



## REPORT ON KEY ISSUES FROM THE HOUSE APPROPRIATIONS COMMITTEE

# BUDGET BRIEFING

DWIGHT EVANS, DEMOCRATIC CHAIRMAN

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## 2010/11 Budget: Commonwealth Checkbook

### Enacted Budget – 2010/11

On June 30, 2010, the House passed the General Appropriations bill. This plan was developed as we emerge from the most serious economic emergency since the Great Depression. While we did not experience a revenue shortfall as serious as last year, we continue to grapple with the after-shocks of a wounded world-wide financial system and dramatic unemployment. Pennsylvania has fared better than many states, but the fiscal issues will demand careful consideration for years to come. While most state programs received cuts, this budget protects the integrity of basic education funding with an increase of \$250 million.

The commonwealth's 2010/11 operating budget contains total state and federal appropriations of approximately \$52.8 billion, an increase of \$1 billion, or two percent, over the revised 2009/10 budget of \$51.8 billion. This includes appropriations for the state General Fund, federal funds, the Motor License Fund, and other special funds (i.e. Lottery Fund and Tobacco Settlement Fund). State expenditures from all funds decrease by about \$199 million for the 2010/11 budget year, or about 0.7%, and federal funds increase by \$1.2 billion or 5.2%. In the recently enacted budget, state funds make up 54 percent of total funds compared with 55 percent in 2009/10 and 63 percent in 2008/09.

The General Fund represents the largest portion of state and federal spending and is the fund over which policymakers have the most influence on expenditures. For 2010/11, the General Fund includes about \$25.3 billion in state revenue and assumes \$2.76 billion in federal American Reinvestment and Recovery Act (ARRA) enhanced Federal Medical Assistance Program (FMAP) and fiscal stabilization funds for a total of just over \$28 billion. This budget is built on the assumption that the federal government will extend the ARRA FMAP for two quarters, through June 2011.

Significant cuts totaling nearly \$1.02 billion are made to appropriations in an effort to align General Fund expenditures with available revenues. On the funding side, no broad based taxes are used to balance the budget; however, a variety of methods are utilized to close the budget gap, which includes transfers and efficiencies that are expected to generate revenue. Most administrative and discretionary appropriations (those

without a state, federal or other mandate) are subject to a cut of at least 0.8%. Increases in the enacted budget largely reflect mandated payments (such as debt service and corrections costs) and an investment in basic education.

### Closing the Budget Gap

The Governor's Executive Budget proposed in February 2010 provided for General Fund expenditures totaling just over \$29 billion comprised of nearly \$27.3 billion in state funds and approximately \$2.8 billion in assumed federal ARRA enhanced FMAP and fiscal stabilization funds. Throughout the 2009/10 fiscal year, revenues ran short of estimate. When combined with updated economic forecasts, the effect on available revenues for the upcoming budget year was significant. The result was a budget shortfall between expected revenues and proposed spending totaling roughly \$1.5 billion. The enacted 2010/11 budget addresses the budget gap with adjustments to funding sources and expenditures that are in addition to the February proposed Executive Budget.

Significant adjustments that affect funding sources, which are worth approximately \$459.4 million, include the following:

- Enhanced revenue collection efforts and improvements in the processing of tax returns, resulting in fewer tax refund errors that are expected to result in a net amount of \$64.3 million for 2010/11.
- Revised estimates of tax refunds which are expected to result in an additional \$275 million in revenue over the 2009/10 and 2010/11 fiscal years.
- Additional prior year lapses worth \$90.4 million (balances from prior year appropriations) carried on the financial statement that contribute to available funding sources (total funds available).
- Transfers for 2010/11 from special funds to the General Fund that are in addition to the February proposed budget and contained in an amendment to the Fiscal Code are estimated at roughly \$30 million. They include:
  - \$745,000 from the Budget Stabilization Reserve Fund.
  - \$5 million from the Emergency Medical Services Operating Fund.

- \$800,000 from the Highway Beautification Fund.
- \$10 million from the Keystone Recreation, Park and Conservation Fund due to a suspension of funds for the State System of Higher Education deferred maintenance program for the second year in a row.
- \$1 million from the Local Government Capital Project Fund.
- \$2.7 million from the Low-Level Waste Fund.
- \$5.4 million from the Pennsylvania Economic Revitalization Fund.
- \$4 million from the Small Business First Fund.

Significant adjustments that affect expenditures include the following net reductions totaling approximately \$1.02 billion:

- \$271 million in the proposed state appropriation for Payment to the Federal Government – Medicare Drug program under the Department of Public Welfare (DPW) as a result of a federal policy change regarding the “clawback” payment.
- \$121 million in the Medical Assistance – Inpatient state appropriation in DPW as a result of additional funds available from a statewide hospital assessment.
- \$121 million in the state appropriation for school employees’ retirement, which will be offset by a transfer of Tobacco Endowment funds to a restricted account to be used to augment this appropriation.
- \$506 million in other significant net reductions in General Fund appropriations throughout the budget. Note that part of these reductions includes \$10 million of savings through rebate programs from the maximization of the use of purchase cards.

## General Fund State Deposits

The total amount of state money available to spend each fiscal year includes deposits received in that year, along with the balance carried over from the immediate prior year and unspent money from previous budgets. Taxes collected from individuals and businesses comprise the largest portion of the state’s deposits. Fees and other non-tax revenue (such as profits from the Liquor Control Board) make up the remainder of deposits.

### Deposits of Tax and Non-Tax Revenue

The Governor’s proposed budget projected that General Fund revenues would be \$525 million short for 2009/10. Through the end of January 2010, General Fund collections were already \$374.4 million behind the official revenue estimate. By the close of the 2009/10 fiscal year, the total revenue shortfall was \$1.2 billion.

According to certified revenue estimates for 2010/11, General Fund revenue receipts are estimated to be

\$26.712 billion, a decline from 2009/10 of 3.4%. Although total tax receipts are expected to grow at approximately 3.1 percent, an offsetting loss of non-recurring non-tax revenue leaves an overall decline in General Fund revenue of \$936.5 million. Note that 2010/11 revenue also includes additional one-time funds enacted in the budget package – \$180 million from the Oil and Gas Lease Fund, as well as \$30 million in transfers from special funds, as mentioned above.

No tax increases are associated with this budget. The only tax change associated with this budget is an increase in the amount of credits available to be awarded as part of the Educational Improvement Tax Credit. The cap on the total amount of credits was increased from \$50 million to \$60 million for the 2010/11 fiscal year. This is estimated to cost the General Fund \$8 million in 2010/11. The cost differs from the increase in the cap because of the manner in which business tax liabilities spread across fiscal years.

## General Fund State Expenditures

### Overview

The following table shows the state appropriations for fiscal year 2010/11, as well as the dollar amount and percentage change from fiscal year 2009/10.

| <b>2010/11 Expenditures</b> |                |                |                  |                       |
|-----------------------------|----------------|----------------|------------------|-----------------------|
| <i>\$s in millions</i>      | <b>2009/10</b> | <b>2010/11</b> | <b>\$ Change</b> | <b>Percent Change</b> |
| <b>State</b>                | \$27,836       | \$28,043       | \$207            | 0.74%                 |
| <b>Appropriations</b>       |                |                |                  |                       |
| <b>Lapses</b>               | (\$195)        |                | \$195            |                       |
| <b>Federal Stimulus</b>     | (\$2,698)      | (\$2,755)      | (\$56)           | 2.09%                 |
| <b>Adjusted Total</b>       | \$24,942       | \$25,289       | \$346            | 1.39%                 |

### Effect of Federal Funds

The federal American Recovery and Reinvestment Act of 2009 (ARRA) provided fiscal relief to the states by increasing the federal Medical Assistance percentage (FMAP) for state Medicaid programs and by allocating Fiscal Stabilization Funds which states may use for education and other public safety services. These funds have been critical in helping states address unprecedented budget deficits during the current economic downturn.

- Pennsylvania is using its Fiscal Stabilization Funds to help fund the agency budgets for the Departments of Education, Corrections and General Services.
- The additional ARRA FMAP is used to pay for Medical Assistance and other Medicaid-related programs that serve individuals with mental retardation, autism and physical disabilities. The ARRA FMAP reflects state Medicaid expenditures that are temporarily shifted to the federal government during the stimulus period.

As authorized under ARRA, the Fiscal Stabilization Funds are available through fiscal year 2010/11 whereas the enhanced FMAP is available only for the first two quarters of 2010/11 as it is scheduled to end after December 2010. (Specifically, ARRA temporarily increased each state's FMAP for the nine quarters beginning October 2008 through December 2010.) The United States Congress continues to debate legislation that would extend the enhanced FMAP beyond December 2010. The enacted budget anticipates the commonwealth will continue to receive the enhanced ARRA FMAP for all four quarters of 2010/11.

Altogether, ARRA funds offset (or reduce) state spending by approximately \$2.7 billion in 2009/10 and \$2.75 billion in 2010/11. Accounting for these ARRA funds, the proposed 2010/11 General Fund spending is \$28 billion (\$25.3 billion in state appropriations plus approximately \$2.756 billion in ARRA appropriations). The table below details the distribution of these ARRA funds by department.

| <b>Federal ARRA Funds Used to Offset State Appropriations</b><br>(Dollars in Thousands) |                     |                     |
|---|---------------------|---------------------|
| <b>ARRA Fund Type / State Agency</b>  | <b>FY 2009/10</b>   | <b>FY 2010/11</b>   |
| <b>Enhanced Federal Medicaid Match (FMAP):</b>  | <b>\$ 1,776,682</b> | <b>\$ 1,834,729</b> |
| Public Welfare  | 1,776,682           | 1,834,729           |
| <b>State Fiscal Stabilization Fund:</b>   | <b>\$ 921,384</b>   | <b>\$ 921,384</b>   |
| Corrections   | 172,911             | 172,911             |
| General Services  | 500                 | 500                 |
| Education   |                     |                     |
| Basic Education   | 654,747             | 654,747             |
| Higher Education  | 93,226              | 93,226              |
| <b>Total Federal ARRA Funds</b>   | <b>\$ 2,698,066</b> | <b>\$ 2,756,113</b> |

## **QUESTIONS AND COMMENTS**

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