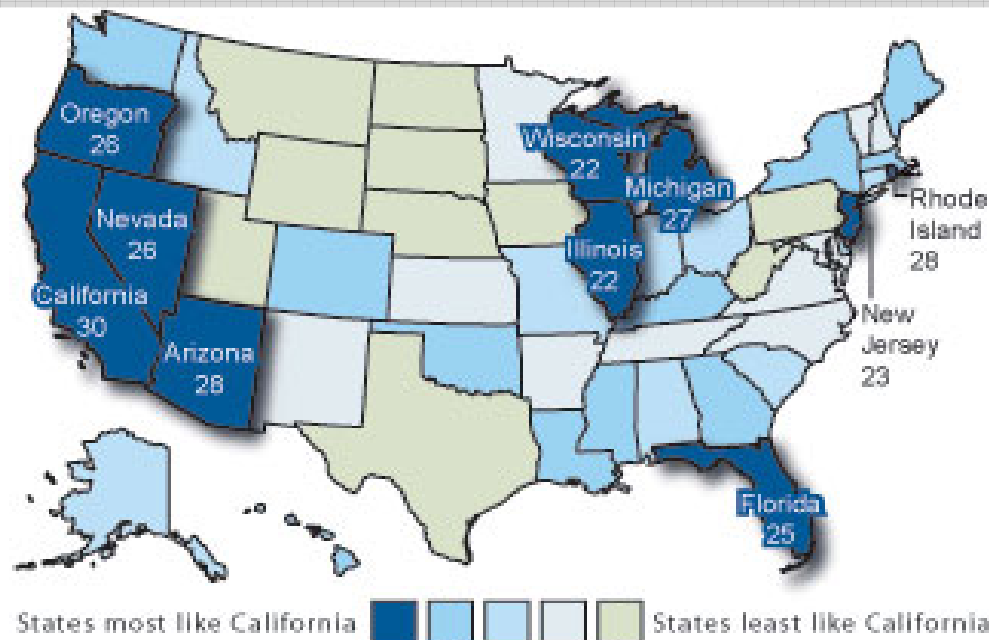
\* 2009 data: National – November; Pennsylvania – October.

Note: November 2009 labor force and nonfarm jobs statistics for Pennsylvania will be released Dec. 18, 2009.

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## Pennsylvania Is the Only Major Industrial State in the Nation Found To Be Fiscally Sound

*The Wall Street Journal, reporting on the Pew study of fiscal status of states, points out that Pennsylvania is among the ten best states with respect to financial condition. In fact, Pennsylvania is the only state in the northeast to be considered fiscally sound. The commonwealth ranked 7<sup>th</sup> in the nation for fiscal stability, tied with the much smaller state of Utah. Pennsylvania's revenue decline was at half the rate of the nation, and 38 states faced a steeper drop in revenue than Pennsylvania.*



**Source:** The Pew Center on the States, "Beyond California: States in Fiscal Peril," November 2009. The states named on the map are those Pew has identified as being in the greatest fiscal peril, according to a scoring system based on several factors. The figures represent the score each state received; California's score of 30 is the highest.

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## Budgetary Challenges

## 2009-10 Enacted Budget

- The 2009-10 enacted General Fund budget is \$27.8 billion.
- During budget enactment, despite proposals to increase 2009-10 base revenue growth, the enacted budget was based on a conservative zero-revenue growth projection for current-law revenues.
- State spending in this budget is \$1.9 billion lower than in 2008-09. When \$2.6 billion in federal stimulus dollars are included, the new \$27.8 billion budget still spends \$524 million less than last year.
- The 2009-10 budget is only the third budget in the past 50 years that is lower than the previous year's budget.
- 142 of the 657 line items in last year's budget are completely eliminated this year. Another 360 line items are reduced from last year's amounts.
- Administrative spending is 9 percent less than in 2002-03. The Governor's Office is funded at 1997-98 levels, while the General Assembly is at the 2003-04 mark.

## 2009-10 Enacted Budget (continued)

- The 2009-10 budget contains no broad-based tax increases.
  - During the past year, 11 other states increased their personal income tax or added tax brackets, 12 states increased their sales tax or broadened the base, and 11 states raised business taxes.
- The 2009-10 budget relies on \$2.3 billion in one-time revenues, \$695 million in recurring revenues and \$250 million in gaming revenues that have yet to be enacted.
- The budget provides for:
  - A \$300 million increase in the state's core funding formula for basic education – the largest increase in state history – while 25 other states cut funding for early childhood and K-12 education and 15 states laid off teachers.
  - A \$10 million increase over last year, to \$97 million, for the Children's Health Insurance Program (CHIP). As a result, 203,000 children will receive health care coverage from the state's Cover All Kids initiative.

## Unfinished Business

*Critical pieces of the 2009-10 budget have not yet been enacted – more than five months past the June 30 deadline.*

- Gaming legislation – to generate \$250 million in revenue
- Capital debt authorization
- Non-preferred appropriations – to provide \$765 million in funding
- Welfare Code – to ensure \$10 million in savings

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## Ongoing Challenges

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### ➤ Health care inflation

- *In recent years, health care costs have increased at an average annual rate of about 10 percent. This rate of growth creates significant budgetary challenges for the commonwealth, both as an employer and as a provider of health care – including to the 2.1 million people in the Medical Assistance program.*

### ➤ Continued growth in the inmate population

- *By June 2011, the inmate population is projected to increase to nearly 56,000 inmates – a 20 percent increase from the inmate population in June 2008.*

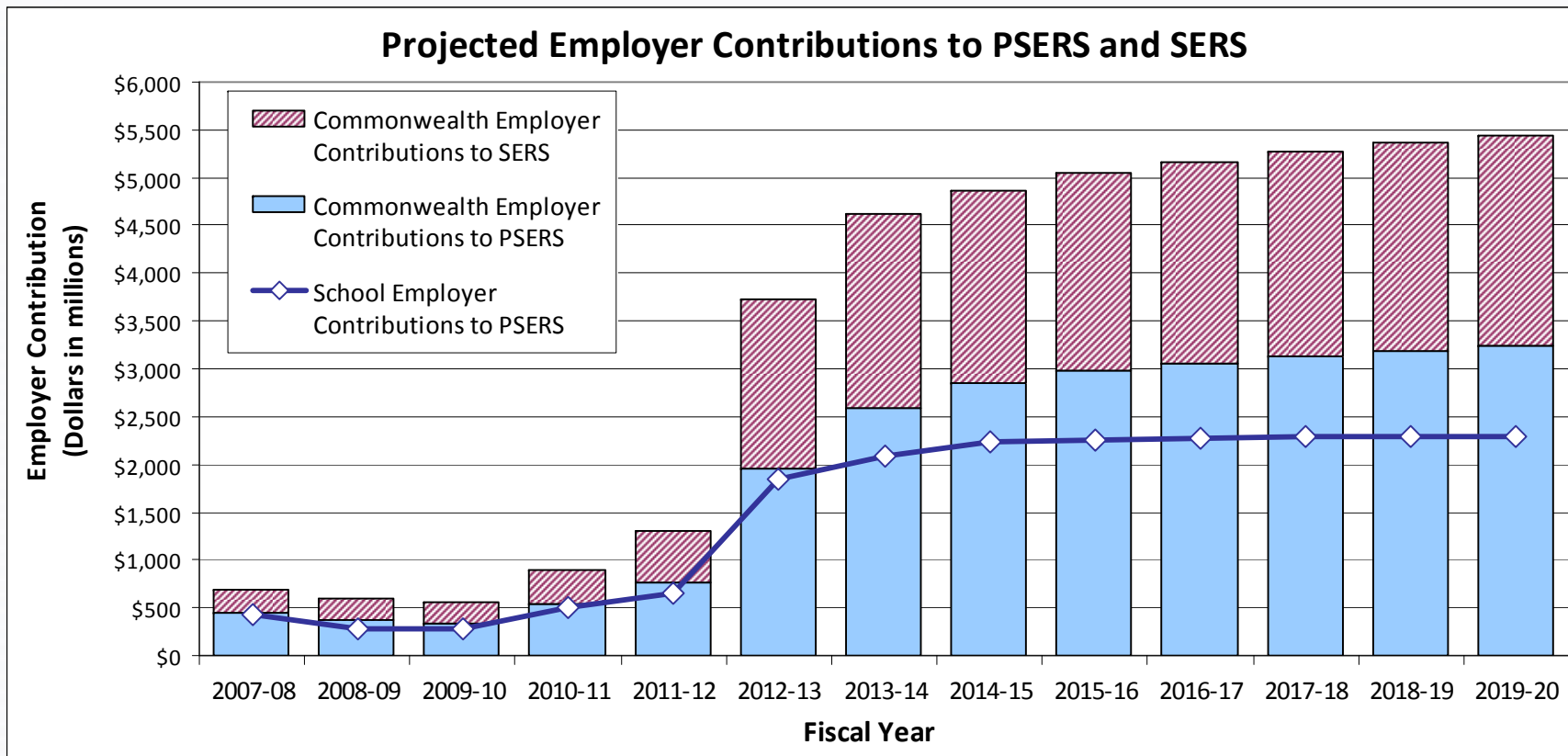
### ➤ Contractually mandated salary increases

- *The commonwealth must provide contractually mandated salary increases that will cost an additional \$190 million in wages and benefits in 2010-11 alone.*



## Ongoing Challenges: Pension Payments

*The strain caused by sudden increases in pension contributions will become far worse. Projections indicate that by 2012-13 the commonwealth's contribution to SERS and PSERS will reach \$3.7 billion – representing a \$2.4 billion single-year increase from 2011-12.*



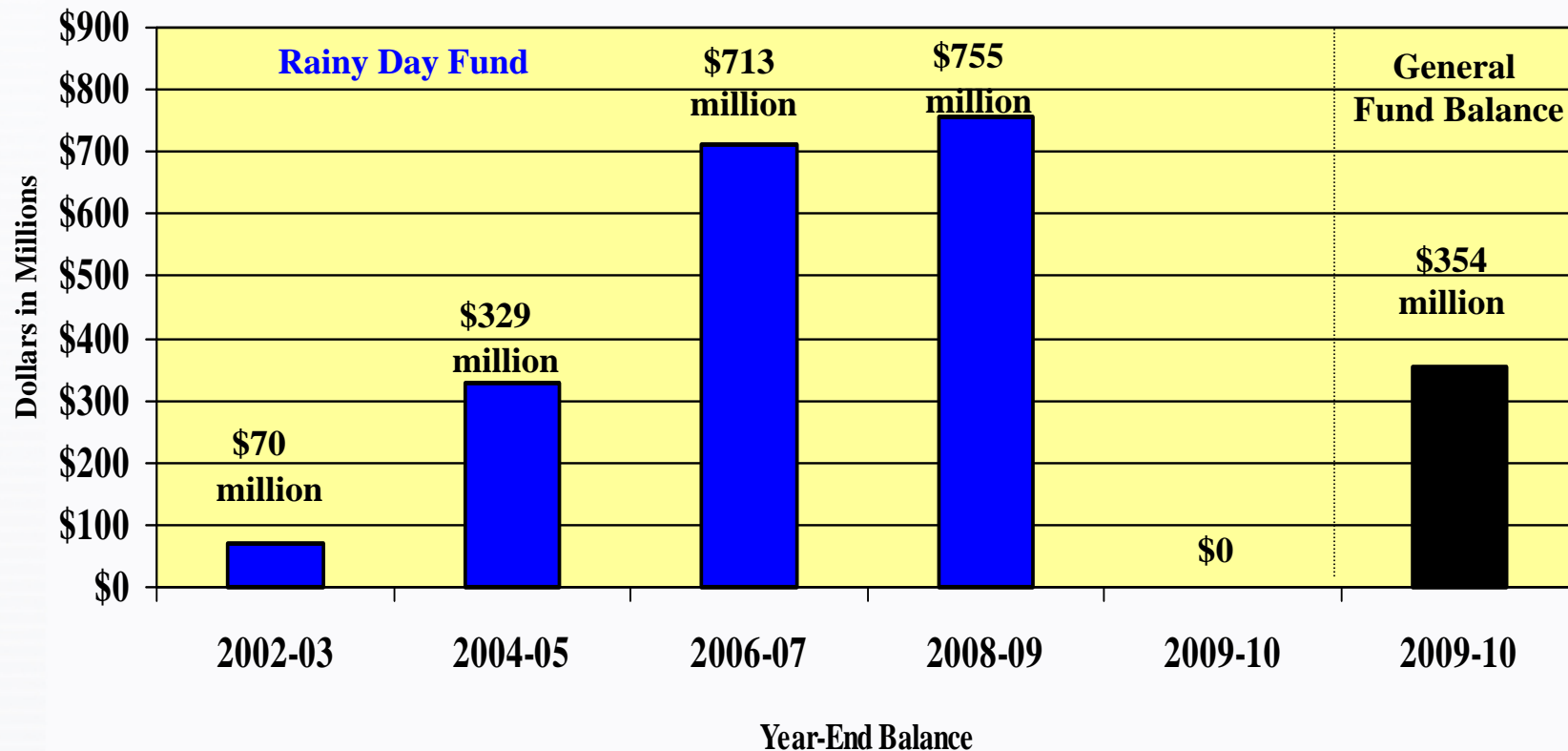
## Ongoing Challenges: Loss of ARRA Funding

*Federal Support for Pennsylvania's Budget from the American Recovery and Reinvestment Act is Expected to End in 2010-11*

- In 2010-11 there will be a \$700 million reduction in the amount of ARRA funds the state will receive that support General Fund expenditures – from \$2.6 billion to \$1.9 billion.
- Although national discussions about extending fiscal relief to states are taking place, it is too early to determine if the federal government will extend state fiscal relief.

## Projected Ending Fund Balance

*Between 2002-03 and 2007-08, the commonwealth directed part of its year-end surpluses to the Rainy Day Fund. As part of the 2009-10 enacted budget, \$755 million was transferred from the commonwealth's Rainy Day Fund to balance the General Fund budget. Because of the use of the Rainy Day Fund at budget enactment, the projected ending balance in the General Fund was \$354 million.*



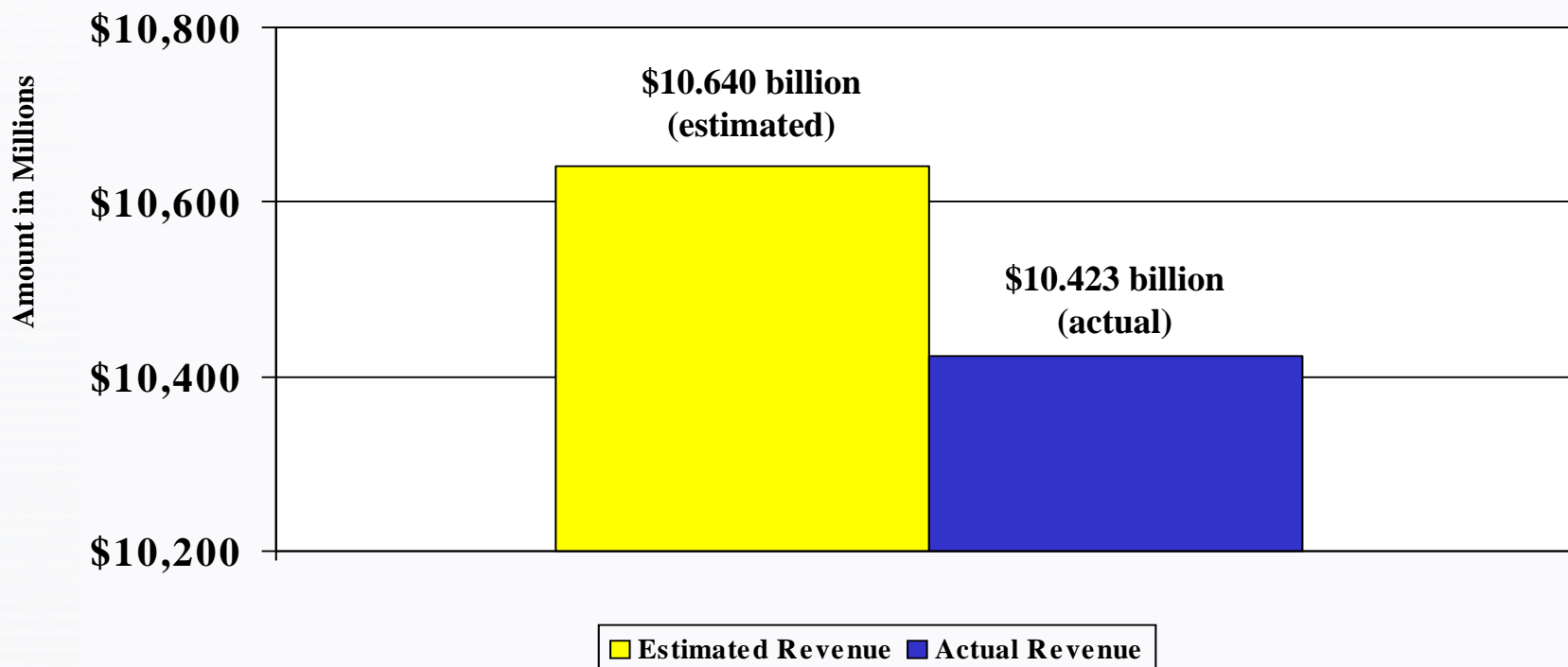
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## **Revised Outlook for the 2009-10 Budget**

## 2009-10 General Fund Revenues

### *Estimated versus Actual Revenue Collections, July-November 2009*

*Despite a conservative, zero-growth projection, General Fund revenue collections in the first five months of 2009-10 were \$217 million lower than estimated (down 2 percent). The administration now projects a year-end revenue shortfall of \$450 million, which is 1.5 percent of estimated total General Fund revenues.*



## Economic and Revenue Update

- Sluggish consumer spending has led to lower-than-expected sales tax revenue.
- High unemployment and stagnant incomes have led to lower-than-expected personal income tax revenue.
- Many households are confronting high debt burdens and tight credit conditions.

*It is too early to know if the recent uptick in U.S. retail sales will improve Pennsylvania's sales tax collections.*

## 2009-10 General Fund Revenues by Tax Type

*In the first five months of 2009-10, collections in three categories of taxes accounted for most of the year-to-date General Fund revenue shortfall.*

Tax Type	Estimated	Actual	\$ Difference	% Difference
	Dollars in Millions			
Corporation Taxes	\$ 694.7	\$ 722.5	\$ 27.8	4%
Consumption Taxes	3,923.1	3,798.2	- 124.9	-3%
Sales & Use – Non- Motor	3,069.4	2,918.8	- 150.6	-5%
All Other	853.7	879.4	25.7	3%
Other Taxes	4,127.1	4,018.8	- 108.3	-3%
PIT Withholding	3,174.2	3,103.1	- 71.1	-2%
PIT Non-Withholding	515.2	480.8	- 34.4	-7%
All Other	437.7	434.9	- 2.8	-1%
Non-Tax Revenue	1,894.8	1,883.2	- 11.6	-1%
<b>Total</b>	<b>\$ 10,639.7</b>	<b>\$ 10,422.7</b>	<b>\$ - 217.0</b>	<b>-2%</b>

## Steps to Ensure Timely Payments

- Cash balances in Treasury normally are low in January and February. This situation has been exacerbated this year by the slowdown in revenues.
- Because of declining cash balances, the commonwealth has taken steps to ensure that it will be able to continue to make timely payments.
- The commonwealth will issue \$800 million in Tax Anticipation Notes (TANs) this month. The TANs will be repaid by June 2010. This is the first time in twelve years that the commonwealth has issued TANs.



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## 2009-10 Revised General Fund Budget

### *Impact of Revenue Shortfall Prior to Corrective Action*

Dollars in Millions

	<u>2009-10 Original</u>	<u>2009-10 Revised</u>
Beginning Balance . . . . .	\$ (2,030)	\$ (2,030)
Base Revenue (net of Refunds Reserve). . . . .	24,274	24,274
<b>REVENUE SHORTFALL. . . . .</b>		<b>(450)</b>
One-Time Revenue (Including Rainy Day Fund). . . . .	2,344	2,344
Recurring Revenue . . . . .	695	695
<i>Gaming Revenue (not yet enacted)</i> . . . . .	250	250
Prior-Year Lapses . . . . .	0	0
Funds Available . . . . .	<u>\$ 25,533</u>	<u>\$ 25,083</u>
Expenditures . . . . .	\$ (27,800)	\$ (27,800)
Federal ARRA Appropriations . . . . .	2,621	2,621
Total Expenditures . . . . .	<u>\$ (25,179)</u>	<u>\$ (25,179)</u>
Ending Balance . . . . .	<u>\$ 354</u>	<u>\$ - 96</u>

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## Budget Balancing Plan

## 2009-10 Budget-Balancing Measures

*To address the anticipated \$450 million revenue shortfall, the commonwealth will freeze \$170 million of current-year spending, reduce remaining prior-year funds by \$50 million, and utilize a portion of the projected ending balance. The current-year spending freeze amount is a less than 1 percent reduction in planned General Fund spending. These actions will maintain an ending balance of \$124 million.*

***If the enactment of gaming legislation does not generate \$250 million in revenue this year, the revenue shortfall will be even larger.***

	(in millions)
Projected Ending Balance (October 9) .....	\$ 354
Revenue Shortfall .....	- 450
Preliminary Ending Balance .....	\$ - 96
Planned December Spending Freeze .....	\$ 170
Additional Lapses .....	50
Revised Ending Balance .....	\$ 124 <sup>27</sup>

## Planned December Spending Freeze

*\$170 Million in Cuts*

\$ 70M	1 percent across-the-board cut to discretionary line items (Reductions to agency operating appropriations and grant programs)
\$ 100M	Targeted cuts to discretionary grant programs
<b>\$ 170M</b>	<b>Total Spending Cuts</b>

## Summary

- The Rendell administration is taking immediate action to mitigate the revenue shortfall in 2009-10.
- Ongoing management and productivity efforts will continue to make the most effective use of taxpayer dollars.
- We need immediate enactment of the remaining budget-related legislation.

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