



COMMONWEALTH OF PENNSYLVANIA
OFFICE OF THE GOVERNOR
HARRISBURG

THE GOVERNOR

February 9, 2010

To the People of Pennsylvania:

These are hard times for governments, whether they are small towns or large states like Pennsylvania. As we enter this new decade, we are emerging from the most prolonged economic downturn since the Great Depression. And this downturn has increased the pressure on state budgets, in the form of greater demands on human service programs, higher levels of unemployment and declining tax revenues.

And yet Pennsylvanians have reason for optimism. We are strong enough to deal with the economy of the present and we are strategically positioned to lead our competitor states and nations in the future, but only if we act as a commonwealth, rather than a collection of political caucuses or special interests.

Since I took office in 2003, we have worked diligently to establish a record of strong fiscal management that protects the state in lean times as well as good ones. This record has been broadly recognized: A recent national study ranked Pennsylvania seventh in the nation for fiscal stability when measured against the factors that led to California's current acute budget crisis. In addition, the study found that the commonwealth's revenue decline was only half the national average and that 35 states had a steeper drop in revenue than Pennsylvania.

This record of fiscal responsibility will allow the commonwealth to maintain essential public services in this time of national economic distress – including preserving the social safety net for children, older Pennsylvanians and families, and continuing to fund a broad range of vital public safety programs.

At the same time, we will build upon our past strong record of success in the areas of education and economic development. By doing so, we will position Pennsylvania and its citizens to take advantage of opportunities that will arise when the national economy rebounds. In that way, we will protect the progress we have made in the past seven years.

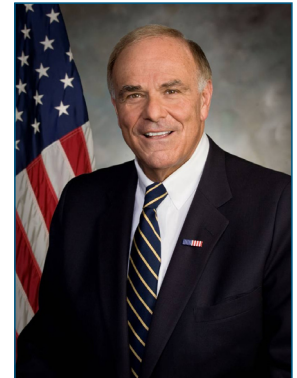
As we look to the future, we know that many challenges will remain even after the economy improves. Federal fiscal relief that has supplemented our budget since 2008-09 will end in 2011, and the commonwealth will need to close that \$2.3 billion gap through a combination of ongoing management and productivity initiatives, budget cuts and new revenue. Doing so will require more tough choices – but they will be less wrenching if we prepare for them now.

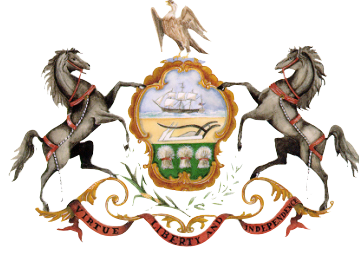
The 2010-11 budget that I introduce today is a budget that works. It balances the needs of our citizens with the financial pressures the national economic downturn has imposed. It readies our young people and businesses for the opportunities that a reviving economy will bring. It also provides a road map to prepare for future fiscal challenges by setting aside new revenue to help balance the 2011-12 budget.

It has been my great honor and privilege to be your Governor for the past seven years. And it is my sincere hope that we will work together this year not only to protect the progress we have made, but also to prepare the commonwealth for continued prosperity in the decade ahead.

Sincerely,

Edward G. Rendell





Commonwealth of Pennsylvania

2010-11 Budget in Brief

A complete copy of the ***Governor's Executive Budget, Budget in Brief***
and more budget information can be found on our Web site:

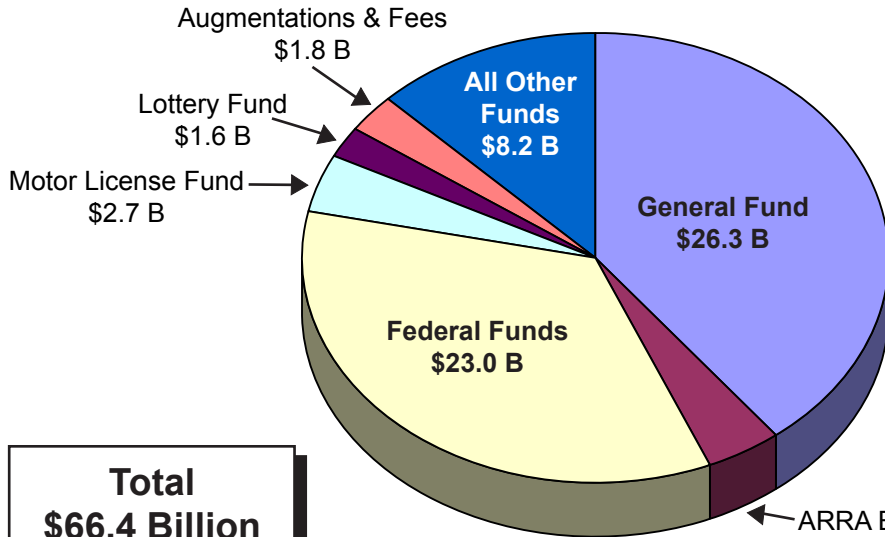
www.budget.state.pa.us

Click on Current and Proposed Commonwealth Budgets.

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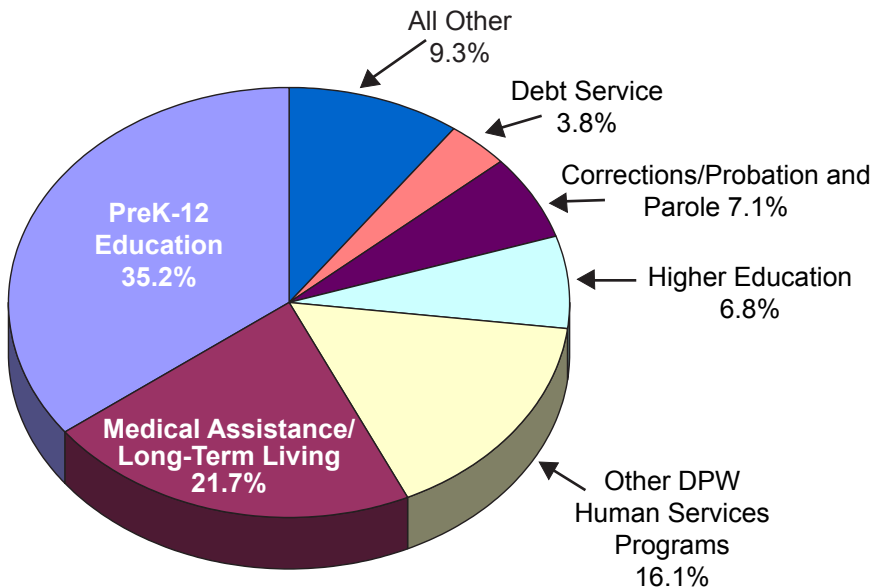
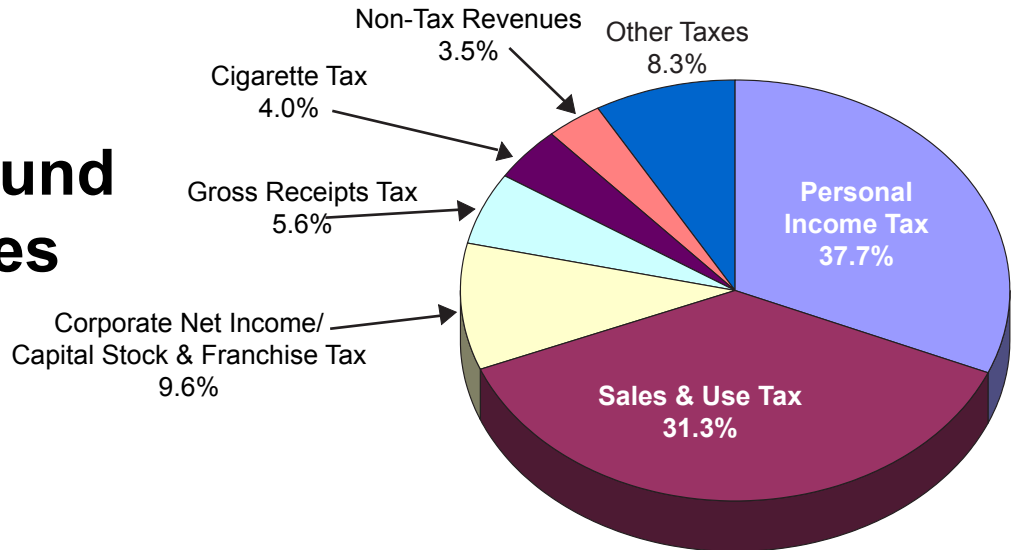
2010-11 Budget Overview



Total Operating Budget

The total Fiscal Year 2010-11 operating budget, including all commonwealth funds, is \$66.4 billion. The General Fund obligation, including \$2.8 billion in federal American Recovery and Reinvestment Act funds, represents 44 percent of this amount.

General Fund Revenues



General Fund Expenditures

Total General Fund Expenditures:

\$ 26.27	Billion State
\$ 2.76	Billion ARRA
\$ 29.03	Billion Total

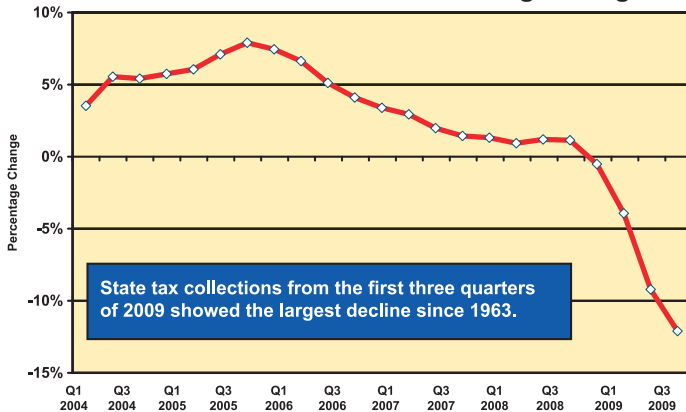
Adopting a Pennsylvania Budget That Works

Along with other state and local governments, families and businesses all across the nation, the commonwealth is grappling with the consequences of the largest economic downturn in decades. But as part of its balanced 2010-11 budget plan, Pennsylvania is committed to maintaining essential public services in times of national economic distress.

Responding to Unprecedented Shortfalls in State Revenues

Since the start of the national recession in December 2007, the commonwealth has faced one of the most challenging economic climates since the Great Depression. State governments across the country have experienced increasing budgetary pressure from higher levels of unemployment, declining sales and income tax revenues, and greater demands on human services programs. A recent independent study showed that across the nation, the year-over-year change in inflation-adjusted state tax collections has averaged negative 12.5 percent over the most recent four quarters. The \$80 billion decline in the tax receipts of the 50 states during the first three quarters of 2009 represented the most rapid reduction in 46 years.¹

Year-Over-Year Percent Change in State Tax Collections: Nationwide Four-Quarter Moving Average

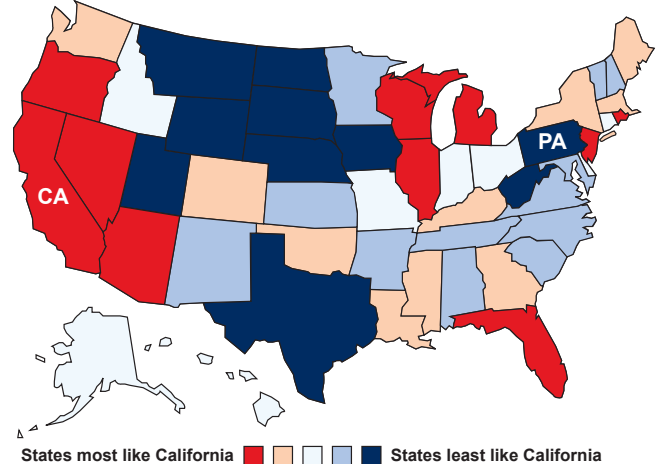


Source: Nelson A. Rockefeller Institute of Government. Original Sources - U.S. Census Bureau (tax revenue) and Bureau of Economic Analysis (GDP price index).

Although the fiscal consequences of the recent economic downturn have been unprecedented, a Pew study of the fiscal status of the states ranked Pennsylvania seventh in the nation for fiscal stability when assessed against the factors that led to California's acute budget crisis. The commonwealth is the only state in the northeast and the only large industrial state to appear in the study's top 10. Further, the commonwealth's revenue decline was only half the national average: 35 states had experienced a steeper drop in revenue than Pennsylvania.

Pennsylvania's efforts to minimize the recession's impact on state services has been augmented by the federal government's recovery program, which has provided new funds for targeted investments in education, public infrastructure and clean energy programs.

Pennsylvania Is the Only Major Industrial State to Be Ranked in the Top 10 in a Recent Pew Study on State Fiscal Crises



In addition, the management and productivity initiatives that have been a priority of the Rendell administration – and ongoing investments in education, economic development, clean energy and infrastructure – will position Pennsylvania's economy to compete even more strongly as the nation continues its economic recovery.

Protecting Funding for Essential Services and Preparing for Future Fiscal Challenges

The 2010-11 budget is a prudent and balanced plan in a time of hard choices. The budget provides funds to protect the social safety net for Pennsylvania's older residents, families, children and vulnerable citizens. It also makes additional key investments to maintain the commonwealth's commitment to public safety.

This budget also anticipates several major challenges facing the commonwealth in the new decade even as the economy improves. Federal fiscal relief that has supplemented our budget since 2008-09 will end in 2011, and the commonwealth will need to close that \$2.3 billion gap through a combination of ongoing management and productivity initiatives, budget cuts and new revenue. The 2010-11 budget also continues the Rendell administration's efforts to address the sharp increase in pension costs that is anticipated in 2012-13 by presenting a funding methodology that would allow the commonwealth to gradually absorb the impact of increased pension contributions over a period of several years.

Addressing these challenges will require more tough choices – but they will be less wrenching if we prepare for them now.

¹ Source: State Revenue Report, January 2010. Nelson A. Rockefeller Institute of Government, Albany, NY.

2010-11 Budget Highlights

- The 2010-11 budget is a budget that works to:
 - ✓ continue to meet our health and safety responsibilities;
 - ✓ invest in our children's education;
 - ✓ keep the cost of state government down; and
 - ✓ prepare for our future challenges.
- The 2010-11 General Fund budget does not rely on any broad-based tax increases.
- The 2010-11 total General Fund budget is \$29 billion – an increase of \$1.15 billion or 4.1 percent after accounting for the use of nearly \$2.7 billion in federal American Recovery and Reinvestment Act funds in 2009-10 and nearly \$2.8 billion in 2010-11.
- Administrative spending in the 2010-11 budget is 4 percent lower than it was in 2002-03. If administrative spending had been allowed to grow at the rate of inflation, commonwealth agencies would spend \$458 million more to operate state government in 2010-11.
- The 2010-11 budget includes a reduction of positions in the commonwealth's current authorized complement that will bring the total reduction since January 2003 to 4,887.
- In the 2010-11 General Fund budget, \$12.3 billion, or 42 percent, is for education.
- The 2010-11 General Fund budget reduces spending by 1 percent in all areas other than Education, Public Welfare, Aging and Long Term Living, Corrections, Probation and Parole, and debt service.
- To help meet future budgetary challenges, this budget proposes to create a new Stimulus Transition Reserve Fund. New revenue will be raised for deposit in this fund beginning in 2010-11 – to be used in 2011-12 and in future budgets. Revenue reform measures will include cutting the state sales tax rate from 6 percent to 4 percent and reducing the Corporate Net Income Tax rate from 9.99 percent to 8.99 percent.

Protecting Our Progress

Property Tax Relief – Nearly \$770 million in property tax relief will be provided in 2010.

Rebuild Pennsylvania Infrastructure Initiative – Invests more than \$537 million in our public infrastructure, including bridges, rail freight lines, small airports, high-hazard dams and flood-related projects, in addition to \$1.9 billion in base Motor License Fund bridge and highway funding.

Continued Investment in Key Economic Development Programs:

- **Opportunity Grants** – \$25 million in total funds, a \$6.7 million increase, to businesses to secure job-creating and job-retaining economic development.
- **Customized Job Training** – \$11 million in total funds, a \$2 million increase, for employee training programs.

- **Infrastructure Development** – \$19 million in total funds, a \$4 million increase, for grants and loans to businesses locating or expanding in the commonwealth and for developing and improving sites and restoring blighted areas.

- **Infrastructure and Facilities Improvement Grants** – \$30 million in total funds, a \$2 million increase, to authorities that issue debt for Tax Increment Financing projects – including redevelopment authorities, convention center authorities and the Pennsylvania Economic Development Financing Authority.

Energy Independence Strategy – Continues to invest \$650 million to help Pennsylvania companies and consumers lower their energy costs, reduce their dependence on foreign oil and develop renewable energy industries.

2010-11 Budget Highlights

Education – Investing in Our Children, Preparing for the Future

PreK-12 Education – More than \$9.5 billion in state funding for basic education, a \$448 million, or 4.9 percent, increase.

Basic Education Subsidy – \$5.9 billion in total funds, a \$354.8 million, or 6.4 percent, increase to support our public schools and to continue phasing in a research-based funding approach to assist districts to advance student achievement.

Special Education – \$1.03 billion in state funding for special education programs.

Accountability Block Grant – \$271.4 million to fund proven educational programs. Includes earmarked funds for quality pre-kindergarten and full-day kindergarten.

Education Assistance Program – \$55.3 million to fund tutoring for 141,000 struggling students in 175 school districts.

Pennsylvania Pre-K Counts – \$85.9 million for pre-kindergarten.

Science: It's Elementary – \$13.5 million to help at least 72,000 students become active science explorers.

Dual Enrollment – \$8 million to help students earn college credit. High school students are taking nearly 24,000 college courses this year as a result of our current investment.

Higher Education Programs – Nearly \$2 billion in total funds, including \$503.4 million for the State System of Higher Education and a \$282.1 million for community colleges.

Grants to Students – \$455.2 million in total funds, including \$403.6 million in Pennsylvania Higher Education Assistance Agency tuition grants.

Preserving the Safety Net – Helping Pennsylvanians in Need

Cover All Kids – \$437.3 million in total funds to provide health insurance coverage for 208,555 uninsured children, representing an increase of \$26.8 million in funding and 10,300 more children served.

Long-Term Living Services – \$4.5 billion in total funds to provide home and community-based services as well as nursing home care to persons with disabilities and older Pennsylvanians, representing an increase of \$251 million in funding and 3,200 more individuals receiving home and community-based care.

Medical Assistance Services – \$11.5 billion in total funds to provide inpatient, outpatient and capitation services for 2.1 million Medical Assistance recipients.

Community Mental Retardation Services – \$2 billion in total funds to provide home and community-based services to nearly 50,000 individuals with mental retardation.

Child Welfare Services – \$1.5 billion in total funds, including an increase of \$23.7 million in state funds, to provide child welfare services to children and youth in need of care and protection.

PACE/PACENET – \$251.7 million in Lottery funds to provide prescription drug coverage for 364,400 seniors, an increase of 4,390 individuals.

adultBasic – \$199.2 million in total funds to maintain health insurance coverage for 50,000 uninsured adults in 2010-11.

Early Intervention Services – \$183.1 million in total funds to provide early intervention services to nearly 34,400 children from birth to age three, an increase of 1,172 children.

Autism Services – \$42.7 million in total funds to support the needs of individuals living with autism spectrum disorder, including home and community-based services for more than 400 adults.

Making Pennsylvania Safer

Marcellus Shale – Funding for 80 new positions for increased oversight by DEP and DCNR for natural gas drilling.

Correctional Institutions – A 7.7 percent increase, for a total of \$137 million in additional funding, which includes \$13 million for 2,000 additional beds at existing institutions.

Probation and Parole – A 7 percent increase, including \$2 million for additional parole agents to enhance supervision and case-processing capabilities.

State Police – A total of 4,400 State Troopers by the close of 2010-11.

Federal Recovery Act

The American Recovery and Reinvestment Act (ARRA), signed into law on February 17, 2009, was created to jump-start the economy. The act outlines five purposes:

- To preserve and create jobs and promote economic recovery.
- To assist those most affected by the recession.
- To provide investments needed to increase economic efficiency by spurring technological advances in science and health.
- To invest in transportation, environmental protection and other infrastructure that will provide long-term economic benefits.
- To stabilize state and local government budgets, in order to minimize and avoid reductions in essential services and counterproductive tax increases.

Under current law, Pennsylvania expects to receive more than \$26 billion from the Recovery Act. Of that amount, individual and business federal tax credits and benefits comprise about \$11 billion. The \$13.5 billion flowing through state government agencies will prevent cuts in education and public safety programs, increase federal reimbursement for Medicaid, build highways and bridges, help workers, improve the environment, support communities, develop alternative energy projects and enhance housing programs. More than \$2 billion will be awarded directly to entities across the state, including local governments, transit agencies, businesses, non-profit organizations and universities.

ARRA Budgetary Relief

The Recovery Act makes a range of funds available for states and school districts to stabilize budgets and maintain critical programs. The commonwealth expects to receive a total allocation of \$2.7 billion in federal funds for the General Fund budget in 2009-10 and anticipates an additional \$2.8 billion in 2010-11.

The 2010-11 budget includes \$921 million in fiscal stabilization funds to prevent cuts in education and public safety programs and approximately \$1.8 billion in enhanced Federal Medical Assistance Percentage funds. The budget anticipates that the 50 states will receive an additional three quarters of enhanced FMAP through September 30, 2011.

State Fiscal Stabilization. Of Pennsylvania's allocation, 81.8 percent (\$748 million in 2010-11) is being used to support elementary, secondary and higher education. The remaining 18.2 percent (\$173 million in 2010-11) is

being used for oversight and to offset state funding in the Department of Corrections. These funds are helping to prevent significant cuts in funding for educational institutions, local government programs and other important services.

Medicaid Funding. The federal government and the states share the cost of Medicaid – the health insurance program for low-income people and others in need. As in previous times of economic hardship, the federal government has temporarily increased its share of Medical Assistance costs, recognizing that vulnerable Americans need more assistance. With the anticipated additional three quarters of FMAP funds, this component of the recovery program is expected to increase federal reimbursements to Pennsylvania by more than \$5 billion over the anticipated 36-month adjustment period between October 2008 and September 2011.

ARRA Economic Stimulus Programs

In addition to providing fiscal relief to counteract declining state revenues, the Recovery Act is also funding critical programs that are preserving and creating jobs in Pennsylvania and making priority investments in clean energy, infrastructure and technology projects:

- **Workforce Programs** – \$3.4 billion in much-needed relief for workforce programs, including job training and unemployment services as well as enhanced unemployment compensation benefits.
- **Transportation Infrastructure Projects** – More than \$1 billion to repair aging roads and bridges. By recognizing the vital link between a safe, reliable transportation infrastructure and the ability for communities and businesses to continue to grow, the economic recovery plan will allow the commonwealth to make much-needed fixes to thousands of bridges and thousands of miles of highways while putting thousands of people to work.
- **Energy Projects** – \$390 million to advance energy programs for businesses, energy producers and homeowners. In addition to creating jobs and saving money, these investments will conserve energy and improve the quality of the environment.
- **Other Infrastructure and Housing Projects** – More than \$478 million for infrastructure and housing, including water and sewer system improvements, tax credits, homelessness prevention and emergency shelters, and National Guard projects.

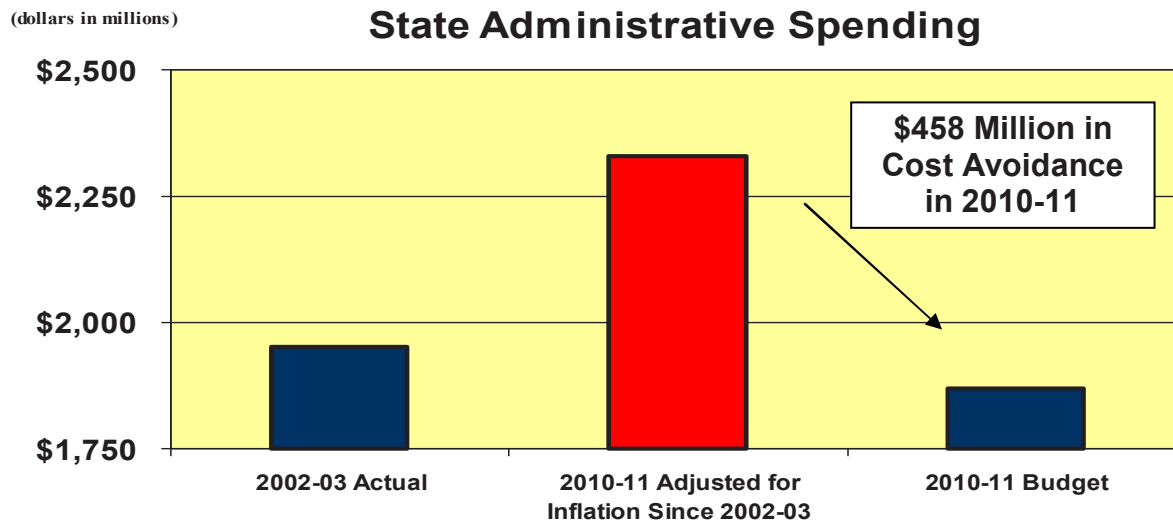
Federal Fiscal Relief	Dollar Amounts in Millions		
	2008-09	2009-10	2010-11
State Fiscal Stabilization — Education	\$63	\$748	\$748
State Fiscal Stabilization — Corrections and Oversight	\$0	\$173	\$173
Enhanced Federal Medical Assistance Percentage (FMAP)	\$1,177	\$1,777	\$1,835
TOTAL Budgetary Relief	\$1,240	\$2,698	\$2,756

Making Government Work Smarter

Despite the recent decline in state revenue, Governor Rendell has been able to sustain critical programs by finding innovative ways to drive down the cost of operating Pennsylvania state government.

Cutting Administrative Costs

Governor Rendell's 2010-11 budget proposal features his fifth consecutive call for level or reduced funding for most general operating appropriations. Since 2002-03, state agencies have reduced their operating costs by 4 percent. If state administrative spending had been allowed to grow at the rate of inflation, commonwealth agencies would spend \$458 million more in this budget to operate state government.



The Governor has ordered a broad range of cost-containment measures as a response to a slower-than-anticipated recovery from the global recession. These actions include:

- Extending a freeze on management and non-union salaries in 2009-10, saving \$87.3 million, and
- Restricting out-of-state travel to save \$14 million annually.

The continuation of the commonwealth's hiring freeze and the elimination of another 500 vehicles from the state's vehicle fleet have also significantly contributed to the administration's efforts to further reduce administrative spending. As a result of the hiring freeze and a series of other initiatives designed to streamline government, the state has 5.5 percent fewer workers than it had in January 2003.

Exceeding Savings Goals

In 2003, Governor Rendell pledged to Pennsylvanians that he would dramatically reduce the cost of government by achieving \$1 billion in annual recurring savings during his first term. After fulfilling this promise, he challenged his cabinet in early 2007 to identify an additional \$500 million worth of efficiencies during his final four years in office. Through the

end of the 2008-09 fiscal year, state agencies were able to deliver \$1.75 billion in annual recurring savings. These administrative savings will be used to support programs that directly affect Pennsylvania's citizens. In this period of economic uncertainty and declining state revenues, these savings are even more important as the administration looks to safeguard those programs that protect Pennsylvania's neediest citizens.

Improving Government Operations

In addition to those agency projects that have yielded program-specific savings, the state's central administrative agencies have developed a series of enterprise-wide initiatives that are cutting costs, eliminating paperwork and delivering higher-quality services for state agencies, their suppliers and constituents. Several of these cost-savings projects are variations on the same "shared-services" theme. Consolidating administrative functions not only cuts costs but also leaves the agencies free to focus on their core programs.

Procurement

The Rendell administration first put this shared-services model to the test via its Strategic Sourcing Initiative, when it transferred most of the responsibility for the state's purchasing

Making Government Work Smarter

activities from dozens of distinct agency administrative offices to the Department of General Services. By bringing state government's buyers together, the administration has reduced the number of positions dedicated to this work and improved service delivery through specialization and enhanced training. By consolidating demand, Pennsylvania has significantly improved its negotiating power with vendors. Through the end of 2009, the Strategic Sourcing Initiative was generating \$325 million in annual savings.

Information Technology Consolidation

In 2004, Governor Rendell directed the Office for Information Technology to begin a multi-year process of consolidating the state's Information Technology resources by aligning agencies' existing investments, planning activities and technical strategies with the state's overall vision for information technology. Through this effort, each agency prepared an IT consolidation assessment and chose either to turn its IT operations over to OIT or to merge with peer agencies. The IT consolidation initiative is not designed to cut positions, but to improve services. Smaller agencies now have access to the commonwealth's full range of IT expertise. The consolidation initiative is now enabling state government to make optimal use of its employees' skills and experience.

Finance Transformation

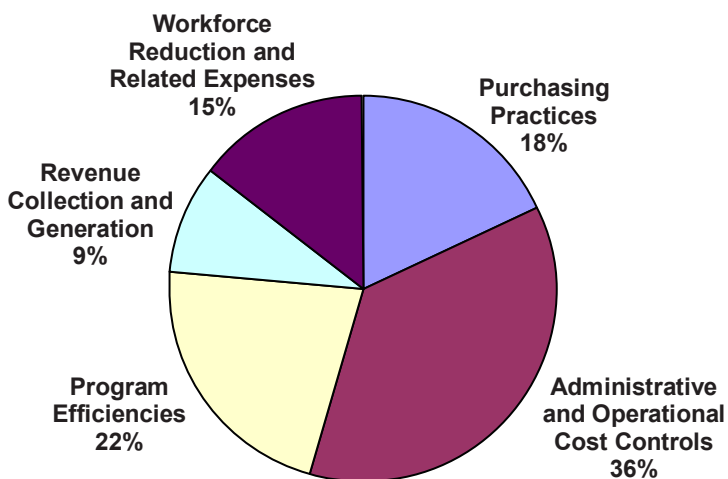
When Governor Rendell took office, the commonwealth was in the midst of a multi-year implementation of its enterprise resource planning system – an information system that integrates the commonwealth's separate administrative databases. After this project was completed, the need to overhaul the state's business practices relating to

purchasing and payment became apparent. The Governor commissioned a comprehensive inventory of Pennsylvania's key purchasing and payment procedures and asked for recommendations that would reduce processing time, improve cash management practices and eliminate red tape.

The results of this effort served as the basis of the Finance Transformation project, which included updating outdated business procedures and reorganizing the offices that provide the key services. Over an 18-month period during 2008 and 2009, the Office of the Budget restructured its Comptroller Operations functions to establish consolidated offices for accounting, auditing, financial management, payables, quality assurance and other key roles. This was a significant change from Comptroller Operations' previous structure, in which agencies were served by six distinct comptroller organizations.

This restructuring eliminated redundancies and made the commonwealth a more attractive business partner for current and prospective vendors. For example, under the old organizational structure there was no standardized way for suppliers to check on the status of their pending payments from the state. Vendors often had to make many phone calls over several days. Now, the Payable Services Call Center is a one-stop shop for questions about vendor registration or payment status. Also, many of the state's suppliers are now participating in an electronic invoicing initiative that eliminates paperwork and accelerates the payment process.

Components of the \$1.75 Billion in Annual Management and Productivity Savings



Making Government Work Smarter

Human Resources Shared Services

One of the benefits of the enterprise resource planning system is that many paperwork-intensive processes, such as requesting and approving vacation time, became paperless for most employees. Although the responsibilities of agency human resources offices changed with the new system, many offices were slower to adjust. In 2009, the Office of Administration launched a Human Resource Shared Services Center Initiative. During the first half of 2010, the center will gradually become responsible for managing common personnel transactions such as transfers or promotions. This change will allow each agency's human resources office to concentrate on those tasks that require agency or program-specific expertise, such as recruitment. The efficiencies realized as a result of this consolidation will reduce operating costs by more than \$1 million per year.

Managing With the Help of Data

To help agencies confront the challenges of maintaining effective operations in tough budget times caused by the

national recession, the Office of Administration has created a series of management reports that agencies are using to review current, accurate data on their personnel, budget and procurement activities. Combining records from several sources, these reports give agency executives the details they need to make informed decisions about how to best allocate their scarce resources.

Managing Smarter to Serve Better

The Rendell administration's management and productivity improvement initiatives have reduced operating costs by more than \$1.75 billion annually and are streamlining key administrative functions relating to personnel, finance, information technology and procurement. These efforts have not only saved money but also have vastly improved the commonwealth's operations, thereby ensuring that taxpayer dollars are spent wisely and directed to programs that benefit Pennsylvania's residents.



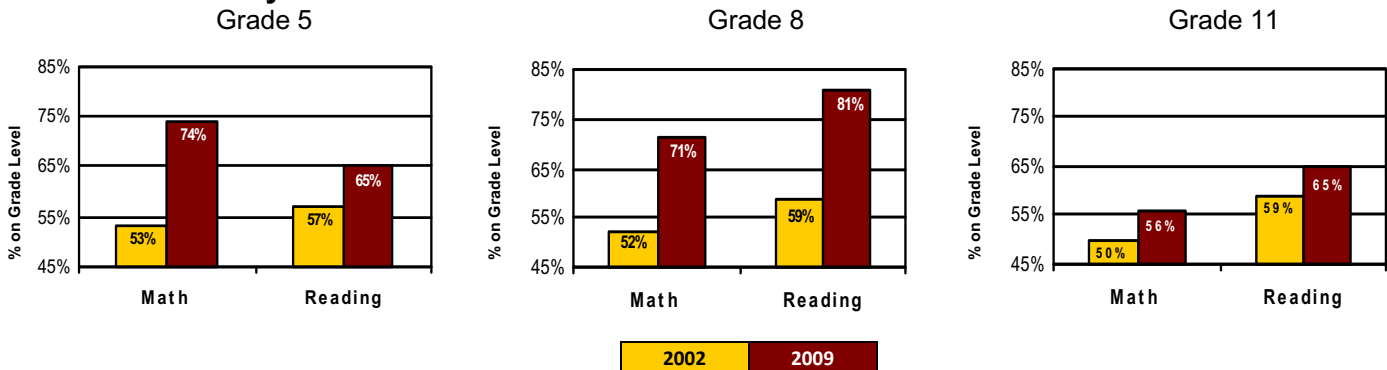
Education - Investing in Our Children, Preparing for the Future

Governor Rendell has made education a top priority for Pennsylvania – championing new investment and greater accountability as critical to the commonwealth’s economic development strategy and in fulfillment of our moral imperative to ensure that today’s students have the opportunity to succeed in the competitive, high-skills knowledge economy of the future.

Pennsylvania is now a real investor in the state’s public schools. Our funding formula recognizes the actual number of students in each district, geographic price differences and the additional costs of English-language learners and children from low-income families. In addition to increases in the Basic Education Subsidy, the Governor and the legislature have provided an additional \$2.5 billion over the past seven years in funds for specific targeted programs, including the highly successful Classrooms for the Future program, Pre-K Counts, the Accountability Block Grant, the Educational Assistance Program and Dual Enrollment.

These programs and resources have had a dramatic and sustained effect on student achievement, with greater student achievement across the state in every grade and subject.

Nearly 30 Percent More Students Are on Grade Level Than in 2002



Beyond the dramatic overall achievement gains that have taken place since 2002, it is important to note that many of the most academically challenged school districts and student populations are making strong progress:

- Nearly three-quarters of students performed on grade level in reading and math in 2009.
- The number of school districts with at least half of their students below grade level dropped from 125 school districts in 2002 to just 18 school districts in 2009.
- Today, 54,000 more students are on grade level in reading and math in grades 5, 8 and 11 (the three grades tested the longest) than in 2002.

Pennsylvania is leading the nation in the scope and depth of our student achievement results. The Center for Education Policy, a leading national educational research organization, identified Pennsylvania as the only state to see increases in student achievement in elementary, middle and high school from 2002 to 2008.

We cannot afford to lose momentum now. The national economic crisis continues to put enormous pressure on state budgets, and Pennsylvania is no exception. But the commonwealth’s substantial investments – in early childhood

education, driving resources to schools and classrooms, supporting teacher effectiveness, and increasing rigor in high schools – have resulted in significant improvement in academic achievement. It is essential that we continue to recognize educational investment as a core component of our economic recovery strategy.

The better prepared Pennsylvania students are when they graduate from high school, the more likely they are to be employed, the more they will earn and generate in tax revenue, and the less the government will have to support them. Growing Pennsylvania’s economy by developing a world-class education system starts with the first day of pre-kindergarten and lasts through the final day of high school and a student’s transition to college or the workforce.

Pennsylvania faces four essential challenges that it must meet in order to ensure that our students are prepared to compete in the global economy:

- High-quality early childhood education is an essential head start to long-term academic success.
- Every student needs to attend a school that has adequate resources in order to obtain the student achievement results we demand.

Education - Investing in Our Children, Preparing for the Future

- Teacher effectiveness is the key to student achievement. High-quality supports for teachers are essential to developing and retaining effective teachers in every classroom.
- Our schools need to be responsive to the changing world economy so that when Pennsylvania students graduate from high school, they are ready for the high-tech, high-skills workplace that awaits them.

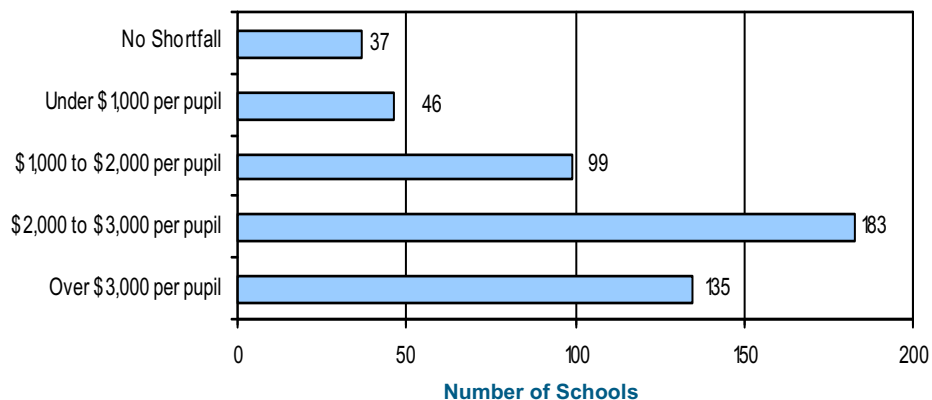
Investing in Student Success

In 2006, the General Assembly commissioned the commonwealth's first study to determine the actual level of resources schools need for students to achieve at grade level. The report concluded that Pennsylvania faced a \$4 billion education funding shortfall.

In February 2008, Governor Rendell proposed a \$2.6 billion, six-year plan to address the shortfall. In July 2008, the legislature: enacted a new school funding law that set an "adequacy target" for each school district based on the formula set forth in the legislature's report; delivered the first-year installment of the state's contribution; and stated in law that "...in order to enable students to attain applicable Federal and State academic standards, it is the goal of this commonwealth to review and meet state funding targets by fiscal year 2013-2014." In October 2009, despite the dramatic economic downturn that caused the commonwealth's General Fund revenue to decline by 11.3 percent, the Governor and the General Assembly funded a significant portion of year two of the six-year plan to provide adequate school funding for all children.

Despite implementation of the first two years of the funding formula and Pennsylvania's ongoing commitment to supporting evidence-based strategies through programs like the Accountability Block Grant, the number of school districts with a significant adequacy gap remains high.

More Than Half of Pennsylvania's School Districts Need \$2,000 or More per Student to Close Their Achievement Gaps



In these difficult economic times, it is more important than ever to prioritize the use of state resources to have the greatest possible impact. One of the key features of Pennsylvania's school funding formula is that the law requires school districts to invest their new resources in a menu of proven academic programs, and it gives the Department of Education the authority to reject the investment plans of academically challenged school districts.

The **2010-11 basic education subsidy includes a \$354.8 million increase** to continue to provide the state funding necessary to address the adequacy gap using the new funding formula. However, economic conditions remain extremely difficult. As was the case last year, the proposed

subsidy increase is less than the amount put forward in the original six-year plan. For this reason, it may take additional years to meet Pennsylvania's original adequacy funding target.

In addition to a substantial increase in the basic education subsidy, the 2010-11 budget maintains Pennsylvania's progress by continuing to support other successful academic programs:

- \$85.9 million for Pennsylvania Pre-K Counts. School districts, Head Start programs and other community providers with proven track records of success provide high-quality pre-kindergarten to 11,800 students.

Education - Investing in Our Children, Preparing for the Future

- \$38.7 million for the Head Start Supplemental Assistance program. For the last five years, Pennsylvania has supplemented federal Head Start funding so this successful program can reach 5,743 children.
- \$271.4 million for the Accountability Block Grant. This initiative funds pre-kindergarten, full-day kindergarten, elementary school class-size reduction and other proven educational programs.
- \$55.3 million for the Education Assistance Program. In 2008-09, Pennsylvania’s hallmark tutoring program provided extra learning time to 172,000 struggling students in 175 school districts and Career and Technical Centers.
- \$13.5 million for Science: It’s Elementary. During 2008-09, Science: It’s Elementary provided hands-on, inquiry-based instructional materials supported by rigorous professional development to 2,700 teachers, enabling 65,000 students to “learn science by doing science” across 52 Pennsylvania counties. The program reached 72,000 students and their teachers in 2009-10.

- Using state tutoring funds to help students pass Keystone Exams or validated local assessments. The commonwealth expects that school districts will target their state tutoring funds – \$55.3 million in 2010-11 – to students who need extra help in meeting the new graduation requirements as the new rules are phased in.
- Helping More High School Students Earn College Credit. Last year, Pennsylvania high school students earned college credits by taking 25,341 courses as a result of the commonwealth’s Dual Enrollment program. The 2010-11 budget provides \$8 million to maintain the program, with 22 percent directed toward low-income students to ensure that these students have access to a program that exposes them to college-level work and helps them to understand that college can be a real option for them.

Increasing the Rigor of High School

In order for students to be prepared for post-secondary success in college or the workplace, high schools must provide them with rigorous coursework in reading, writing, mathematics, science and technology and hold them to high standards of achievement in these subjects.

In 2009, Pennsylvania promulgated final regulations that put in place new high school graduation requirements and provided students with more options – and more support – to meet the new rules. Under the new regulations, students must demonstrate proficiency in core academic subjects through a number of options, including passing new end-of-course subject-matter exams as part of a final grade, passing validated local assessments or passing national subject-matter assessments such as Advanced Placement or International Baccalaureate exams.

To ensure that all high school students stay in school and are ready and able to graduate, Pennsylvania is providing more resources and support to teachers and school districts than ever before:

- Implementing a comprehensive instructional improvement system. Pennsylvania has begun creating a state-of-the-art instruction improvement system that links standards, assessments, curriculum, instruction, materials, resources and interventions.

Total Higher Education Funding is Nearly \$2 Billion

Key Higher Education Funding

(In Millions)

Community Colleges	\$282.1
State System of Higher Education	\$503.4
State-Related Universities:	
Pennsylvania State University	\$333.9
University of Pittsburgh	168.0
Temple University	172.7
Lincoln University	13.8
Total – State-Related Universities	\$688.4
Non-State-Related Universities and Colleges	\$ 30.5
PA Higher Education Assistance Agency	\$455.2

Investing in Our Children, Preparing for the Future

The 2010-11 budget represents the final year in Governor Rendell’s administration – one of historic investment in boosting achievement throughout Pennsylvania’s public education system, coupled with stronger accountability and increased efficiency. The budget creates new opportunities for students from the first day of pre-kindergarten to the day they receive their college degree.

Preserving the Safety Net

Helping Children, Older Pennsylvanians and Families Survive Tough Economic Times

Although Pennsylvania's economy has fared better than the economies of many other states, the commonwealth's social safety net needs to be protected to help children, families and vulnerable adults in tough economic times.

The agencies that deliver human services to the citizens of the commonwealth continue to meet their needs, but entitlement programs continue to see caseload growth as a result of the current economic climate.

- **Supplemental Nutrition Assistance Program.** The demand for nutrition assistance (food stamps) is at an all-time high in Pennsylvania and across the nation. In December 2009, the number of Pennsylvania children and adults eligible for SNAP reached approximately 1.5 million, a 19 percent increase from 2008's monthly average.
- **Cash Assistance.** The number of people receiving Temporary Assistance for Needy Families cash assistance increased by 9 percent between December 2008 and December 2009, reversing an almost four-year trend of caseload declines. Although approximately 1,700 individuals continue to leave cash assistance each month, the recent caseload increases reflect the acute impact of the national economic climate on the ability of low-income Pennsylvanians to obtain and keep jobs.
- **Medical Assistance.** In 2010-11, the Medical Assistance program will provide health care and long-term care services to more than 2.1 million Pennsylvanians, a 3 percent increase over the prior year.
- **adultBasic.** The number of uninsured adults seeking adultBasic health care coverage grew to nearly 370,000 in January 2010, more than double the number in January 2009. In an effort to address this increasing need, this budget assumes the continuation of the Community Health Reinvestment contribution and Tobacco Settlement funds to provide health care coverage to 50,000 people in 2010-11.

The Commonwealth Provides Vital Services to Children, Older Pennsylvanians and Others in Need

PROGRAM	People Served 2009-10	People Served 2010-11
Medical Assistance – Health Care for Low-Income Elderly, Disabled, Children, Adults and Chronically Ill Adults	2,068,699	2,130,785
Pharmaceutical Assistance Contract for the Elderly (PACE)/ PACENET)	360,011	364,400
Protection for Children at Risk Due to Abuse, Neglect and Delinquency	285,077	288,480
Cash Assistance (TANF, General Assistance and State Blind Pension)	244,371	257,615
Child Care for Low-Income Families	231,085	242,665
Children's Health Insurance Program	198,240	208,555
Community Behavioral Health Services	195,465	196,105
Community Mental Retardation and Autism Services	49,921	50,336
adultBasic	50,000	50,000

* Eligible individuals may receive services in more than one category.

Maintaining the Safety Net Depends on Additional Cost Containment

The 2010-11 budget continues efforts by this administration to control costs and increase fiscal oversight for the Medical Assistance program. Several new cost-containment initiatives are proposed, including:

- Increased Pharmaceutical Rebates (\$102.5 million in savings)
- Increased Pharmacy Efficiencies (\$4.6 million in savings)
- Reduced Fraud and Abuse and Expanded Third-Party Liability (\$4.4 million in savings)

Preserving the Safety Net

Restructuring Pennsylvania's Long-Term Living System

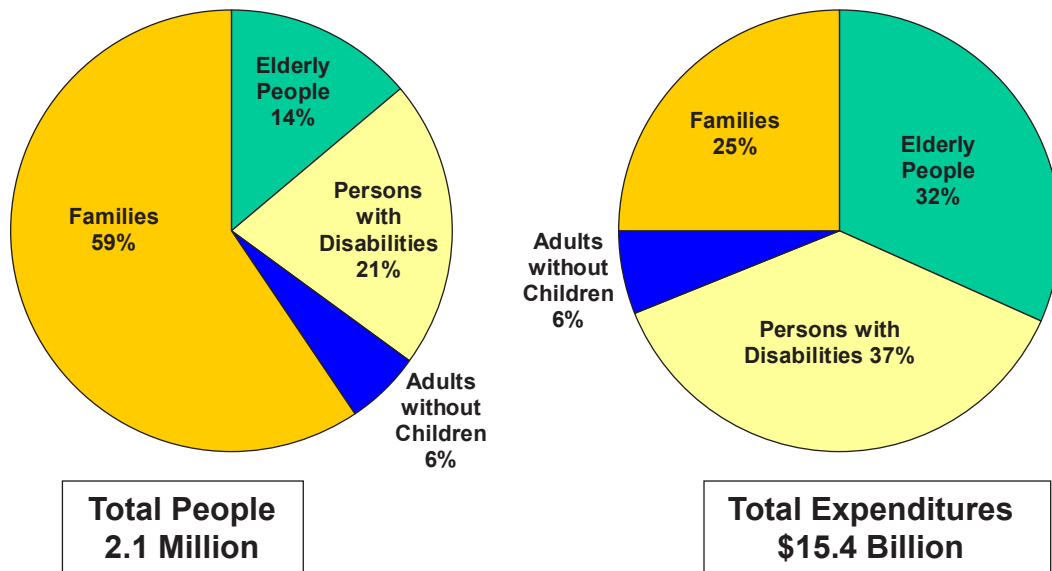
The 2010-11 budget proposes to further integrate the long-term living programs administered by the departments of Aging and Public Welfare by consolidating these programs into the Department of Aging and Long Term Living. Establishing a single state entity for the administration of long-term living services will rebalance long-term living resources by consolidating policy, financing, quality management and administration into one department. This consolidated department will enhance the ability of persons with disabilities and older persons to live with dignity and independence in the setting they prefer.

Expanding Home and Community-Based Services

The 2010-11 budget continues to support home and community-based services:

- \$2 million to provide home and community-based services for 150 additional individuals with mental retardation, including 100 young people leaving the special education system.
- \$4.7 million to provide home and community-based services for 226 additional individuals with autism.
- \$14.3 million to support community-based mental health programs for 155 persons discharged from state hospitals.
- \$6.2 million to provide home and community-based services to 1,692 additional older Pennsylvanians.
- \$11.1 million to provide home and community-based services to 1,524 additional individuals with disabilities.
- \$5.3 million to provide early intervention services for 1,172 additional infants, toddlers and preschoolers who are experiencing developmental delays.

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



Elderly and disabled persons are only 35 percent of the total Medical Assistance population, but they account for 69 percent of the Medical Assistance expenditures. Families comprise 59 percent of the Medical Assistance population but account for just 25 percent of the expenditures.

Making Pennsylvania Safer

Even with the significant budgetary pressures resulting from the economic downturn, the commonwealth is continuing its comprehensive and proactive approach to keeping Pennsylvanians safe in their homes and communities.

This budget maintains the Rendell administration's commitment to public safety by continuing to ensure a historically high complement of State Police Troopers, providing the Department of Corrections and the Board of Probation and Parole with funding to help improve public safety, enhancing the security of Pennsylvania's driver's licenses and photo identification, and strengthening our ability to monitor and inspect oil and gas drilling.

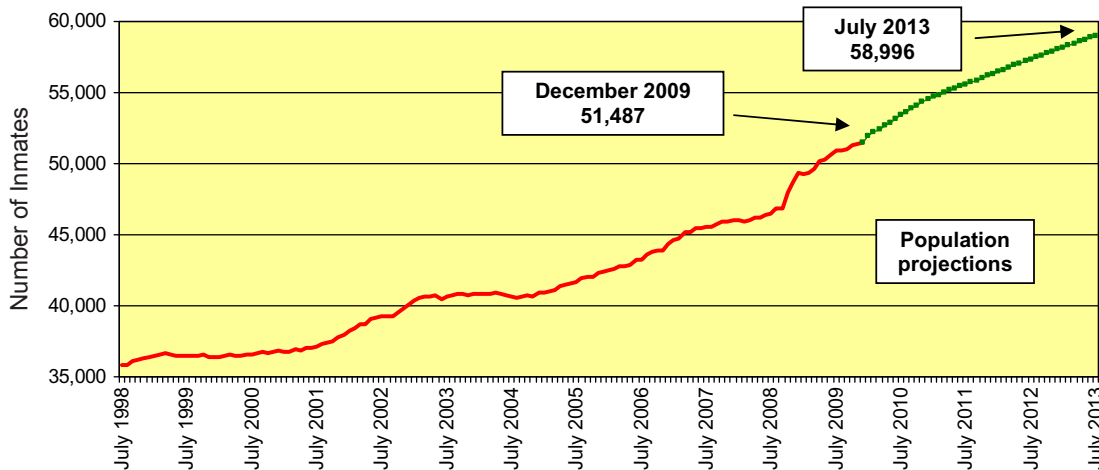
- **Continued Funding for a Historically High State Police Trooper Complement**

Recognizing the vital role played by Pennsylvania's State Troopers in protecting communities across the commonwealth, Governor Rendell has supported substantial increases in the statewide Trooper complement to historically high levels. This budget maintains that commitment by funding a new State Police cadet class that will begin its training program in October 2010.

- **An Expanded Capacity to Safely House Inmates**

Pennsylvania's prison population continues to rise. To address this trend, the 2010-11 budget provides \$13 million in funding to the Department of Corrections for more than 2,000 additional beds in new housing units at nine correctional institutions. The budget also provides \$2 million for additional parole officer positions to improve parolee supervision and to reduce the likelihood of repeat offending.

Offenders Incarcerated in the State Prison System



The number of offenders incarcerated in the state prison system is projected to increase by 14 percent, from more than 51,000 inmates to nearly 59,000 inmates by July 2013. The 2010-11 budget provides new funding for an additional 2,018 prison beds.

- **Enhanced Security for Driver and Vehicle Documentation**

Pennsylvania's driver's licenses and ID cards are often the primary method for verifying personal identity across the commonwealth and throughout the nation. Safeguarding license holders from identity theft is therefore central to the commonwealth's public safety objectives.

The most recent ID technologies and processing improvements will help make state identification and vehicle title documents even more difficult to counterfeit. The budget provides \$334,000 to PennDOT to continue implementing these security enhancements.

- **Increased Staffing to Monitor and Inspect Oil and Gas Drilling**

Drilling for new natural gas wells in Pennsylvania's Marcellus Shale region is increasing at a record pace. The Department of Environmental Protection has issued permits for 2,500 Marcellus wells, and current estimates are that the number of permits will double in 2010. To support the safe extraction of gas from the Marcellus Shale region, prevent land contamination and ensure the continued protection of Pennsylvania's water supply, the 2010-11 budget includes 68 new positions, funded by gas drilling permit fees, to strengthen the department's oil and gas program. The budget also includes 12 new positions in the Department of Conservation and Natural Resources for increased oversight of gas drilling in state forests.

Property Tax Relief for Pennsylvania

The 2010-11 Budget Provides Nearly \$770 Million in Continued Property Tax Relief

This budget provides nearly \$770 million in property tax relief, including \$613.7 million in broad-based property tax relief and \$129.1 million in property tax and rent rebates for older Pennsylvanians. When fully in place, this tax reform will cut property taxes by more than \$1 billion each year. This will ensure that Pennsylvania communities will be able to compete even more effectively for new and existing businesses and be even more attractive places for families to live and prosper.

Continuing Property Tax Relief for Pennsylvania Homeowners

The 2010-11 budget marks the fourth year of historic property tax relief for Pennsylvania homeowners. The Taxpayer Relief Act – signed into law in 2006 – has already eliminated school property taxes for more than 123,000 older Pennsylvanians. In the coming year, Pennsylvania homeowners, on average, will continue to receive nearly \$200 in state-funded property tax relief – with even more savings for older adults who have the most urgent need.

- In 2010-11, the \$613.7 million in broad-based property tax cuts will translate to an average of nearly \$200 for every Pennsylvania household. Instead of reducing property taxes, Philadelphia's share of funding for broad-based tax relief will be used to reduce the city's wage tax, which is a greater barrier to economic

growth in Philadelphia. The Taxpayer Relief Act also allows Scranton to use a portion of its tax relief funds to cut that school district's wage tax, the highest of all Pennsylvania school districts.

- The Property Tax/Rent Rebate program will provide \$129.1 million in property tax and rent rebates for nearly 600,000 older Pennsylvanians earning less than \$35,000 a year. This program funds tax relief for nearly 405,000 homeowners and 195,000 renters. These older Pennsylvanians will receive additional property tax relief through the broad-based property tax relief eligible to all homeowners.
- Older Pennsylvanians who pay a significant portion of their income in property taxes or who live in high property-tax areas will receive additional targeted property tax relief totaling \$26.9 million in 2010-11.

Estimated Property Tax Relief Funded by Expanded Gaming in Pennsylvania

Type of Tax Relief	Amount of Tax Relief in 2010-11
Property tax relief for all homeowners from gaming revenue (wage tax relief in Philadelphia)	\$613.7 million
Enhanced property tax rebates of up to \$650 for older Pennsylvanians earning up to \$35,000 a year	\$129.1 million
Higher rebates for older Pennsylvanians with a high tax burden or those living in cities with a high tax burden	\$26.9 million
TOTAL	\$769.7 million

Pennsylvania's favorable business and tax climate, along with property tax reductions that are the direct result of the successful implementation of expanded legalized gaming, strongly position the commonwealth to attract and retain jobs.

Readying for Future Fiscal Challenges

The 2010-11 budget is a balanced plan that responds to the difficult fiscal environment that will affect state revenues and expenditures in the coming fiscal year. It also positions Pennsylvania to confront two major financial challenges: the end of federal stimulus funding in 2011 and the sharp increase in pension contributions anticipated in 2012-13.

Federal Fiscal Relief Funds Will End in 2011

The American Recovery and Reinvestment Act of 2009 (ARRA) is a concerted effort by the federal government and the states to preserve and create jobs, protect essential public services and make priority investments in clean energy, infrastructure, technology and education that will transform the nation. In Pennsylvania, the Recovery Act has provided funds for critical programs that benefit local businesses, individuals and families – in areas as varied as targeted tax incentives, highway construction, supplemental nutrition and weatherization assistance.

This budget includes funding from two major components of the federal stimulus program: budget stabilization funds to prevent cuts in education, public safety and other critical government programs; and temporary increases in the federal government's matching funds for the Medical Assistance program. These funds have been vitally important in counteracting the most rapid decline in state revenues in decades.

At the time of this budget's publication, Congress was considering a short-term extension to the federal government's increased share of Medical Assistance matching funds as originally enacted in ARRA. The 2010-11 commonwealth budget anticipates that the states will receive an additional three quarters of enhanced Federal Medical Assistance Percentage (FMAP) funds through September 30, 2011.

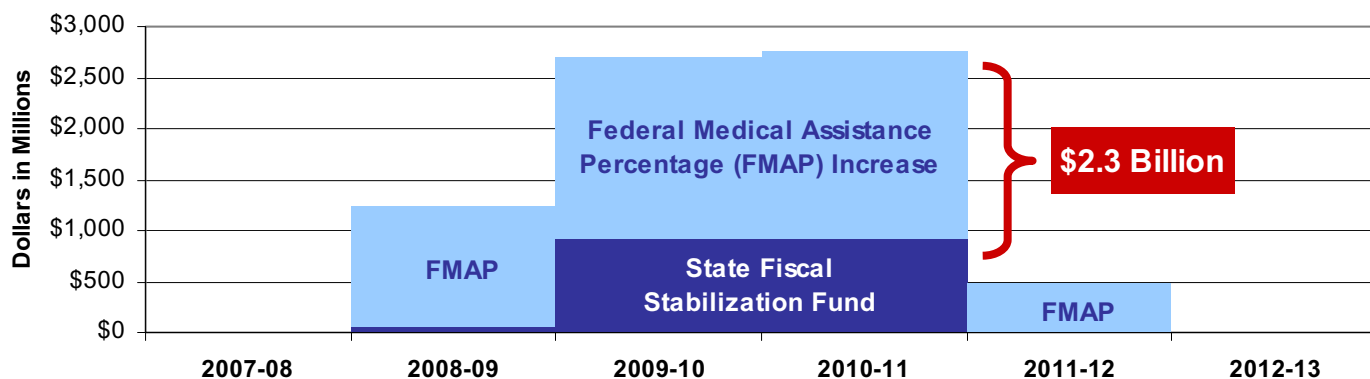
As a result of existing and anticipated federal action, \$921 million in fiscal stabilization funds and approximately \$1.8 billion in enhanced Medical Assistance matching funds will mitigate the need for drastic service cuts or broad-based tax increases that would otherwise be required to present



a balanced budget in 2010-11. Federal fiscal relief has also provided the opportunity for the commonwealth to implement accountability measures that place Pennsylvania in a prominent position among the states as the nation returns to sustained economic growth.

However, 2011 will likely be the final year for which state fiscal stabilization and enhanced FMAP funds are available. Although this supplemental funding has greatly enhanced the commonwealth's ability to maintain critical services during the recession and its immediate aftermath, the end of the stimulus program will leave Pennsylvania in a precarious financial situation in budget year 2011-12. The lack of these funds will create a \$2.3 billion gap that will need to be closed by further service efficiencies, program cuts and new state revenue growth.

The Impact of Recovery Act Funds on the Commonwealth's General Fund Budget



Readying for Future Fiscal Challenges

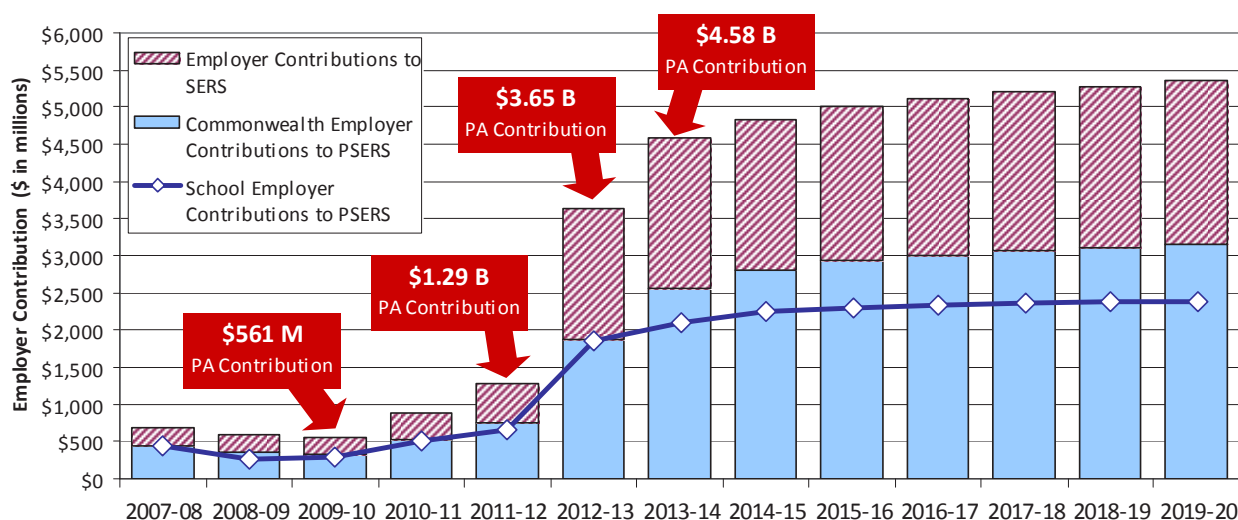
The Pension Rate Spike – A Huge Increase in Employer Contributions Is Due in 2012

In 2012-13 the commonwealth will face a sharp increase in employer contributions to the Public School Employees' Retirement System (PSERS) and to the State Employees' Retirement System (SERS). Implementing an effective response to this challenge will be critical in preserving Pennsylvania's progress out of the economic downturn.

For PSERS, under current law and using the system's annual earnings assumption (8 percent per year), the commonwealth contribution is projected to increase from \$758 million in 2011-12 to \$1.88 billion in 2012-13. That represents a single-year increase of \$1.13 billion. School district costs for retirement will also spike, with their contribution increasing from \$658 million to \$1.86 billion.

For SERS, also assuming 8 percent investment returns between now and 2012, employer contributions are forecast to increase from \$531 million in 2011-12 to \$1.77 billion in 2012-13, a single-year increase of \$1.24 billion.

Projected Employer Contributions to PSERS and SERS Under Current Law



The rate spike is a result of retirement benefit enhancements approved by the General Assembly before Governor Rendell took office, actuarial adjustments to both systems enacted in 2002 and 2003 that postponed large short-term increases in employer contributions, and significantly lower-than-anticipated stock market returns in 2001-02 and in 2008-09.

The Plan to Mitigate the 2012-13 Rate Spike

The 2010-11 budget proposes a pension funding method that will insulate the commonwealth and school districts from the employer rate spike in a manner that still recognizes the need for state and school employers to contribute significant additional funds to both systems over the next decade. The proposal would require the commonwealth to adopt a new policy to determine the annual pension contribution rate for SERS and PSERS. The objectives of this proposal are to:

- 1) Take the first steps to returning the pension systems to actuarial soundness this year by funding significant increases in employer contributions over 2009-10 levels;

- 2) Mitigate the projected 2012-13 rate spike;
- 3) Deliver a funding schedule that makes contribution increases more incremental and predictable, allowing time to absorb the impact of changes in retirement costs; and
- 4) Retain features of the current law wherever possible, including the five-year smoothing of actuarial gains and losses, as well as level-dollar contributions.

The plan consists of two interrelated components: a “fresh start” for the pension systems’ liabilities and an incremental phase-in to higher contributions.

In the same way as refinancing a mortgage, a fresh start would allow the commonwealth to start anew and begin an incremental upward ascent in funding retirement costs. Based on their most recent actuarial valuations, the retirement systems would undertake a fresh start that would reamortize liabilities over 30 years. The systems would retain both their more-conservative level-dollar amortization schedules and

Readying for Future Fiscal Challenges

their ability to recognize each year's investment gains and losses incrementally over five years.

A fresh start goes some way toward mitigating the rate spike, but still results in a substantial one-time increase in the employer contributions required for both pension systems. Therefore, the proposal adds to the fresh start solution a series of incremental steps that would limit annual contribution increases to sustainable amounts over a period of approximately 10 years. In conjunction with this incremental system, a fresh start could offer a meaningful medium-term solution for the commonwealth's pension challenges.

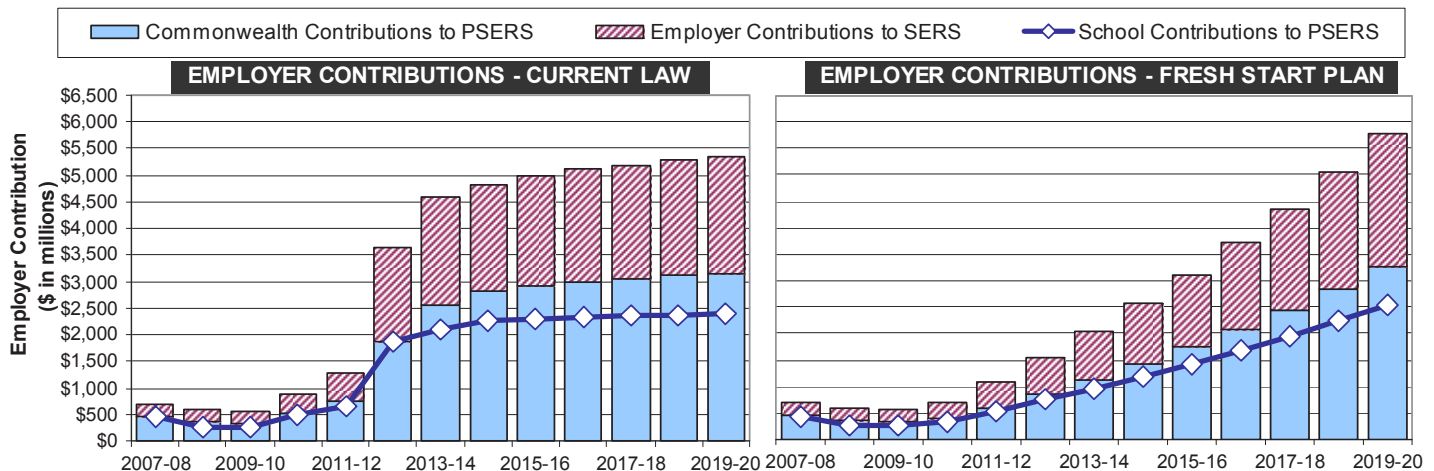
In 2010-11, the commonwealth and school district employers would begin to fund the incremental step-up in pension costs by increasing employer contribution rates to PSERS and SERS by 1 percent of payroll. This represents an additional all-employer investment in our pension systems of \$200 million – or 24 percent – over 2009-10 levels. Thereafter, contribution amounts would be scheduled to increase annually by a maximum of 3 percent of payroll.

The resulting funding schedule would introduce a new contribution schedule that increases the commonwealth's and school districts' employer contributions in a graduated and predictable manner over the next 10 to 11 years. Higher-than-expected investment returns would reduce the number of years of phase-in required. Finally, any increase in benefits, such as new cost-of-living adjustments, would add to the unfunded liability and would therefore require immediate additional employer contributions to be appropriated for the systems.

This pension funding strategy meets the immediate challenges facing the commonwealth's two statewide public pension systems head on. It offers a solution that both addresses the 2012-13 rate spike and provides a road map back to long-term actuarial soundness for the pension systems, providing greater security that the commonwealth and school districts will be able to meet all future pension funding obligations for both current and future retirees.

Projected Employer Contributions to PSERS and SERS Under the Fresh Start Plan

The 2010-11 budget will take the first steps to returning our pension systems to actuarial soundness, with \$200 million in additional employer contributions to the pension systems over 2009-10 levels. Future increases will be significant but incremental, allowing state and school district budgets to absorb the impact of increased pension costs over a period of 10 years.



A Road Map to Future Sustainability

Despite the balanced budget plan for 2010-11 and Pennsylvania's advancements over the last seven years, the commonwealth faces significant challenges in 2011-12 as a result of continued weaknesses in state revenue collections, unemployment at higher-than-average levels, a phase-out of federal fiscal relief and the spike in contributions to the two statewide pension systems that is due in 2012-13. Our collective response to these challenges will be critical in preserving Pennsylvania's progress in this new decade.

Creating a Fairer Tax Structure

Over the past seven years, Governor Rendell has enacted tax cuts that have substantially reduced property taxes for Pennsylvania families, generated billions of dollars in tax savings for Pennsylvania businesses and improved the commonwealth's overall economic competitiveness. This budget proposes additional tax reforms in 2010-11 that will build on this record and create a fairer tax structure for both families and businesses. All revenues will be placed in a Stimulus Transition Reserve Fund.

Pennsylvania's Businesses Gain \$5.7 Billion in Tax Savings

Since 2003, business tax cuts have reduced the cost of doing business in Pennsylvania by a total of \$5.7 billion. These savings have strengthened the commonwealth's business climate, improving the bottom line for companies and increasing their ability to create and retain jobs. Specific tax cuts include major reductions in the capital stock and franchise tax, targeted new tax credits and an expansion of the net operating loss deduction.

Total Savings Through Tax Cuts (dollars in millions)

	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
Business Tax Cuts	\$20.3	\$181.3	\$386.9	\$716.4	\$1,240.8	\$1,506.4	\$1,605.1	\$1,616.9
Non-Business Tax Cuts	\$61.2	\$134.4	\$155.1	\$190.8	\$331.0	\$1,005.1	\$966.5	\$990.6
TOTAL	\$81.5	\$315.7	\$542.0	\$907.2	\$1,571.8	\$2,511.5	\$2,571.6	\$2,607.5

Business Tax Cuts – Includes Capital Stock and Franchise Tax; sales tax; research and development, education improvement, Keystone Innovation Zone and other tax credits; and net operating loss expansion.

Non-Business Tax Cuts – Includes special poverty exemption, inheritance tax recouple to federal estate tax, 529 college savings plan deductions and all property tax relief.

Independent studies confirm that Pennsylvania's tax climate is competitive with and in many cases is better than the tax climates in surrounding and other competitor states.

The Governor's Tax Reform Package: Creating a Fairer Tax System That Prepares Pennsylvania for Future Fiscal Challenges

Despite this record of accomplishment, Pennsylvania tax rates are still too high. Governor Rendell is proposing a tax reform package that will lower the Sales and Use Tax

and the Corporate Net Income Tax rates to create a fairer tax structure for both families and businesses. The budget also eliminates the Vendor Sales Tax Discount, extends the tobacco tax to include cigars and smokeless tobacco, and proposes a new severance tax on natural gas extraction. These measures will give Pennsylvania a more reliable tax base that grows with the economy while at the same time improving the commonwealth's competitive position.

All revenues from these measures raised during the 2010-11 fiscal year will be placed in a new **Stimulus Transition Reserve Fund** to help balance Pennsylvania's 2011-12

Stimulus Transition Reserve Fund – Proposed Revenue Sources

Type of Revenue	Additional Revenue September 2010 to June 2011	Resulting Revenue Used for 2010-11 Budget	Transfer to Stimulus Transition Reserve Fund
Sales and Use Tax Reform (cut sales tax rate to 4% and eliminate 74 tax exemptions)	\$531.5 million	\$0	\$531.5 million
Eliminate the Vendor Sales Tax Discount	\$73.6 million	\$0	\$73.6 million
Extend Tobacco Products Tax to Cigars and Smokeless Tobacco	\$41.6 million	\$0	\$41.6 million
Natural Gas Severance Tax	\$160.7 million	\$0	\$160.7 million
Business Tax Package (combined reporting, single sales factor, uncap the Net Operating Loss deduction)	\$66.6 million	\$0	\$66.6 million
Total	\$874.0 million	\$0	\$874.0 million

Creating a Fairer Tax Structure

budget when federal stimulus funding from the American Recovery and Reinvestment Act ends and the state's pension obligations begin to increase. In 2010-11, the federal government is projected to provide Pennsylvania with \$2.8 billion in stimulus funding, but only \$500 million of these funds will be available in 2011-12. Unless steps are taken today, the commonwealth will be faced with the choice of drastic spending cuts or massive tax increases.

Pennsylvania Can Cut the Sales and Use Tax Rate From 6 Percent to 4 Percent

Governor Rendell proposes to reduce Pennsylvania's Sales and Use Tax rate from 6 percent to 4 percent and to eliminate 74 categories of tax exemptions, many of which have been added to the Tax Code over the last half century. As a result, Pennsylvania's sales tax rate will be reduced by one-third, making it the second-lowest rate among states that have a sales tax. Vital necessities such as food, clothing and prescription medicine will continue to be exempt from the sales tax. The Governor's plan preserves the original exemptions for manufacturers that cover processing, agriculture and machinery and equipment. These changes will be effective on September 1, 2010.

Pennsylvania adopted its first sales tax in 1953. As originally enacted, the sales tax applied to nearly all categories of tangible goods, with only a limited number of exemptions. However, Pennsylvania's sales tax law has been amended numerous times over the last half century, and those amendments have chipped away at the tax base. Exempting the basic necessities of food, clothing and prescription medicine that benefit virtually all Pennsylvanians can be justified on economic and tax fairness grounds. However, it is hard to make a case for many of the other exemptions that have been added over the years, that benefit a relatively small number of taxpayers and that have no clear public policy purpose.

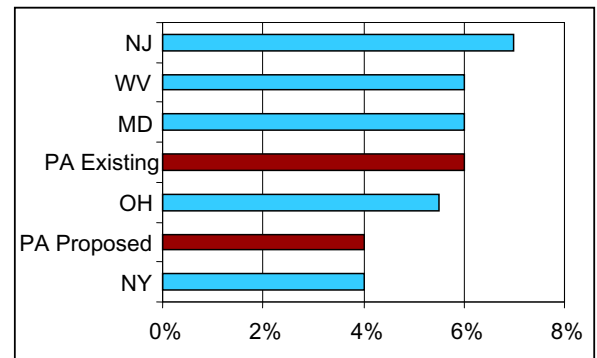
Pennsylvania's current sales tax is applied to tangible goods while services are left largely untaxed. This broad exclusion is increasingly hard to justify as services have grown steadily as a share of the U.S. economy. Spending on services represented less than half of total consumption during the 1950s, but now it accounts for more than two-thirds of consumption. The Governor's proposal would add nearly all services into the tax base except for health care services and educational tuition. By realigning the sales tax base to make it more closely match the mix of goods and services in the economy, Pennsylvania can significantly lower the sales tax rate and create a more equitable tax system.

Many other states, including neighboring states, already tax many of the goods and services that Pennsylvania excludes.

Category	Number of Other States That Tax This Category
Personal Hygiene Products	43
Telephone – Residential	35
Caskets and Burial Vaults	37
Magazines	32
Flags	31
Candy/Gum	31
Coal	23
Firewood	23
Dry-Cleaning & Laundry Services	20
Basic Television	19
Wrapping and Packing Supplies	11
Rail Transportation Equipment	11
Water and Sewage Services	11

Governor Rendell's plan will also bring Pennsylvania's sales tax rate below the rates in nearly all of our neighboring states. The lower sales tax rate will benefit many retailers located near the Pennsylvania border who have previously expressed concern about customers traveling across state lines to shop.

Pennsylvania's Sales Tax Rate Will Fall From 6 Percent to 4 Percent



Additional Common Sense Tax Measures

This budget proposes three additional revenue enhancement measures that will take effect July 1, 2010. The additional revenue generated from these measures also will be directed to the Stimulus Transition Reserve Fund to balance future budgets.

- Eliminating the Vendor Sales Tax Discount.** This budget proposes to eliminate this 1 percent discount to companies that file their Sales and Use Tax payments on time. This discount dates back to the 1950s when businesses had to manually calculate what they owed to the state. Today, more than 90 percent of

Creating a Fairer Tax Structure

companies electronically file their sales tax records to the state. Removing the discount will not unduly burden businesses, since more than half receive a discount of only \$9 a year and two-thirds of all filers receive less than \$100 a year.

- **Other Tobacco Products Tax.** Pennsylvania remains the only state in the nation that does not tax tobacco products such as smokeless tobacco and cigars. Governor Rendell is again proposing that we end this anomaly. Polls show that 90 percent of the public supports taxing these products, especially if the taxes are used to fund health care programs.
- **Marcellus Shale Severance Tax.** Pennsylvania has immense natural gas reserves in a geologic formation known as the Marcellus Shale. Large corporations in the oil and gas industry have already expanded their Pennsylvania operations to extract these reserves, and the industry is growing at a rapid pace. The Department of Environmental Protection has issued permits for 2,500 Marcellus wells as of December 31, 2009, and current estimates are that the number of permits will double in 2010. Pennsylvania is one of just six states in the nation that does not tax natural gas, and there is broad public support for this kind of an energy tax.

The Business Tax Reform Package Will Cut Taxes and Improve Competitiveness

This budget also proposes a set of business tax reforms that will level the playing field for Pennsylvania businesses, reduce Pennsylvania's Corporate Net Income Tax rate, and help Pennsylvania companies add more jobs. Today, approximately three out of four Pennsylvania companies subject to the tax pay no Corporate Net Income taxes in Pennsylvania. The Governor's business tax reform package will put an end to tax avoidance strategies that are being used today and will make Pennsylvania the 24th state to adopt a process called combined reporting.

States That Have Adopted Combined Reporting Since 2005

State	Year Adopted
Texas	2006
West Virginia	2007
New York	2007
Michigan	2007
Massachusetts	2008
Wisconsin	2009

Current law requires separate company reporting, which allows businesses to shelter profits through the use of legal tax avoidance strategies. Some companies establish

passive investment companies, such as Delaware holding companies, to shift income outside the commonwealth. Other businesses reduce or eliminate their tax bill through strategies that have no economic rationale other than to minimize corporate tax bills. Mandatory combined reporting will put an end to these tax avoidance strategies.

The Governor's business tax reform package will also implement the following changes, effective for tax years beginning on or after January 1, 2011:

- **Reduce the Corporate Net Income Tax rate from 9.99 percent to 8.99 percent.** Pennsylvania's Corporate Net Income Tax rate is currently the second-highest in the nation and the highest among surrounding states. Companies looking for a location may be deterred by the published rate before finding out the advantages of coming to Pennsylvania. Reducing the Corporate Net Income Tax rate by one percentage point to 8.99 percent will bring Pennsylvania's rate closer to rates in nearby states and will make Pennsylvania a more attractive location for businesses.
- **Adopt a single sales factor for the apportionment of income.** The Governor's plan also adopts a single sales factor model, which will benefit manufacturers and other firms that sell to national and global markets. Under the single sales factor system, Pennsylvania will no longer calculate taxes based on a firm's workforce or physical presence but will instead consider only the share of a company's sales that take place in Pennsylvania. The single sales factor model is good for employers, including manufacturers who already have a significant presence in Pennsylvania but sell most of their goods and services in other markets. Supporting the existing manufacturing job base and creating incentives for new firms to locate in Pennsylvania will create and retain jobs.
- **Remove the cap on net operating losses prospectively, and retain the current cap of \$3 million, or 20 percent, of taxable income for prior years' losses.** Under the Governor's proposal, Pennsylvania will join 44 other states that do not have a dollar limit on the amount of net operating losses that can be carried forward to offset future earnings. By lifting the cap on net operating loss deductions, Pennsylvania will become a more attractive place for entrepreneurs to start new businesses and create new jobs. Many companies, including technology and biotech firms, do not record profits for the first few years of operation. Uncapping the net operating loss deduction will help create more jobs in these industries as well as alternative energy, clean transportation and environmental cleanup companies. These sectors represent significant opportunities for job growth in Pennsylvania's green economy, which is forecast to generate 115,000 new jobs between 2010 and 2020.

Creating a Fairer Tax Structure

Creating a Fairer Tax Structure

Governor Rendell's tax package will lower tax rates for individuals, families and business and will improve Pennsylvania's overall tax climate. These measures will give Pennsylvania a reliable tax base that grows with the economy while at the same time improving the commonwealth's competitive position. The Governor has proposed a balanced 2010-11 budget that does not utilize any revenues from these measures and instead prudently reserves the additional revenue to help balance future budgets and offset both the loss of federal stimulus funds and increasing pension costs.

Tax Cuts Will Save Pennsylvania's Businesses and Families More Than \$10 Billion From 2006-07 Through 2010-11

Existing Major Tax-Saving Initiatives	Dollars in Millions				
	2006-07	2007-08	2008-09	2009-10	2010-11
Continued CSFT Phase Out.....	\$ 523.4	\$ 859.6	\$ 1,048.3	\$ 1,162.4	\$ 1,128.8
Special Poverty Expansion (\$500 per dependent).....	13.3	13.0	12.7	12.4	12.2
Research and Development Tax Credit Expansion	25.0	25.0	40.0	40.0	40.0
Sales tax credits (Call Centers).....	30.0	30.0	30.0	15.0	13.5
Sales tax credits (Telecommunications).....	45.3	48.8	52.6	56.6	61.0
Inheritance Tax (recouple to federal return basis) .	161.3	174.7	186.9	186.1	188.7
Educational Improvement Tax Credits.....	29.0	45.0	45.0	30.0	20.0
Keystone Innovation Zone Tax Credits.....	6.0	25.0	25.0	25.0	25.0
Film Production Tax Credit	-	40.8	74.3	42.0	60.0
Keystone Opportunity Zones.....	0.9	0.9	0.9	0.9	0.9
Malt Beverage Investment Tax Credit.....	1.0	1.1	1.1	-	-
Expansion of Net Operating Loss Cap and Increase Sales Factor.....	35.5	108.3	126.4	172.0	205.8
TAP & 529 Plan Contribution Deductions.....	16.2	18.7	16.8	18.1	20.0
Health Savings Accounts.....	2.0	2.5	3.8	4.0	4.2
CSFT Exemption for certain Restricted Professional Corporations	11.5	10.2	8.8	8.6	8.5
SUT Exemption for investment in metal bullion....	2.1	2.2	2.4	2.7	2.9
CSFT Exclusion increase to \$160,000	1.6	4.9	4.9	5.3	6.1
Life Valuation Fees	1.9	1.9	1.9	1.9	1.9
Sub-Chapter S Elections	1.1	1.2	1.4	1.6	1.8
Agricultural Easement Valuation Reductions.....	0.1	0.2	0.2	0.3	0.3
Bank Shares Tax-Goodwill Deduction	-	26.2	28.5	28.4	28.6
Resource Enhancement and Protection Tax Credit	-	3.2	9.1	5.0	4.5
Powdered Metals Exemption.....	-	2.4	0.4	0.4	0.4
Remanufactured Locomotives Exemption.....	-	1.2	1.1	1.1	1.0
Volunteer Responder Retention and Recruitment Tax Credit	-	-	1.9	0.2	0.0
KOZ Expansion (SUT building exemption/ apportionment CNIT/CSFT).....	-	-	0.3	1.6	1.7
Property Tax Relief	-	124.6	786.8	749.9	769.7
Annual Total.....	\$ 907.2	\$ 1,571.6	\$ 2,511.5	\$ 2,571.5	\$ 2,607.5
Cumulative Total.....	\$ 907.2	\$ 2,478.8	\$ 4,990.3	\$ 7,561.8	\$ 10,169.3

2010-11 General Fund Revenues

Pennsylvania Revenue Sources

Dollars in Millions	Actual Collections 2008-09	Estimated Collections 2009-10	Estimated Collections 2010-11
Personal Income Tax	\$10,198.6	\$10,005.4	\$10,378.8
Sales and Use Tax	\$8,135.5	\$8,090.5	\$8,624.0
Corporate Net Income Tax	\$1,979.9	\$1,854.8	\$1,794.2
Capital Stock and Franchise Tax	\$787.7	\$960.3	\$852.2
Gross Receipts Tax	\$1,376.8	\$1,473.5	\$1,541.3
Cigarette Tax	\$754.2	\$979.8	\$1,091.2
Other Taxes	\$2,061.9	\$2,176.8	\$2,272.2
Non-Tax Revenues ¹	\$235.2	\$2,758.6	\$961.2
Total	\$25,529.8	\$28,299.7	\$27,515.1
Difference from prior year	\$(2,398.3)	\$2,769.9	\$(784.6)
Percentage Difference	-8.6%	10.8%	-2.8%

¹ Non-tax revenue includes various one-time transfers in 2009-10, including the transfer of \$755 million from the Budget Stabilization Reserve (Rainy Day) Fund. A transfer of \$180 million from the Oil and Gas Lease Fund is proposed in 2010-11.

2010-11 Motor License Fund *

INCOME

(Dollars in Millions)



Liquid Fuels Tax — \$1,181

Licenses and Fees — \$844

Turnpike Commission Payment — \$513

Other — \$81

Total Income	\$2,619
Beginning Balance.....	106
TOTAL.....	\$2,725

OUTGO

(Dollars in Millions)



Highways & Bridges — \$1,622

State Police — \$533

Local Subsidy — \$232

Other — \$173

Total Outgo	\$2,709
Ending Balance	16
TOTAL.....	\$2,725

Licensing & Safety — \$124

Debt Service — \$25

* This budget assumes the federal government will approve Pennsylvania's request to initiate tolling on Interstate 80.

2010-11 General Fund Expenditures

(dollar amounts in thousands)

<u>Department</u>	<u>2008-09 Actual</u>	<u>2009-10 Available</u>	<u>2010-11 Budget</u>
Aging and Long Term Living.....	\$ 1,166,940 ¹	\$ 1,251,085 ¹	\$ 1,319,824 ¹
Agriculture.....	76,085	67,830	62,435
Attorney General.....	94,509	86,522	85,657
Auditor General.....	54,520	48,303	48,070
Civil Service Commission.....	1	1	1
Community & Economic Development.....	579,753	275,848	297,304
Conservation and Natural Resources.....	113,369	92,369	91,375
Corrections.....	1,605,505	1,785,240 ²	1,922,079 ²
Education.....	11,336,329 ²	11,381,297 ²	11,824,090 ²
<i>Basic Education (Pre K-12).....</i>	<i>9,597,049</i>	<i>9,756,171 ²</i>	<i>10,204,504 ²</i>
<i>Higher Education.....</i>	<i>1,614,174 ²</i>	<i>1,526,895 ²</i>	<i>1,521,820 ²</i>
<i>Public Library Subsidy.....</i>	<i>75,137</i>	<i>60,000</i>	<i>58,800</i>
<i>All Other.....</i>	<i>49,969</i>	<i>38,231</i>	<i>38,966</i>
Emergency Management Agency.....	22,142	15,494	12,448
<i>Disaster-Related Funding.....</i>	<i>5,290</i>	<i>-</i>	<i>-</i>
<i>All Other.....</i>	<i>16,852</i>	<i>15,494</i>	<i>12,448</i>
Environmental Protection.....	219,225	160,764	157,013
Executive Offices.....	254,299	204,486	183,989
Fish and Boat Commission.....	17	17	17
General Services.....	117,868	120,675 ²	123,749 ²
Governor's Office.....	7,293	6,900	6,831
Health.....	273,051	239,147	232,183
Higher Education Assistance Agency.....	472,873	455,170	455,170
Historical & Museum Commission.....	31,895	22,105	19,348
Insurance.....	117,432	123,635	126,570
<i>Children's Health Insurance.....</i>	<i>86,900</i>	<i>97,112</i>	<i>100,375</i>
<i>All Other.....</i>	<i>30,532</i>	<i>26,523</i>	<i>26,195</i>
Judiciary.....	307,141	276,860	276,860
Labor & Industry.....	120,650	92,045	88,961
Legislature.....	330,633	303,850	301,411
Lt. Governor's Office.....	1,428	1,075	1,053
Military & Veterans Affairs.....	127,000	111,276	115,646
Probation & Parole Board.....	111,605	117,664	125,842
Public Welfare.....	9,435,927 ³	9,253,430 ³	9,667,112 ³
<i>Medical Assistance.....</i>	<i>4,931,089 ³</i>	<i>4,618,754 ³</i>	<i>4,977,664 ³</i>
<i>Mental Health.....</i>	<i>757,629</i>	<i>784,561</i>	<i>765,685</i>
<i>Mental Retardation.....</i>	<i>1,159,310 ³</i>	<i>1,228,966 ³</i>	<i>1,255,465 ³</i>
<i>County Child Welfare.....</i>	<i>1,042,890</i>	<i>1,048,374</i>	<i>1,072,050</i>
<i>Cash Grants.....</i>	<i>258,079</i>	<i>268,579</i>	<i>278,175</i>
<i>Child Development.....</i>	<i>496,436</i>	<i>510,632</i>	<i>507,929</i>
<i>All Other.....</i>	<i>790,494</i>	<i>793,564</i>	<i>810,144</i>
Revenue.....	181,509	198,602	203,881
Securities Commission.....	1,782	1,400	1,386
State.....	12,465	10,148	9,648
State Employees Retirement System.....	4	4	4
State Police.....	182,305	182,664	184,697
Tax Equalization Board.....	1,207	1,159	1,147
Transportation.....	11,720	11,013	12,033
Treasury.....	955,348	976,792	1,071,673
<i>Debt Service.....</i>	<i>904,510</i>	<i>932,578</i>	<i>1,023,959</i>
<i>All Other.....</i>	<i>50,838</i>	<i>44,214</i>	<i>47,714</i>
TOTAL APPROPRIATIONS	\$ 28,323,830	\$ 27,874,870	\$ 29,029,507
Less Federal Fiscal Relief Funds:			
Enhanced Medical Assistance Percentage.....	\$ (1,176,623)	\$ (1,776,682)	\$ (1,834,729)
State Fiscal Stabilization Fund.....	\$ (62,852)	\$ (921,384)	\$ (921,384)
STATE APPROPRIATIONS	\$ 27,084,355	\$ 25,176,804	\$ 26,273,394

¹ 2008-09 Actual and 2009-10 Available amounts were appropriated in the Department of Public Welfare. This budget proposes to reorganize the commonwealth's long-term living services within a new Department of Aging and Long Term Living.

Includes enhanced ARRA Federal Medical Assistance Percentage appropriations.

² Includes ARRA State Fiscal Stabilization Fund appropriations.

³ Includes enhanced ARRA Federal Medical Assistance Percentage appropriations.

General Fund Financial Statement

Dollars in Millions

	2008-09 Actual	2009-10 Available	2010-11 Budget	2011-12 Planning Year
Beginning Balance	\$ 585	\$ -2,030	\$ 37	\$ 4
Revenues:				
Receipts	\$ 24,305	\$ 27,574 ¹	\$ 26,060	\$ 27,340
Revenue Shortfall .....	. . . . .	- 525	. . . . .	. . . . .
Additional Projected Revenue .....	. . . . .	. . . . .	180	. . . . .
Prior Year Lapses.....	164	60	. . . . .	. . . . .
Funds Available.....	<u>\$ 25,054</u>	<u>\$ 25,079</u>	<u>\$ 26,277</u>	<u>\$ 27,344</u>
Expenditures:				
Appropriations ²	\$ 28,324	\$ 27,875	\$ 29,029	\$ 30,284
State Fiscal Stabilization Fund.....	-63	-921	-921	. . . . .
Enhanced Medical Assistance Percentage.....	-1,177	- 1,777	-1,835	-498
Current Year Lapses .....	. . . . .	- 135	. . . . .	. . . . .
Total Expenditures	<u>\$ 27,084</u>	<u>\$ 25,042</u>	<u>\$ 26,273</u>	<u>\$ 29,786</u>
Ending Balance	<u><u>\$ -2,030</u></u>	<u><u>\$ 37</u></u>	<u><u>\$ 4</u></u>	<u><u>\$ -2,442</u></u>

Stimulus Transition Reserve Fund ³

	2010-11	2011-12
2011-12 Ending Balance		\$ -2,442
Revenue Collected During 2010-11		874
Severance Tax	\$ 161	260
Vendor Sales Tax Discount.....	74	76
Other Tobacco Products Tax.....	42	47
Sales and Use Tax	531	863
Combined Reporting.....	66	167
Total Revenue	<u>\$ 874</u>	<u>\$ 2,287</u>
Revised 2011-12 Ending Balance		<u><u>\$ -155</u></u>

¹ Includes \$755 million transferred from the Budget Stabilization Reserve Fund in accordance with Act 50 of 2009.

² Includes State General Fund appropriations and Federal ARRA funds appropriated from the enhanced Federal Medical Assistance Percentage and the State Fiscal Stabilization Fund.

³ See the Creating a Fairer Tax Structure section on Page 22 for additional information regarding the proposed Stimulus Transition Reserve Fund.

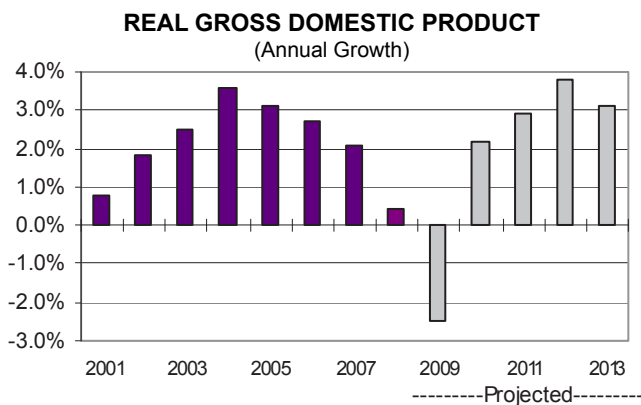
The Economic Outlook for 2010-11

Economic forecasts are a key ingredient in constructing the budget's revenue forecasts and they also help the government project likely levels of demand for many public goods and services.

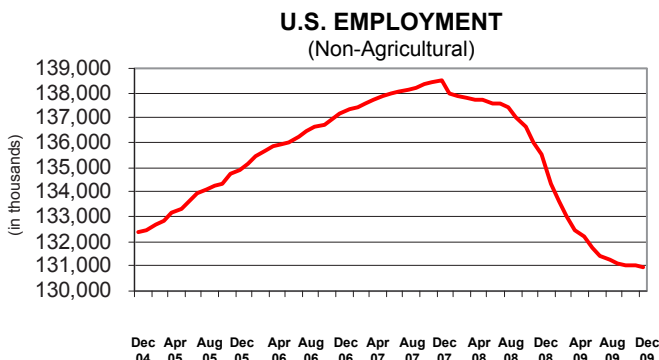
Recent Economic Trends

The U.S. economy officially entered recession in December 2007. At 25 months as of January 2010, the current contraction is the longest recession since the Great Depression, which lasted 43 months. It is also more than double the 10-month length of the average postwar recession. Furthermore, the depth of this recession is much steeper than the two most recent recessions of 2001 and 1991. If forecasters are correct, peak-to-trough declines in real GDP have exceeded those of the 1973-75 and 1980-82 recessions, when the peak-to-trough declines in real GDP were 3.1 percent and 2.6 percent, respectively.

During 2009, the economy is estimated to have contracted 2.5 percent – the largest such contraction in the post-war period. The economy contracted during five of the six quarters between January 1, 2008 and June 30, 2009. Moderate growth of 2.25 percent returned during the third quarter of 2009 and strong growth of 5.1 percent is estimated to have occurred during the fourth quarter of 2009.



Since peaking in December 2007, employment levels have been declining significantly. Monthly claims for unemployment compensation have averaged 400,000 nationally since September 2008. All told, the U.S. economy



has lost 7.6 million jobs since December 2007. The growth in the U.S. unemployment rate accelerated significantly during 2009, rising from 7.4 percent in January 2009 to 10.1 percent by October 2009, before declining to 10.0 percent by December 2009.

As the national economy entered recession in December 2007, businesses again were looking to gains in productivity to soften the impact. Gains in productivity combined with declining wages, massive job losses and declines in consumer and business spending have rendered moot any discussion of inflation in the near term. However, rising energy prices in 2007 and early 2008 contributed greatly to the current recession. Led by surging energy costs, inflation peaked at 3.8 percent in 2008. The 2008 peak level of inflation was the highest rate since the 1991 recession, when it was 5.4 percent. Since the collapse of the credit and equity markets in the fall of 2008, consumption has declined, wages are depressed and oil prices have moderated, resulting in an inflation rate of -0.3 percent in 2009.

The Federal Reserve and other central banks throughout the world have been injecting massive amounts of liquidity into the global financial system in an effort to avoid a depression. The amount of this fiscal stimulus is staggering. To date, the Fed and other U.S. agencies have lent, spent or guaranteed \$8.2 trillion in emergency funds to stimulate the economy. The Fed has dramatically expanded its balance sheet to inject more than \$2 trillion in liquidity into the financial markets in order to stem the credit crisis. U.S. public debt has surged to \$7.7 trillion, up \$1.3 trillion from a year ago and from an average of \$5 trillion in 2007.

In addition to extensive monetary policy moves orchestrated by the Federal Reserve, the federal government was also aggressive in enacting new legislation to combat the recession. With the U.S. economy in recession in early 2008, Congress enacted the Economic Stimulus Act of 2008. The act provided an estimated \$152 billion in tax breaks and tax incentives for individuals and businesses. Shortly after the stunning collapse of Lehman Brothers on September 15, 2008, Congress enacted the Emergency Economic Stabilization Act of 2008, which created the Troubled Assets Relief Program or TARP. This program authorized the U.S. Treasury to purchase up to \$700 billion in "troubled assets" – largely mortgage-backed securities – and to make direct investments into banks. Finally, in February 2009 Congress enacted the \$787 billion American Recovery and Reinvestment Act to assist the economy. The act provides: \$288 billion in tax relief (\$237 billion for individuals and \$51 billion for businesses); \$144 billion in state and local government fiscal relief; \$111 billion in enhanced infrastructure and science spending; \$147.7 billion for health care benefits and programs; and \$90 billion for enhanced education programs.

The Economic Outlook for 2010-11

Job losses, declines in household wealth and tighter credit are just a few of the factors adversely affecting consumer spending. The 2009 decline was the largest since 1974. Furthermore, annual growth in real consumer expenditures has declined only twice before in the post-war period. When looking at real consumer spending on a monthly basis, consumption has declined in 14 of the past 22 months – making it the worst-performing period since the Great Depression.

Forecast for 2010

Annual growth in real GDP is projected to be 2.2 percent in 2010. A combination of data from two forecasting sources is highlighted below. As noted, both real and nominal GDP contracted during 2009. Similarly, corporate profits and real personal consumption expenditures also contracted in 2009. The current forecast anticipates that the recession will likely have ended in mid-to-late 2009 but the recovery will likely be subdued, as it was during the 2001 recession. Modest growth is forecast for 2010 and beyond.

Declines in housing construction and housing finance led the economy into recession. Until the housing markets stabilize, any recovery will be uneven. For all of 2010, residential construction is expected to grow just 5.8 percent on an annual basis. Further, sales of existing homes rose in 2009 for the first time in four years. Still, median existing housing prices plunged more than 12 percent last year – the sharpest fall since the Great Depression. Overall median existing housing prices are expected to continue to grow minimally in 2010 and 2011, at annual rates of 1.3 percent and 1.2 percent, respectively.

Real consumer spending is expected to have declined for two straight years through December 2009. While spending declined on an annual basis during 2009, the last two quarters of 2009 did provide positive growth as real consumer spending grew an estimated 2.9 percent

and 1.7 percent, respectively. The forecast for 2010 includes projected growth of 1.8 percent in real consumer expenditures. Beyond 2010, real consumer spending is expected to grow only moderately, in the low 2.0 percent range through 2014.

Personal income growth experienced similar annual declines in 2008 and 2009, declining 0.4 percent and 1.6 percent, respectively. Despite rising unemployment, growth in real personal income is expected to rebound in 2010, growing 1.7 percent annually. Stronger personal income growth is forecast from 2011 through 2013, as unemployment eases.

The U.S. economy has shed nearly 7.6 million jobs during the current recession. More than 4.5 million jobs were lost in 2009, with most of the losses occurring during the first two quarters. The U.S. unemployment rate in December 2009 was 10.0 percent; economists estimate it will peak at 10.4 percent during the first quarter of 2010. Unemployment rates are expected to remain elevated at 10.2 percent and 9.6 percent in 2010 and 2011, respectively. December 2007 saw peak employment at 138 million people; economists estimate that it will be at least until 2012 before that figure is reached again.

Pennsylvania Outlook

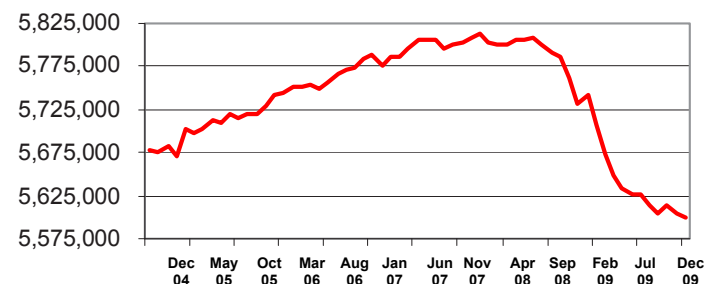
The commonwealth's economic performance is largely dependent upon job growth. Since December 2007 and the start of the national recession, Pennsylvania has lost more than 212,000 jobs. In December 2009, the commonwealth's unemployment rate was 8.9 percent, its highest level since August 1984. The national unemployment rate for December 2009 was 10 percent. Pennsylvania's unemployment rate has now been equal to or below the national average for 83 of the past 84 months.

Pennsylvania's fiscal year 2009 job losses were lower than the national average, and remained less steep than those of the surrounding states of New Jersey, Delaware and Ohio. Further, among the ten largest states, only Texas, New York and Pennsylvania lost jobs at rates lower than the national average.

Forecast Change in Key US Economic Indicators Annual Percentage Growth*				
Indicator	2008	2009p	2010p	2011p
Nominal GDP	2.6	-1.4	3.4	4.5
Real GDP	0.4	-2.5	2.2	2.9
Real Personal Consumption	-0.2	-0.6	1.8	2.4
Corporate Profits (After Tax)	-11.5	-6.3	14.3	2.7
Unemployment Rate (Rate)	5.8	9.3	10.2	9.6
CPI	3.7	-0.3	1.7	1.9
Federal Funds (Rate)	1.9	0.2	0.2	1.7

* Assumptions in this chart, as well as other assumptions, are incorporated in the 2010-11 fiscal year revenue estimates.
p=projected

PENNSYLVANIA EMPLOYMENT
(Non-Agricultural)



The Economic Outlook for 2010-11

Employment in the commonwealth saw job losses across all sectors in 2009 except for the educational and health services sectors – which had job growth of 2.0 percent in 2009, and the government sector – which had job growth of 0.1 percent in 2009. The manufacturing and information technology sectors had the worst year-over-year rate of job losses in Pennsylvania in 2009, with manufacturing jobs down 10.3 percent and information technology jobs down 6.6 percent. The construction, natural resources and mining; financial services; and professional and business services sectors also saw significant job losses in 2009, with each sector experiencing year-over-year job losses in excess of 5.4 percent.

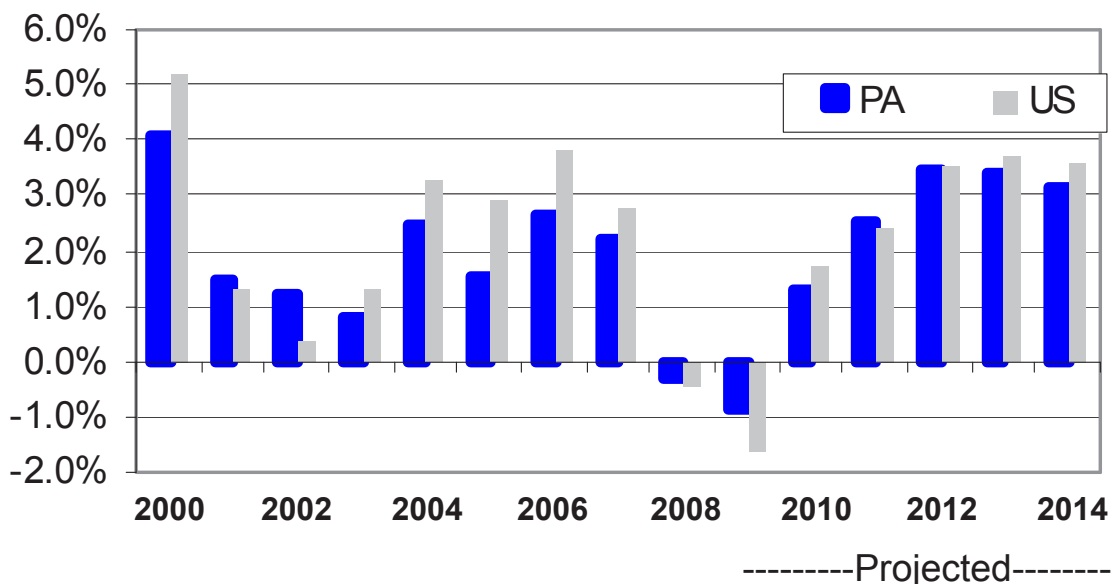
The annual change in employment levels in Pennsylvania is forecast at around -0.4 percent in 2010, while positive job growth is expected to return in 2011 at a rate of 1.5 percent annually. Slightly more robust job growth is forecast for the commonwealth in 2012, with job growth forecast at 2.2 percent. As the national economy begins to recover in 2010, the rate of job growth in Pennsylvania is expected to again lag behind the national average. Total peak-to-trough job losses for the commonwealth are expected to reach 231,000 and the state unemployment rate is expected to peak at 9.3 percent during early 2010, according to forecasts from IHS Global Insight.

The inverse relationship of the U.S. and the commonwealth growth in personal income has re-emerged during the current

recession. As the current recession has deepened, the rate of growth in real personal income plunged for the nation as a whole, as it did for the commonwealth. However, the decline in the rate of growth was less severe for Pennsylvania than for the rest of the nation. In fact, the commonwealth ranked 12th in the nation in terms of the percent change in personal income during 2008. Economists expect that the rate of growth in Pennsylvania real personal income will exceed the national average in 2011 and 2012. This strong performance is partially the result of the diversification of the Pennsylvania economy and a stronger state labor market. The growth of less recession-prone industries such as health care, pharmaceuticals, education and government has aided the commonwealth.

The short-term outlook for Pennsylvania is that its economy remains heavily dependent on the national economy. The commonwealth actually outperformed the national economy during 2008, growing at an annual rate of 1.1 percent while the national economy grew at a rate of only 0.4 percent. Similarly, during 2009, the state economy again outperformed the national economy by recording a lower loss – negative 2.0 percent for the commonwealth versus negative 2.5 percent for the broader U.S. economy. Beginning in 2010 through 2012, the gap between the two rates of growth is expected to re-emerge as the national economy expands.

PA and U.S. Real Personal Income
(Annual Growth)



2010-11 Capital Budget

	<u>Millions</u>
<u>From Bond Funds</u>	
Agriculture	\$ 103.5
Conservation and Natural Resources.....	9.0
Corrections	46.3
Education.....	105.3
Environmental Protection	91.0
General Services.....	0.6
Historical and Museum Commission	18.6
Military and Veterans Affairs	68.3
Public Welfare	24.7
State Police	16.5
Transportation-Local Transportation Assistance	172.7
Subtotal Bond Funds	<u>\$ 656.5</u>
<u>From Current Revenues</u>	
Conservation and Natural Resources.....	\$ 25.7
Historical and Museum Commission	0.9
Transportation	359.4
Subtotal Current Revenues	<u>\$ 386.0</u>
TOTAL CAPITAL PROJECTS TO BE AUTHORIZED	<u><u>\$ 1,042.5</u></u>

The Capital Budget process provides for the acquisition, design, construction, and or renovation of new or existing commonwealth buildings, facilities, physical betterments or improvements.

Agriculture

Provides for improvements to the Farm Show Complex, agricultural laboratories and other agricultural-related facilities.

Conservation and Natural Resources

Provides for construction and renovation of support, day use, camping facilities and utility systems at the state parks; construction of district offices, central garages, radio communications systems and rehabilitation of forest roads in forest districts.

Corrections

Provides for construction and renovation of administrative, industrial, educational and housing facilities, and utilities at the state-owned correctional institutions.

Education

Provides for construction expansion, renovation and conversion of classrooms and auxiliary buildings, utilities and recreational facilities for the State System of Higher Education, state-owned schools and state-related universities.

Environmental Protection

Provides for construction and improvement projects to protect the environment and the health and safety of citizens using state lands and waterways. These projects include flood protection construction and flood control projects.

General Services

Provides for the construction, renovation and improvements to state office buildings and facilities.

Historical and Museum Commission

Provides for restoration and renovation of historic facilities, installation of fire and security systems, development of fixed exhibits and miscellaneous building and utility improvements at commonwealth-owned museums and historic sites.

Military and Veterans Affairs

Provides for land acquisition, renovations, additions and replacement at the state armories and veterans' homes. Also may include original furniture and equipment authorizations.

Public Welfare

Provides for construction and renovation of patient buildings, support facilities and utilities at the state institutions for individuals with mental illness and mental retardation, restoration centers and youth development centers.

State Police

Provides for renovation, expansion and construction of troop headquarters, station facilities and driver examination facilities.

Transportation

Provides for improvements for local mass transit agencies, rail freight and air transportation projects. Also provides for the construction, and reconstruction of highways and bridges on the commonwealth road system and major federally-designated safety projects.