

Commonwealth of Pennsylvania

2011-12 Mid-Year Budget Briefing

Tom Corbett
Governor

Charles B. Zogby
Secretary of the Budget

December 20, 2011

The Projected 2011-12 General Fund Budget

Prior to Corrective Action

When Governor Corbett took office in January, the 2011-12 deficit was projected to be almost 14 percent of estimated expenditures. This projection was based on a forecast of state revenues that assumed no changes in tax structure or tax rates, combined with an expenditure forecast that assumed the continuation of all existing state programs and activities, an increase in the inflation rate, no assumed savings from improvements in government efficiency, and growth in caseloads for all mandated services such as Medical Assistance.

	<i>Dollars in Millions</i>
Beginning Balance	\$ (155)
Receipts	<u>25,869</u>
Funds Available	\$ 25,714
Expenditures	<u>(29,874)</u>
Ending Balance	<u><u>\$ (4,160)</u></u>

2011-12 Enacted Budget Highlights

The 2011-12 budget was balanced with no tax increases and refocused the investment of tax dollars in the core functions of government, including: adhering to fiscal discipline; promoting limited, transparent and effective government; supporting free enterprise and job creation; funding students and promoting educational excellence; protecting public health and safety; and maintaining the human services safety net.

- The 2011-12 enacted General Fund budget is \$27.15 billion – a decrease of \$1.17 billion, or 4.1 percent, from 2010-11. Overall, state spending is reset to near 2008-09 levels.
- The budget eliminated 66 appropriation line items – cutting \$822 million in annual spending. It reduced funding for 226 appropriations and consolidated an additional 52 appropriations to streamline government.
- Administrative spending in the budget was reduced by 4 percent.

General Fund Financial Statement

(Dollars in Millions)

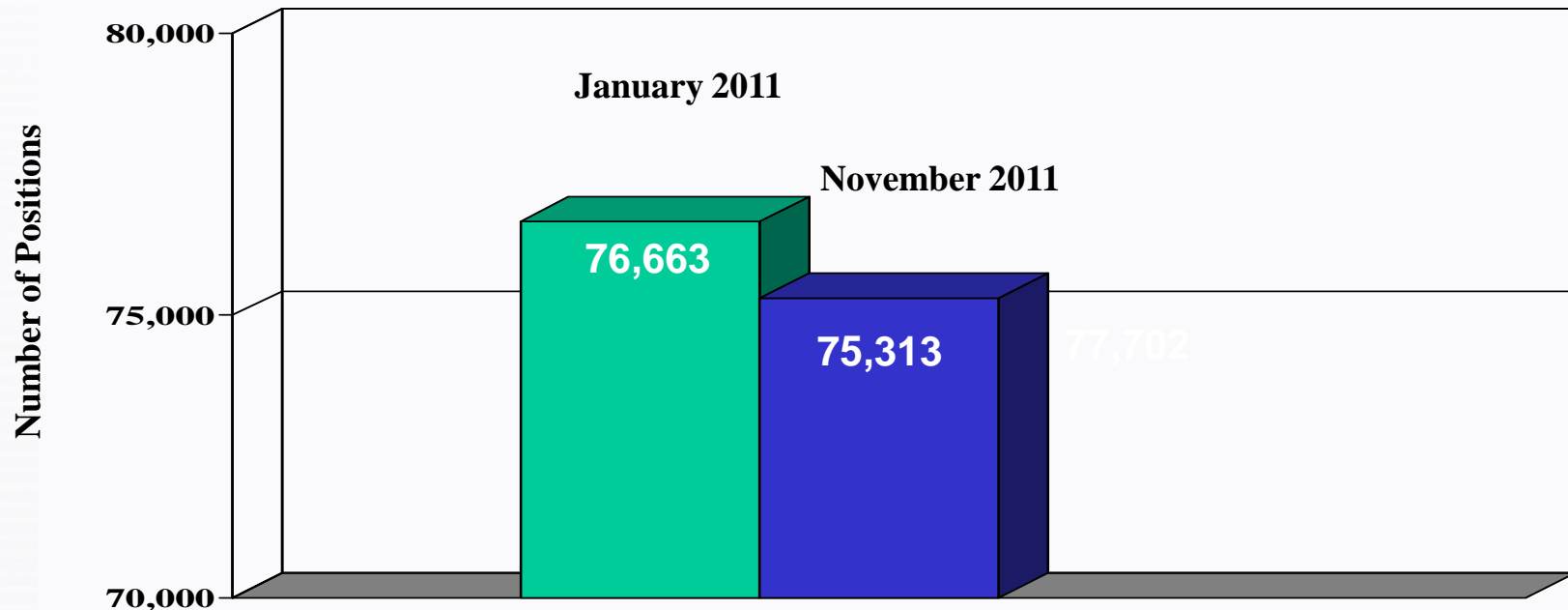
	<u>2010-11</u> <u>Actual</u>	<u>2011-12</u> <u>Enacted</u>
Beginning Balance	\$ (294)	\$ 1,073
Revenue Estimate	26,712	27,841
Adjustment to Estimate	785	0
Refunds	(1,150)	(1,270)
Total Revenue	\$ 26,347	\$ 26,571
Prior-Year Lapses	94	63
Funds Available	\$ 26,147	\$ 27,707
Total Expenditures	\$ (28,321)	\$ (27,149)
Federal ARRA Appropriations	3,066	0
Current-Year Lapses	181	0
State Expenditures	\$ (25,074)	\$ (27,149)
Preliminary Balance	1,073	558
Transfer to the Rainy Day Fund	0	(140)
Ending Balance	\$ 1,073	\$ 418

Post-Enactment Developments

Reducing Administrative Spending

In the first 10 months of the administration, the size of the workforce was reduced by 1.8 percent – or 1,350 positions. Additionally, the administration has implemented significant changes to the commonwealth’s fleet and travel programs that are designed to ensure additional accountability and reduce costs.

Reducing the Size of the Commonwealth’s Workforce



DPW's Office of Program Integrity

The Department of Public Welfare created a new Office of Program Integrity earlier this year. The new office is tasked with several responsibilities aimed at reducing welfare fraud, waste and abuse.

The office will:

- Collaborate with the Office of Inspector General on Medical Assistance overpayment and recovery.
- Implement IT initiatives to improve coordination.
- Increase the department's statewide auditing presence.
- Ensure only eligible individuals receive benefits.
- Increase the department's regulatory presence by enforcing existing penalties, sanctions and laws.
- Redesign provider enrollment and monitoring processes.

Revisions to the Commonwealth Capital Plan

Governor Corbett's administration is taking steps to significantly reduce the level of capital commitments requiring the issuance of debt.

- **Reducing by 50 percent** the level of Public Improvement Projects in new project releases for commonwealth-owned buildings and facilities.
 - This program averaged \$415 million in new commitments annually in the last administration.
 - Governor Corbett's administration has a goal of \$150 million to \$200 million per year.
- **Reducing by 50 percent** the level of Higher Education new-project releases that the commonwealth provides to the State System of Higher Education and the state-related universities.
 - The prior administration was committing \$310 million per year.
 - The Corbett administration will return this funding level to its traditional amount of \$155 million per year.
- The Corbett administration is reviewing the **Redevelopment Assistance Capital Program** with the goal of reforming the program by infusing objectivity, transparency and accountability into a defined application and award process while at the same time reducing the size of the current program.

Pennsylvania Retains Double-A Bond Rating

The commonwealth's credit rating remains a solid double-A. Standard & Poor's, Moody's and Fitch have reaffirmed the commonwealth's "double-A" credit rating, which is the second-highest level of credit.

According to the rating agencies, the commonwealth's credit strengths include:

- Diverse, broad and relatively stable economy, with wealth levels slightly above the national average, buttressed by its large health and higher education sectors.
- A state debt position that is moderate and well-controlled, with tax-supported debt ratios roughly at national average level.
- The 2011-12 budget was adopted on time and reflects significantly reduced reliance on non-recurring resources.

Pennsylvania Retains Double-A Bond Rating, Cont'd.

The rating agencies also noted the following credit challenges for Pennsylvania:

- Revenues are below the official estimate for the first quarter of 2011-12, and in light of the expected slowing in economic growth, revenue shortfalls could grow through the fiscal year.
- The commonwealth's financial position and liquidity remain weak relative to its historic position and will likely deteriorate in 2011-12 if revenue shortfalls continue.
- Annual debt service costs, pension contributions and other post-employment benefit costs will increase substantially through 2015-16, absorbing an increasing percentage of the budget, and challenging the commonwealth's ability to return to structural balance.

Downward Revisions to U.S. Economic Forecasts

The 2011-12 budget was adopted in June 2011 and was based on economic forecasts available at that time. Since then, most economists – including Global Insight – have significantly lowered their forecasts for economic growth for 2011 and 2012. These downward revisions are consistent with the commonwealth’s below-estimate tax revenue collections during the first five months of the fiscal year.

Global Insight’s Outlook for Fiscal Year 2011-12

Changes from May to December

	<u>May 2011</u>	<u>December 2011</u>
Real GDP	3.0%	1.7%
Consumer Expenditures	4.7%	4.2%
U.S. Wages & Salaries	4.6%	3.0%

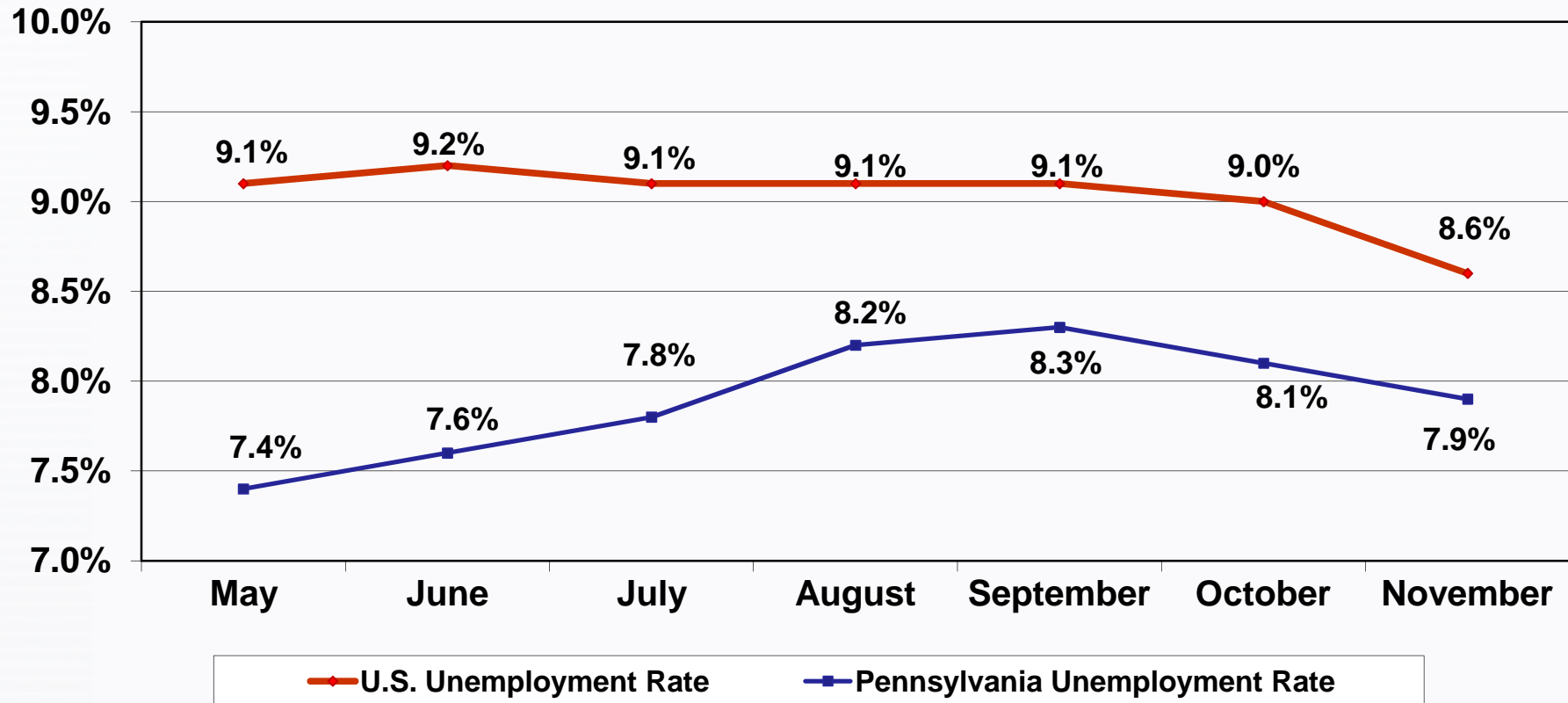
2011-12 General Fund Revenues

In the first five months of 2011-12, collections across nearly all revenue categories failed to meet estimates. Revenue collections are now \$345.3 million below estimate.

	Estimated	Actual	\$ Difference	% Difference
Tax Revenue:	<i>(Dollars in Millions)</i>			
Corporation Taxes	\$ 917.7	\$ 750.7	\$ -167.0	-18.2%
Consumption Taxes	4,237.6	4,222.3	- 15.3	-0.4%
Sales & Use – Non- Motor	3,182.5	3,149.1	- 33.4	-1.0%
All Other	1,055.1	1,073.2	18.1	1.7%
Other Taxes	4,462.3	4,304.5	- 157.8	-3.5%
PIT Withholding	3,436.7	3,337.3	- 99.4	-2.9%
PIT Non-Withholding	513.6	483.8	- 29.8	-5.8%
All Other	512.0	483.4	- 28.6	-5.6%
Non-Tax Revenue	102.4	97.2	- 5.2	-5.1%
Total	\$ 9,720.0	\$ 9,374.7	\$ - 345.3	-3.6%

U.S. and PA Jobless Rates, 2011

While Pennsylvania's unemployment rate has moved up since May 2011, it has remained at or below the U.S. rate for 61 consecutive months.



Source: PA Department of Labor and Industry, Monthly Seasonally Adjusted Labor Force Data.

Implications for the 2011-12 Budget

- \$500 million in potential year-end General Fund revenue shortfall based on the latest econometric models
 - Shortfalls projected for corporate taxes, personal income tax and non-motor vehicle sales tax
- Governor Corbett directed his budget office to develop options for a budgetary freeze.

General Fund Financial Statement

(Dollars in Millions)

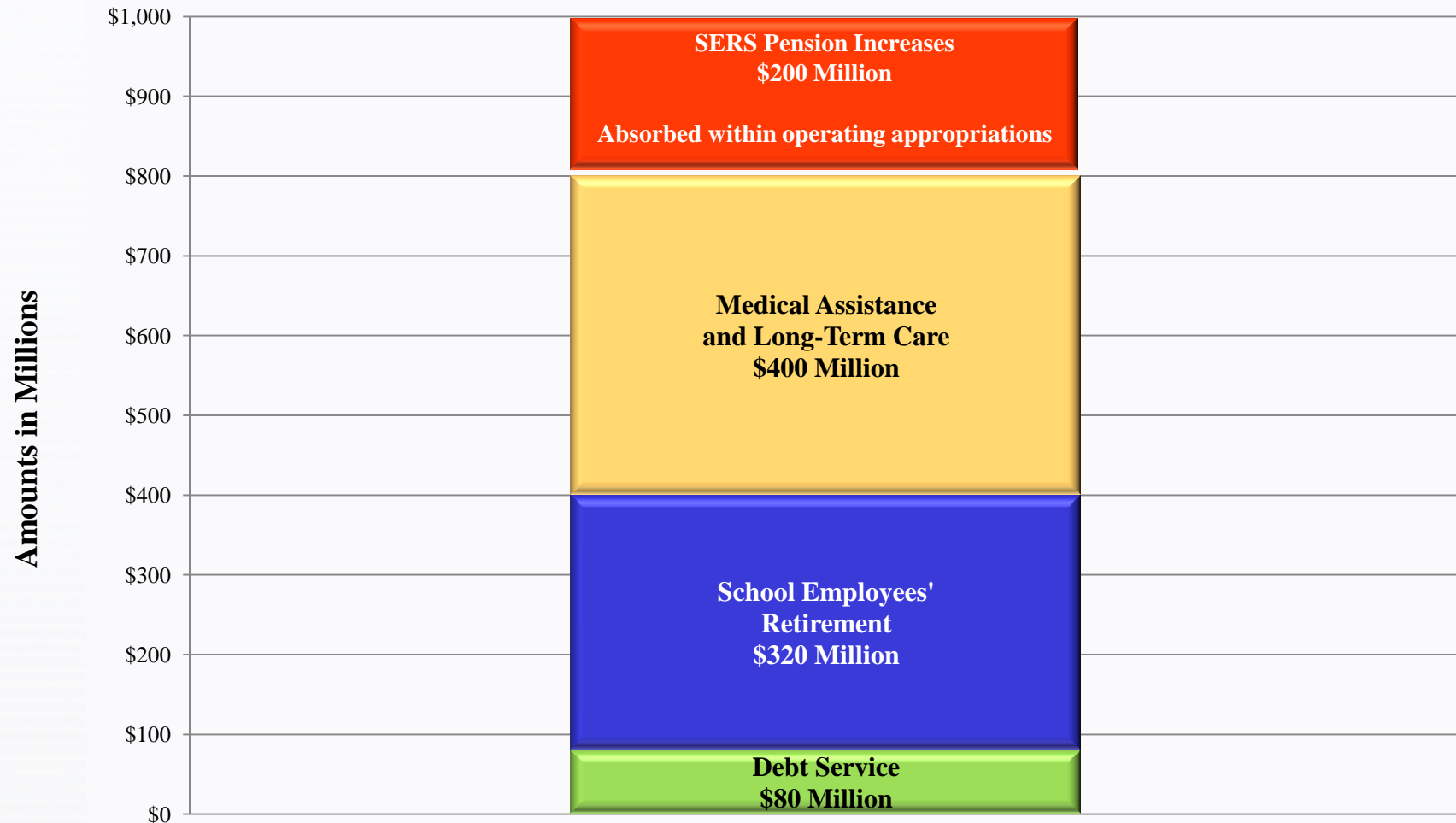
	<u>2011-12 Enacted</u>	<u>2011-12 Revised</u>
Beginning Balance	\$ 1,073	\$ 1,073
Revenue Estimate	27,841	27,841
Adjustment to Estimate	0	(500)
Refunds	(1,270)	(1,270)
Total Revenue	\$ 26,571	\$ 26,071
Prior-Year Lapses	63	163
Funds Available	\$ 27,707	\$ 27,307
Total Expenditures	\$ (27,149)	\$ (27,149)
Current-Year Lapses	0	0
State Expenditures	\$ (27,149)	\$ (27,149)
Preliminary Balance	558	158
Transfer to the Rainy Day Fund .	(140)	(40)
Ending Balance	\$ 418	\$ 118

2012-13 Budget Planning

Challenges Ahead for the 2012-13 Budget

- Pension cost growth of \$520 million (\$320 million for school employees' retirement and \$200 million for state employees' retirement that agencies must absorb)
- Continued growth in debt service before capital spending reforms begin to put costs on a more sustainable path
- Managing growth in welfare spending in light of continued health care cost inflation
- Controlling the growth of Corrections' costs
- Pending litigation against the commonwealth

Growth in Mandatory Spending in the 2012-13 Budget



Growth in PSERS and SERS Contributions

The most recent actuarial funding ratio for the Public School Employees' Retirement System is 69.1 percent, with an unfunded liability of \$26.5 billion. The State Employees' Retirement System funding ratio is 75 percent, with an unfunded liability of \$10 billion.

(dollars in millions)

	FY2009-10	FY2010-11	FY2011-12	FY2012-13	FY2013-14	FY2014-15	FY2015-16
PSERS Rate (%)	4.8%	5.6%	8.7%	12.3%	16.7%	21.2%	23.7%
PSERS - State Share (\$)	\$342.6	\$408.6	\$600.2	\$920.2	\$1,330.1	\$1,796.3	\$2,165.8
SERS Rate (%)	4.0%	5.0%	8.0%	11.5%	16.0%	20.5%	25.0%
SERS - Total Share (\$)	\$226.4	\$296.8	\$468.1	\$693.5	\$994.3	\$1,312.7	\$1,649.7
Total Contributions (\$)	\$569.0	\$705.4	\$1,068.3	\$1,613.7	\$2,324.4	\$3,109.0	\$3,815.5

PSERS = Public School Employees' Retirement System
 SERS = State Employees' Retirement System

Other Economic and Budgetary Concerns

- Potential for further negative impact on revised forecast for GDP growth if federal payroll tax holiday and emergency unemployment benefits set to expire on 12/31/11 are not extended by Congress
- Unemployment Compensation loan repayments that take effect in January 2012, increasing by 0.3 percent the federal tax employers must pay
- The ongoing economic crisis in Europe, with the potential for further global economic instability that could prolong the stagnation of the U.S. economy and delay its recovery
- Uncertainty over the amount of federal funding that may be available to states in the coming fiscal year
 - Automatic sequestration cuts of 8.8 percent across the board that take effect January 2013

General Fund Financial Statement

(Dollars in Millions)

	<u>2011-12</u> <u>Revised</u>	<u>2012-13</u> <u>Preliminary</u>
Beginning Balance	\$ 1,073	\$ 118
Revenue Estimate	27,841	28,375
Adjustment to Estimate	(500)	0
Refunds	(1,270)	(1,290)
Total Revenue	\$ 26,071	\$ 27,085
Prior-Year Lapses	163	0
Funds Available	\$ 27,307	\$ 27,203
Base Expenditures	\$ (27,149)	\$ (27,149)
Mandatory Spending Growth	0	(800)
State Expenditures	\$ (27,149)	\$ (27,949)
Preliminary Balance	158	(746)
Transfer to the Rainy Day Fund	(40)	0
Ending Balance	\$ 118	\$ (746)

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