

Governor's Mid-Year Budget Briefing

December 19, 2006

Edward G. Rendell
Governor

Michael J. Masch
Secretary of the Budget

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PA Keyword: Budget
See: Budget & Financial Rpts

**2006-07
Budget
Highlights**

2006-07 Enacted Budget Highlights

The 2006-07 enacted budget invests in our children, promotes job creation, increases our state's global competitiveness and preserves the social safety net that protects the elderly, disabled and other Pennsylvanians in need.

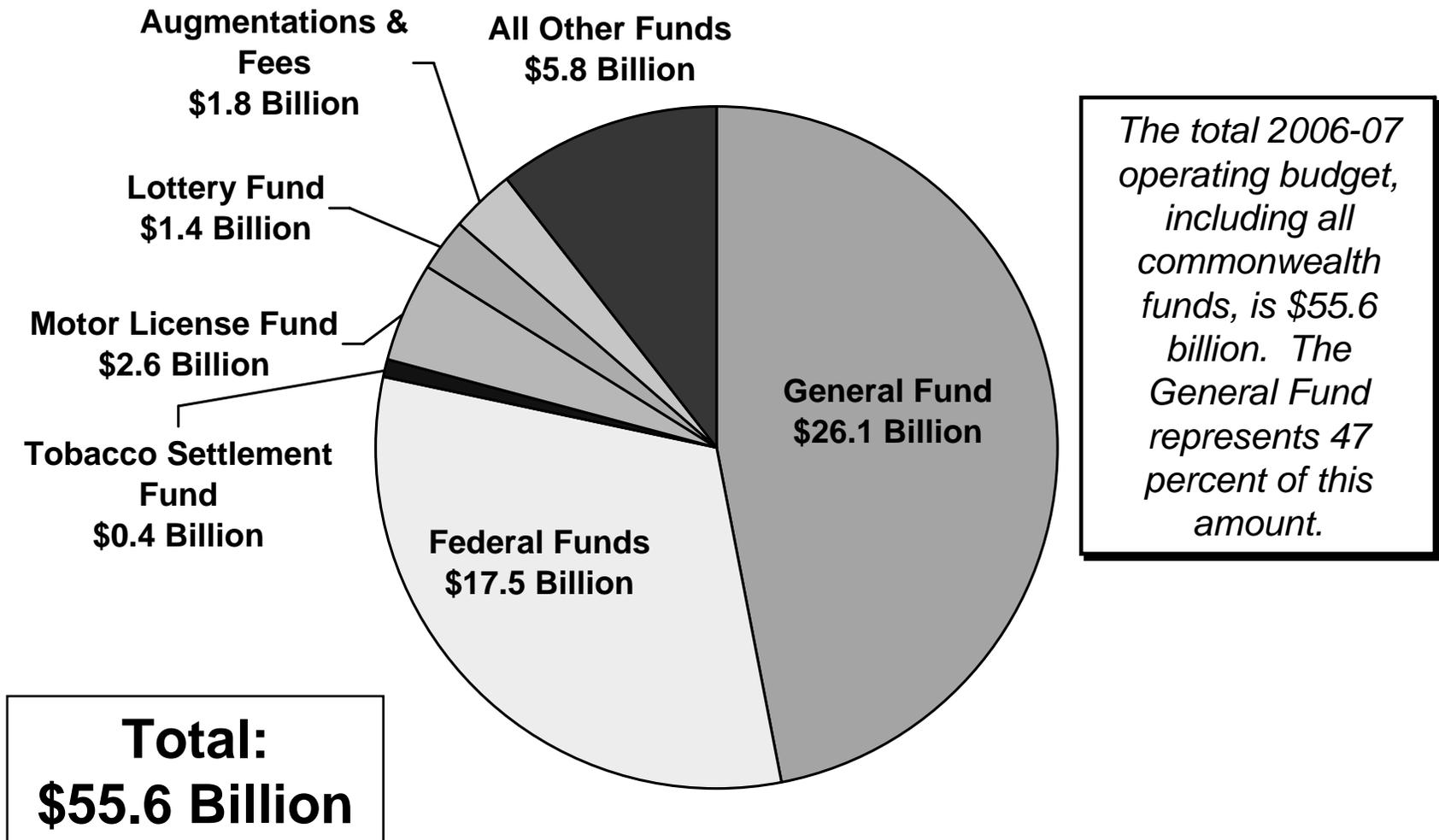
- The 2006-07 enacted General Fund budget is **\$26.1 billion**, an increase of \$1.4 billion, or 5.8 percent, over 2005-06.
- In the enacted budget, **\$760 million**, or more than half, of the \$1.4 billion increase in General Fund expenditures is for **education – PreK-12, Higher Education and public libraries**.
- If increases for education, DPW social welfare programs, Corrections and legally mandated debt service are excluded from the \$1.4 billion growth in spending, the remainder of **the General Fund budget grew by only 0.9 percent**.
- The enacted budget increases the balance of the **Rainy Day Fund** by 50 percent – an increase of \$171 million to a new balance of **\$512 million**.
- The enacted budget has **no new taxes or tax increases** and includes **\$297 million** in additional targeted **business tax cuts** and a new **\$25 million** tax break for Pennsylvanians making contributions to qualified **Tuition Account Programs**.
- The enacted budget re-invests savings realized through innovation and increased efficiency; by **eliminating waste and improving government operations**, the commonwealth is expected to achieve nearly \$1 billion in annual savings in 2006.
- The enacted budget includes **\$25 million** to **rebuild bridges and communities devastated by the June 2006 flooding**.

Major Initiatives in the 2006-07 Budget

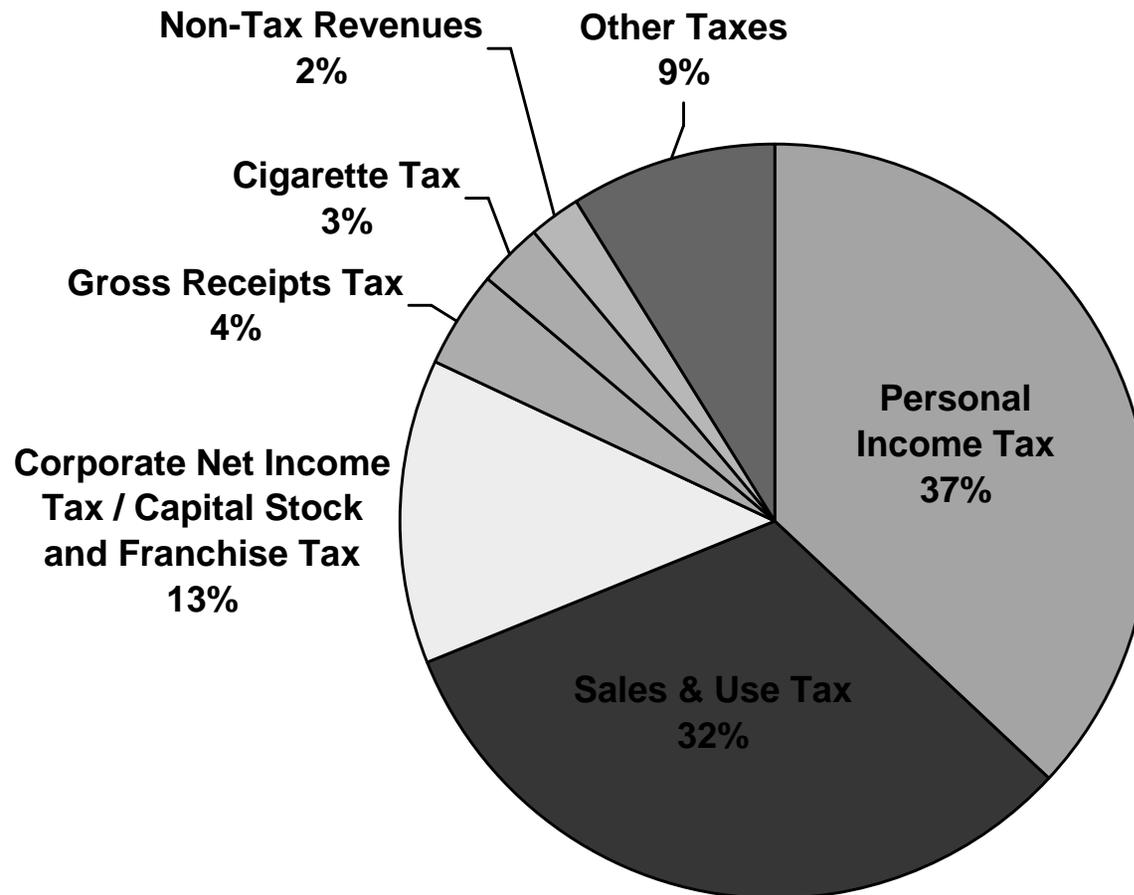
- **Education:** A \$635 million, or 7.8 percent, increase in funding for PreK-12 education.
- Historic level of investment in **PA Libraries** - \$75.5 million
- **Cover All Kids:** Affordable health insurance coverage for all uninsured Pennsylvania children
- **PACE Plus Medicare:** Prescription drug coverage for an additional 120,000 seniors/elimination of Medicare Rx gaps.
- **World Trade PA:** \$15 million to increase Pennsylvania's competitiveness worldwide.
- An additional \$130 million to continue **improvements to Pennsylvania's highways and bridges**
- Nearly 320 **additional state troopers** to support public safety

2006-07 Budget Overview

2006-07 Total Operating Budget



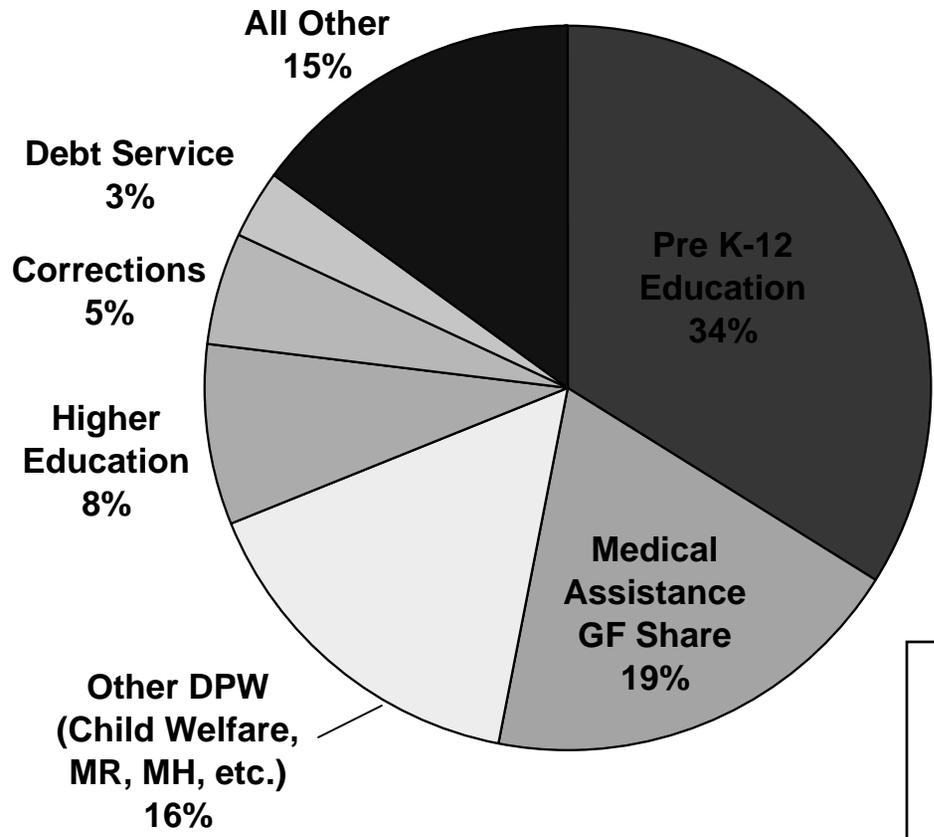
2006-07 General Fund Revenue Sources



More than two-thirds (69 percent) of General Fund revenues are derived from the Personal Income Tax and the Sales & Use Tax.

2006-07 General Fund Expenditures

The \$26.1 billion General Fund budget increased this year by \$1.4 billion, or 5.8 percent, from \$24.7 billion in 2005-06.



Spending on Education, Medical Assistance, other Public Welfare programs, Corrections and Debt Service comprise 85 percent of total General Fund expenditures.

Total GF Expenditures: \$26.1 Billion

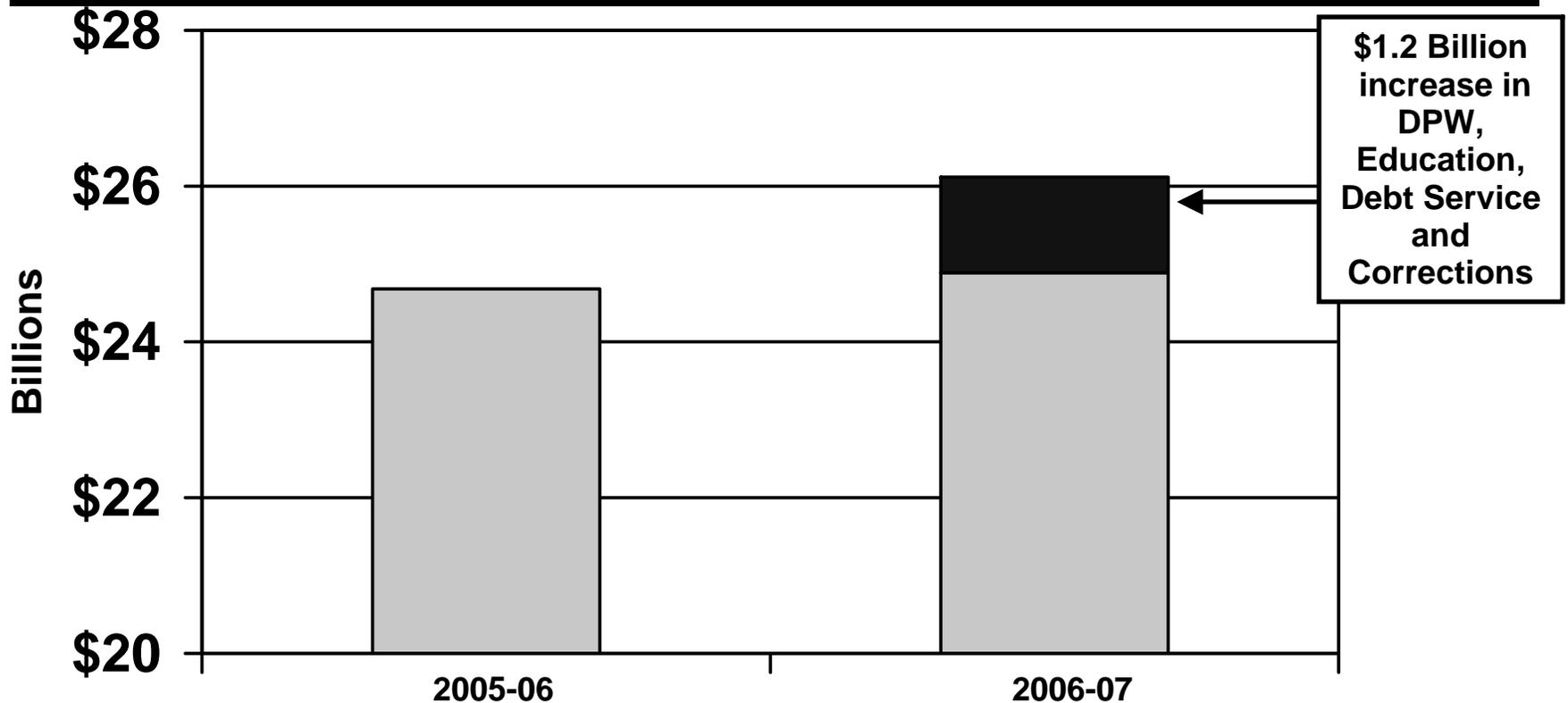
2006-07 General Fund Expenditures

Increases for Education, DPW programs (MA, MR, MH, Child Welfare and Long-Term Living), Debt Service and Corrections account for 84 percent of the growth in the 2006-07 General Fund budget.

	<u>(dollars in millions)</u>		
	<u>2005-06</u>	<u>2006-07</u>	<u>Difference</u>
Basic Education	\$ 8,144	\$ 8,779	\$ 635
Higher Education	1,904	2,015	111
DPW Social Welfare/Human Services .	8,920	9,155	235
Debt Service	721	886	165
Corrections	1,358	1,415	57
All Other	3,634	3,864	230
Total	<u>\$ 24,681</u>	<u>\$ 26,114</u>	<u>\$1,433</u>

Growth in 2006-07 Expenditures

The 2006-07 enacted budget increases spending on Education, Public Welfare, Debt Service and Corrections by \$1.2 billion, or 4.9 percent, from 2005-06. The remainder of the General Fund budget grew by only 0.9 percent.



2006-07 General Fund Financial Statement

	Dollars in Millions		
	<u>2004-05</u> Actual	<u>2005-06</u> Available	<u>2006-07</u> Budget
Beginning Balance	\$ 77	\$ 365	\$ 514
Receipts	23,309	24,819	25,605
Prior Year Lapses	<u>97</u>	<u>166</u>	<u>. . . .</u>
Funds Available	\$ 23,483	\$ 25,350	\$ 26,119
Expenditures	\$ - 23,054	\$ - 24,338	\$ - 26,114
Supplemental Appropriations	-343
Current Year Lapses	16
Preliminary Balance	<u>\$ 429</u>	<u>685</u>	<u>\$ 5</u>
Transfer To Rainy Day Fund	<u>-64</u>	<u>-171</u>	<u>- 1</u>
Ending Balance	<u><u>\$ 365</u></u>	<u><u>\$ 514</u></u>	<u><u>\$ 4</u></u>

National Growth in General Fund Budgets

Across all 50 states, 26 states enacted budgets this year that exceeded Pennsylvania's 5.8 percent rate of growth. The average spending increase for all states is 7.0 percent this year compared to the year before.

All-State Average Increase: 7.0%

Alaska	27.9%	New York	9.4%	Illinois	4.3%
South Carolina	20.1%	California	9.2%	Rhode Island	3.9%
Utah	17.0%	Nebraska	9.1%	Kentucky	3.7%
Wyoming	16.6%	Mississippi	8.7%	New Hampshire	2.3%
Hawaii	16.0%	Florida	7.9%	Michigan	2.1%
Virginia	15.4%	Kansas	7.3%	Connecticut	2.0%
Maryland	14.4%	Arkansas	6.1%	Indiana	1.9%
Nevada	14.3%	North Dakota	6.0%	Maine	1.6%
Delaware	12.2%	Tennessee	5.9%	South Dakota	1.6%
Arizona	11.8%	Pennsylvania	5.8%	Vermont	1.5%
New Jersey	11.7%	Idaho	5.7%	Washington	0.4%
North Carolina	10.6%	Iowa	5.2%	Minnesota	0.0%
Alabama	10.2%	Wisconsin	5.2%	Texas	-1.4%
West Virginia	10.1%	Colorado	5.1%	New Mexico	-3.9%
Oklahoma	9.5%	Ohio	4.9%	Louisiana	-5.4%
Massachusetts	9.4%	Montana	4.8%	Oregon	-8.8%
Missouri	9.4%	Georgia	4.5%		

Source: National Association of State Budget Officers

2006-07 Budget Overview

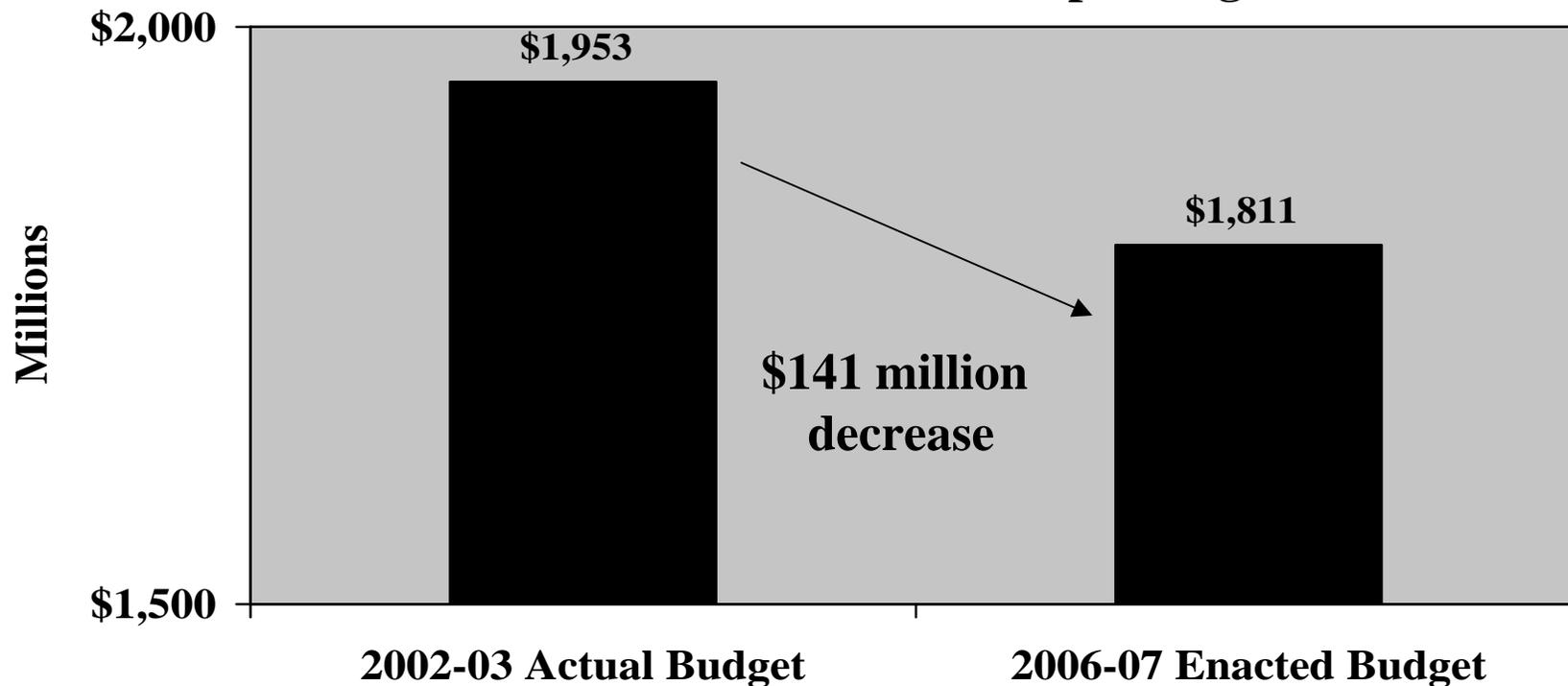
**Making
Government
Work Smarter**

Continuing to Cut the
Cost of Government

Pennsylvania Is Cutting Administrative Spending

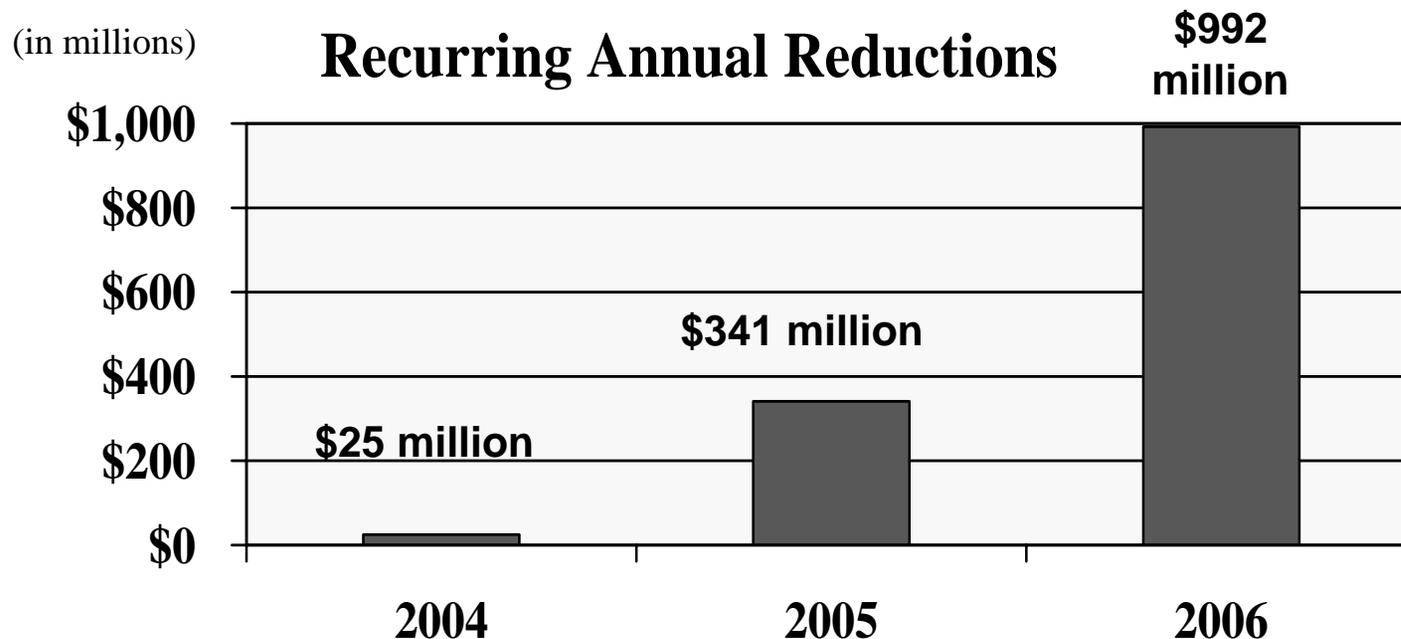
The Rendell administration is committed to making needed investments in education, economic development and human services. One way this is being accomplished is by reducing administrative spending to the maximum extent possible so more state resources can go to vital programs that Pennsylvanians rely on. Despite inflationary increases in health benefit costs, fuel costs and numerous other costs, administrative spending has still been reduced by 7.2 percent between 2002-03 and 2006-07.

State Administrative Spending



PA is on Track to Achieve \$1 Billion in Annual Cost - Cutting Management & Productivity Improvements

Governor Rendell pledged to cut the cost of government and improve the way the commonwealth works. In four years, by developing new business practices and focusing on innovation and efficiency throughout government, this administration implemented 147 savings initiatives and reduced expenditures by \$992 million, with more initiatives planned.



Examples of Making Government Work Smarter

Because it is the largest state agency, the Department of Public Welfare has been a major focus of the administration's management and productivity efforts. Other areas of focus have been reducing the size of the commonwealth's fleet and improved revenue generation at the Liquor Control Board and the State Lottery.

- ✓ **Implementing a Preferred Drug List**
- ✓ **Strategic Sourcing Initiative**
- ✓ **Collecting Money Owed from Private Insurance Companies**
- ✓ **Denying Fraudulent Medicaid Claims**
- ✓ **Using Electronic Payments Instead of Paper Checks**
- ✓ **Reducing Fleet Costs**
- ✓ **Controlling Construction Costs**
- ✓ **Revenue Increases from Consumer-Oriented Business Practices at the Liquor Control Board**
- ✓ **Expanded Lottery Venues**

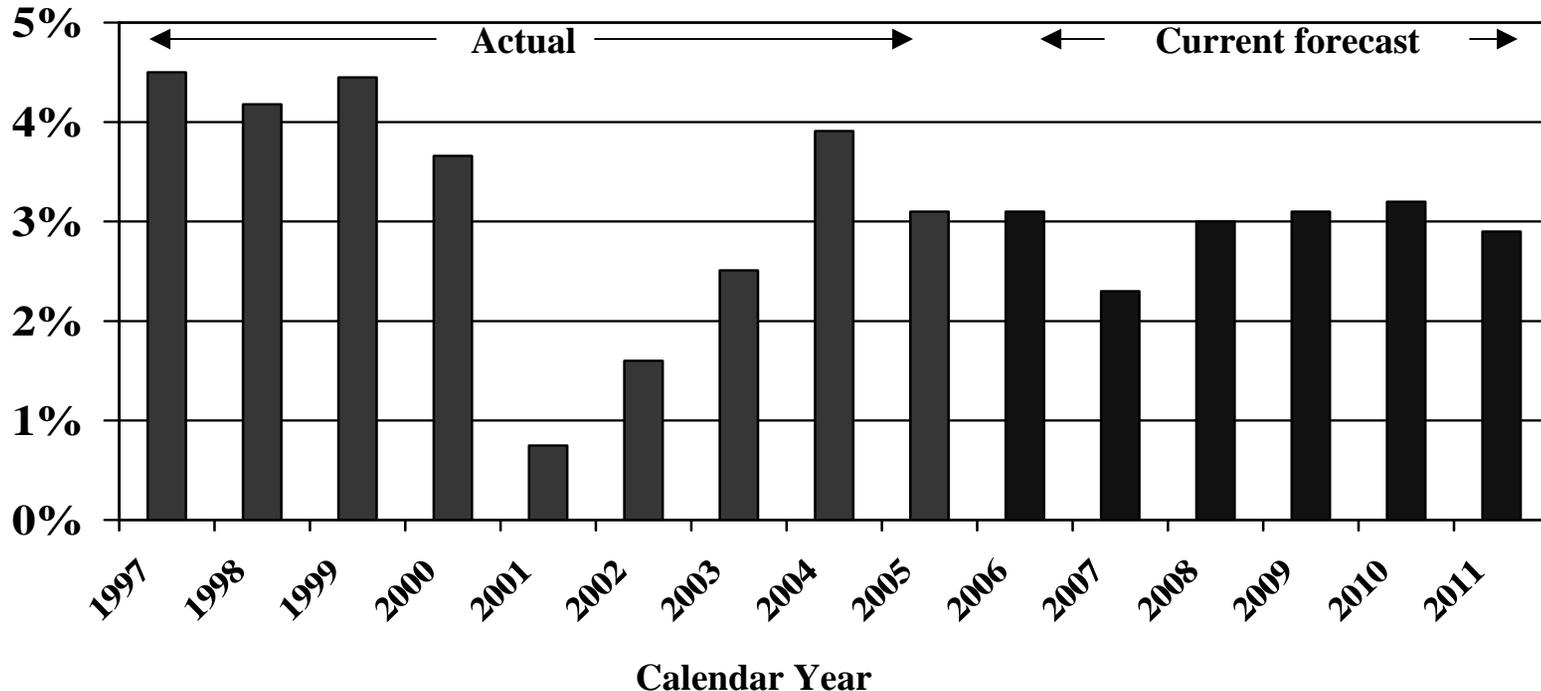
2006-07 Budget Overview

**Economic
Outlook**

Real U.S. Gross Domestic Product

Annual Growth

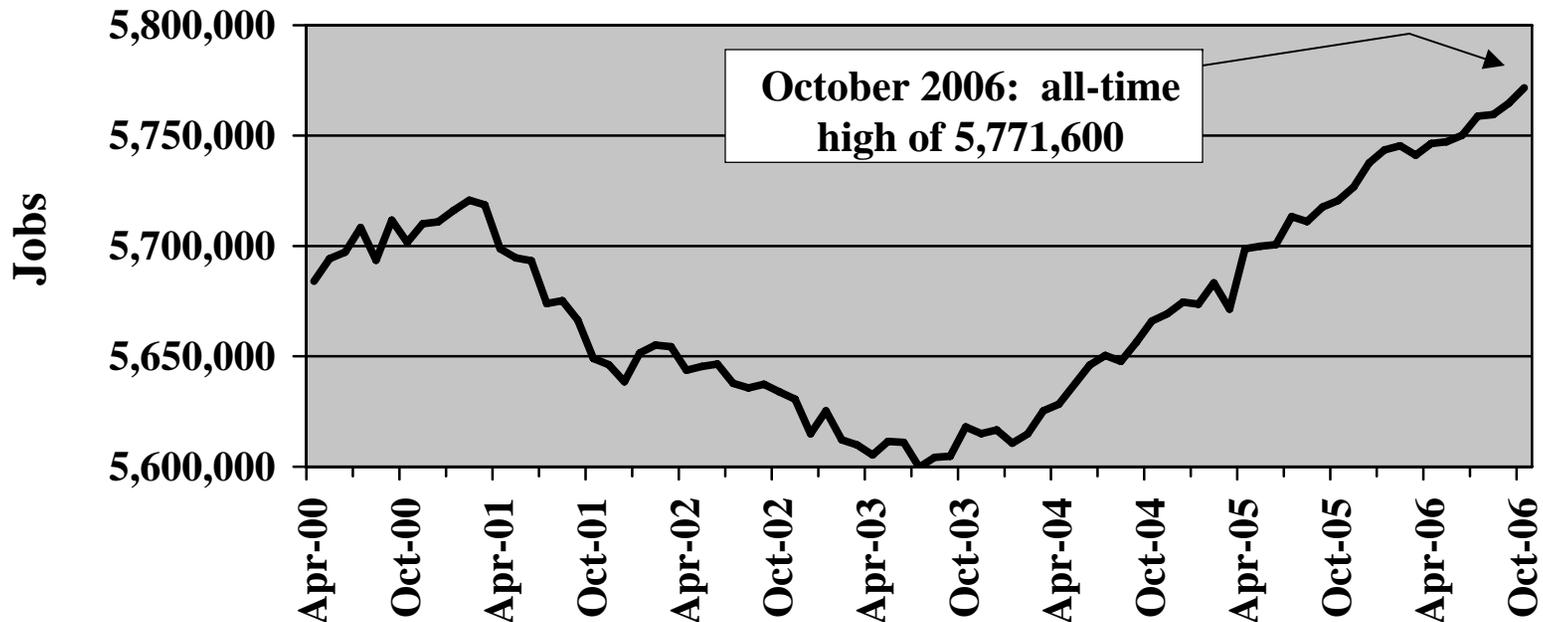
The post-recession recovery peaked in 2004. GDP growth dropped to 3.1 percent in calendar year 2005 and is projected to remain at that level in 2006. GDP is projected to drop further in 2007 - to 2.3 percent - before recovering, but even that recovery is not projected to reach 2004 levels. Since revenue estimates for the 2006-07 fiscal year were certified in early July 2006, growth estimates for Real GDP, a leading indicator for commonwealth revenues, have slowed, according to the economic forecasting firm Global Insight. Reasons for this slower rate of growth include a sharp downturn in the housing market and more cautious consumer spending.



Pennsylvania Job Growth

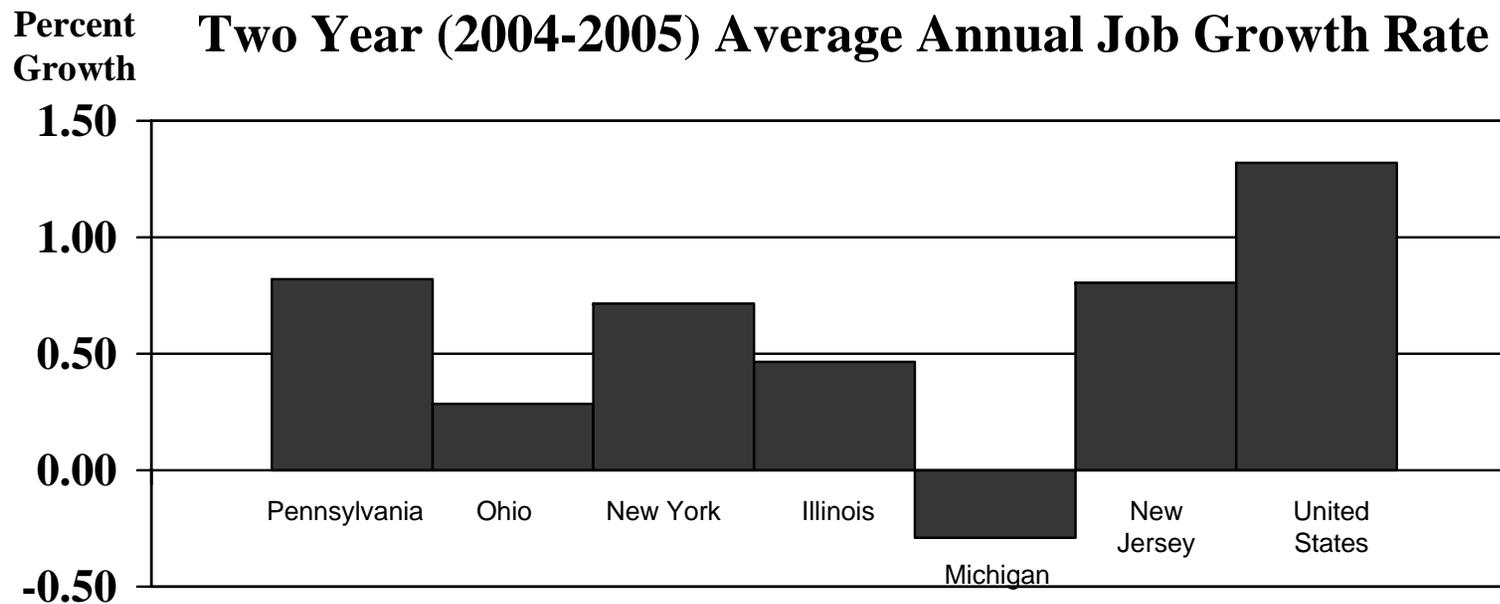
The brightest spot in the economic outlook for Pennsylvania is job growth. In October 2006, Pennsylvania reached a historic high in the number of non-farm jobs, seasonally adjusted. The state's monthly unemployment rate in October was 4.3 percent, lower than the national unemployment rate. Since January 2003, the Pennsylvania economy has generated a net increase of nearly 150,000 jobs. State investments, including the Economic Stimulus program, have been a major factor behind the turnaround.

Steady Rise in Pennsylvania Jobs (non-farm)



PA Job Growth Outperforms Similar States

For Pennsylvania, the general slowing of the U.S. economy has been offset, in part, by strong post-recession job growth. Pennsylvania's job growth has routinely outperformed similar states. In 2004 and 2005, Pennsylvania had a higher average job growth rate than Ohio, New York, Illinois, Michigan and New Jersey.



Housing Slumps Nationally and in Pennsylvania

While Pennsylvania's housing market is faring better than housing markets in states like New York, Florida and California, it is still slowing, as evidenced by a 12 percent decline in the number of sales of existing housing units between the third quarter of 2005 and the third quarter of 2006. The housing slump impacts the commonwealth's collections of the Realty Transfer Tax and Sales and Use Tax, which collectively lag official estimates by a total of \$44 million through November 2006.

	Q3 2005 Actual	Q3 2006 Projected	Q1 2007 Projected
Total Housing Starts (thousands)	49.8	42.9	41.1
New Median Price (\$)	157,768	168,980	177,326
Unit Sales Existing (thousands)	256.7	226.8	215.6
Existing Median Price (\$)	150,437	155,855	154,545

Source: *U.S. Markets State Economies, Northeast*, Summer 2006, Global Insight

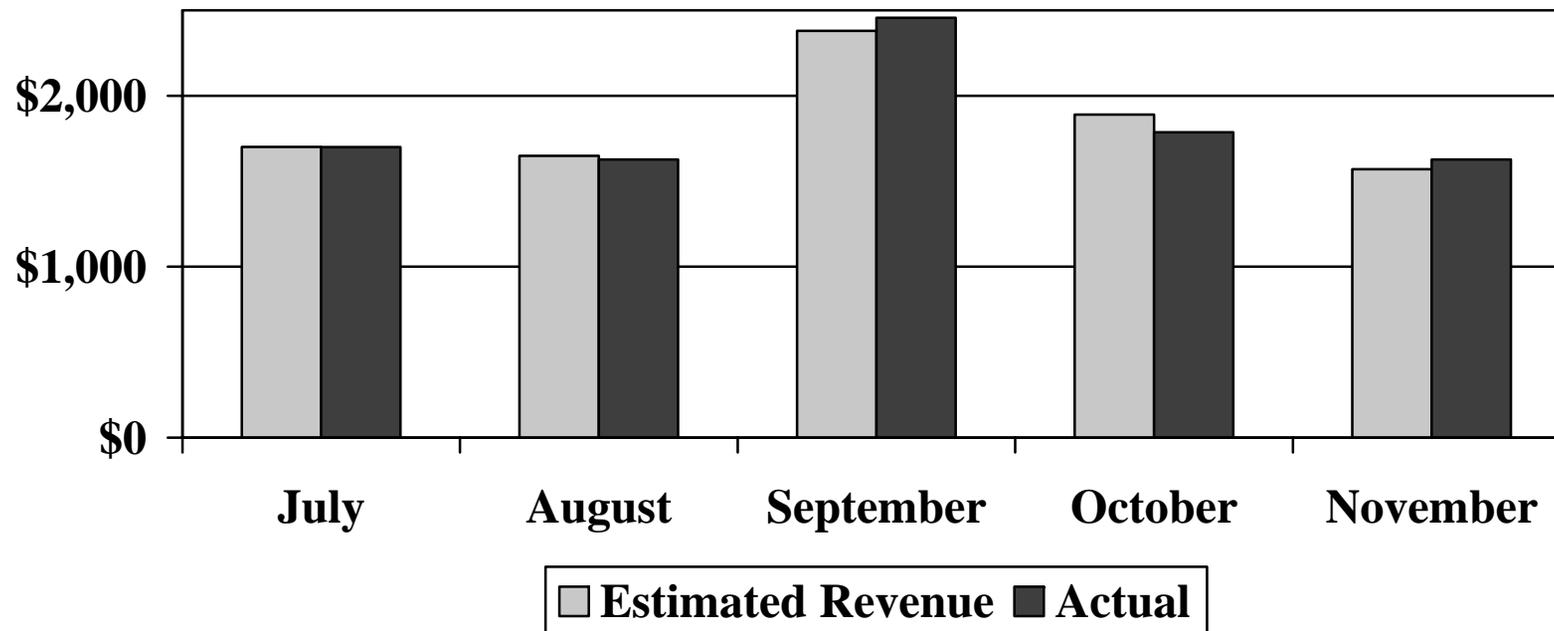
2006-07 Budget Overview
General Fund
Revenues

General Fund Revenues

Estimated versus Actual Revenue Collections

In November, monthly collections were \$56 million higher than projected, causing year-to-date collections to rise to \$8.7 million above estimate. But November collections exceeded estimate largely due to a one-time, unanticipated corporation tax settlement of \$42 million. If this settlement had not occurred, year-to-date collections would lag the official estimate by \$33 million.

Amount in millions



Year-to-Date General Fund Revenues

While total commonwealth revenues closely tracked official estimates through November, several categories of revenues lagged official estimates by more than \$68 million, including Sales Tax – Non-Motor Vehicles, the Inheritance Tax and the Real Estate Transfer Tax. Revenue shortfalls in these categories have been offset by higher-than-estimated collections in Treasury Earnings, Business/Corporate Taxes and the Personal Income Tax. Were it not for a \$42 million unanticipated corporation tax settlement in November, year-to-date revenues would be \$33 million below estimate.

Year-to-Date - General Fund Revenues

Revenue Source:	YTD Est.	YTD Actual	\$ Diff	% Diff	YTD Est. as % of Full Yr. Est.
All Other Taxes & Revenues	\$ 150,800	\$ 135,482	\$ (15,318)	-10.2%	26.42%
Sales Tax - Non-Motor Vehicles	3,112,900	3,087,609	(25,291)	-0.8%	41.83%
Inheritance Tax	321,000	296,900	(24,100)	-7.5%	41.25%
Real Estate Transfer Tax	271,200	252,509	(18,691)	-6.9%	44.34%
Licenses & Fees	31,800	31,116	(684)	-2.2%	26.75%
Escheats	(18,000)	(24,820)	(6,820)	37.9%	-36.00%
Sales Tax - Motor Vehicle Sales	505,800	504,357	(1,443)	-0.3%	43.46%
Treasury Earnings	52,700	99,538	46,838	88.9%	37.64%
Business/Corporate Taxes	964,100	998,759	34,659	3.6%	18.59%

Loss of Federal Funding

(partial list)

2003-04 through 2006-07

Pennsylvania faces constant pressure from federal funding cuts. Since 2003-04, the federal government has cut nearly \$1.7 billion in funding for Pennsylvania, forcing the state to make up for federal cuts with state funds. The alternative would have been to make deep cuts in funding for specific social welfare programs like nursing home care. Further and deeper cuts have been proposed by the Bush administration that have not yet been implemented.

Federal Changes	2003-04	2004-05	2005-06	2006-07	Cumulative
IGT Phase-Out	-\$132.0 M	-\$148.0 M	-\$119.5 M	-\$113.8 M	-\$513.3 M
FMAP Reduction				-\$27.3 M	-\$27.3 M
One-Time Enhanced FMAP		-\$336.4 M			-\$336.4 M
One-Time Flexible Grant			-\$418.0 M		-\$418.0 M
Medicare Part D “Clawback”			-\$141.8 M	-\$196.7 M	-\$338.5 M
Federal Block Grant Cuts		-\$6.3 M	-\$30.2 M	-\$21.2 M	-\$57.7 M
Total	-\$132.0 M	-\$490.7 M	-\$709.5 M	-\$359.0 M	-\$1,691.2 M

Anticipated 2007-08 Federal Funding Changes

Changes in federal funding likely to impact the commonwealth's 2007-08 budget include an increase in the amount of the Medicare Part D clawback and continuing phase-out of the IGT, as well as potential federal changes to the provider assessment and other Deficit Reduction Act provisions that will reduce federal support. It is estimated that further federal cutbacks will cost the commonwealth an additional \$225.2 million in 2007-08.

Anticipated 2007-08 Federal Changes	Estimated 2007-08 Cost
Further IGT Phase-Out	-\$108.7M
Further FMAP Reduction	-\$47.2 M
Provider assessment cap reduction (preliminary estimate)	-\$ 16.6 M
Medicare Part D "Clawback"	-\$52.7 M
Total	-\$225.2 M

2006-07 Budget Overview

Changes to

Business Taxes

2006-07 Business Tax Cuts

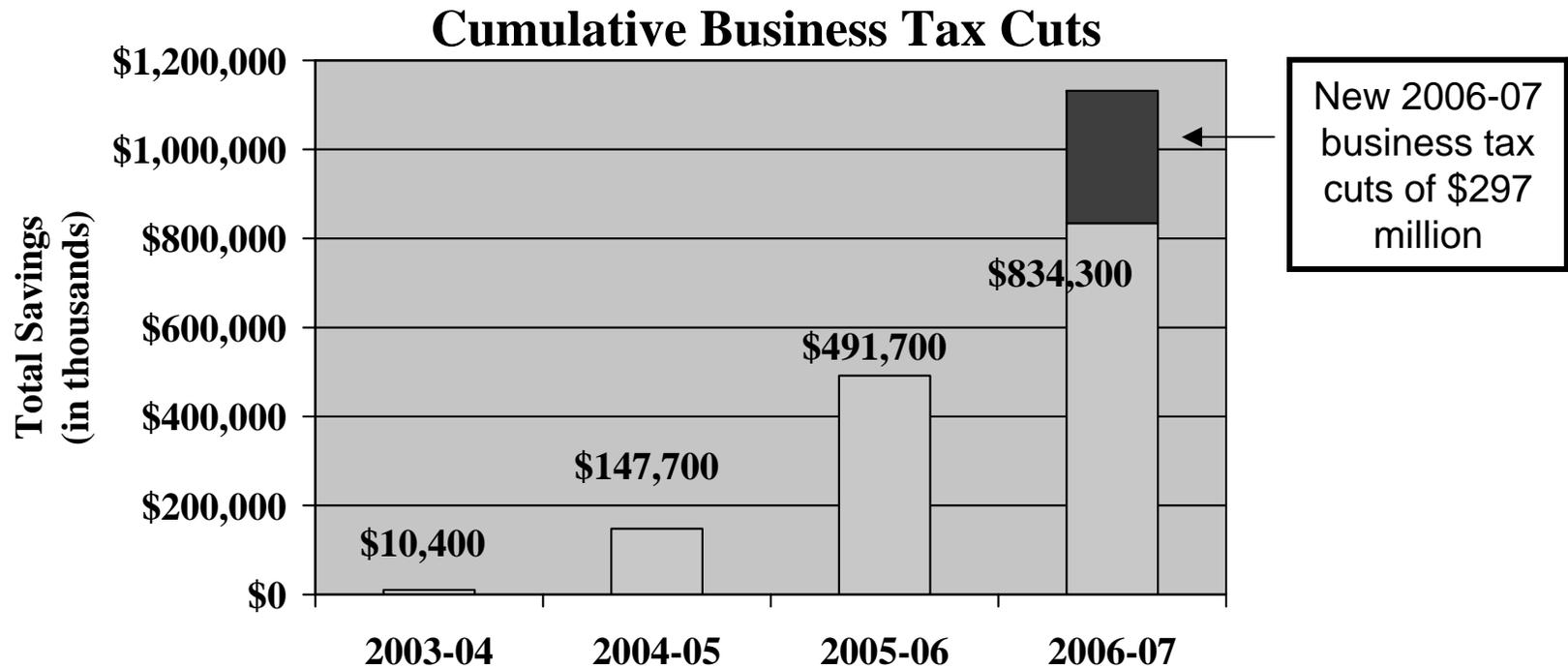
Business taxes were cut more than \$297 million in 2006-07. There has been a cumulative total of \$1.1 billion in business tax cuts from 2003-04 to 2006-07. The 2006-07 cuts include:

- **Capital Stock and Franchise Tax** – acceleration of the phase-out by one-tenth of a mill (\$21.7 million) to lower the rate to 4.89 mills, creation of an exemption for single-member Restricted Professional Companies (\$7.2 million) and expansion of the exemption to \$150,000 (\$1.6 million), for a total reduction of \$249.4 million in 2006-07
- **Research and Development Tax Credit** – An increase of \$10 million, for a \$40 million total credit
- **Net Operating Loss Carry-Forward** – A \$21 million tax cut brought about by increasing the NOL cap per company from \$2 million to \$3 million per year or 12.5 percent of taxable income

Cumulative Business Tax Cuts

2003-04 through 2006-07

The 2006-07 budget includes more than \$297 million in new business tax cuts, including \$249 million from the Capital Stock and Franchise Tax (CSFT), \$21 million from raising the Net Operating Loss cap from \$2 million to \$3 million or 12.5 percent of taxable income, \$14 million from increasing the sales factor weighting to 70 percent, and an additional \$10 million from the Research and Development Tax Credit. Since 2003, the administration has reduced business taxes by \$1.1 billion.



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

Pennsylvania's Business Tax Climate

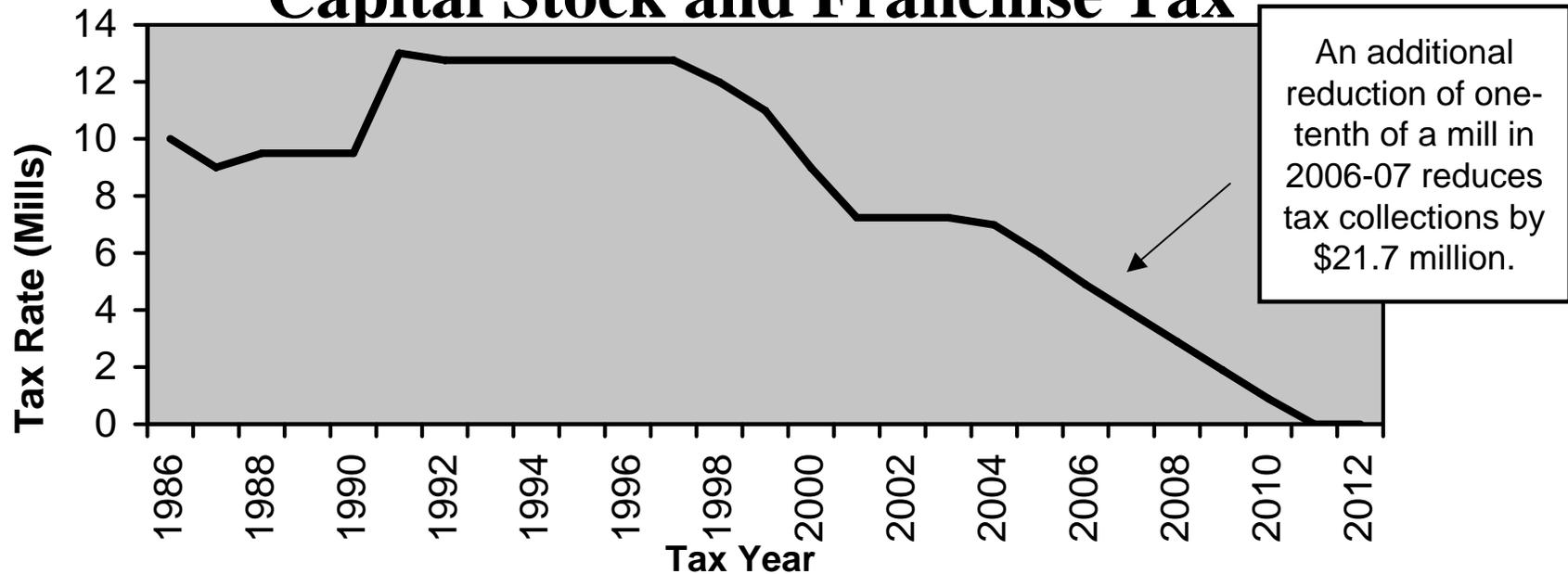
22nd Most Competitive in the Nation

In its 2007 State Business Tax Climate Index, the non-partisan, business-funded Tax Foundation ranked Pennsylvania's tax structure 22nd best among the 50 states for the second straight year – and higher than its 28th position ranking in 2003. In the 2007 rankings, the Tax Foundation praised the commonwealth for its individual income and property taxing systems and cited Pennsylvania as one of the states likely to raise its ranking steadily over the next few years – making the commonwealth even more appealing to businesses.

In particular, the Tax Foundation:

- ✓ Ranked Pennsylvania's taxing system for Personal Income Tax among the best in the nation, an important factor for the increasing number of businesses that report income through the individual income tax code.
- ✓ Highlighted Pennsylvania as one of the states making positive changes to its tax structure, which will continue to improve its business tax climate in the future.
- ✓ Noted that the Capital Stock and Franchise Tax is on schedule to be phased out completely by 2011 with yearly decreases of 1 mill per year.

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



- Accelerating the phase-out by an additional one-tenth of a mill beyond the scheduled rate for tax year 2006 will lower the rate from 5.99 mills in 2005 to 4.89 mills (a \$240.6 million reduction). That change, along with a new exemption for single-member restricted professional companies (a \$7.2 million reduction) and the expansion of that exemption to \$150,000 (a \$1.6 million reduction), will save Pennsylvania's businesses a total of \$249.4 million in 2006-07.
- Cumulative business tax reductions from major tax savings initiatives for 2003-04 through 2006-07 total \$1.1 billion, including more than \$820 million from the Capital Stock and Franchise Tax phase-out as well as other reductions.

2006-07 Budget Overview

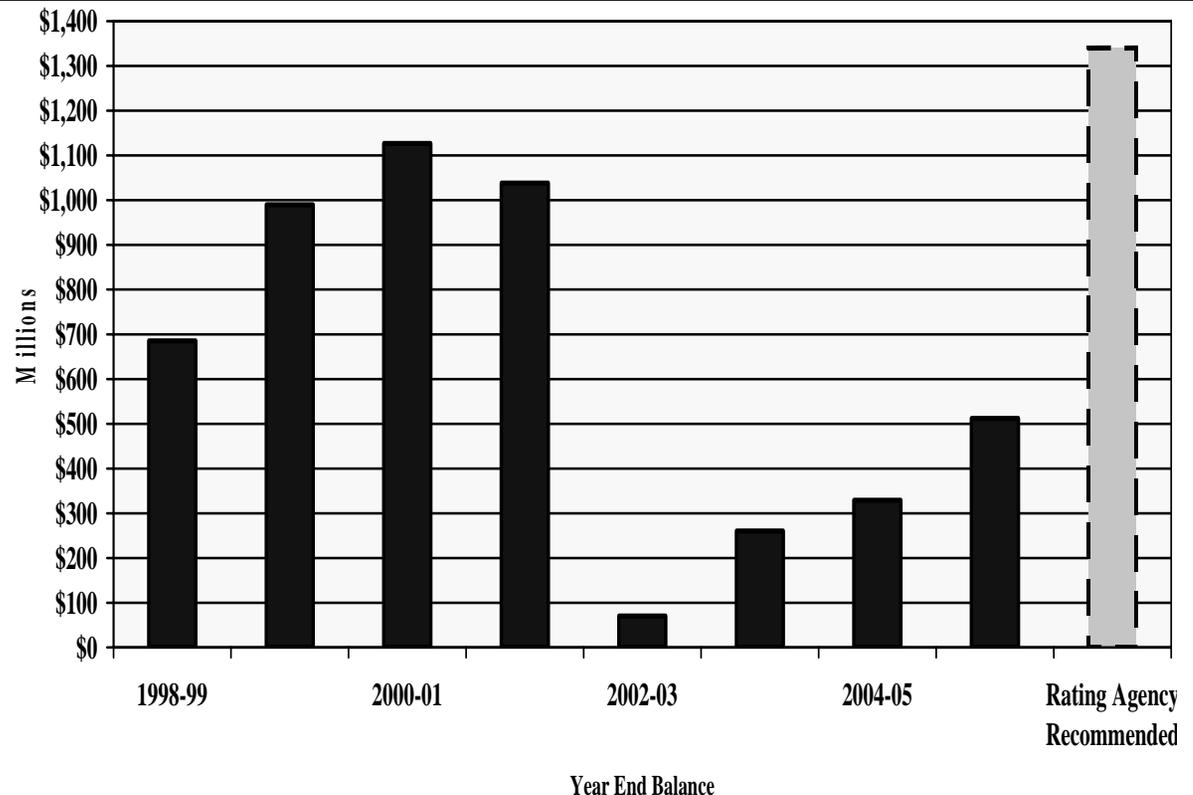
**The
Rainy Day
Fund**

Status of PA's Rainy Day Fund

PA Rainy Day Fund balances were built up substantially during the latter part of the 1990s and peaked at more than \$1.1 billion in 2000-01. The Fund was depleted in order to balance the 2001-02 and 2002-03 General Fund budgets. Through disciplined budget administration, the Rendell administration was able to make annual year-end transfers of surplus that brought the Rainy Day Fund balance to \$512 million by the end of 2005-06.

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

To meet this criteria, Pennsylvania would have to increase the Rainy Day Fund balance to \$1.34 billion, an increase of \$828 million.



General Fund Outlook at Mid-Year

Anticipated 2006-07 Supplemental Appropriations

(Dollar Amounts in Thousands)
2006-07 Available

Conservation and Natural Resources – <i>Add'l Gypsy Moth Spraying</i> .	\$	2,434
Education	\$	6,749
<i>Early Intervention ~ \$4.5 million to serve 800 more children, with statutory change to reallocate 2006-07 funds. Otherwise \$7.9 million is needed.</i>		
<i>Tuition for Children and Orphans ~ \$2.2 million for increased enrollment and higher tuition costs</i>		
Environmental Protection – <i>Add'l Black Fly Spraying</i>	\$	3,405
Military and Veterans Affairs		
<i>Supplemental Life Insurance (Act 105 of 2006).....</i>		
	\$	965
Public Welfare	\$	22,636
<i>Outpatient ~ \$12 million due to increase in fee-for-service eligibles.</i>		
<i>Inpatient ~ \$7 million due to increase in fee-for-service eligibles.</i>		
<i>Youth Development Institutions ~ \$3.7 million to address staffing issues.</i>		
State – <i>Lobbying Disclosure (Act 134 of 2006)</i>	\$	500
Emergency Management Agency – <i>2006 Flood Disaster Relief.....</i>	\$	3,000
		<hr/>
Total Anticipated Supplemental Appropriations.	\$	<u>39,689</u>

Fiscal Impact of Enacted Legislation

Since the enactment of the 2006-07 General Appropriations Bill, 17 bills have been enacted that have fiscal implications, totaling \$6 million in 2006-07 and \$17 million in 2007-08. Of those bills, 12 require additional state funds, the majority of which will be absorbed by agencies in 2006-07, and five reduce state revenue.

	(dollars in thousands)	
	2006-07	2007-08
New Costs		
• National Guard Supplemental Life Insurance	\$ 965	\$ 710
• Lobbying Disclosure	\$ 500	\$ 2,900
• Home Care Agencies Licensure	\$ 280	\$ 560
• Worker Compensation Program Enhancements	\$ 250	\$ 1,500
• Tougher Penalties on Sex Offenders	\$ 212	\$ 800
• Court Interpreters	\$ 209	\$ 416
• Additional Criminal Background and Child Abuse Checks	\$ 0	\$ 3,900
• Miscellaneous	<u>\$ 366</u>	<u>\$ 1,952</u>
Subtotal – New Costs	\$ 2,782	\$ 12,738
Revenue Losses		
• Life Insurance Valuation Fee Decrease	\$1,900	\$ 1,900
• Expiration of Gift Cards	\$ 650	\$ 1,650
• “Official Documents” State Sales Tax Exclusion	\$ 500	\$ 500
• Miscellaneous	<u>\$ 76</u>	<u>\$ 185</u>
Subtotal – Revenue Losses	\$3,126	\$ 4,235
Total	<u>\$5,908</u>	<u>\$16,973</u>

2006-07 General Fund

Projected Status

(in millions)

November 30, 2006 Balance	\$6
Revenue Adjustment	- 3
Additional Lapses	85
Supplemental Appropriations	<u>- 40</u>
Preliminary Balance	\$48
Transfer to Budget Stabilization Reserve Fund	<u>- 12</u>
Projected June 30, 2007 Balance	\$36

2006-07
Budget Overview

2006-07 Budget Overview
Education

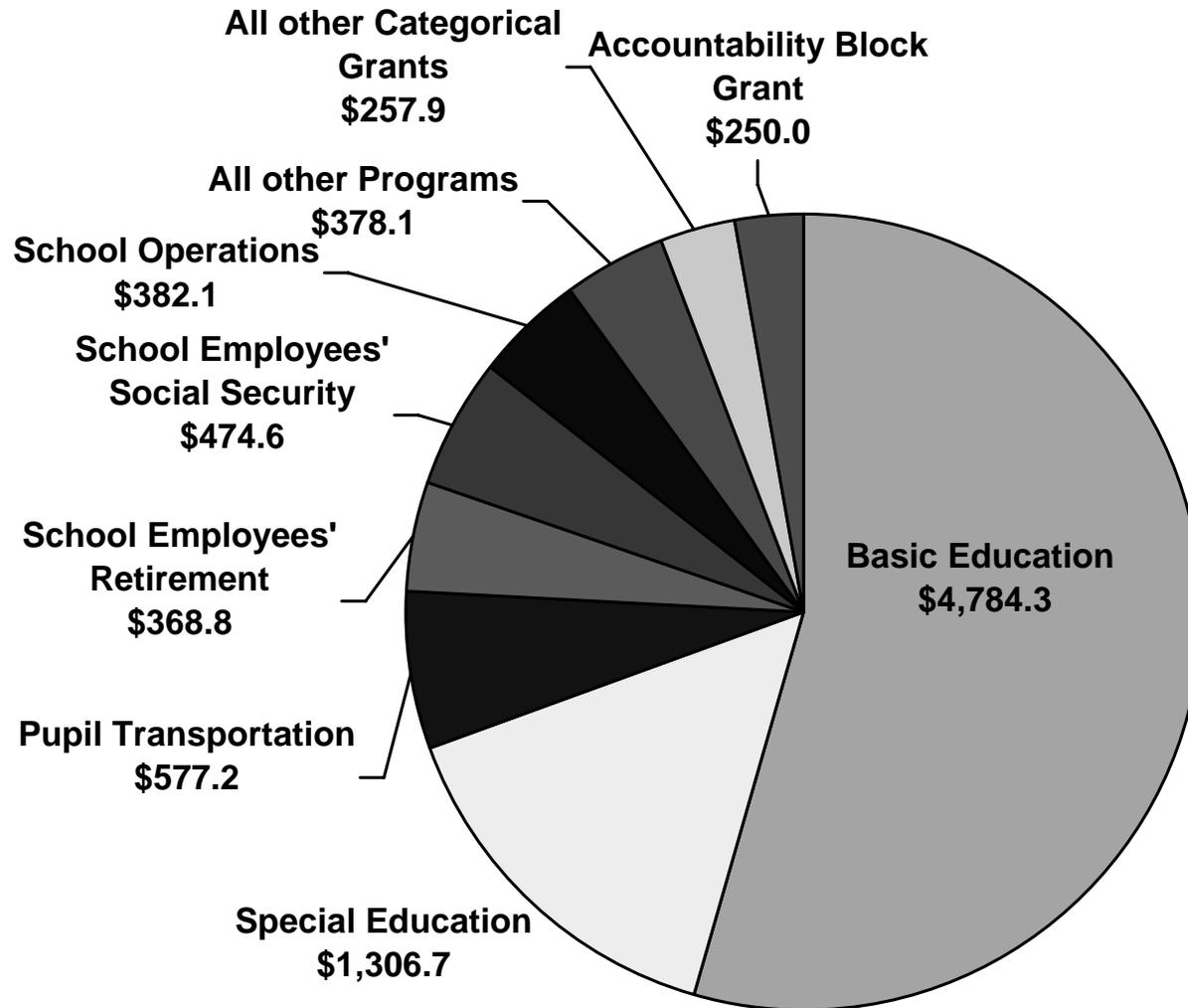
Investing In Pennsylvania's Future

The 2006-07 budget increases total education funding by \$760 million.

- **\$269 million increase (6 percent) in Basic Education Funding** - \$4.8 billion in total. This increase continues the foundation-based funding supplement to help school districts where per-student spending is inadequate to deliver a quality education.
- **\$27.6 million increase (3 percent) in Special Education Funding** - \$981 million in total.
- **\$250 million, a \$50 million increase**, for the third year of the **Accountability Block Grants**. These grants help nearly 80,000 students benefit from pre-kindergarten, full-day kindergarten, reduced class size and tutoring.
- **\$40 million, a 33 percent increase** in state funding for **Head Start** pre-kindergarten classrooms, to serve 5,750 children.
- **Job Ready PA: \$66 million for tutoring** in the most academically challenged school districts.
- **Job Ready PA: \$12.6 million increase for community colleges.**

2006-07 Funding for PreK-12 Education

(amounts in millions)



Since 2002-03, the Rendell Administration has boosted investments in education by \$1.8 billion, or more than 26 percent, to a total of \$8.8 billion.

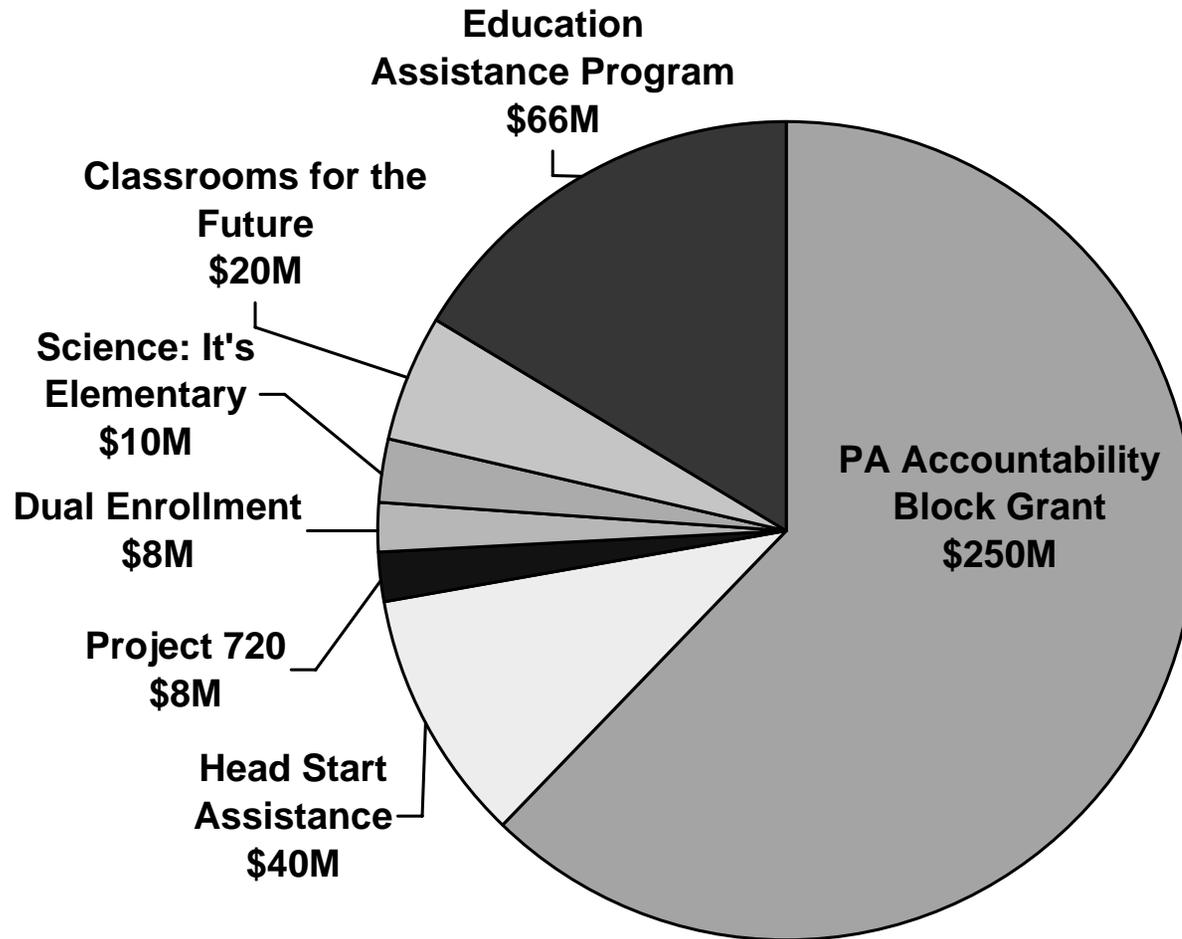
**Total:
\$8.8 Billion**

Transforming Pennsylvania's High Schools

The 2006-07 budget provides more than \$22 million in additional funding to increase the rigor of high school curricula and improve accountability and results.

- **Job Ready PA: \$8 million** for **dual enrollment** programs that let high school students earn college credit while they complete their graduation requirements.
- **Job Ready PA: \$8 million** to transform Pennsylvania's high schools through **Project 720**, the state's **high school improvement** initiative.
- **Reinvigorating College and Career Counseling: \$3 million** for school districts to **upgrade their career and counseling programs**.
- **Accountability for Results: \$2 million** to make school-leader accountability a reality through annual **incentive bonuses for meeting targets** for increasing student learning in math and reading.
- **Improving Teacher Quality: \$1.2 million** to help 500 Pennsylvania teachers earn **National Board certification**.

2006-07 Targeted Education Investments



More than \$402 million in new targeted education investments designed to improve student achievement is part of the 2006-07 budget.

**Total:
\$402 Million**

Investing In Pennsylvania's Future

The 2006-07 budget builds on Pennsylvania's accomplishments over the last three years by recommending three new initiatives that will make Pennsylvania a leader in readying our students for the jobs of the future while giving our high-tech businesses the employees they need to thrive.

- **\$10 million - Science: It's Elementary.** Provides hands-on learning equipment and intensive teacher training to elementary schools that commit to upgrading their science curriculum. Makes every Pennsylvania student a scientist in the classroom and gives school districts access to a strategy that has been proven to lead not just the nation but also the world.
- **\$20 million - Classrooms for the Future.** Makes every high school classroom in the commonwealth a high-tech center of learning. Through a multi-year initiative, every high school classroom in the four core subjects will have an Internet-equipped laptop computer on each student desk and multi-media technology at the teacher's fingertips.
- **\$4 million for technology professional development** for Pennsylvania teachers and school leaders.
- **\$3.7 million - From the Classroom to the Board Room.** Expands the *New Economy Technology Scholarship Program* to 500 more college students and raises the maximum annual grant to \$4,000. The current program provides grants of up to \$3,000 a year for three years to students pursuing college degrees in computers, math and science who commit to work in Pennsylvania after graduation.

Investing In Pennsylvania's Future

Early Childhood Education Funding

Pennsylvania is moving from near-last among the 50 states to becoming a key investor in early childhood education. These investments will continue in 2006-07 – highlighted by a 33 percent increase in funding for Head Start expansion so that this proven program can serve nearly 5,750 children. According to Kids Count, a project of the Annie E. Casey Foundation, Pennsylvania's ranking in the percent of 3- to 5-year-olds enrolled in nursery school, pre-school or kindergarten increased from 29th to 23rd from 2002 to 2004.

In 2005-06, with more than \$135 million in state funding for Head Start, pre-K and full-day kindergarten...

- 318 school districts funded full-day kindergarten with the Accountability Block Grant,
- 40 school districts funded quality pre-kindergarten with the Accountability Block Grant, and
- 18,165 children benefited from K-3 class reduction size.



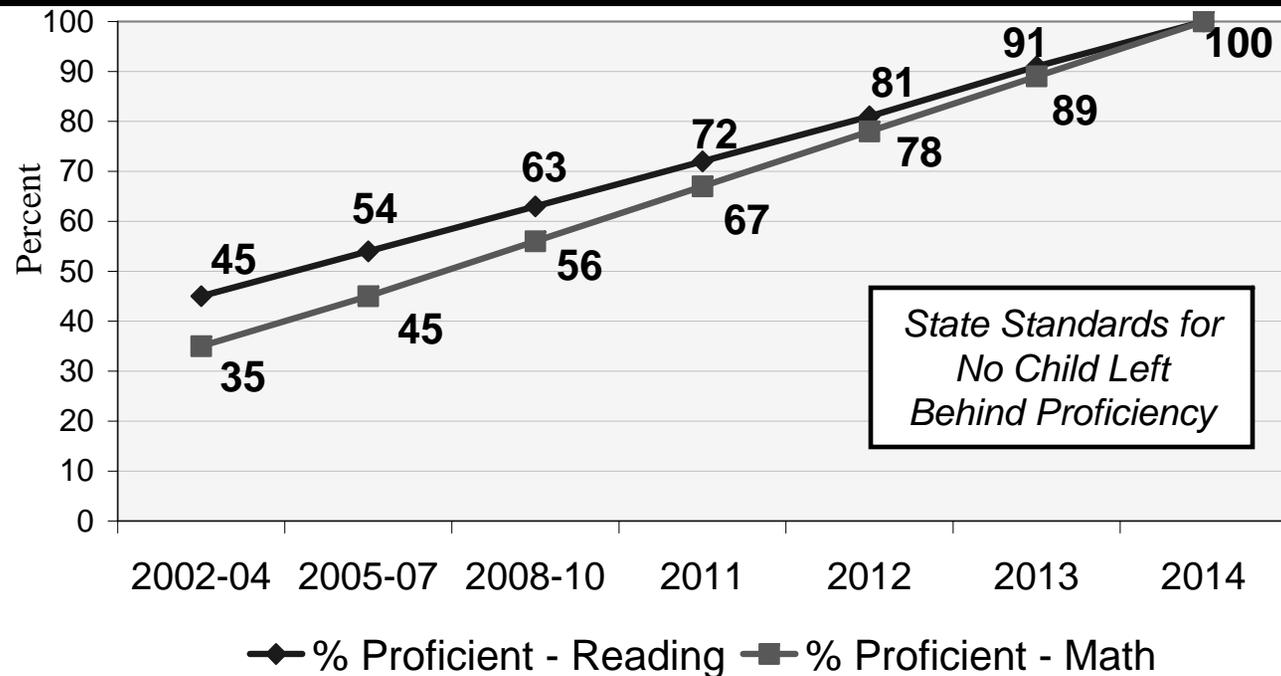
Accountability Block Grant
Early Childhood Education

- PreK and Full-Day K
- Full-Day Kindergarten
- Pre-Kindergarten

No Child Left Behind Reading & Math Targets

Pennsylvania has until 2014 to reach 100 percent proficiency in reading and math, as required by the federal No Child Left Behind standards. Our investment in proven educational programs must keep pace if Pennsylvania schools are to reach these achievement goals. These investments are already showing results. The number of fifth-graders meeting state standards in math increased from 53 percent of our students in 2002 to 69 percent in 2004-05, while the number of fifth-graders meeting standards in reading rose from 57 percent to 64 percent during the same period. In addition, in a recent ranking of the percentage of proficient fourth-grade reading students, Pennsylvania advanced from 13th in 2002 to 9th in 2005.

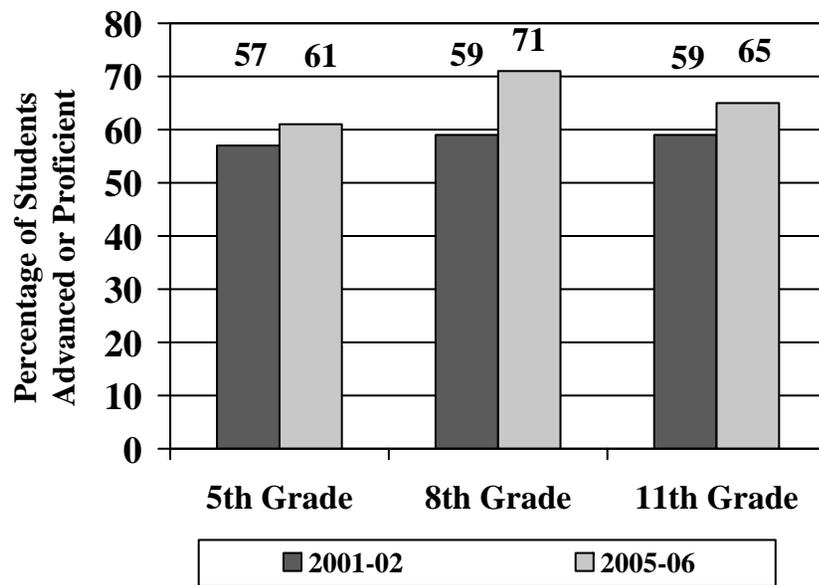
In 2003-04, nearly one in five Pennsylvania schools failed to make Adequate Yearly Progress as defined by No Child Left Behind, and the requirements will get even steeper beginning this spring.



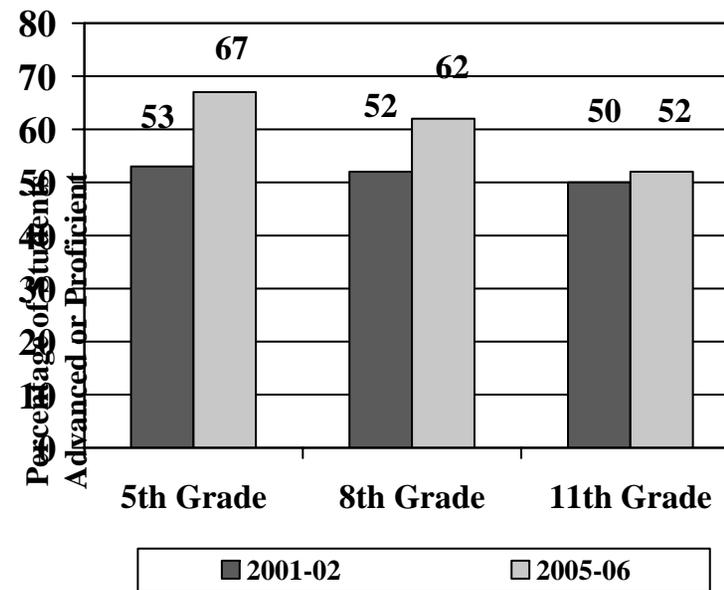
Student Achievement

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

**Reading PSSA Results
2001-02 vs. 2005-06**



**Math PSSA Results
2001-02 vs. 2005-06**



2005-06 Adequate Yearly Progress (AYP) 2005-06 PA System of School Assessment (PSSA)

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

- ✓ 90% of Pennsylvania School Districts met Adequate Yearly Progress in 2006.
- ✓ Students in the lowest-performing school districts have made significant progress in reading and mathematic proficiency since the 2001–2002 school year.
 - ✓ Fifth graders improved by 21.3 percentage points in mathematics and 9.3 percentage points in reading
 - ✓ Eighth graders improved by 16.9 percentage points in mathematics and 17.4 percentage points in reading
 - ✓ Eleventh graders improved by 5.6 percentage points in mathematics and 9.4 percentage points in reading

Higher Education in the 2006-07 Budget

Pennsylvania is making significant investments in higher education funding in the 2006-07 budget.

Higher education funding includes:

5.0% increase for the Community Colleges	\$ 264.7 M
5.0% operating increase for State System of Higher Education	\$ 487.9 M
4.5% operating increases for the State-Related Universities	
Penn State University	\$ 327.7 M
University of Pittsburgh	164.6 M
Temple University	169.5 M
Lincoln University	13.5 M
Total – State-Related Universities	\$ 675.3 M
4.9% increase for the Pennsylvania Higher Education Assistance Agency’s Grants to Students program	\$ 386.2 M
119.4% for SciTech Scholarships	\$ 6.8 M
Expansion of clinical education opportunities and student retention activities to address the shortage of nurses	\$ 7.5 M

Historic Level of Support for Public Libraries in the 2006-07 Budget

(amounts in thousands)

1995-96	\$26,190
1996-97	\$28,550
1997-98	\$29,407
1998-99	\$30,289
1999-00	\$47,286
2000-01	\$62,289
2001-02	\$75,289
2002-03	\$75,289
2003-04	\$47,789
2004-05	\$57,914
2005-06	\$61,362
2006-07	\$75,500

The 2006-07 enacted budget includes a 23 percent increase in the Public Library Subsidy – to \$75.5 million. This is the largest amount ever appropriated by the commonwealth in support of public libraries, enabling Pennsylvania to retain its rank as a national leader in state support of public libraries.

2006-07 Budget Overview

Caring for

Pennsylvanians

in Need

The Rendell Administration's Guiding Principles for Preserving and Reforming the Safety Net

- **No cuts will be made to health services and social services provided to children.**
- **No one currently receiving health care services from the commonwealth will lose eligibility.**
- **Pennsylvania will be able to meet increases in demand for services to low-income children, children at risk due to neglect and abuse, chronically ill adults, uninsured working families, disabled individuals, the infirm elderly and other Pennsylvanians in need.**

Caring for All Pennsylvanians

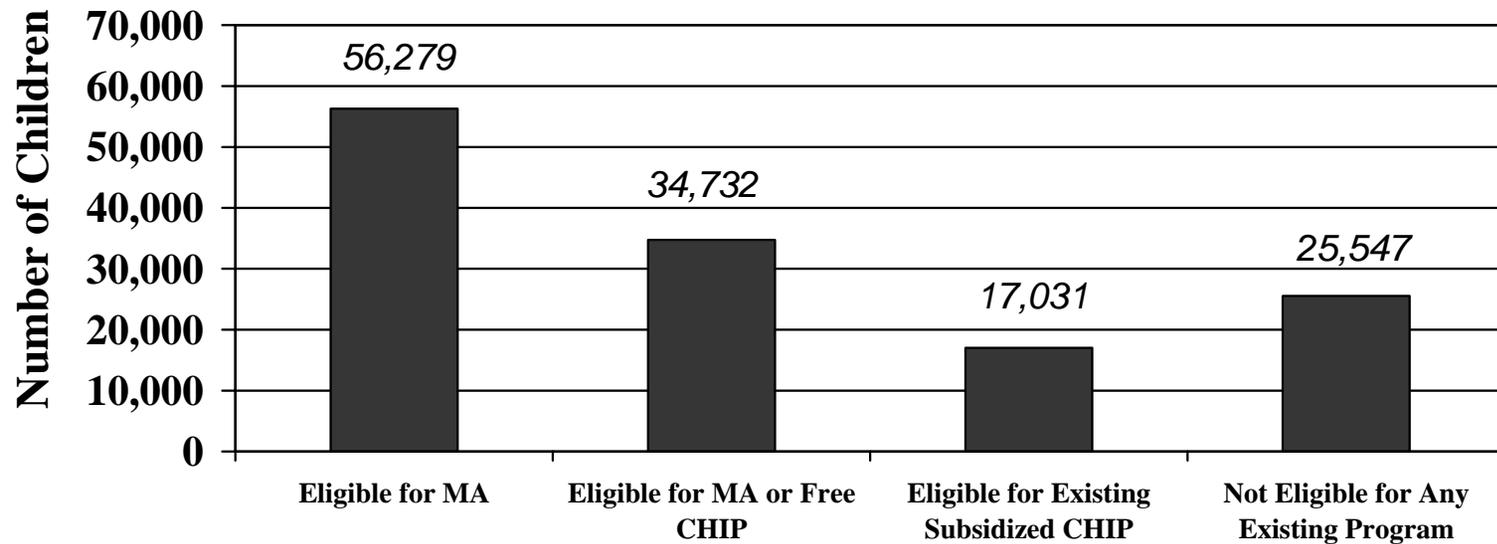
Changes in People Served in 2006-2007 (estimated)

Medical Assistance	80,133
<i>Disabled People</i>	7,605
<i>Elderly People</i>	10,639
<i>Children</i>	69,435
<i>Chronically Ill Adults</i>	1,853
<i>Other Adults</i>	- 9,399
Children in Child Welfare System	638
Children in Child Care	16,959
Community Mental Retardation Programs	620
Children's Health Insurance Program (CHIP)	17,118
<i>(Including Cover All Kids)</i>	
Uninsured Working Pennsylvanians (adultBasic)	11,000
PACE Plus Medicare	120,000

Cover All Kids

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

Pennsylvania's Uninsured Children



Current Eligibility Category

Cover All Kids: The Basics

Cover All Kids, a new state program, will guarantee access to affordable, comprehensive health care coverage for all uninsured children in Pennsylvania. In 2006-07 Cover All Kids will insure nearly 15,000 additional children at a cost of \$14.6 million in state and federal funds.

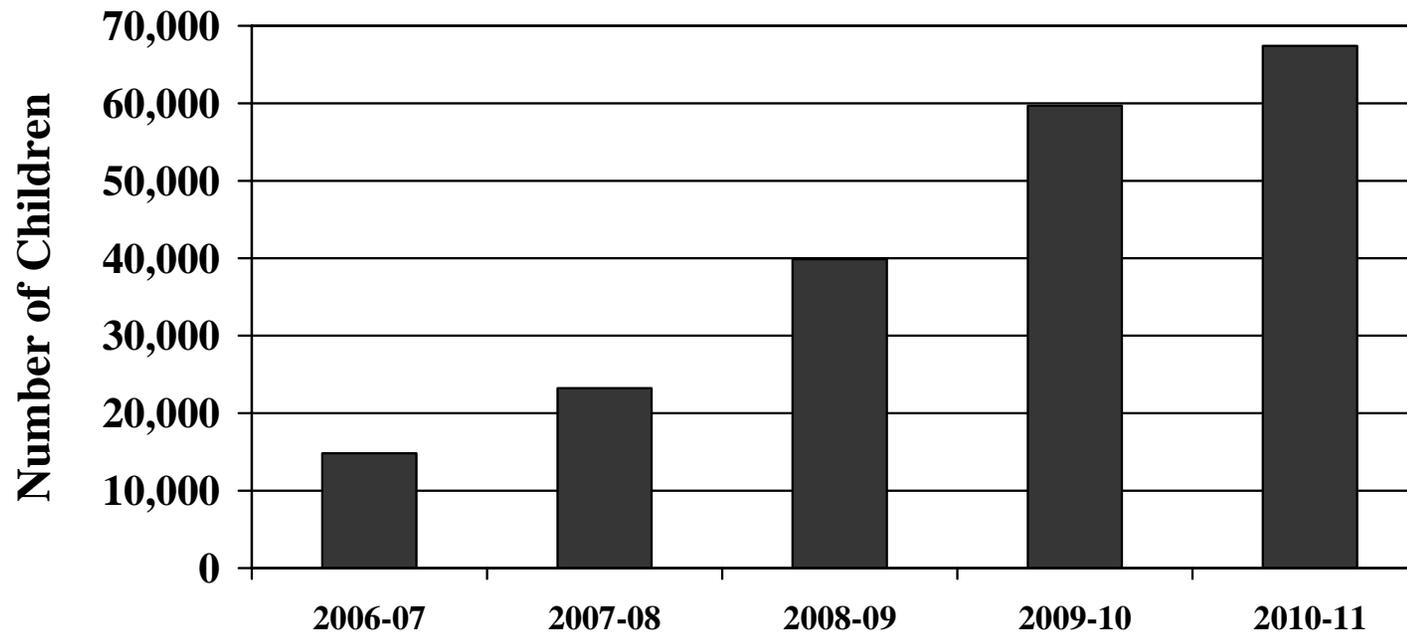
Cover All Kids will:

- **Provide comprehensive health care coverage, including visits to doctors, hospitalization, prescription drugs, mental health and substance abuse services, vision, dental and home health care.**
- **Subsidize coverage for children in families whose annual income does not exceed 300 percent of the federal poverty level (\$70,000 for a family of four). Family premiums will range, on average, between \$36 and \$57 per month per child.**
- **Offer at-cost coverage for children in families whose income exceeds 300 percent of poverty (on average, \$143 per month per child).**

Cover All Kids: Projected Program Growth

Cover All Kids will enroll nearly 15,000 uninsured children in 2006-07, growing to nearly 70,000 currently uninsured children within five years. These increases will be achieved through enhanced outreach efforts, federally approved increases in income eligibility for subsidized coverage and new opportunities for higher-income families to purchase health care coverage at cost.

Cover All Kids Additional Insured Children



TANF Work Participation Trends Adults Receiving Cash Assistance

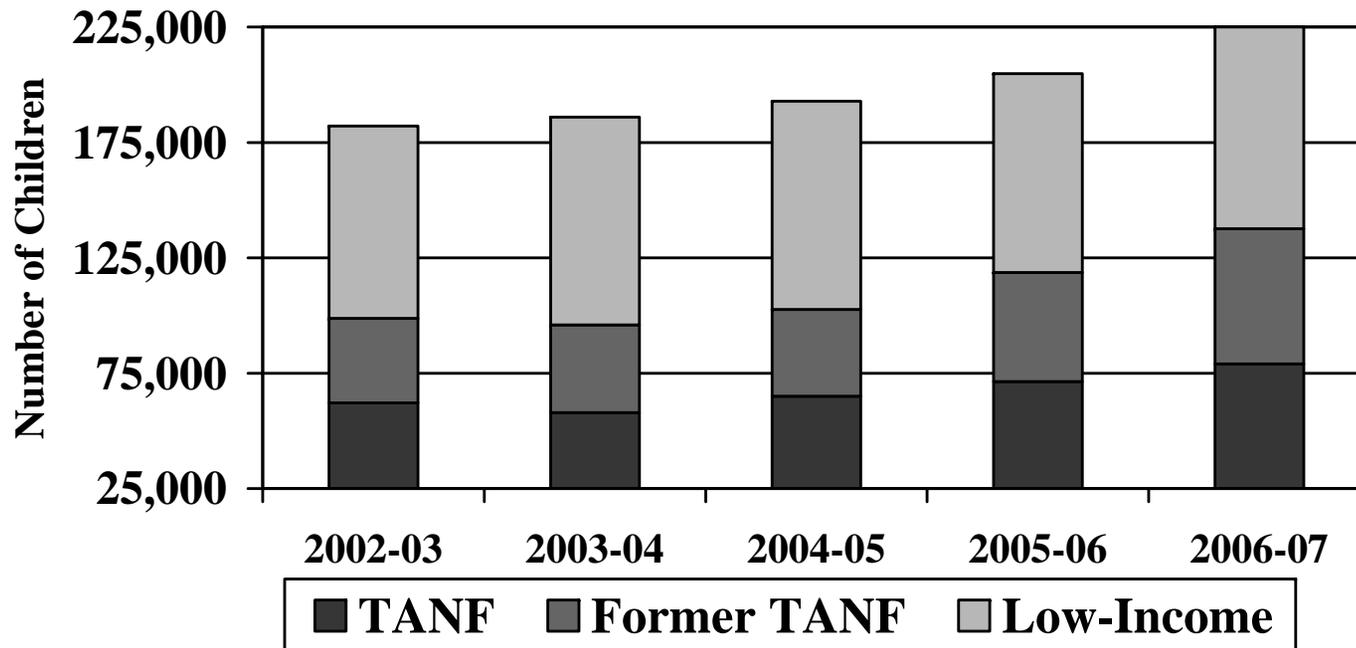
Pennsylvania provides cash assistance, job training and child care for low-income adults transitioning from welfare to work using federal funds provided under the Temporary Assistance for Needy Families (TANF) program. The federal Deficit Reduction Act of 2005 requires states to meet a 50 percent work participation rate for TANF recipients in federal fiscal year 2007. Failure to meet the requirement could result in up to a five percent, or \$36 million, penalty to the TANF grant and deeper cuts in subsequent years. Pennsylvania has increased its overall participation rate to 47 percent and is well on the way to meeting the federal standard. The 2006-07 budget includes \$38 million for additional child care and support services to assist clients in meeting the work requirements. Work participation activities include subsidized and unsubsidized employment, work experience programs, on-the-job training, job search, community service and vocational education.

2006	Families Required to Participate	Families Fully Participating	Federal Work Participation Rate
January	64,733	9,900	15%
April	61,809	13,157	21%
July	39,206	12,552	32%
October	35,073	16,576	47%

Subsidized Child Care Services

Improving the quality and availability of early childhood programs has been a priority for the Rendell administration, and affordable child care is an essential component of the commonwealth's efforts to move families from welfare to work. Since 2002-03, the number of children participating in subsidized child care has grown from 182,000 to 225,000 – an increase of 24 percent. In addition, the 2006-07 budget unifies the commonwealth's child care programs so that families have “one door” for all subsidized child care in their local communities.

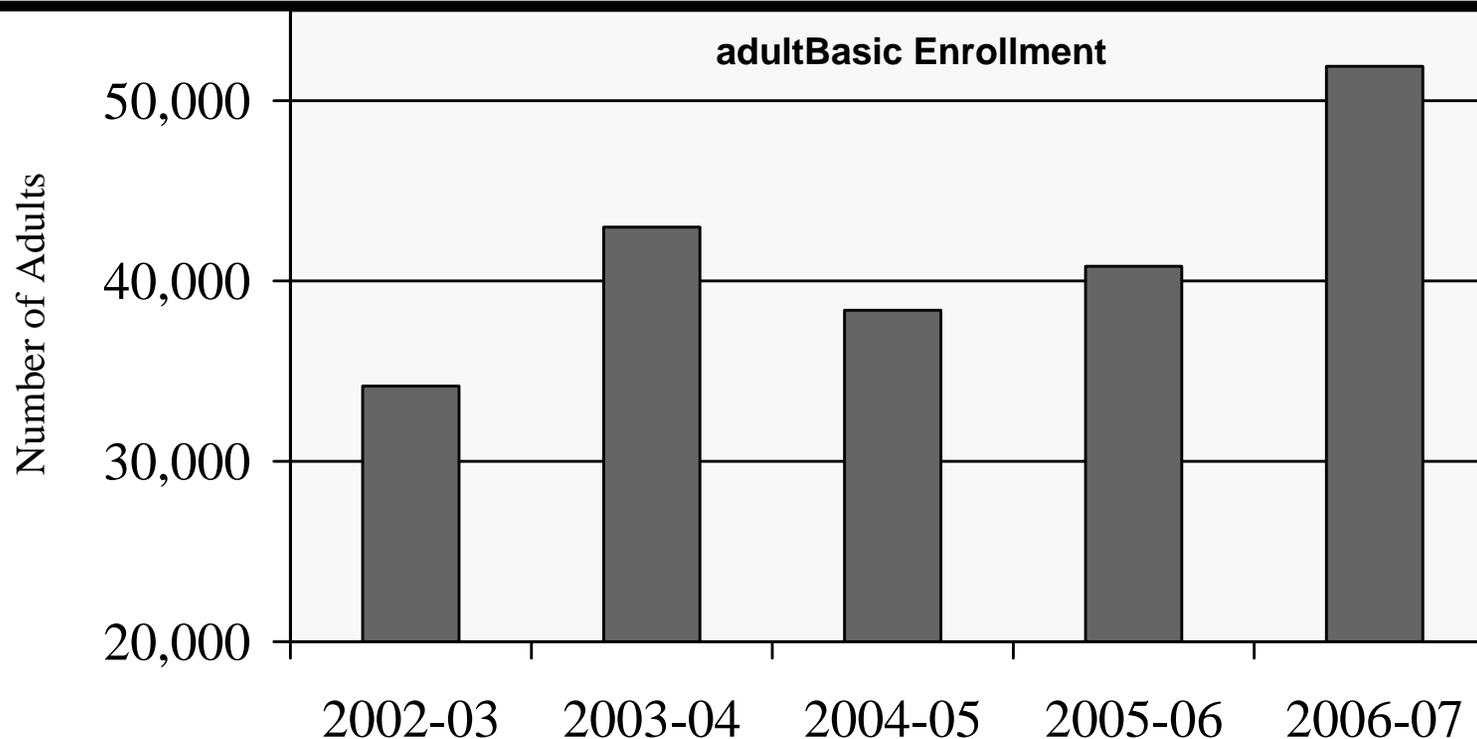
Pennsylvania Children in Subsidized Child Care



TANF = Temporary Assistance for Needy Families

adultBasic Program

The 2006-07 budget includes \$5.5 million in additional funding for the adultBasic program, which provides basic health care insurance for low-income working adults. This additional funding will provide health insurance to more than 11,000 additional low-income working adults. Since the beginning of the Rendell administration, enrollment has grown from 34,171 adults to 51,901 adults – a 52 percent increase. Some of this increase is attributable to an agreement with Pennsylvania’s four Blue Cross/Blue Shield plans for an annual commitment of funds, totaling an estimated \$1 billion over six years. This additional funding will provide affordable basic health care coverage for thousands of low-income and uninsured Pennsylvanians.



Caring for All Pennsylvanians

The 2006-07 enacted budget includes \$89 million to increase services for children, adults and families in need. In addition, the budget expands the Behavioral Health HealthChoices program to provide managed mental health and substance abuse services to more than 72,300 additional Medical Assistance recipients in 2006-07.

Children's Services

- \$22 million to provide **early intervention services** for 5,537 additional children from birth through age five – a total state investment of \$242.8 million.
- \$28.3 million to provide **child care services** to 15,000 additional children in **TANF and former TANF families who are moving from welfare to work** – a total state investment of \$157 million.
- \$5.5 million to provide **subsidized child care services** to 1,861 additional children in **low-income, working families** – a total state investment of \$107.7 million.
- \$3 million to **expand quality early learning experiences** to 21,000 additional children through the Keystone STARS Program – a total investment of \$35.7 million.
- \$6.3 million to allow **more children to be adopted** and to continue to provide financial assistance to those who have already been adopted – a total state investment of \$55.2 million.

Caring for All Pennsylvanians

Health Care Services

- \$5.5 million to provide **subsidized health care insurance** for 11,092 additional **uninsured working adults** – a total investment of \$166 million.
- \$1.7 million to provide **breast and cervical cancer screening** for 4,209 additional low-income, high-risk women ages 40 to 49.

Home and Community-Based Services

- \$16.8 million to provide **home and community-based services** to 806 additional **people with mental retardation** and to address new federal requirements – a total state investment of \$789.6 million.

2006-07 Budget Overview

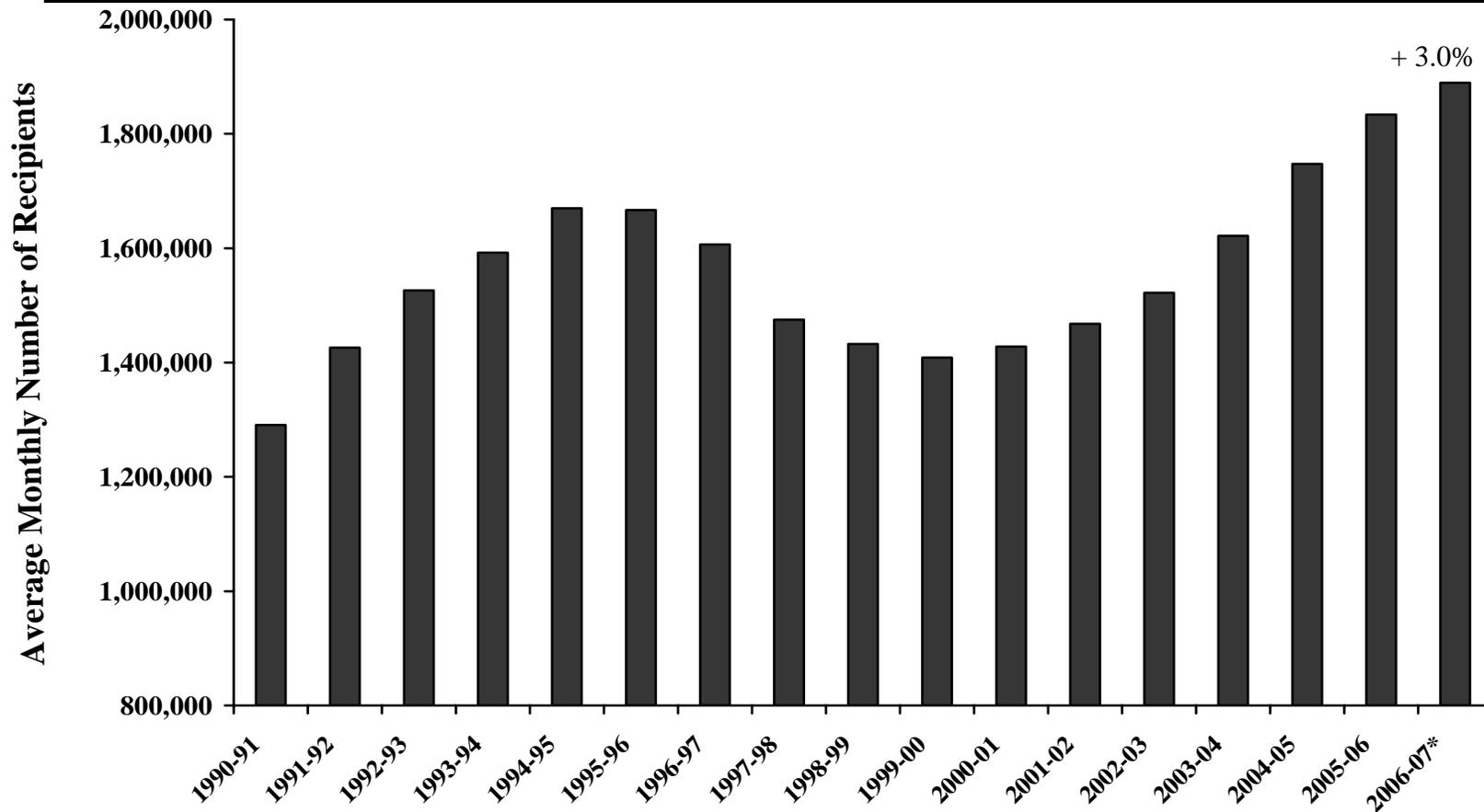
Medical Assistance

Medical Assistance in Pennsylvania

- Provides medical care for low-income individuals
 - Children, pregnant women, the elderly and people with disabilities
 - Currently serves 1.9 million people
- Comprehensive benefits package
 - inpatient and outpatient services
 - long-term care
 - prescription drugs
 - limited cost sharing
- Provider network includes 68,000 providers
- Total annual expenditures exceed \$14 billion
- State-administered but jointly funded with federal, state and county funds
- State funding from the General Fund, Lottery Fund and Tobacco Settlement Fund

MA in PA - Serving More People in Need

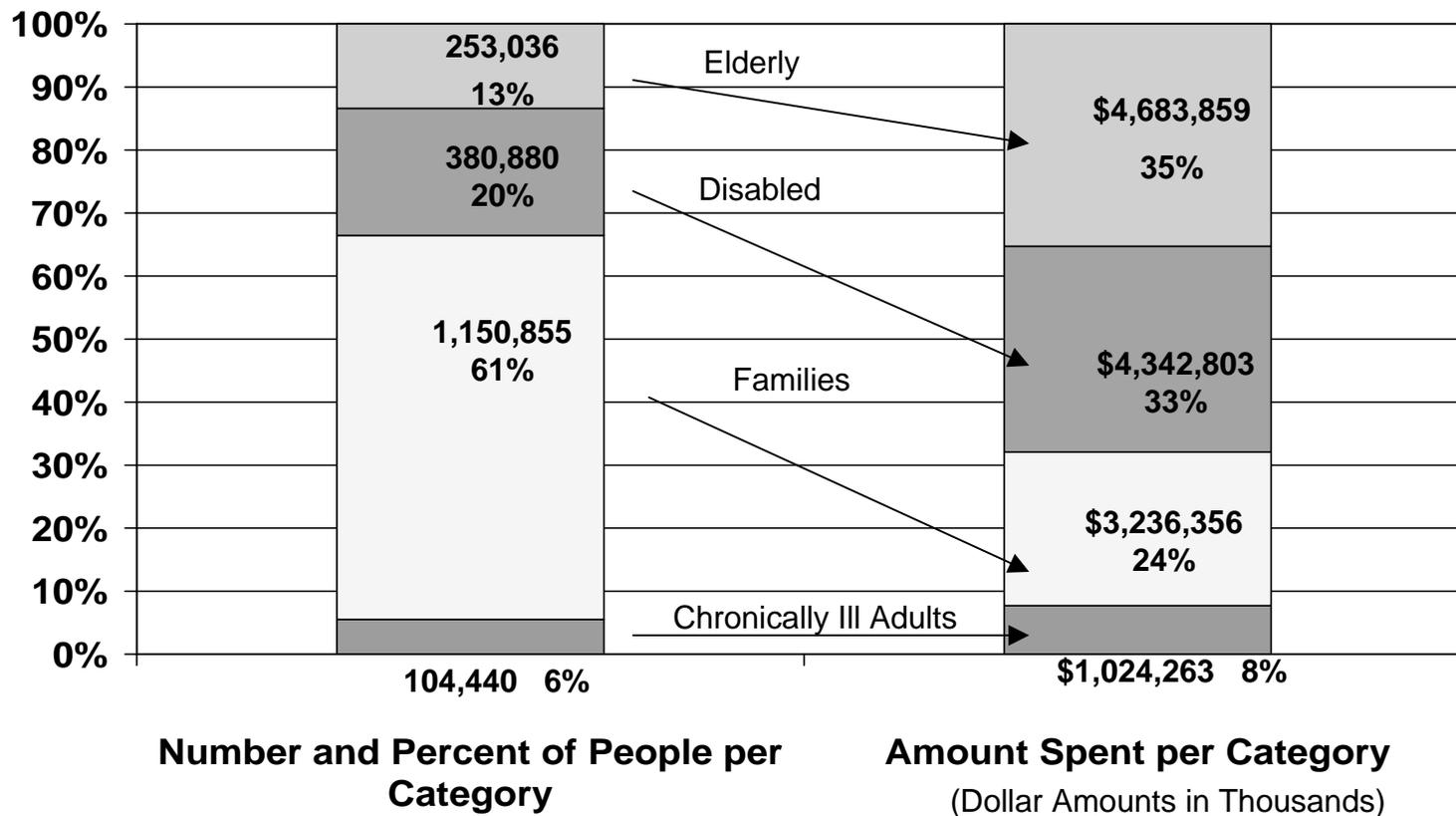
Advances in health care have made it possible for more people to live longer with chronic diseases and conditions. Many of these people need but cannot afford services to assist them in their daily lives. The commonwealth provides these supports as well as other health care services through the Department of Public Welfare's Medical Assistance (MA) program.



*Projected

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

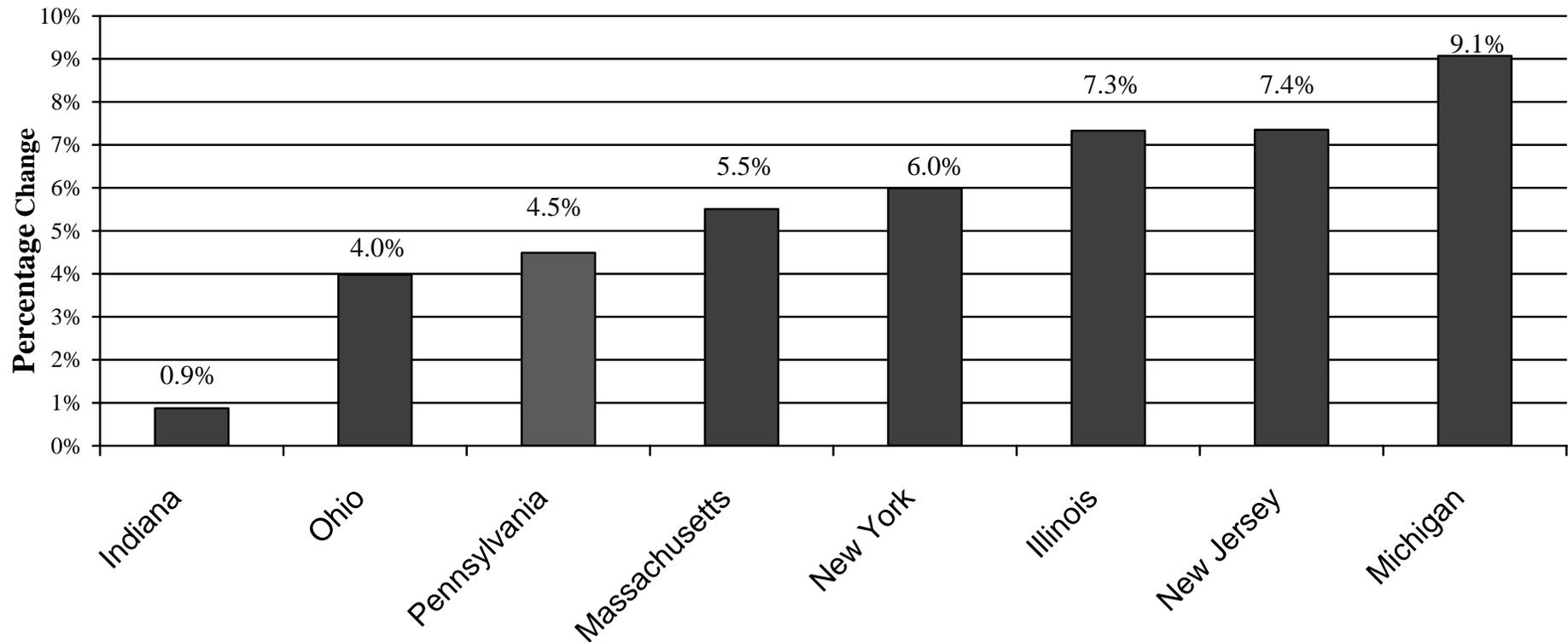
**Medical Assistance Recipients by Category and Cost
2006-07**



Medicaid Enrollment Trends

Pennsylvania versus Other Large Industrial States (2004 to 2005)

From 2004 to 2005, most of the large industrial states experienced higher rates of growth in Medicaid enrollments than Pennsylvania, with Michigan seeing an increase of more than 9 percent. Pennsylvania's increase was 4.5 percent compared with growth in Massachusetts, New York, Illinois and New Jersey.

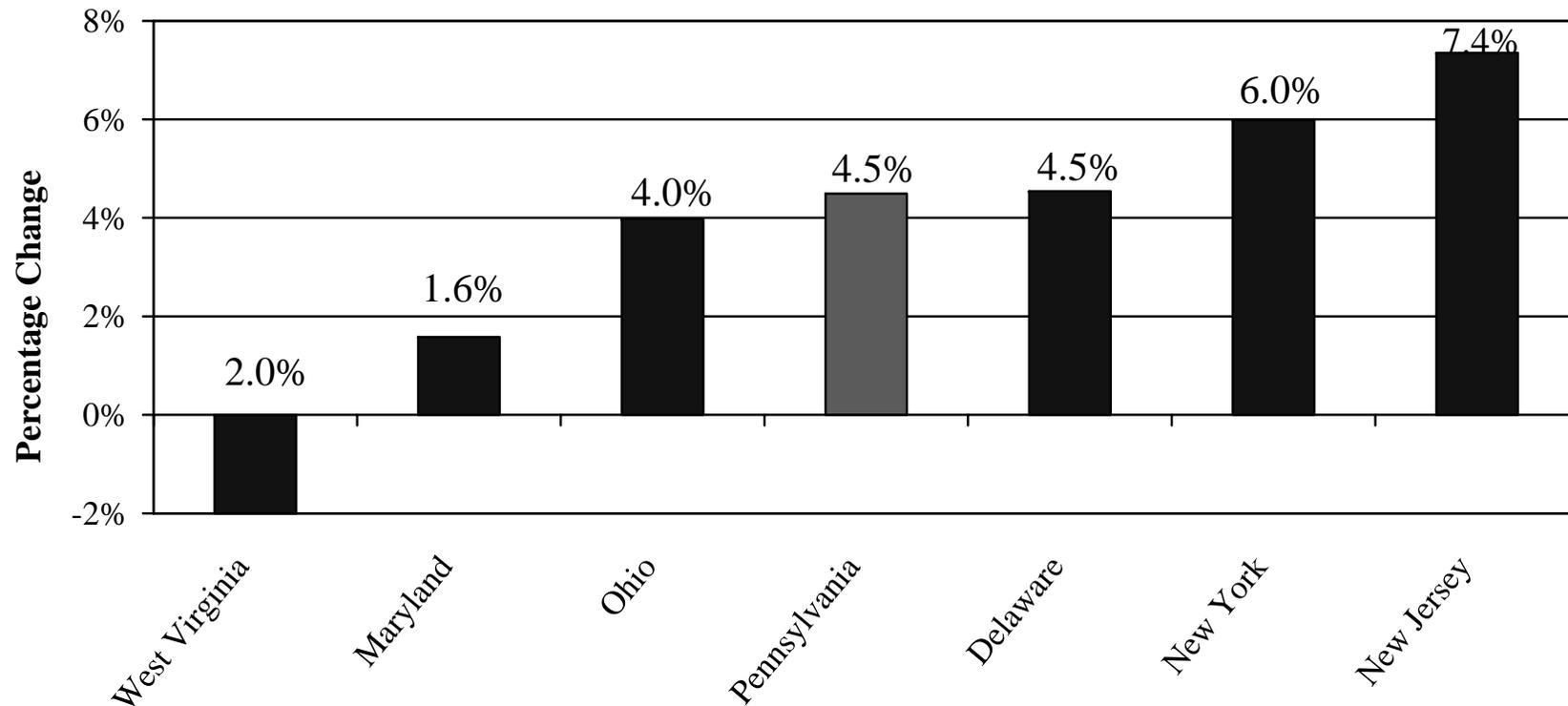


Source: Centers for Medicare and Medicaid Services, Medicaid and Managed Care Enrollment Tables.

Medicaid Enrollment Trends

Pennsylvania versus Surrounding States (2004 to 2005)

From 2004 to 2005, Pennsylvania's Medicaid enrollment growth was in the middle of the pack compared to neighboring states. Three neighboring states had higher growth rates, and three states had lower growth rates than the commonwealth.



Source: Centers for Medicare and Medicaid Services, Medicaid and Managed Care Enrollment Tables.

MA Redesign and Cost Containment Initiatives

Building upon the reforms to the commonwealth's safety net initiated in last year's budget, the 2006-07 budget includes additional measures to increase the efficiency and integrity of the Medical Assistance program. Combined, these initiatives are estimated to result in savings of \$379 million in 2006-07, freeing up these funds to continue programs that serve Pennsylvanians in need.

Dollars in millions

Selected Initiatives	2005-06		2006-07	
	Original	Actual	Original	Revised
Reduce administrative cost and enhance efficiency	\$ 88.8	\$ 111.2	\$ 92.7	\$ 111.2
Increase third-party liability collections and decrease fraud and abuse	\$ 20.5	\$ 36.4	\$ 31.8	\$ 31.5
Implement preferred drug list/other pharmaceutical efficiencies	\$ 82.1	\$ 82.1	\$ 94.1	\$ 82.1
Redesign fee-for-service benefit package	\$ 24.2	\$ 24.2	\$ 26.9	\$ 24.2

MA Redesign and Cost Containment Initiatives (cont'd)

Dollars in millions

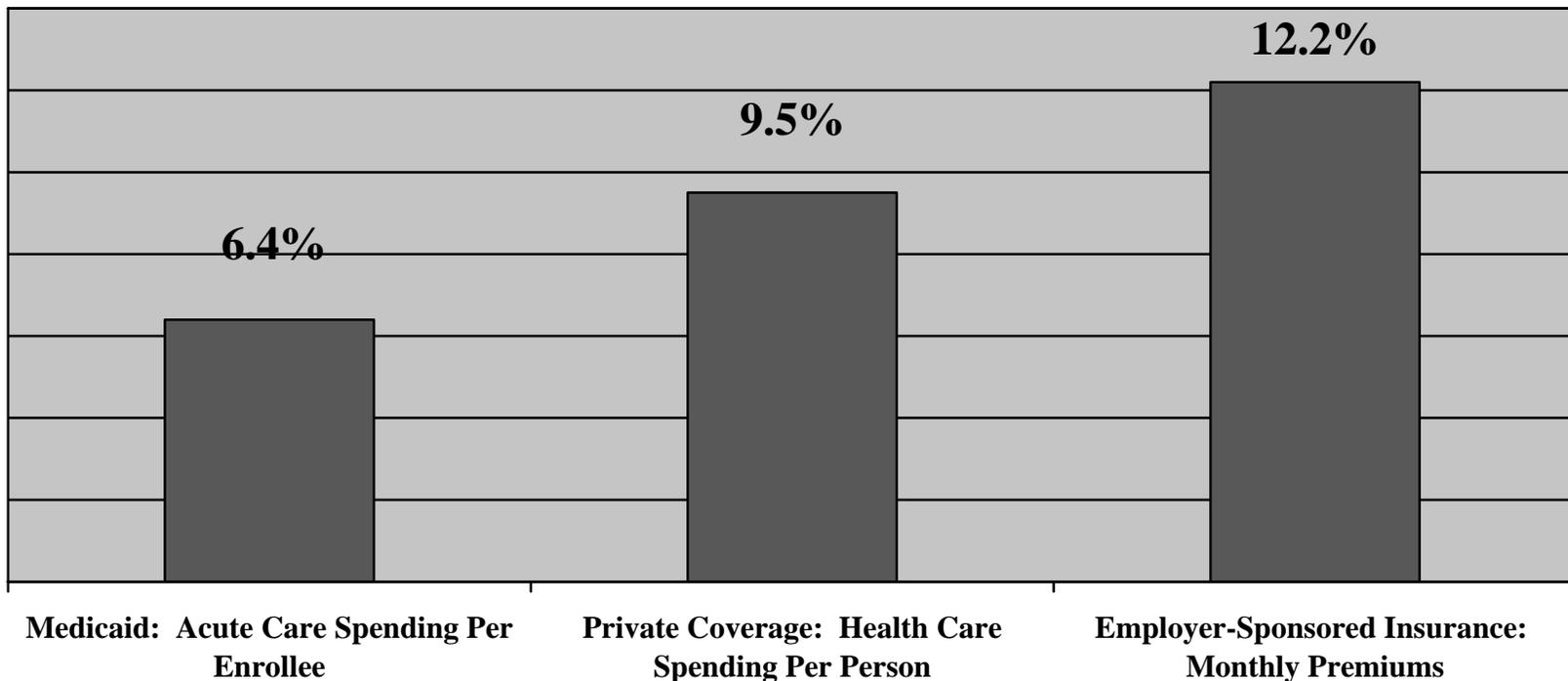
Selected Initiatives	2005-06		2006-07	
	Original	Actual	Original	Revised
Implement other initiatives (academic medical centers, unpaid medical expense deduction and MATP efficiencies)	\$51.5	\$ 50.6	\$ 63.4	\$50.6
Implement selective contracting	NA	NA	\$ 16.8	\$ 3.0
Improve oversight of hospital utilization	NA	NA	\$ 13.0	\$ 13.0
Seek federal payments for veterans in nursing facilities	NA	NA	\$ 5.1	\$ 0
Expand federal reimbursements for county long-term care costs	NA	NA	\$ 10.0	\$ 10.0

Managing Medicaid is a National Problem

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

States Are Managing MA Costs But Growth is Still High

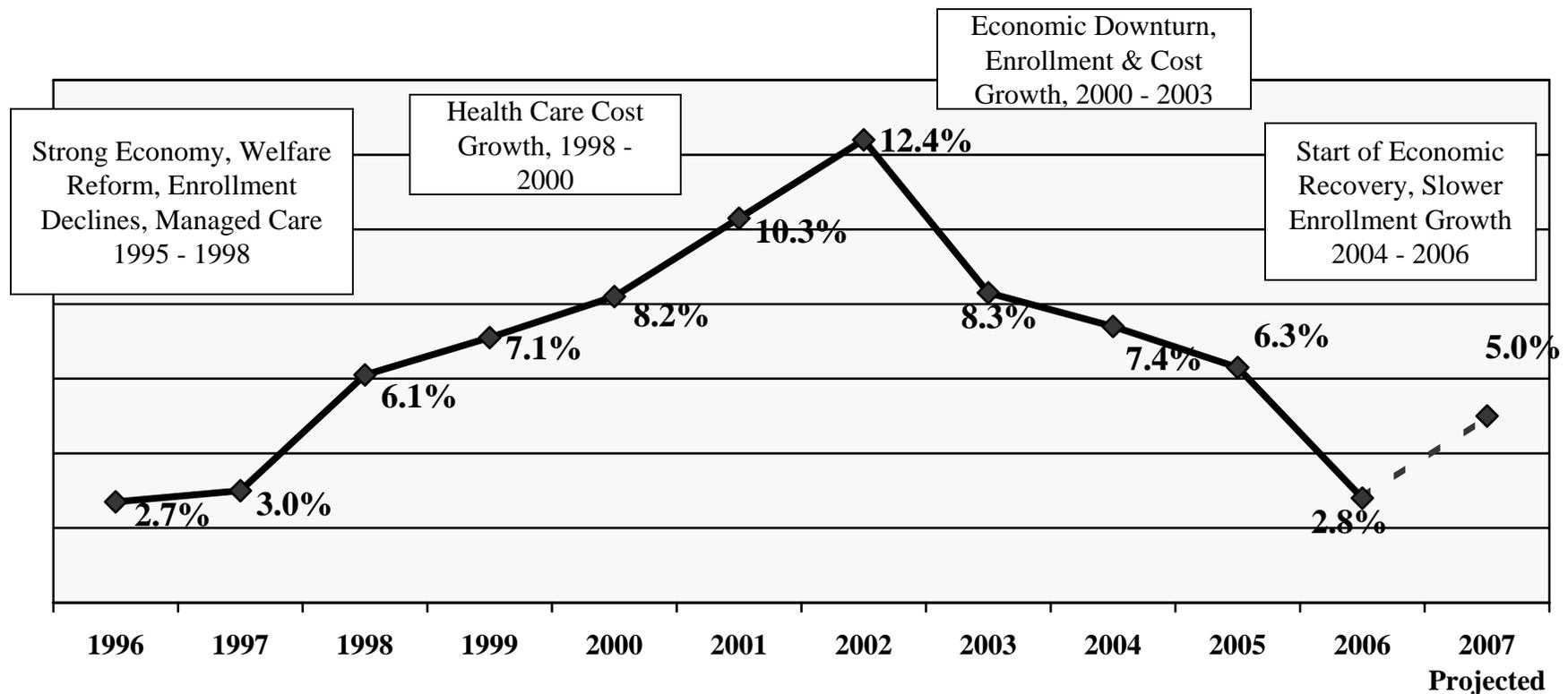
Per Capita Medicaid Spending Growth in the U.S. Compares Favorably to Growth in Private Health Care Spending 2000 - 2004



SOURCE: Kaiser Commission on Medicaid and the Uninsured. "Results from a 50-State Medicaid Budget Survey, State Fiscal Years 2006 and 2007" October 2006.

National Medicaid Spending Growth

MA Spending Growth is Down from 2002 Peak but Costs are Still Rising
1996 – 2007

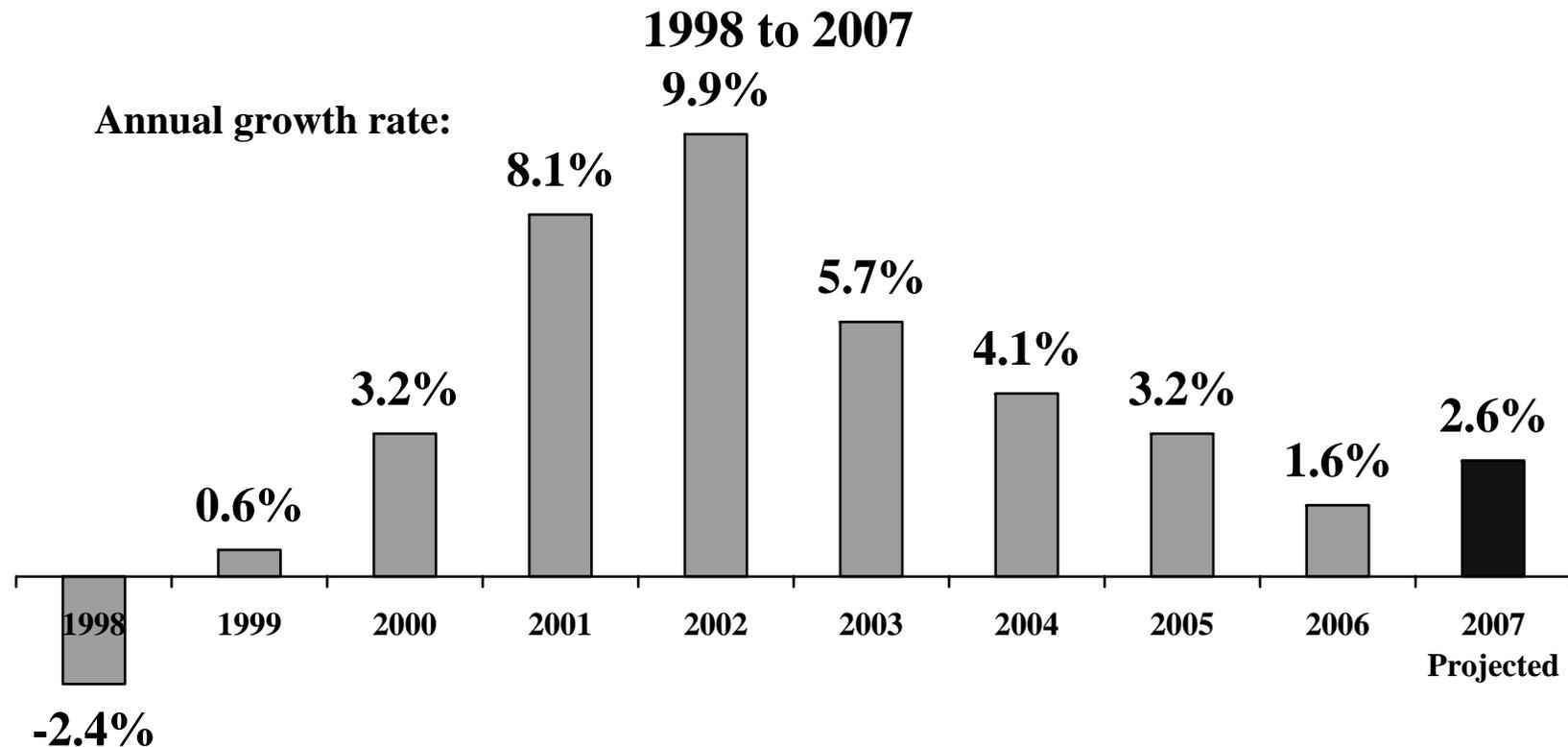


Note: Estimates in State Fiscal Year. Preliminary estimate for 2007.

SOURCE: Kaiser Commission on Medicaid and the Uninsured. “Results from a 50-State Medicaid Budget Survey, State Fiscal Years 2006 and 2007” October 2006.

Percent Change in U.S. Medicaid Enrollment

Enrollment Growth Down from 2002 Peak But Rolls Are Still Growing



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

SOURCE: Kaiser Commission on Medicaid and the Uninsured. "Results from a 50-State Medicaid Budget Survey, State Fiscal Years 2006 and 2007" October 2006.

2006-07 Budget Overview

**PACE Plus Medicare
Comprehensive Prescription Drug
Coverage for Older Pennsylvanians**

PACE Plus Medicare Prescription Drug Program

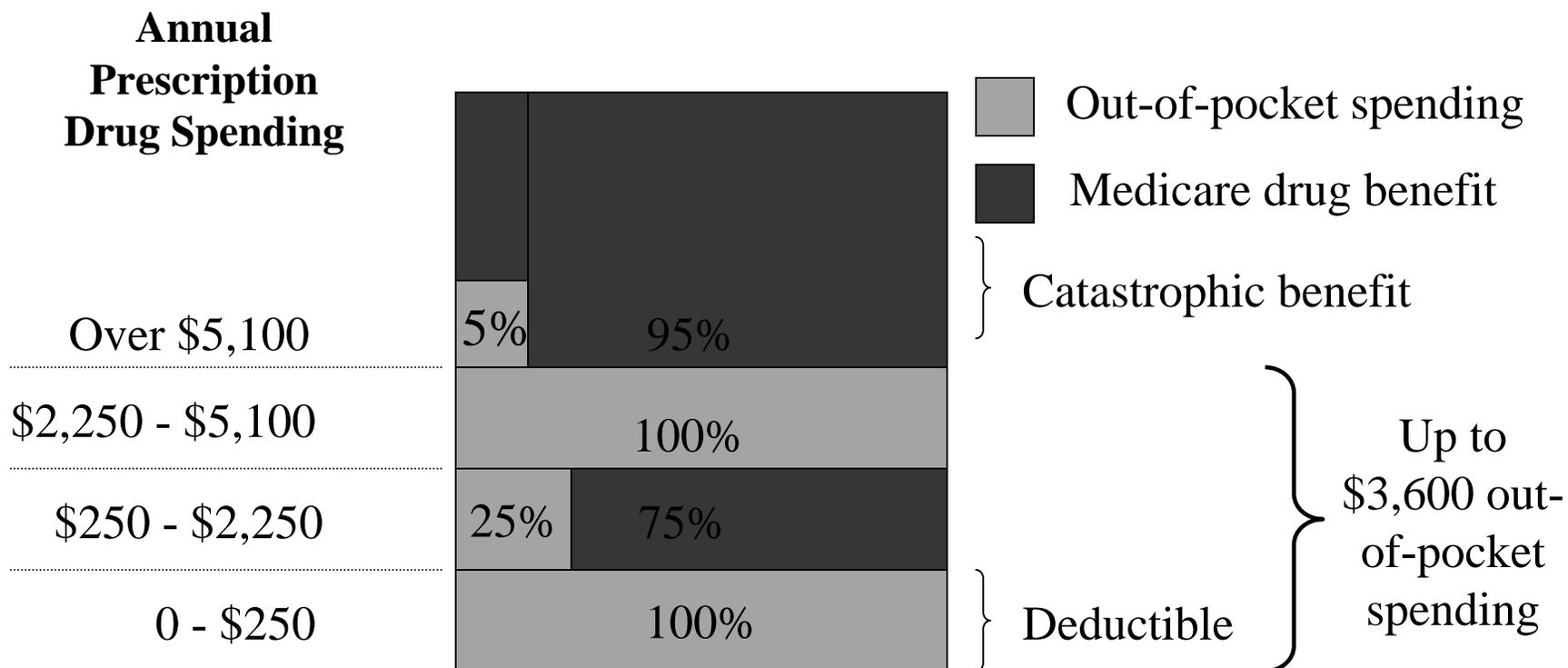
Integrating PACE/PACENET Benefits with Medicare Part D

The new PACE Plus Medicare program “wraps around” the federal program and fills the gaps in coverage, including when PACE/PACENET participants reach the so-called “doughnut hole” in the Medicare Part D coverage.

- ✓ In July 2006, the Pennsylvania General Assembly passed and Governor Rendell signed legislation establishing PACE Plus, which enhances the commonwealth’s PACE and PACENET programs to provide seamless pharmaceutical coverage with the new Medicare Part D prescription benefit.
- ✓ To assist in coordinating benefits, PACE/PACENET acts as the authorized representative for its cardholders to assess eligibility and apply for low-income subsidies, to select and enroll in Part D plans that best match cardholders’ prescription and pharmacy profiles, and to undertake appeals from Part D plans’ denials of coverage or determination of non-preferred status for particular drugs.
- ✓ PACE Plus Medicare began automatic enrollment on September 1, 2006, for PACE/PACENET cardholders in Medicare Part D plans with 233,000 enrolled in Part D plans. It is anticipated that as of January 1, 2007, more than 85 percent (268,000) of the PACE/PACENET recipients will be enrolled in a Part D plan.
- ✓ In 2007, seniors will have the option of selecting from 11 plans offered by nine companies.

Medicare Part D Prescription Drug Program

How the Standard Medicare Part D Program Works for Households with Incomes Greater Than 150% of Poverty



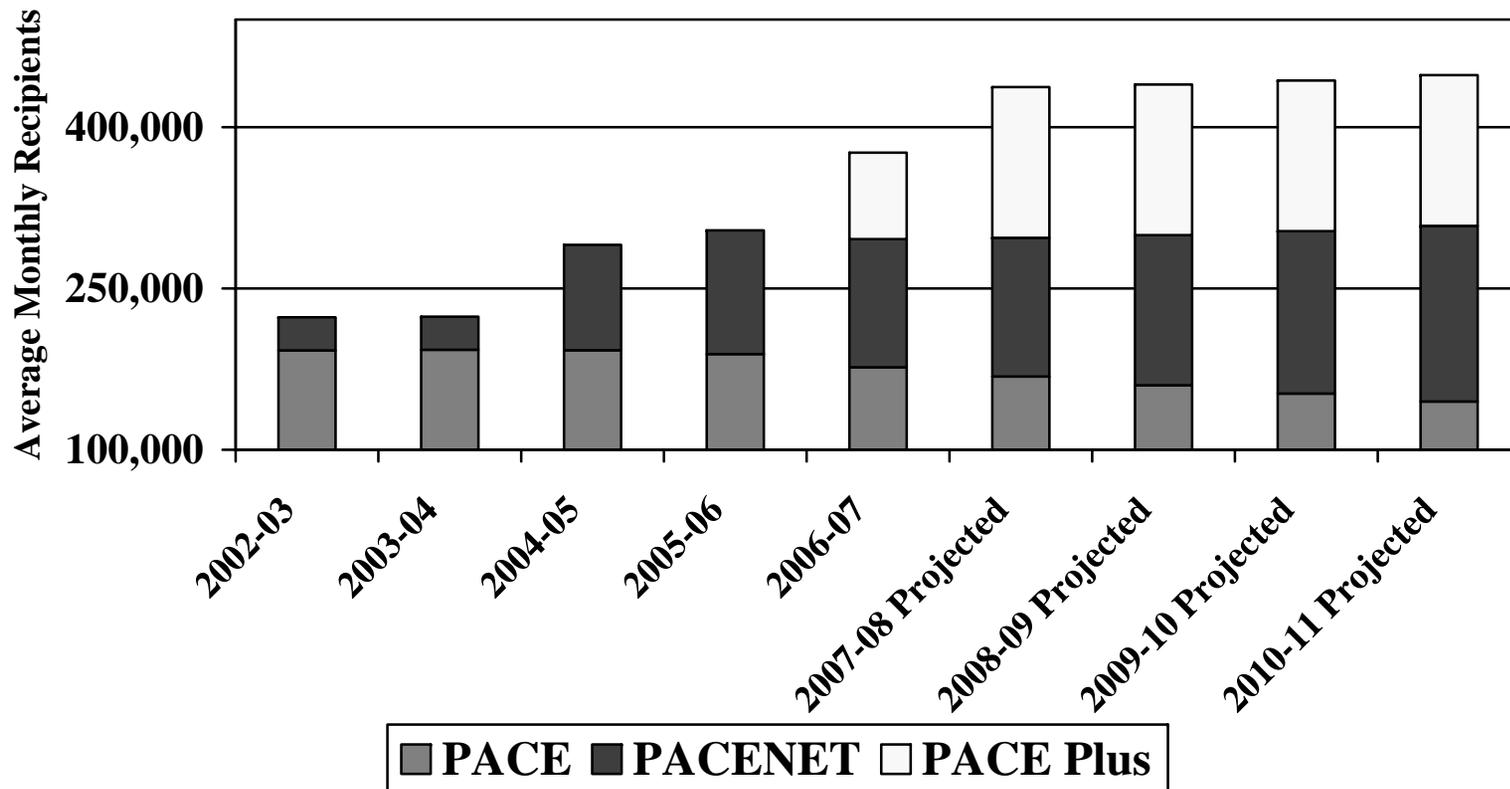
Medicare Part D plans may offer alternative options as long as they are actuarially equivalent.

PACE Plus Wraps Seamlessly Around the Medicare Part D Benefit

Costs	PACE	PACENET
	<i>The state:</i>	<i>The state:</i>
Premiums	Pays the cost of the monthly premium.	Eliminates the \$40 per month PACENET deductible. Consumers will pay the premium of the Medicare Part D plan in which they are enrolled.
Deductibles	Pays for deductibles except program co-pays.	Pays for deductibles except program co-pays.
Drug Coverage	Pays for drugs excluded under federal law and those not covered under a plan's formulary.	Pays for drugs excluded under federal law and those not covered under a plan's formulary.
Co-payments	Pays co-pay and co-insurance differentials in excess of the PACE co-pays (\$6 for generics and \$9 for brands).	Pays co-pay and co-insurance differentials in excess of the PACENET co-pays (\$8 for generics and \$15 for brands).
Gap Coverage	Covers the gap.	Covers the gap.
Catastrophic Coverage	Pays for drugs excluded under federal law and those not covered under a plan's formulary when the drug costs exceed \$5,100.	Pays for drugs excluded under federal law and those not covered under a plan's formulary when the drug costs exceed \$5,100.

Pharmaceutical Assistance Program Enrollment

The 2006-07 budget provides funding to extend PACE/PACENET coverage by June 2007 to an additional 120,000 seniors who are currently eligible for, but not enrolled in, PACE/PACENET, assisting them with coverage gaps in the federal Medicare prescription drug program. PACE Plus provides seamless pharmaceutical benefits in coordination with the federal Medicare prescription drug program.



2006-07 Budget Overview

Long-Term Living

Providing Consumers With Long-Term Living Choices

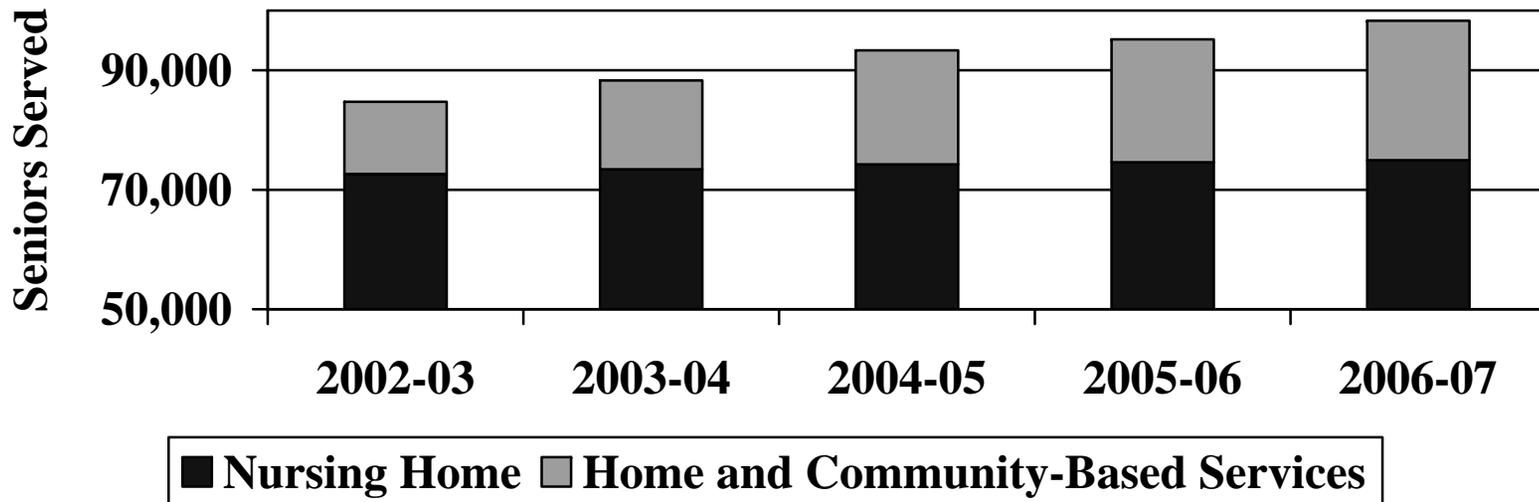
In the fall of 2005, Governor Rendell established the Long-Term Living Council to develop plans for the future of Medical Assistance long-term living services in the commonwealth, building upon the administration's successes to date in reforming and rebalancing the state's long-term care system. The Long-Term Living Council has developed several initiatives to improve state long-term living services in Pennsylvania. Those initiatives are included in the enacted 2006-07 budget.

- Continue the administration's expansion of home and community-based services (HCBS) – resources are budgeted in 2006-07 to serve more than 33,000 elderly and disabled consumers in a HCBS setting, a 93 percent increase since 2002-03.
- Increase efforts to educate nursing home residents about HCBS and assist individuals who wish to return to their homes and communities.
- Expand expedited application processes for home and community-based services for the most at-risk consumers.
- Encourage nursing homes to “right-size” and reconfigure their businesses to respond to increased consumer demand for home and community-based services.
- Initiate a study of long-term living supply and demand over the next 20 years to prepare the commonwealth for the demographic and market challenges that lie ahead with the aging of the baby boomers.

Expanding Long-Term Living Choices for Seniors

The number of seniors using home and community-based services has increased 70 percent since 2002-03. An additional 14 percent increase is projected in 2006-07. Long-term living services in Pennsylvania are beginning to resemble the service mix in other states where seniors have a range of appropriate options for meeting their long-term care needs.

Growth in Nursing Facility and Home and Community-Based Services for Seniors in Pennsylvania



2006-07 Budget Overview

**Promoting Economic
Growth, Job Creation
and Business
Competitiveness**

Pennsylvania's Economic Competitiveness

Pennsylvania has improved its competitive position among the states since 2002-03 due in large part to the Economic Stimulus Program, the "Job Ready PA" workforce development program, targeted business tax cuts, Growing Greener and enhanced investments in education at every level.

- ✓ Pennsylvania has the world's 17th largest economy.
- ✓ Pennsylvania's Gross State Product exceeds \$487 billion, ahead of Saudi Arabia, Sweden and Switzerland and greater than South Africa, New Zealand, Malaysia and Ecuador combined.
- ✓ Since 2002, Pennsylvania's growth in exports has outpaced the national trend and the trend in key competitor states, including Illinois, New York, Indiana, Ohio, New Jersey and Michigan.
- ✓ In 2002, Pennsylvania exports ranked 37th. In 2005, Pennsylvania exports ranked 9th.
- ✓ Since 2002, state-assisted trade sales have increased 156% in Pennsylvania, stronger than the national trend and key competitor states.
- ✓ Pennsylvania remains the most successful state at attracting manufacturing projects (10% of all North American projects in 2005). The March 2006 issue of Site Selection magazine ranked Pennsylvania among the top 10 states in the nation with respect to new and expanded corporate facilities, outperforming all other states in the Northeast.

Update on the Economic Stimulus Program

(dollar amounts in thousands)

Program	Projects Funded	Funds Committed	Program	Projects Funded	Funds Committed
Infrastructure Projects:			Community Revitalization:		
Business in Our Sites	107	\$300,000	Homeownership Choice	52	\$62,300
PennWorks	53	\$172,500	Hometown Streets	271	\$176,100
Tax Increment Financing	2	\$10,000	Business and Other Private-Sector Investments:		
Infrastructure Facilities Improvement Program	9	\$5,900	First Industries Fund (Agriculture/Tourism)	297	\$66,400
Redevelopment Assistance Capital Program	350	\$1,053,000	Second Stage Loan Program	5	\$2,500
Community Revitalization:			Venture Capital Investment Fund	14	\$46,600
Main Street Downtown Business Renewal	235	\$23,100	Building PA	9	\$47,000
Elm Street Downtown Residential Renewal	111	\$20,600	KIZ	21	\$7,200
Enterprise Zones	114	\$19,100	Core Industries	17	\$20,100
Housing and Redevelopment Assistance	318	\$95,100	Base Realignment and Closures	Multiple Sites	\$6,000
			TOTAL	1,985	\$2,133,500

Pennsylvania's Economic Stimulus Program is Creating Jobs

Program	Jobs Pledged
Infrastructure Projects:	
Business in Our Sites	116,524
PennWorks	86,945
Tax Increment Financing	1,500
Infrastructure Facilities Improvement Program	4,495
Community Revitalization:	
Main Street Downtown Business Renewal	461
Elm Street Downtown Residential Renewal	25
Enterprise Zones	1,438
Housing and Redevelopment Assistance	142

Program	Jobs Pledged
Business and Other Private-Sector Investments:	
First Industries Fund (Agriculture/Tourism)	2,051
Second Stage Loan Program	34
Core Industries	2,257
Keystone Innovation Zones	2,304
TOTAL	218,176

Growing Greener II

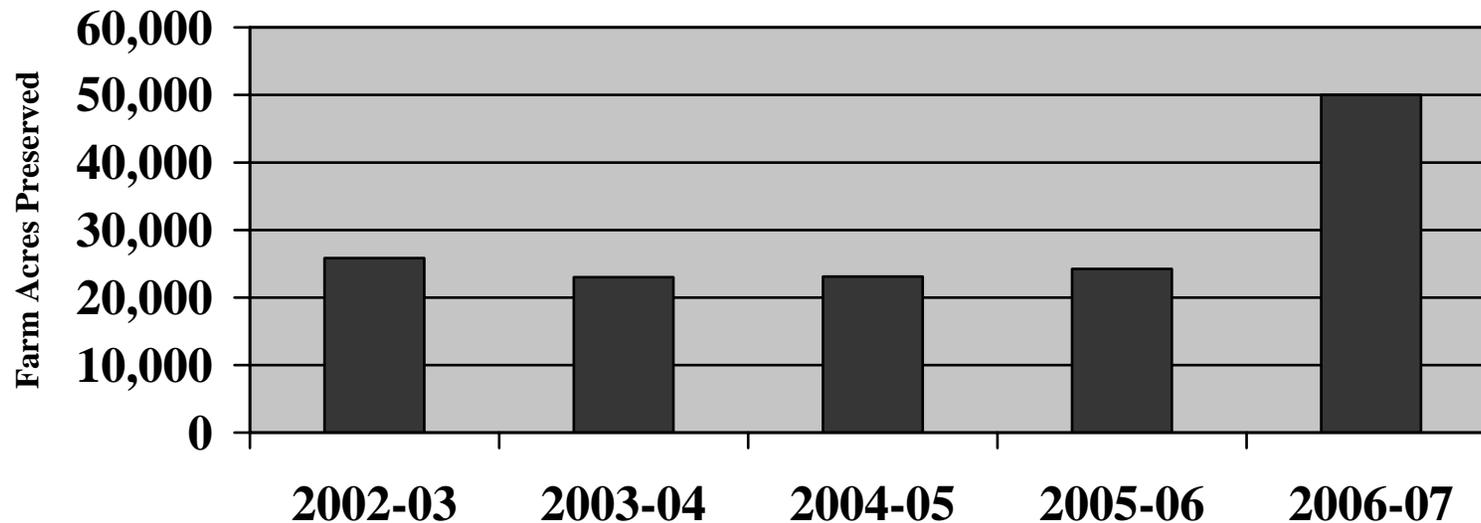
Growing Greener II represents one of the largest investments ever in improving Pennsylvania's environment. A total of \$216 million in commitments for more than 600 different projects was made in the first year of the program. By the end of 2006-07, commitments are expected to reach more than 800 different projects totaling nearly \$295 million.

- **\$230 million** (\$80 million committed to date) to the **Department of Environmental Protection** to clean up rivers and streams, take on serious environmental problems at abandoned mines and contaminated industrial sites and finance the development and deployment of advanced energy projects.
- **\$217.5 million** (\$70 million committed to date) to the **Department of Conservation and Natural Resources** to preserve open spaces, improve state parks and enhance local recreational needs.
- **\$80 million** (\$22 million committed to date) to the **Department of Agriculture** to protect working farms.
- **\$50 million** (\$11 million committed to date) to the **Department of Community and Economic Development** to revitalize communities through investments in housing and mixed-use redevelopment projects.
- **\$27.5 million** (\$25 million committed to date) to the **Pennsylvania Fish and Boat Commission** to repair fish hatcheries and aging dams.
- **\$20 million** (\$7 million committed to date) to the **Pennsylvania Game Commission** for habitat-related facility upgrades and repairs.

Growing Greener II - Showing Results for a Better Pennsylvania Environment

Growing Greener II is already proving itself, as demonstrated by the increasing number of farmland acres that will be preserved for Pennsylvania's future. Approximately 50,000 acres of farmland will be preserved in 2006-07, an increase of nearly 100 percent since 2002-03. Pennsylvania's efforts in preserving its farmland earned it the top ranking in 2005 from the National Association of State Departments of Agriculture in the number of acres of farmland preserved.

Preserving Pennsylvania's Farmland



2006-07 Budget Overview

**Public Safety
and
Security**

Pennsylvania Safety and Security – A Commonwealth Priority

The 2006-07 budget provides additional investments to continue Pennsylvania's efforts to increase the security and safety of Pennsylvania's residents and businesses.

- ✓ \$80.8 million in federal funds for **bio-terrorism preparedness**
- ✓ \$25.0 million in state gaming funds for **volunteer company grants**
- ✓ \$25.0 million in total funds for **flood disaster relief**
- ✓ \$17.6 million in state funds for **statewide radio system**
- ✓ \$12.3 million in federal funds for **pandemic influenza preparedness**
- ✓ \$8.8 million in state funds to increase **driver's license security**
- ✓ \$8.0 million in total funds for **hazard mitigation**
- ✓ \$2.1 million in state funds for four **new correctional housing units**

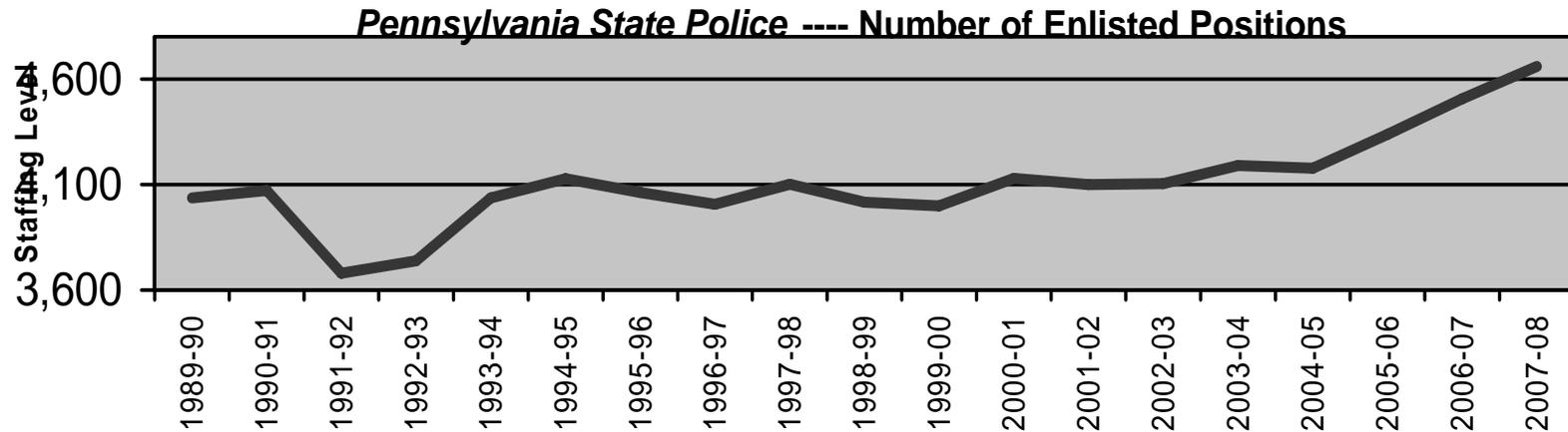
Pennsylvania is Supporting Those Who Defend Our State and Nation

The 2006-07 budget continues Governor Rendell's efforts to support the men and women of Pennsylvania's National Guard. The Pennsylvania National Guard has been called upon to join in the global war on terror and to support hurricane-ravaged areas of the Gulf Coast, providing the largest number of troops of any state outside the region.

- ✓ \$1 million for Pennsylvania **base preservation and development efforts**
- ✓ \$300,000 for the implementation of Governor Rendell's **Support Our Troops Initiative** and other veterans programs
- ✓ ***Military Family Relief Assistance Program*** to help soldiers and their families who face emergency situations
- ✓ ***National Guard Educational Assistance Program*** benefits have been extended
- ✓ **New protections for soldiers:**
 - increasing maximum voluntary life insurance coverage for eligible National Guard members to \$400,000 – the commonwealth will pay that portion of the premium not paid by the federal government
 - allowing soldiers to qualify for their parents' health insurance coverage when they return to school after deployment
 - supporting soldiers who defer motor vehicle insurance coverage during deployments
 - granting additional paid military leave to state employees who are deployed

Pennsylvania State Police

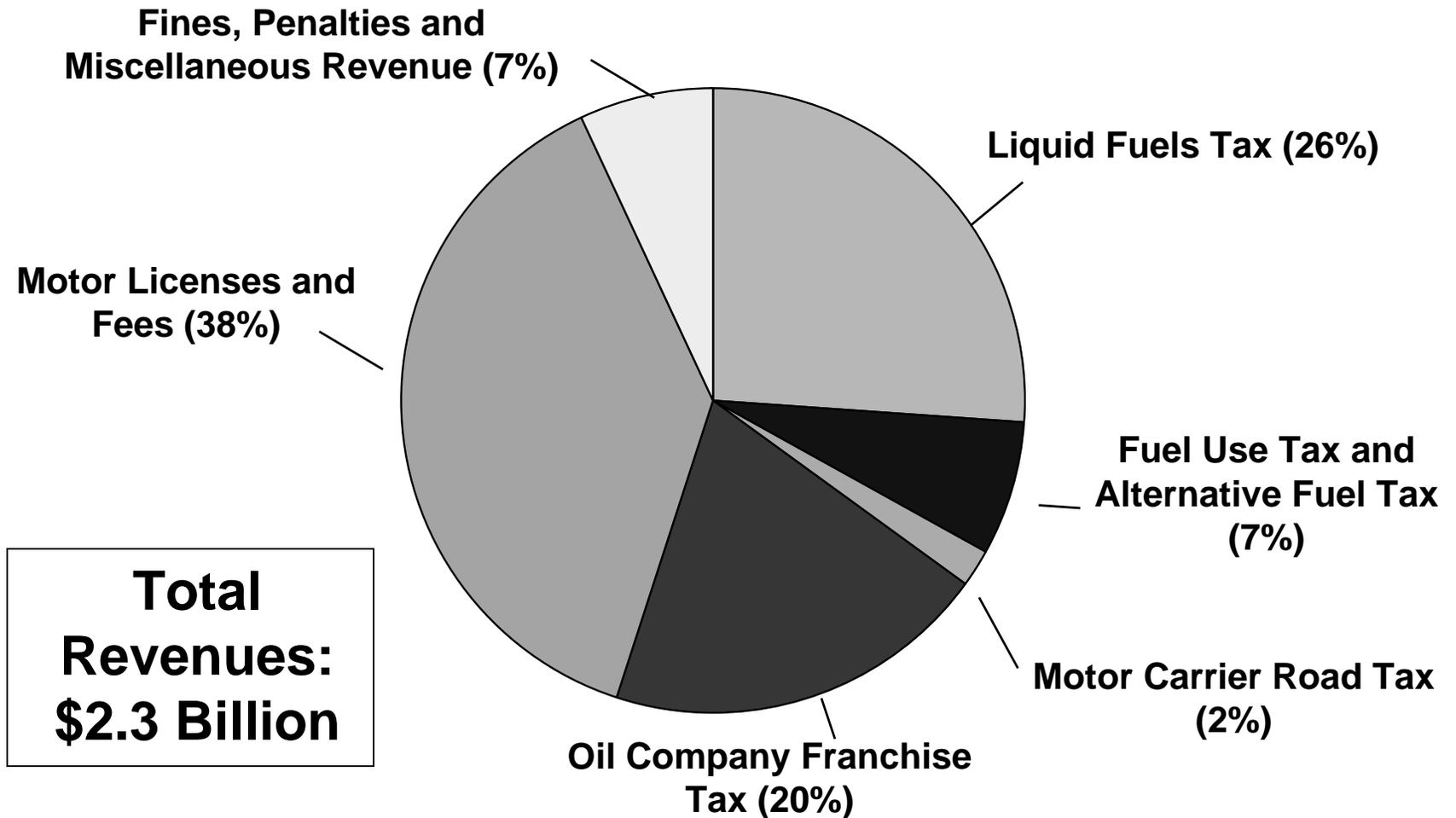
Recognizing the critical role of the State Police in ensuring public safety in the future, the 2006-07 enacted budget includes funding for 316 additional trooper positions. The enacted budget also provides funding to civilianize 60 additional enlisted personnel currently performing desk duties and to transition them back into active law enforcement duties. The Pennsylvania State Troopers Association must drop its objection to the administration's civilianization efforts before this funding can be accessed and the number of enlisted personnel devoted to law enforcement is increased even more.



2006-07 Budget Overview

Transportation

2006-07 Motor License Fund Revenue Sources



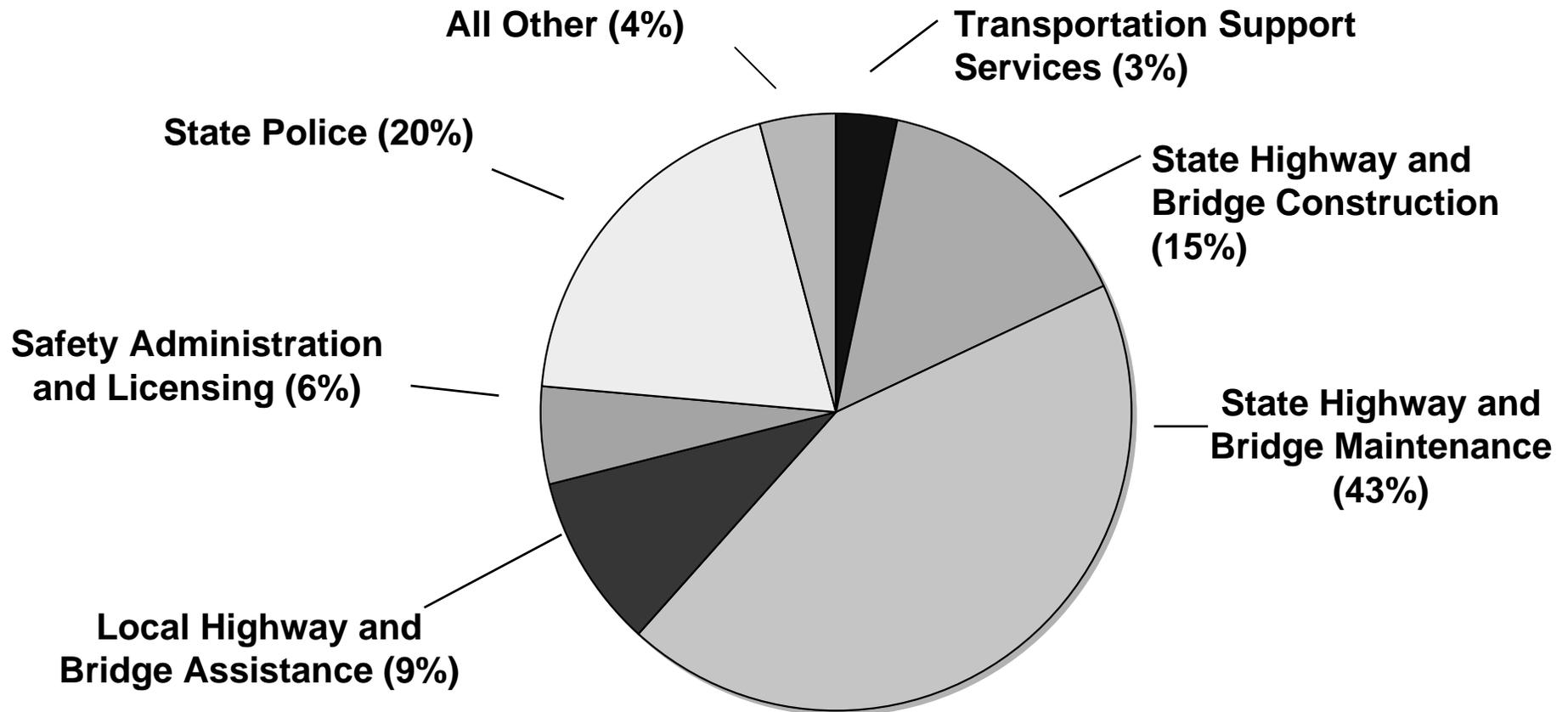
Motor License Fund Revenues

Fuel taxes and license fee revenues comprise approximately 94 percent of Motor License Fund revenues. Interest, fines and other miscellaneous revenues comprise the remaining 6 percent of fund revenues.

Major Revenue Sources	2006-07 (in thousands)
Liquid Fuels Taxes:	
Liquid Fuels Tax (\$0.12/gallon) (primarily gasoline)	\$ 598,670
Fuel Use Tax (\$0.12/gallon) (primarily diesel)	163,800
Alternative Fuel Tax	730
Motor Carriers Road Tax/International Fuel Tax Agreement (\$5 ID markers, \$0.12/gallon and OCFT element)	33,060
Oil Company Franchise Tax (\$0.195/gallon)	476,850
Total	\$1,273,110
Motor Licenses and Fees (\$36 registration, \$36 license renewal/ID)	<u>\$875,890</u>
Subtotal: Liquid Fuel Taxes and License/Fee Revenues	\$2,149,000
Total Motor License Fund	\$2,279,050

2006-07 Motor License Fund Expenditures

About 67 percent of all non-restricted Motor License Fund dollars are used to build or maintain roads and bridges in the commonwealth. The remainder is used for highway law enforcement, licensing, and safety and support activities.



Highway Funds Continue Strong Growth Trend

Even after “flexing” some additional federal transportation funds to keep the state’s 15 transit agencies operating, Pennsylvania highway spending is still growing substantially, with an anticipated \$427 million increase in total funds in 2006-07. Pennsylvania highway spending in 2006-07 is 24 percent, or \$1 billion, higher than when Governor Rendell took office. From 2002 to 2004, Pennsylvania’s highways improved by 6 percent, according to the widely used International Roughness Index.

Total Pennsylvania Highway Funding

(in millions of dollars)

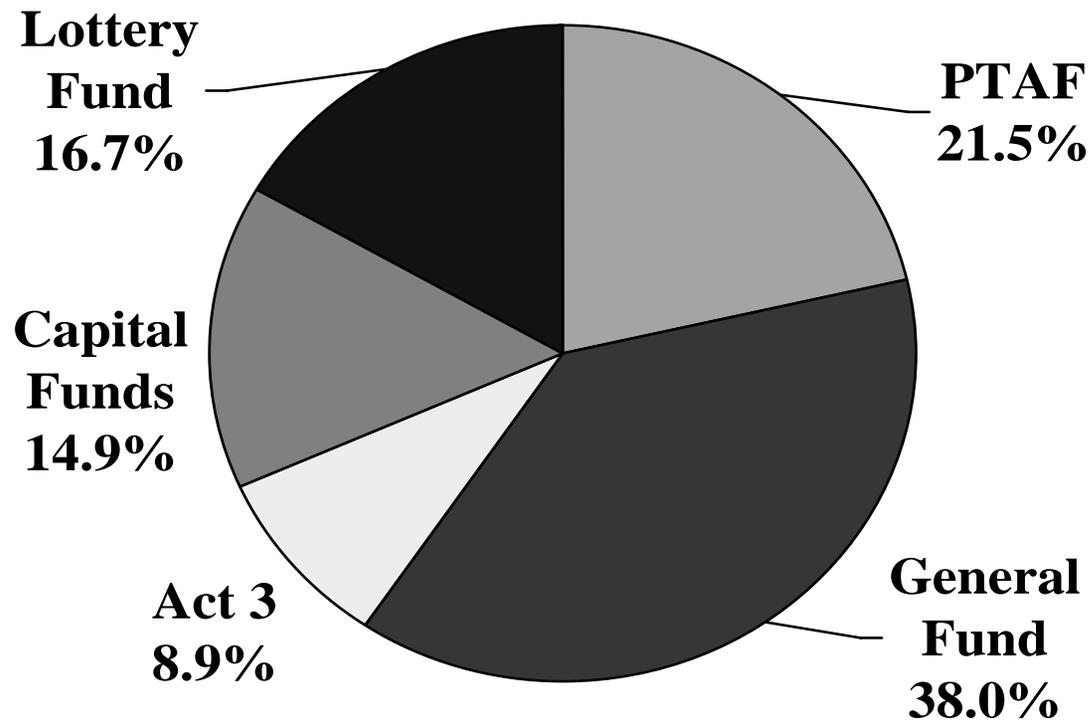
Flexed Funds for Transit

(in millions of dollars)

	State Funding	Federal Funding	Total Funding	Dollar Change	Percent Change	Standard Flex Funds	“Crisis” Flex Funds
2000-01	\$2,943	\$1,112	\$4,055	-	-	\$46	-
2001-02	\$2,940	\$1,272	\$4,212	\$157	3.9%	\$36	-
2002-03	\$2,949	\$1,265	\$4,214	\$2	0.0%	\$31	-
2003-04	\$2,966	\$1,205	\$4,171	(\$43)	-1.0%	\$59	-
2004-05	\$3,124	\$1,081	\$4,205	\$34	0.8%	\$48	\$74
2005-06	\$3,570	\$1,224	\$4,794	\$589	14.0%	\$25	\$202
2006-07	\$3,815	\$1,406	\$5,221	\$427	8.9%	\$25	\$138

Pennsylvania Public Transit Funding

Pennsylvania invests more than \$840 million per year in capital and operating support for public transportation agencies throughout the state, leveraging an additional \$500 million in federal and local funding investment.



2006-07 Budget Overview

Gaming

Property Tax/ Rent Rebate Program

Status Update on Gaming

The Gaming Control Board expects to award six Category 1 licenses and five Category 2 licenses by the end of 2006-07, which will generate \$550 million in license revenue. Of the facilities awarded licenses, the Board estimates that five Category 1 sites will be operational by the end of the fiscal year. The first Category 1 site, Mohegan Sun at Pocono Downs, has been very successful during its first weeks of operation. As of December 16, preliminary estimates of gross terminal revenues at Mohegan Sun were \$14.7 million, generating \$5 million to be used for long-awaited property tax relief for Pennsylvanians.

Slot Facilities Overview

<i>Category</i>	<i>Facility</i>	<i>Open Date</i>
1	Pocono Downs	11-14-06
1	Philadelphia Park	12-19-06
1	Chester	01-16-07
1	Erie	02-15-07
1	The Meadows	05-05-07
1	Penn National	01-01-08

Gaming License Revenue

The introduction of slot facilities throughout the commonwealth will generate \$550 million in license revenue during 2006-07. To date, \$100 million in license revenue has been collected.

Gaming License Revenue Schedule

(in millions of dollars)

	<i>2006-07</i> <i>Q1</i>	<i>2006-07</i> <i>Q2</i>	<i>2006-07</i> <i>Q3</i>	<i>2006-07</i> <i>Q4</i>	<i>2006-07</i> <i>Total</i>
<i>Category 1</i>	\$0	\$100	\$100	\$100	\$300
<i>Category 2</i>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$250</u>	<u>\$250</u>
Total	\$0	\$100	\$100	\$350	\$550

Uses of Gaming Revenues

In 2006-07, \$61 million of gaming revenues will be used to repay the General Fund for the initial gaming start-up loan and the 2005-06 volunteer fire company grant program. An additional \$40 million will be used to fund ongoing programs. In addition, the Taxpayer Relief Act of 2006 provides for a transfer of \$200 million of gaming license revenues to expedite property tax relief for Pennsylvania's senior citizens.

<i>Type</i>	<i>Amount</i>
Compulsive Problem Gambling Treatment Fund ¹	\$ 1,500,000
Local Law Enforcement Grants	\$ 5,000,000
Volunteer Companies Grants	\$ 25,000,000
DCNR in-lieu-of tax payments	\$ 4,849,000
Game Commission in-lieu-of tax payments	\$ 3,400,000
Fish & Boat Commission in-lieu-of tax payments	\$ 72,000
General Fund loan repayment	\$ 36,100,000
2005-06 Volunteer Companies Grants GF repayment	\$ 25,000,000
<i>Expedited Property Tax Relief</i>	<i>\$200,000,000</i>
<i>Total</i>	<i>\$300,921,000</i>

¹ Compulsive gambling funding is based on .001 percent of gross terminal revenue, or \$1.5 million, whichever is greater.

Property Tax Relief

For tax year 2006, the number of Pennsylvania seniors receiving property tax relief will increase 125 percent as a result of the Taxpayer Relief Act.

Tax Year 2006

	Previous Property Tax Rent Rebate Program	Additional Under the Taxpayer Relief Act	Total
Homeowners	169,808	409,179	578,987
Renters	167,309	10,745	178,054
Total	337,117	419,924	757,041

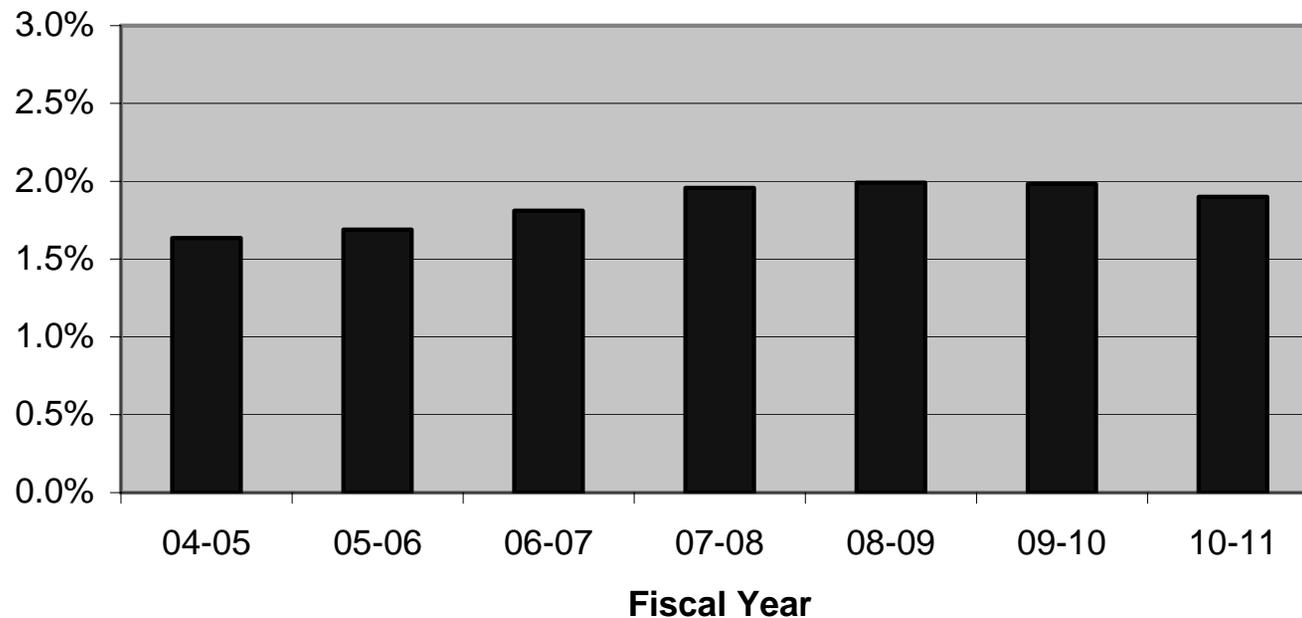
2006-07 Budget Overview

**Debt
Service**

Pennsylvania's Debt Affordability

Growing personal income keeps the planned bond issuance affordable as General Fund debt service as a percent of personal income remains below the generally accepted criteria of 3 percent for issuers considered to have a "low debt burden."

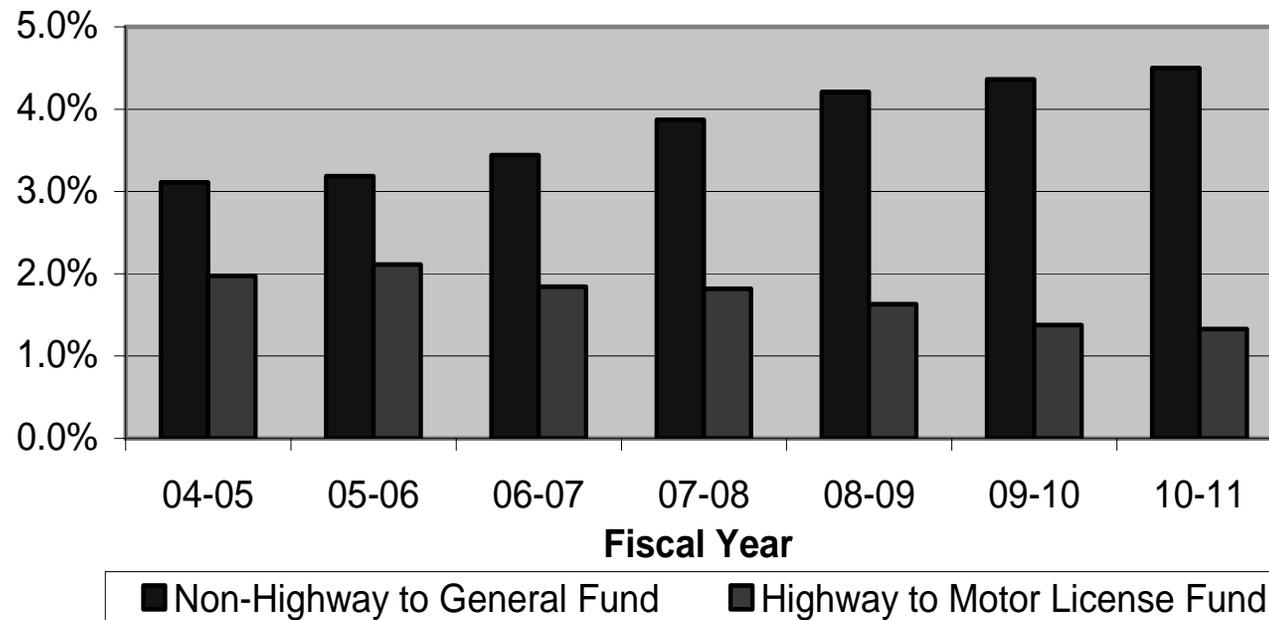
General Obligation Bond and Lease Rental Debt as a Percent of Personal Income



Pennsylvania's Debt Affordability

In 2006-07 the commonwealth will spend \$886 million, or 3 percent of its General Fund budget, on Debt Service. The commonwealth's General Fund debt service as a percent of revenues remains below the generally accepted criteria of 5 percent for issuers considered to have a "low debt burden." The commonwealth issues debt to pay for capital enhancements to state-owned facilities, environmental remediation and economic development projects.

**General Fund Supported Debt Service
as a Percent of Revenues**



**Challenges
in 2006-07
and Beyond**

Challenges in 2006-07 and Beyond

- Slowing economic growth
- The transportation funding crisis
- Health care cost inflation, both for commonwealth employees and for the 1.9 million Pennsylvanians in the Medical Assistance program
- An aging Pennsylvania that requires more costly services
- Increasing offender population
- Pensions and other post-employment benefit costs
- Collective bargaining

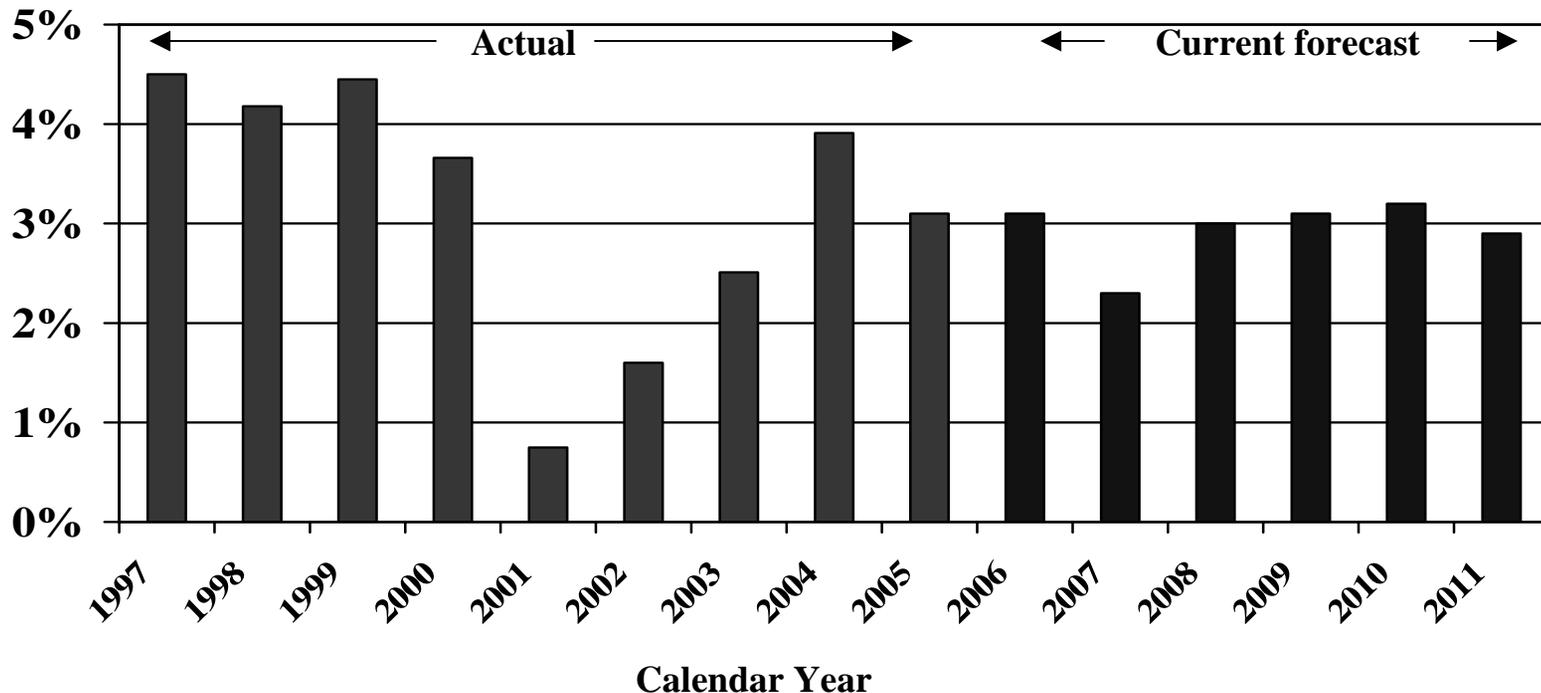
Challenges in 2006-07 and Beyond

**Slowing
Economic
Growth**

Real U.S. Gross Domestic Product

Annual Growth

The post-recession recovery peaked in 2004. GDP growth dropped to 3.1 percent in calendar year 2005 and is projected to remain at that level in 2006. GDP is expected to drop further in 2007 to 2.3 percent before recovering, but even that recovery is not projected to reach 2004 levels. Since revenue estimates for the 2006-07 fiscal year were certified in early July 2006, growth estimates for Real GDP, a leading indicator for Commonwealth revenues, have slowed according to Global Insight. Reasons for this slower rate of growth include a sharp downturn in the housing market and more cautious consumer spending.



Causes for Concern

The Housing Market Party Is Over

- “A housing downturn is dragging the U.S. economy into an extended period of below-trend growth...”¹
- “A steeper housing downturn than we had previously assumed chops just over one percentage point off growth in this period through its direct GDP contribution alone.”¹

The Slowdown is Here

- “The U.S. economy slowed dramatically in the second quarter of 2006. Four successive sluggish employment reports have marked this slowdown.”²

¹ Global Insight, September 2006

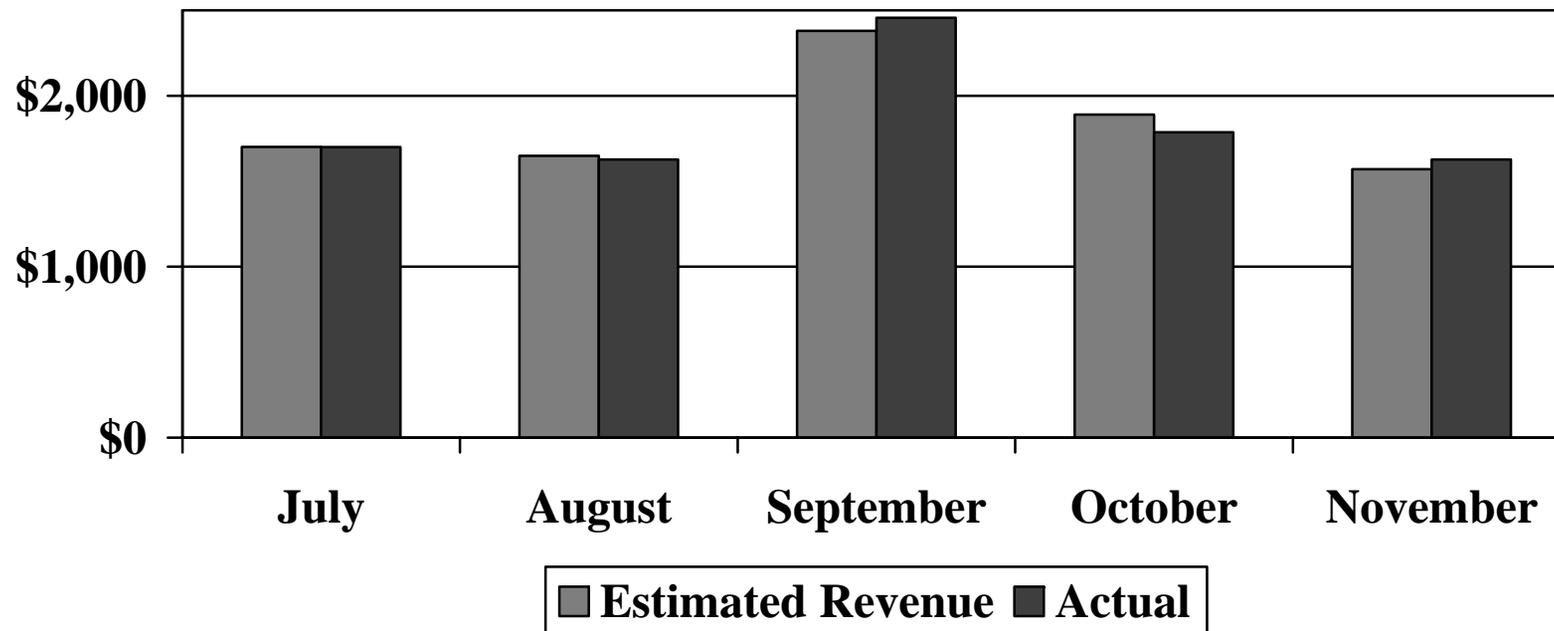
² Global Insight, Summer 2006

General Fund Revenues

Estimated versus Actual Revenue Collections

In November, monthly collections were \$56 million higher than projected, causing year-to-date collections to rise to \$8.7 million above estimate. But November collections exceeded estimate largely due to a one-time, unanticipated corporation tax settlement of \$42 million. If this settlement had not occurred, year-to-date collections would lag the official estimate by \$33 million.

Amount in millions



Challenges in 2006-07 and Beyond

**The Transportation
Funding Crisis**

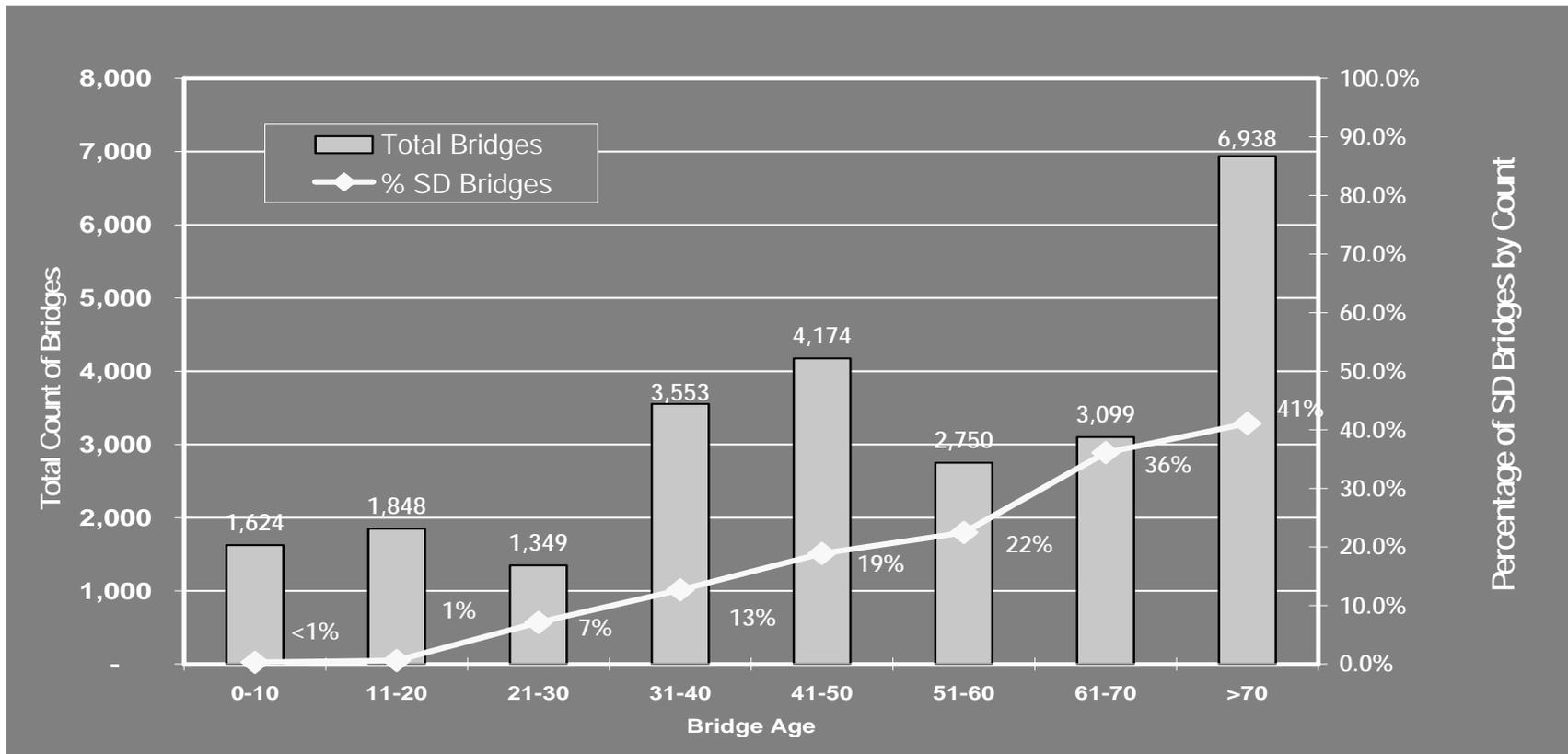
Key Findings of the Transportation Funding and Reform Commission

In February 2005, Governor Rendell issued Executive Order 2005-01, creating the Transportation Funding and Reform Commission. Between February 2005 and November 2006, the Commission studied Pennsylvania's transit system, reviewed transit system audits, solicited public input and identified options for reforming the system. The major findings of the commission are listed below.

- Need for more revenue is real
- Opportunities exist for reform
- Guiding principles drive recommendations
- No new revenue without reforms

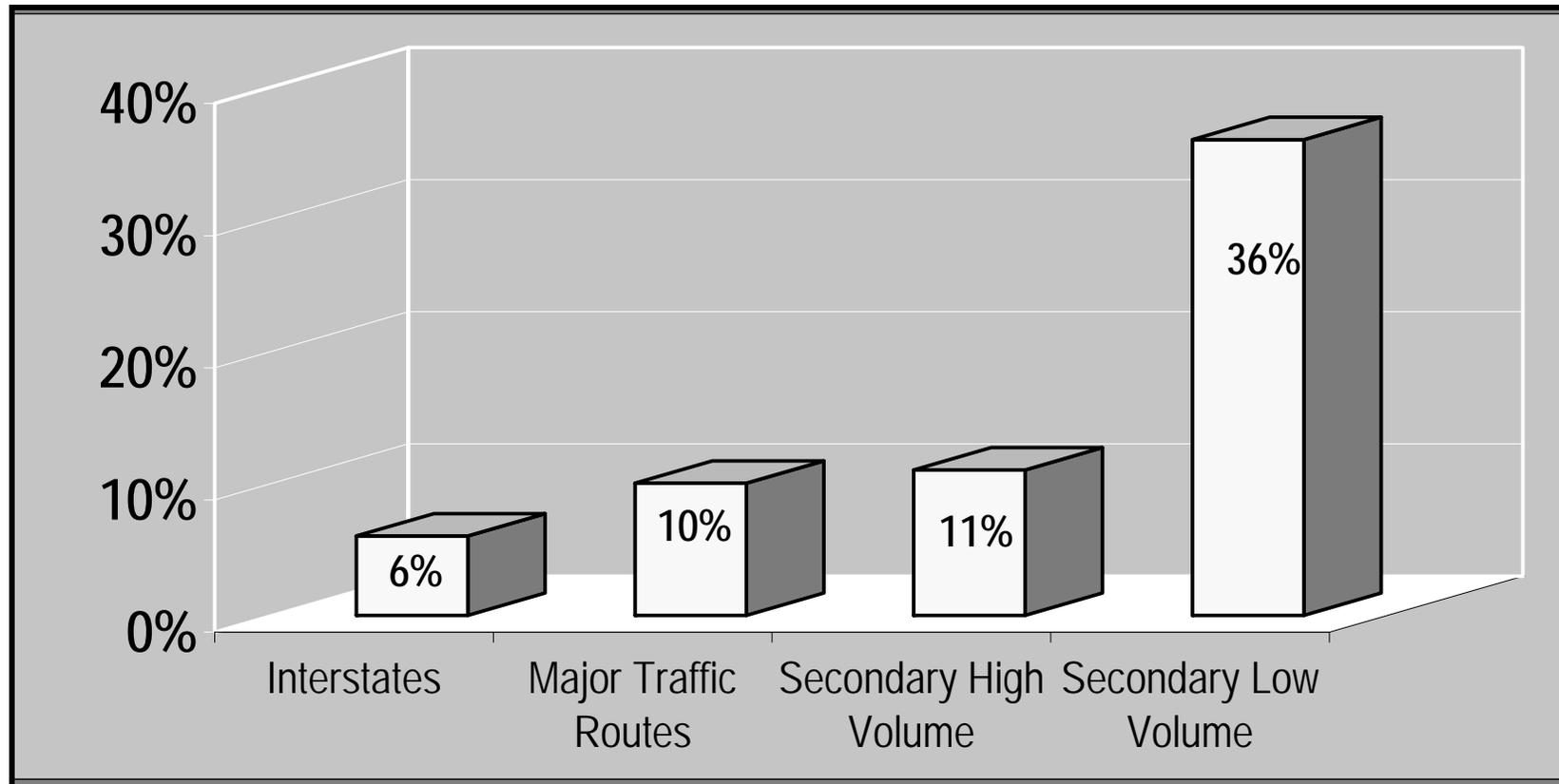
Structurally Deficient Bridges by Bridge Age - 2006

The commonwealth has more than twice the percentage of structurally deficient (SD) bridges than the national average. Nearly 6,000, or 23 percent, of all the commonwealth's bridges are structurally deficient. The percentage of structurally deficient bridges increases for older bridges – 41 percent of bridges 70 years or older are in need of major repairs.



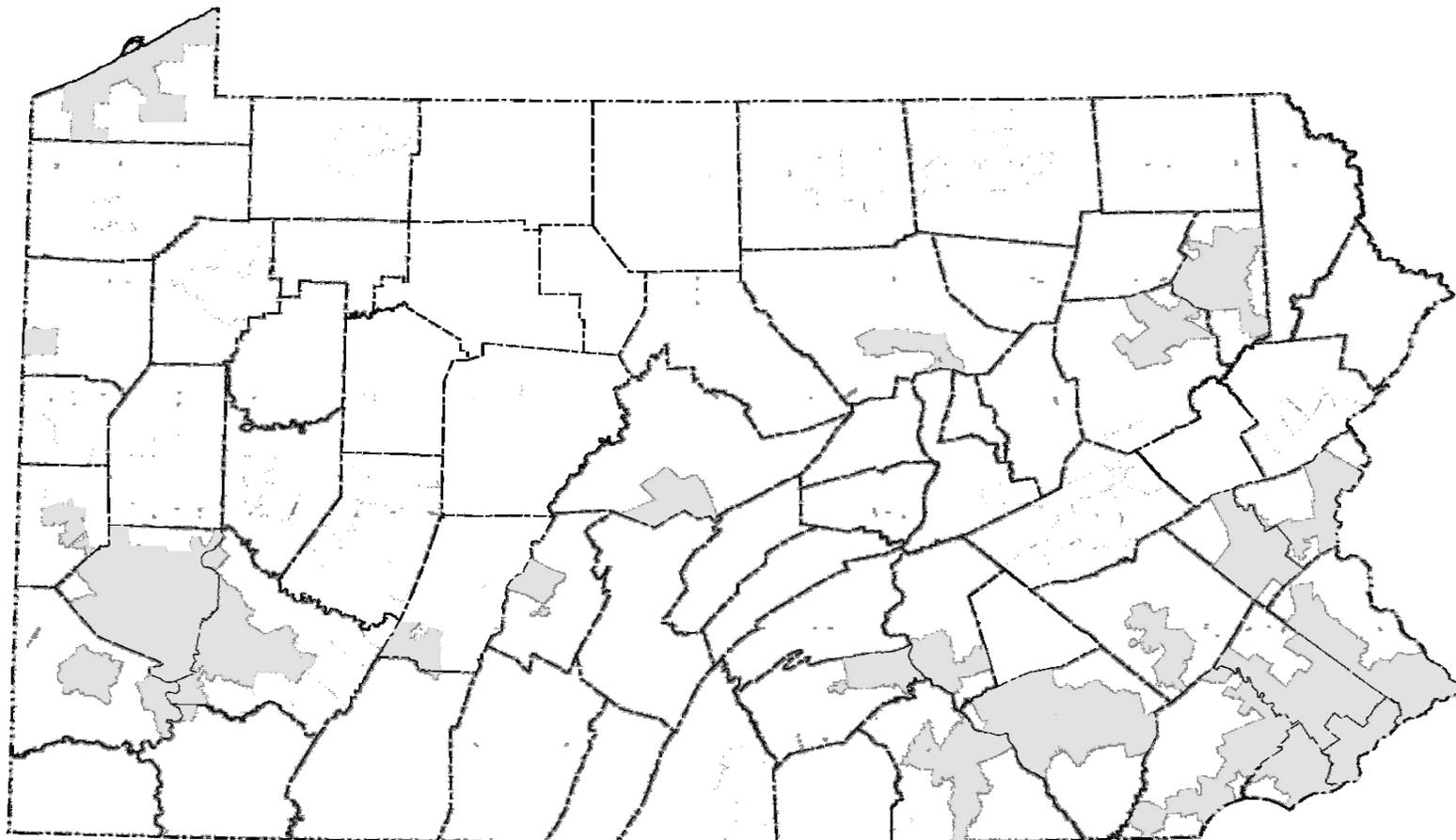
Poor Pavement Conditions

More than one-third of the 21,000 miles of state-owned secondary roads are rated "poor."



Public Transit in Pennsylvania

In 2005, Pennsylvania's public transit systems provided 414 million rides.



CLASS 1-3 (Urban)



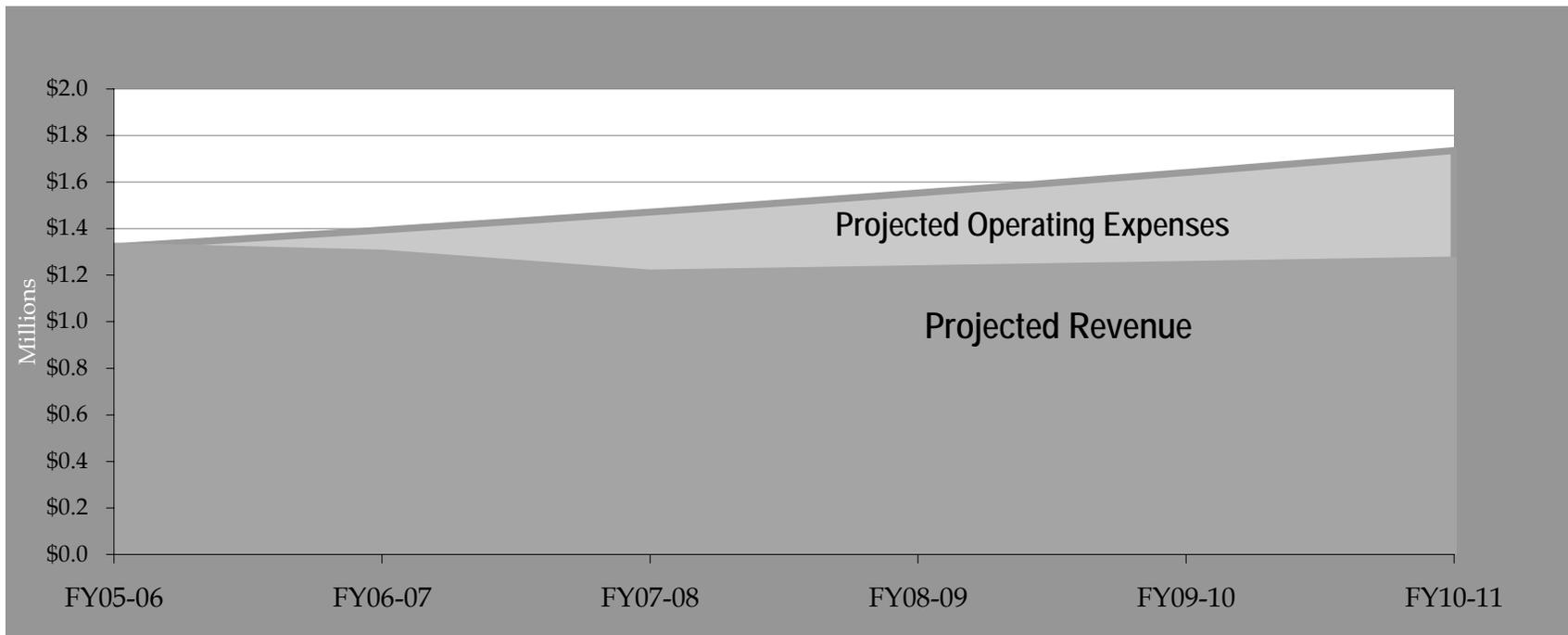
CLASS 4 (Rural)



CLASS 5

Expense Growth vs. Revenues

Funding for public transportation is currently inadequate as a result of the almost complete elimination of federal operating funds, the poor performance of a major state revenue source and the freezing for several years of the state's General Fund operating subsidy. Without any changes to available revenues or service interruptions, the commonwealth's transit agency expenditures are projected to exceed revenues by \$500 million, or 37 percent, by 2010-11.



Transportation Funding and Reform Commission Recommendations

To address the highway, bridge and public transportation funding crisis, the Commission recommended \$1.7 billion in additional revenue that would add approximately \$7 per month to the average driver's costs and \$5 per month to the average homebuyer. The Commission suggested that the \$1.7 billion in additional revenue could be reduced if the commonwealth entered into a public-private partnership for some of its assets.

State Highways and Bridges - \$900 Million Increase

- \$750 Million: increase the Oil Company Franchise Tax to 11.5 per gallon
- \$150 Million: increase various registration and licensing fees

Local Highways and Bridges - \$65 Million Increase

- 20 percent increase in state payment for county and municipal highways and bridges
~ one cent per gallon

Public Transportation - \$760 Million Increase

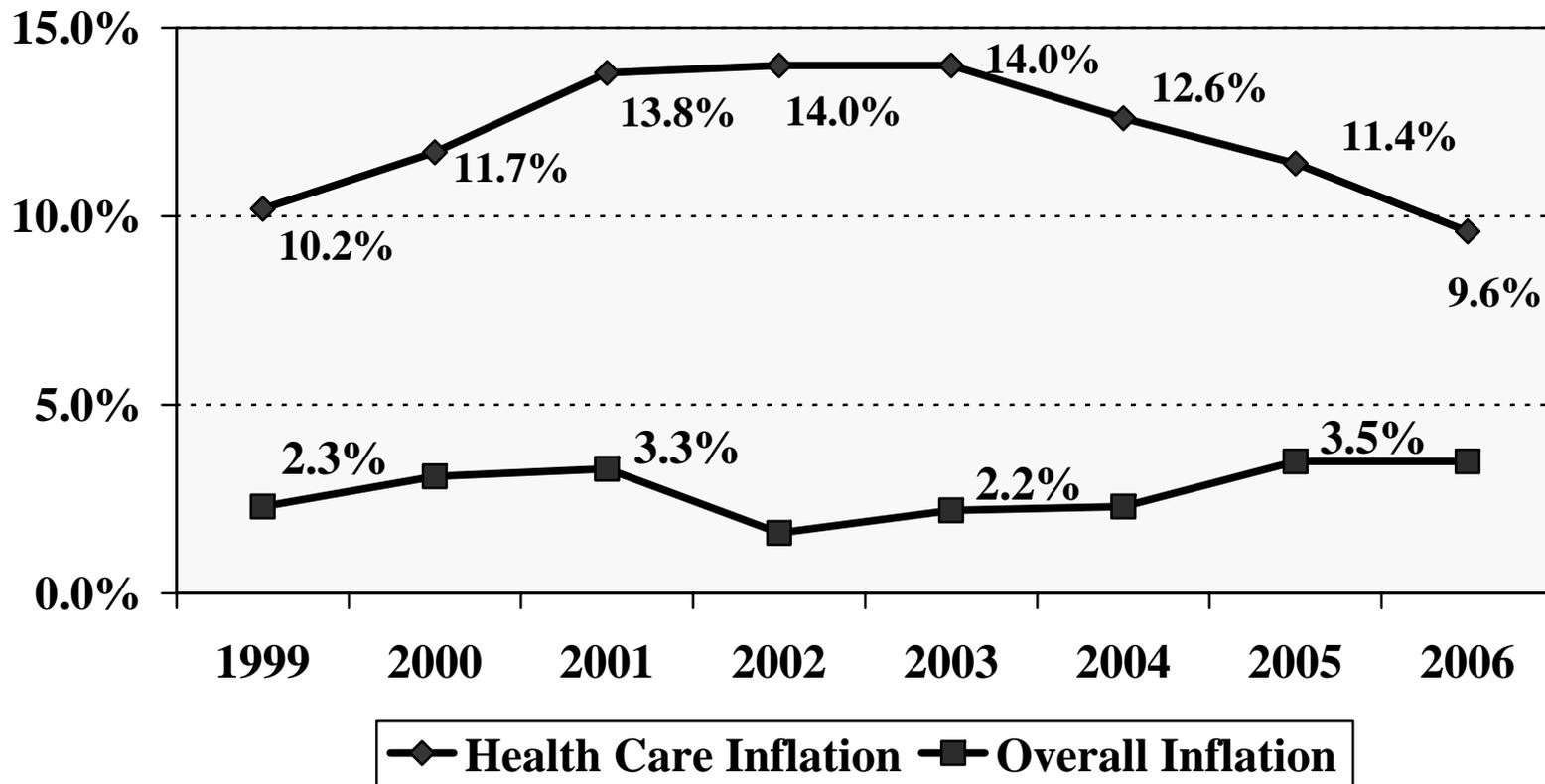
- \$576 Million increase in state funds – increase the Realty Transfer Tax
- \$184 Million increase in local funds
- Revenue neutral swap of \$589 Million in existing public transportation revenues for either sales or personal income tax revenues

Challenges in 2006-07 and Beyond

**Continuing
Health Care
Cost Inflation**

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

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

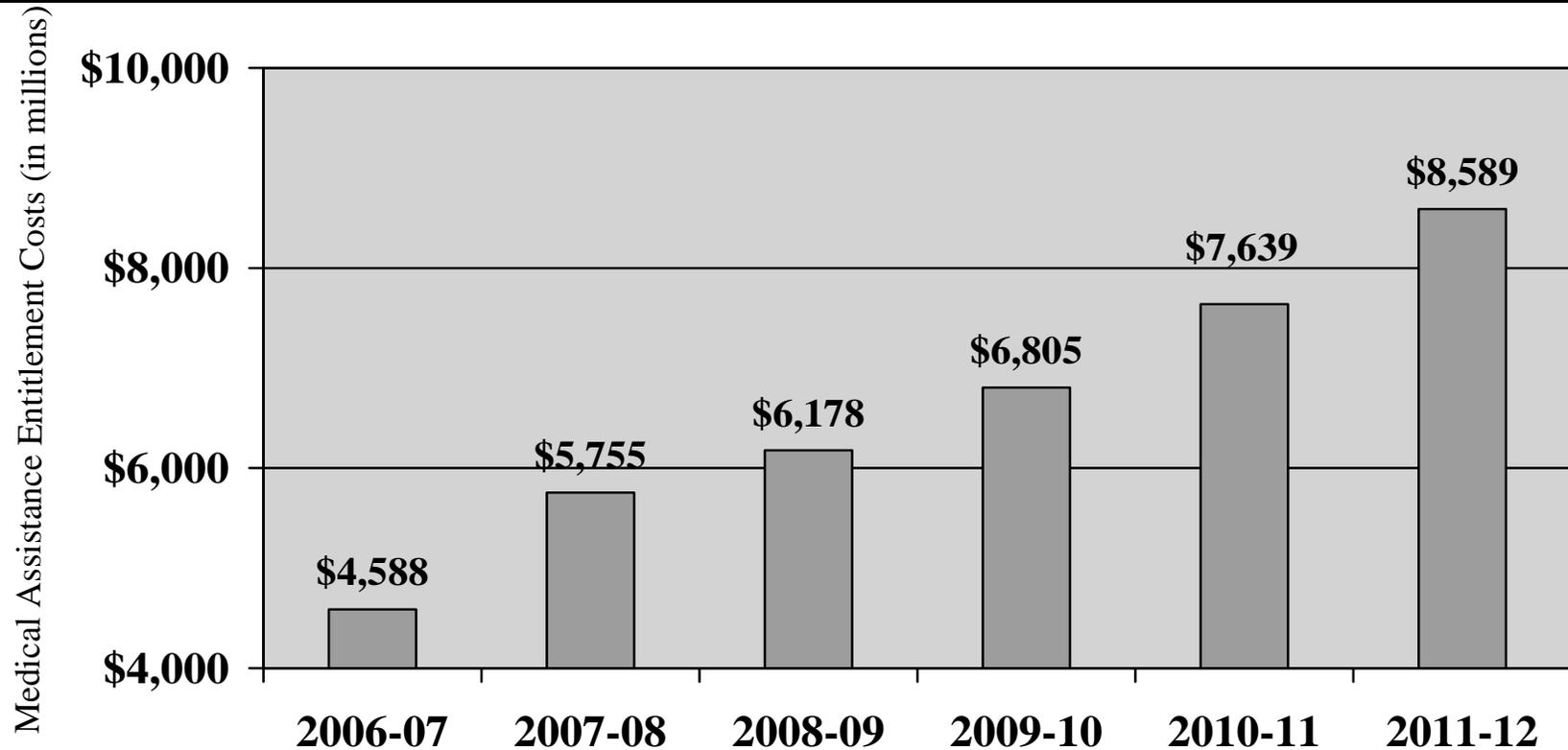


Health care composite inflation rates developed from data provided by Buck Consultants

Projected Medical Assistance Entitlement Costs

(General Fund only)

Between 2006-07 and 2011-12, the General Fund share of Medical Assistance entitlement spending is projected to increase 87 percent from \$4.6 billion to \$8.6 billion.



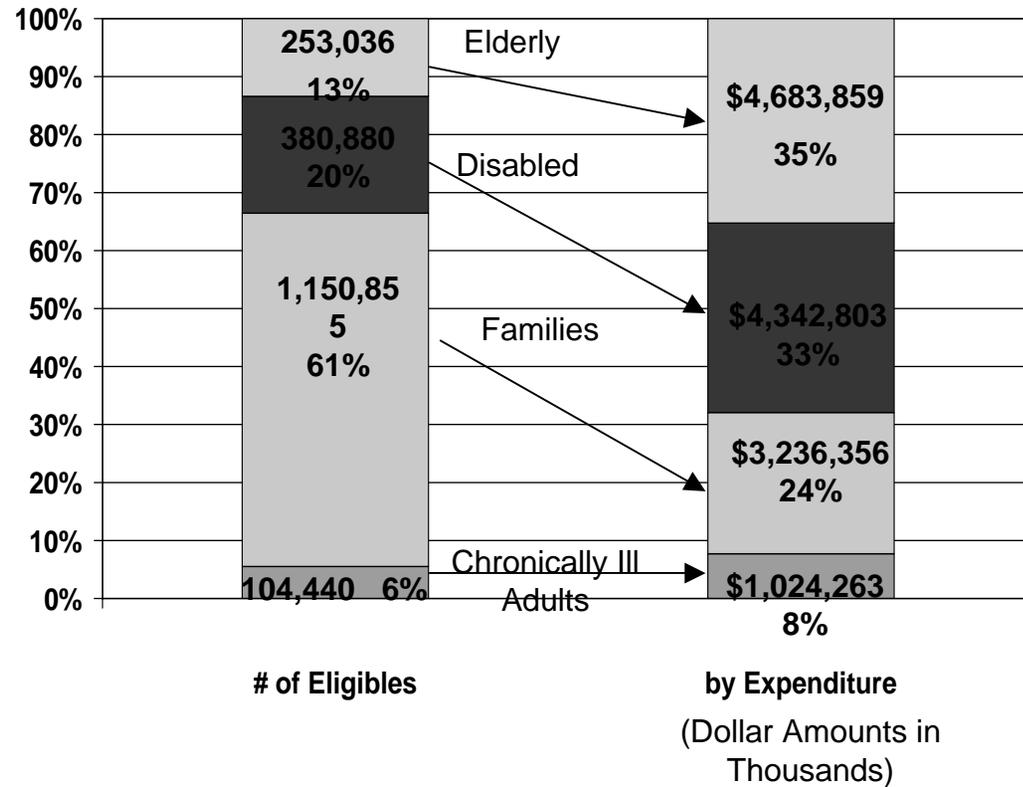
Challenges in 2006-07 and Beyond

**An Aging
Pennsylvania**

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

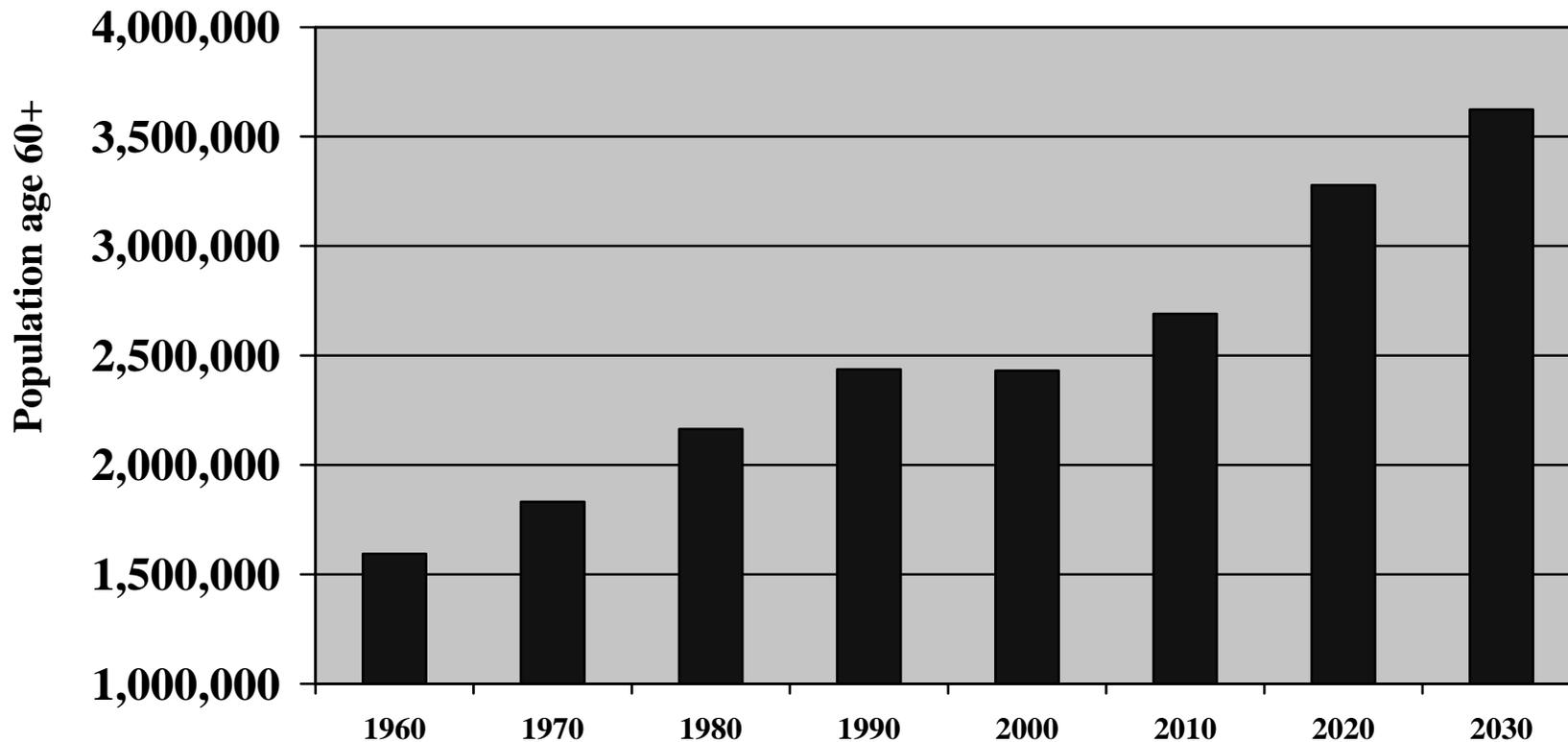
- The elderly and disabled are 1/3 of Medical Assistance recipients but represent more than 2/3 of the costs.
- As Pennsylvania's elderly population grows, costs will increase exponentially.
- Because the Medical Assistance program is an entitlement, managing the growth of this program is a challenge given Pennsylvania's demographics.

Medical Assistance Recipients by Category and Cost
2006-07



Expected Growth of Population 60+: 10-year changes from 1960 to 2030

The "Baby Boomer" generation begins to turn age 60 this year. By the year 2020, one in every four Pennsylvanians will be age 60 or older. Providing services for the rapidly growing number of seniors, especially those 85 and older, will present a major challenge for the Commonwealth in the coming years.

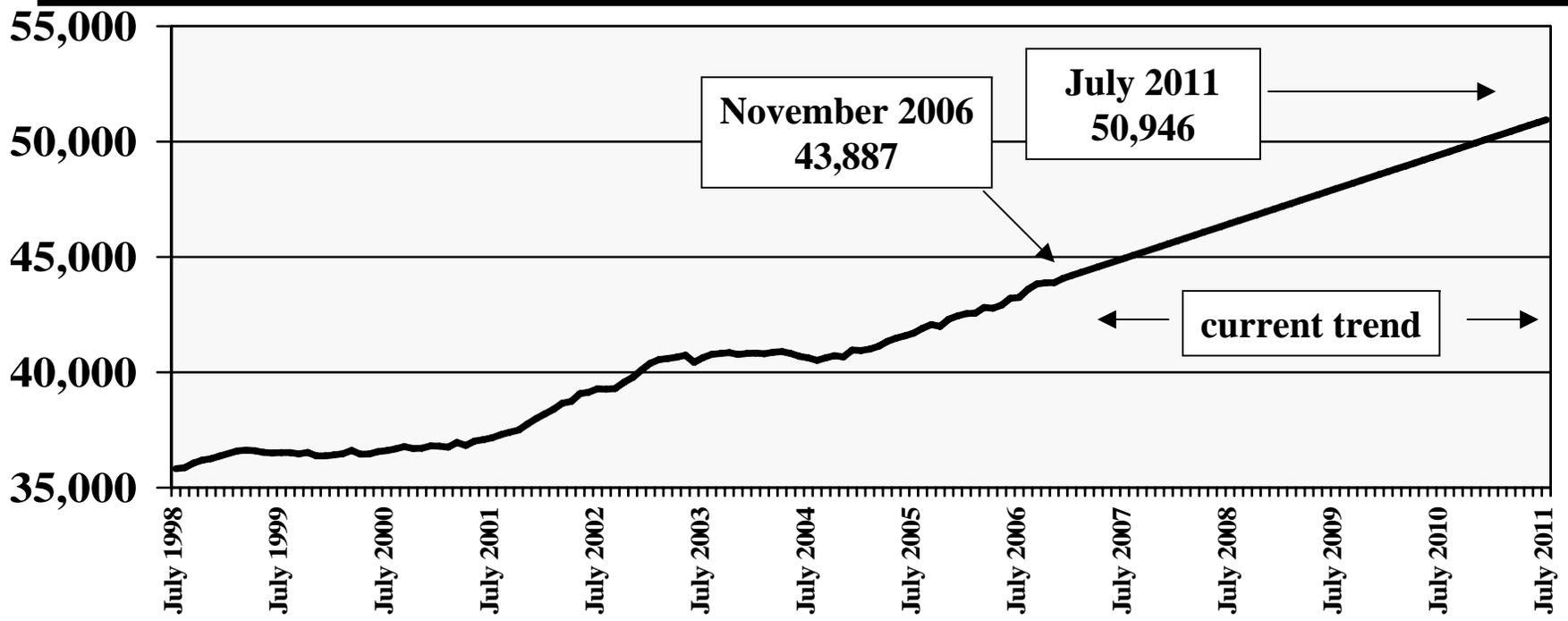


Challenges in 2006-07 and Beyond

**Increasing
Offender
Population**

Department of Corrections Inmate Population

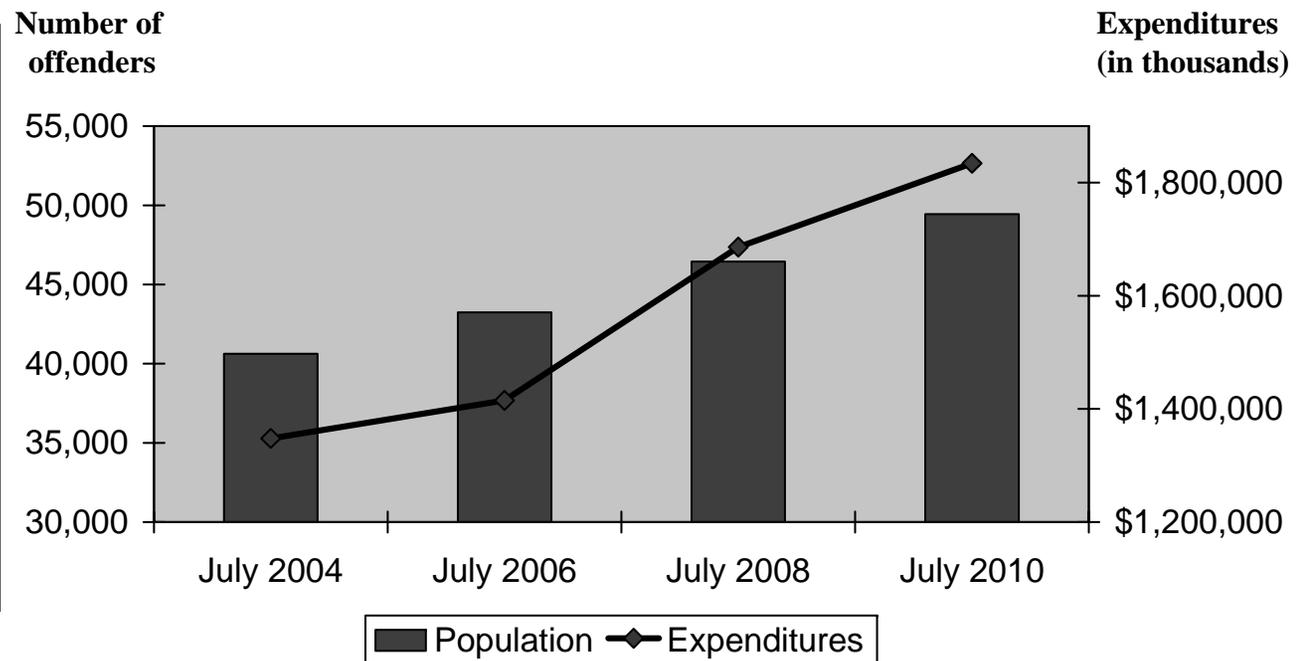
The number of offenders incarcerated in State Correctional Institutions could increase from 43,887 inmates in November 2006 to nearly 51,000 inmates by July 2011, an increase of 16 percent, based on current trends.



Department of Corrections Population

As the number of offenders in State Correctional Institutions (SCI) increases, the cost of operating SCIs increases as well. From 2004-05 to 2010-11, the annual operating costs of Pennsylvania's correctional system are projected to increase by \$486 million, or 36 percent.

- To accommodate this projected offender growth, Pennsylvania might need to have additional capacity.
- In addition to the overall offender growth, offenders in SCIs are aging and require more costly care.



Challenges in 2006-07 and Beyond

**Pensions and
Other Post
Employment
Benefits**

Pension Costs

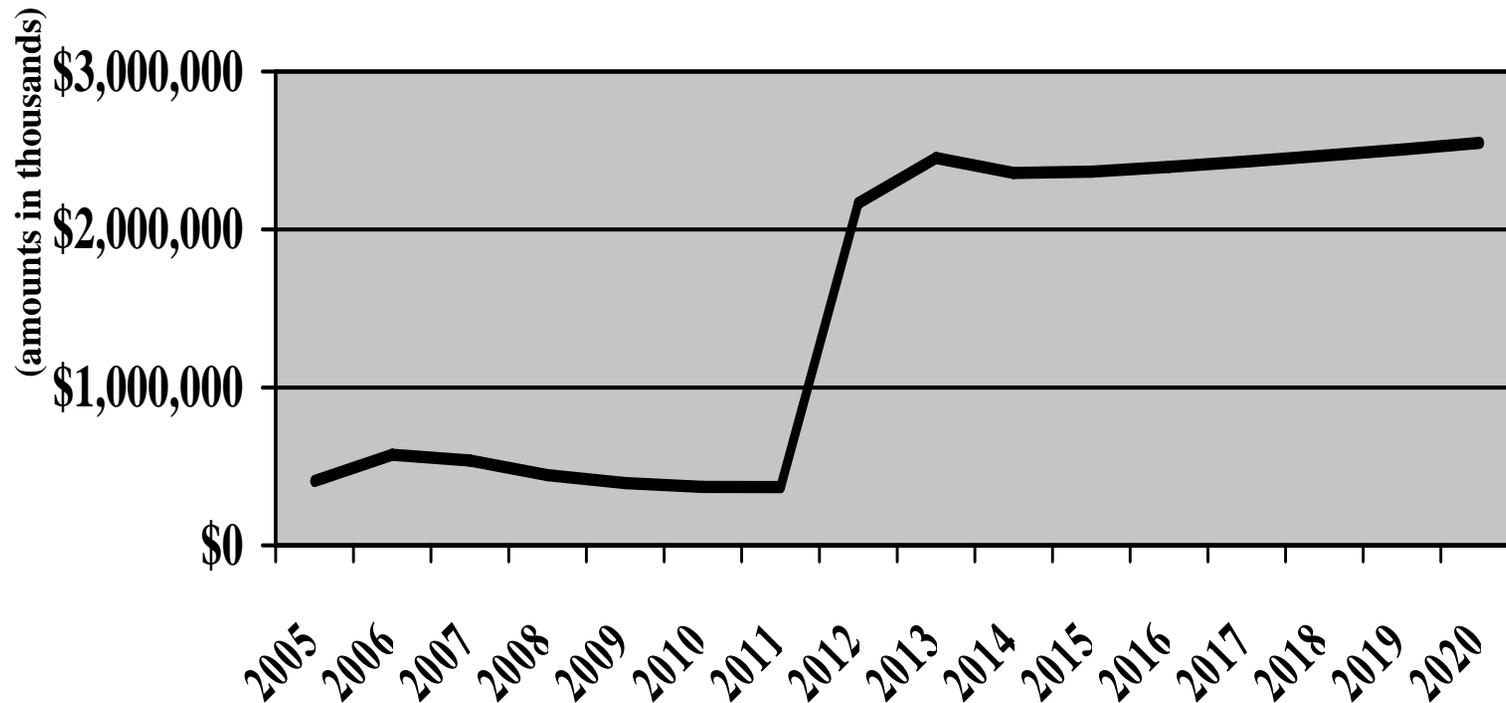
- The Commonwealth contributes funds to the State Employees' Retirement System (SERS) for its own employees and to the Public School Employees' Retirement System (PSERS) for employees of Pennsylvania school districts.
- Contributions to both systems have grown significantly from 2005-06 to 2006-07.
- After several years of more moderate increases, contributions to both systems are projected to spike in 2012-13.

	Actual FY2005-06	Budget FY2006-07	2005-06 to 2006-07 % Change	Projected FY2012-13	2006-07 to 2012-13 % Change
SERS	\$152,807	\$205,535	34.5%	\$947,114	360.8%
PSERS	\$254,495	\$368,757	44.9%	\$1,220,512	231.0%
Total	\$407,302	\$574,292	41.0%	\$2,167,626	277.4%

- The dramatic increases in employer contributions in 2012-13 are the result of significant benefit improvements in 2001, reduced stock market returns in the early 2000s, a COLA in 2002 and other legislative changes that reduced/delayed contributions.
- The Commonwealth cannot wait until 2012-13 to address this issue.

Pension Payments – Current and Future Challenges

The strain caused by sudden increases in the pension contribution will become far worse: by 2012-13, the state's contribution to SERS and PERS will reach \$2.2 billion – an increase of 277 percent from 2006-07.



Other Post-Employment Benefits (OPEB)

- The Governmental Accounting Standards Board (GASB) has issued Statement 45 that requires governments to report financial obligations for post-employment benefits provided to employees as part of their compensation for services.
- Post-employment health care benefits are the most common form of OPEB and are a very significant financial commitment for governments.
- Prior to GASB Statement 45, governments used a “pay-as-you-go” accounting approach in which the cost of benefits is not reported until after the employee retires.

Other Post-Employment Benefits

- The Commonwealth will be required to disclose post-employment benefit costs in accordance with GASB 45 beginning in 2007-08.
- Preliminary estimates show Pennsylvania's net unfunded actuarially accrued liability to be \$14 billion.
- Rating agencies have indicated they expect governments to take positive and proactive steps to address their OPEB liabilities.

Challenges in 2006-07 and Beyond

**Collective
Bargaining**

Summary of Major Provisions of the Commonwealth's Collective Bargaining Agreements*

2003-04 to 2006-07

In order to cover rising healthcare costs, Pennsylvania's major collective bargaining units agreed to contracts with significant wage restraint and health plan redesign.

Pay Increases

	<u>General Salary Pay Increases:</u>
▪ FY 2003-04	0%
▪ FY 2004-05	0%
▪ FY 2005-06	3.0% (effective July 1, 2005)
▪ FY 2006-07	3.5% (effective Jan 1, 2007)

Annual Service Increments:

NONE
One Step effective July 2004
NONE
One Step effective July 2006
One Step effective Jan 2007

Health Benefits

- **Increase in financial contributions by the Commonwealth from \$190 per employee pay period to:**

▪ FY 2003-04	\$235
- (plus an \$80 million additional contribution in 2003-04)	
▪ FY 2004-05	\$270
▪ FY 2005-06	\$275
- (plus \$8.7 million additional contribution in 2005-06)	
▪ FY 2006-07	\$300
- (plus \$49.9 million additional contribution in 2006-07)	
- **Significant Health Plan Re-Design and Restructuring**

* Only includes bargaining units whose contracts expired 6/30/03. Does not include State Police, Corrections Officers, Park Rangers and Capitol Police bargaining units.

Salary and Benefit Cost Increases

The final year of the current collective bargaining agreement provides longevity increments in July 2006 and January 2007 and a general salary pay increase of 3.5 percent on January 1, 2007. The Commonwealth must commit \$96 million to annualize the January 2007 salary increases – even before any new collective bargaining agreement is reached.

Current Collective Bargaining Agreement Costs

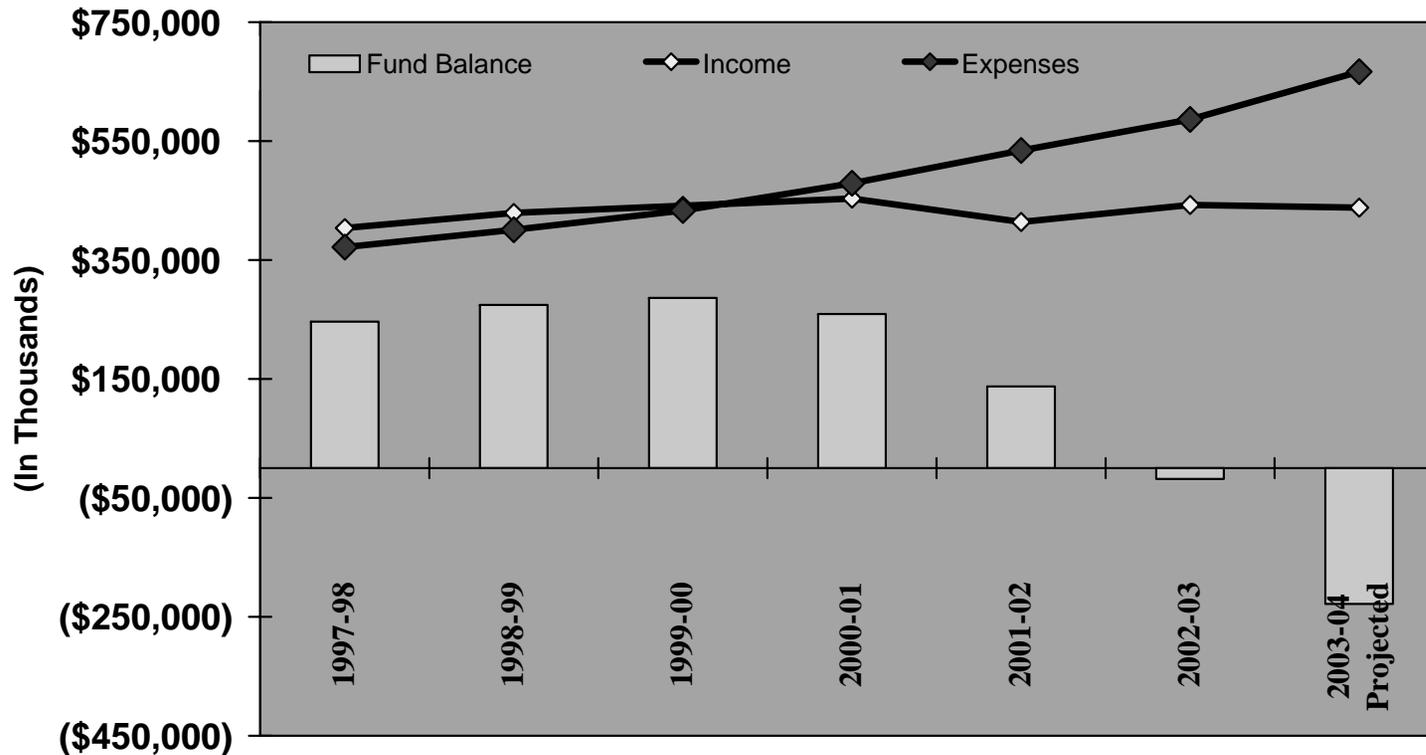
	2005-06	2006-07	Increase
Salaries/Wages	\$2,857.1 Million	\$3,091.6 Million	\$234.5 Million
PEBTF Active Health Program	\$612.4 Million	\$665.9 Million	\$53.5 Million
Additional PEBTF Active Health Payment	\$8.7 Million	\$49.9 Million	\$41.2 Million
TOTAL	\$3,478.2 Million	\$3,807.4 Million	\$329.2 Million

Note: Salary/wage increases include bargaining units with contracts expiring 6/30/07.

Pennsylvania Employees Benefit Trust Fund

Active Employee Health Program Prior to Corrective Action

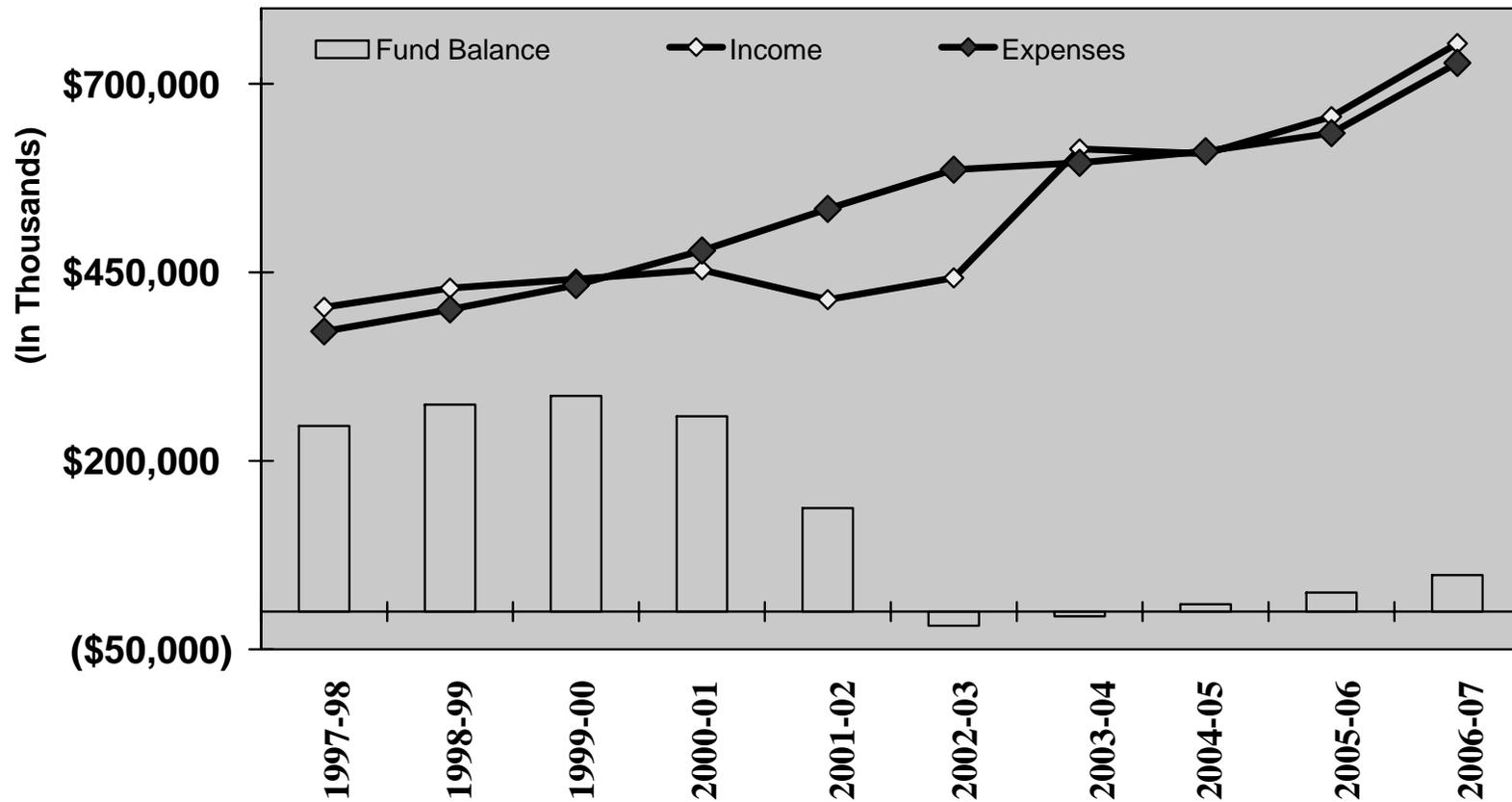
As health care costs escalated for commonwealth employees in the late 1990s, state contributions to the Pennsylvania Employees Benefit Trust Fund (PEBTF) were not increased to compensate. On the contrary, several “contribution holidays” actually reduced state contributions. The “savings” were used to cover increases in wage and salary costs. PEBTF reserves were depleted to make up the difference. By 2003-04, PEBTF reserves had been depleted, and the PEBTF was on the verge of insolvency.



Pennsylvania Employees Benefit Trust Fund

Active Employee Health Program After Corrective Action

The Pennsylvania Employees Benefit Trust Fund (PEBTF) has been stabilized through plan redesign, the Get Healthy Initiative and increased commonwealth contributions.



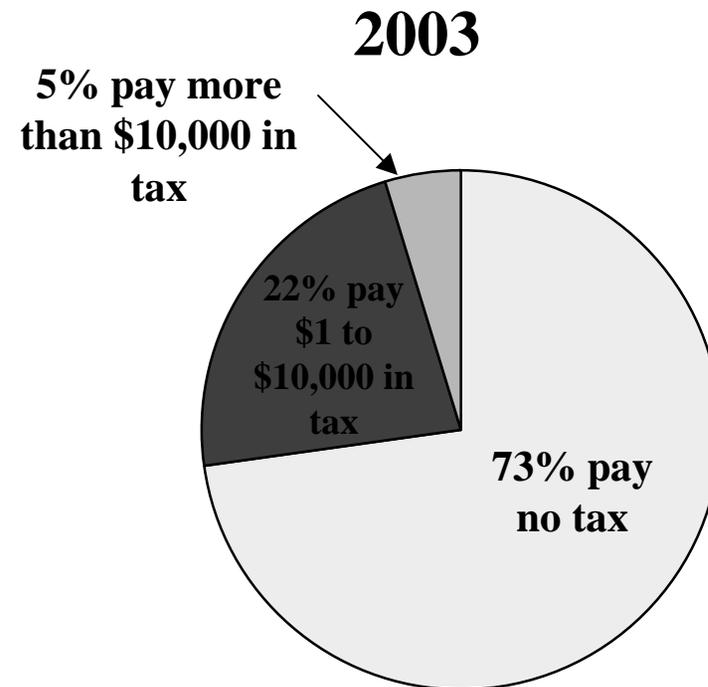
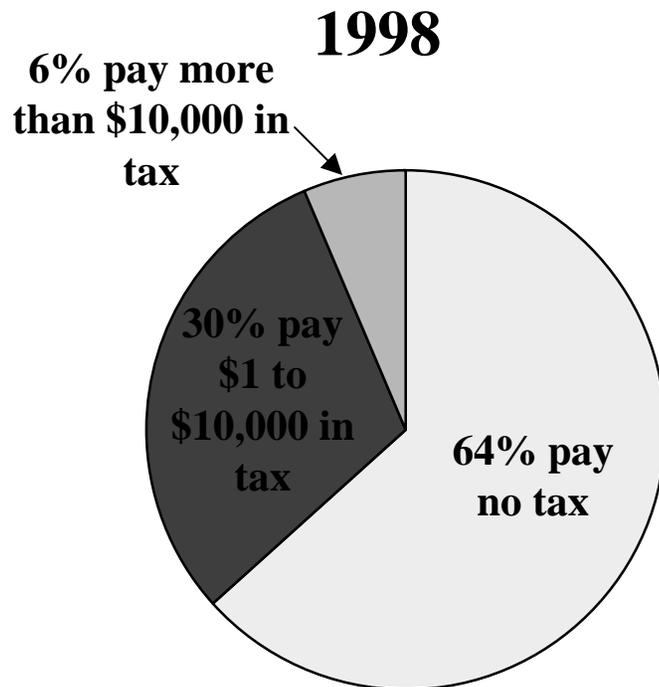
Challenges in 2006-07 and Beyond

Business

Tax Reform

Corporate Net Income Tax

The percentage of Corporate Net Income tax filers with no net income has been steadily increasing – from 64 percent of returns in 1998 to nearly 73 percent of returns in 2003. More than 95 percent of all Corporate Net Income Tax filers paid \$10,000 or less in Corporate Net Income taxes during 2003.

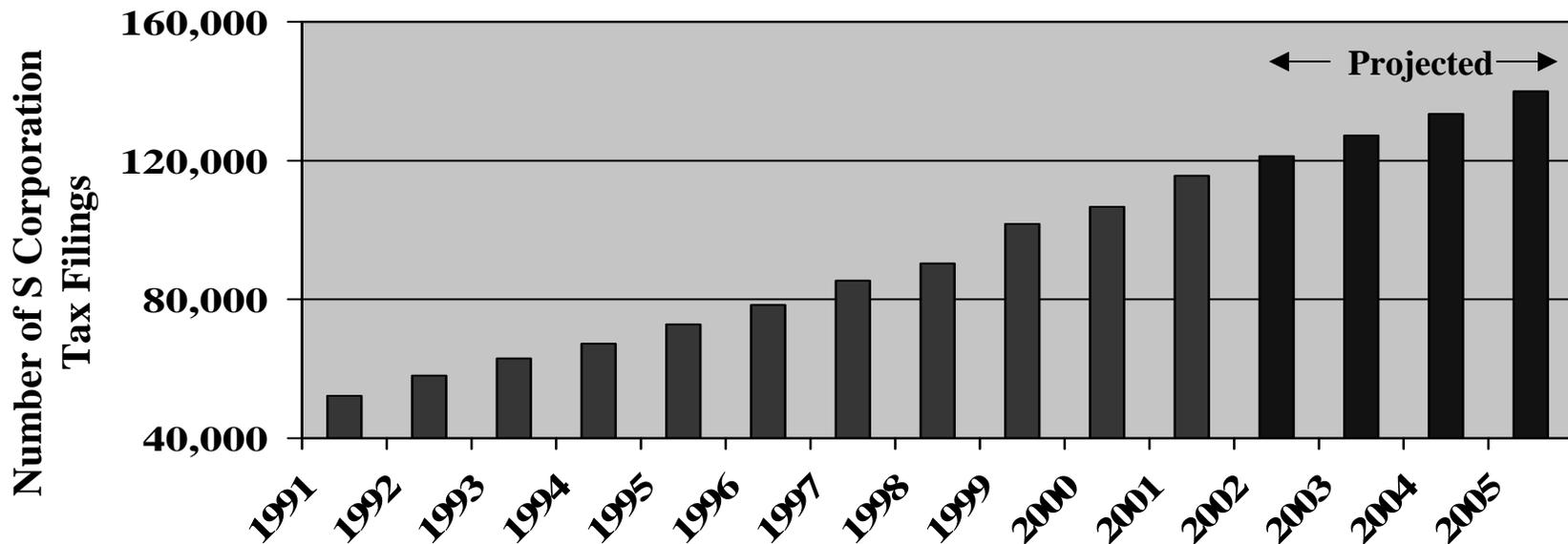


□ \$0 ■ \$1 - \$10,000 ▒ > \$10,000

□ \$0 ■ \$1 - \$10,000 ▒ > \$10,000

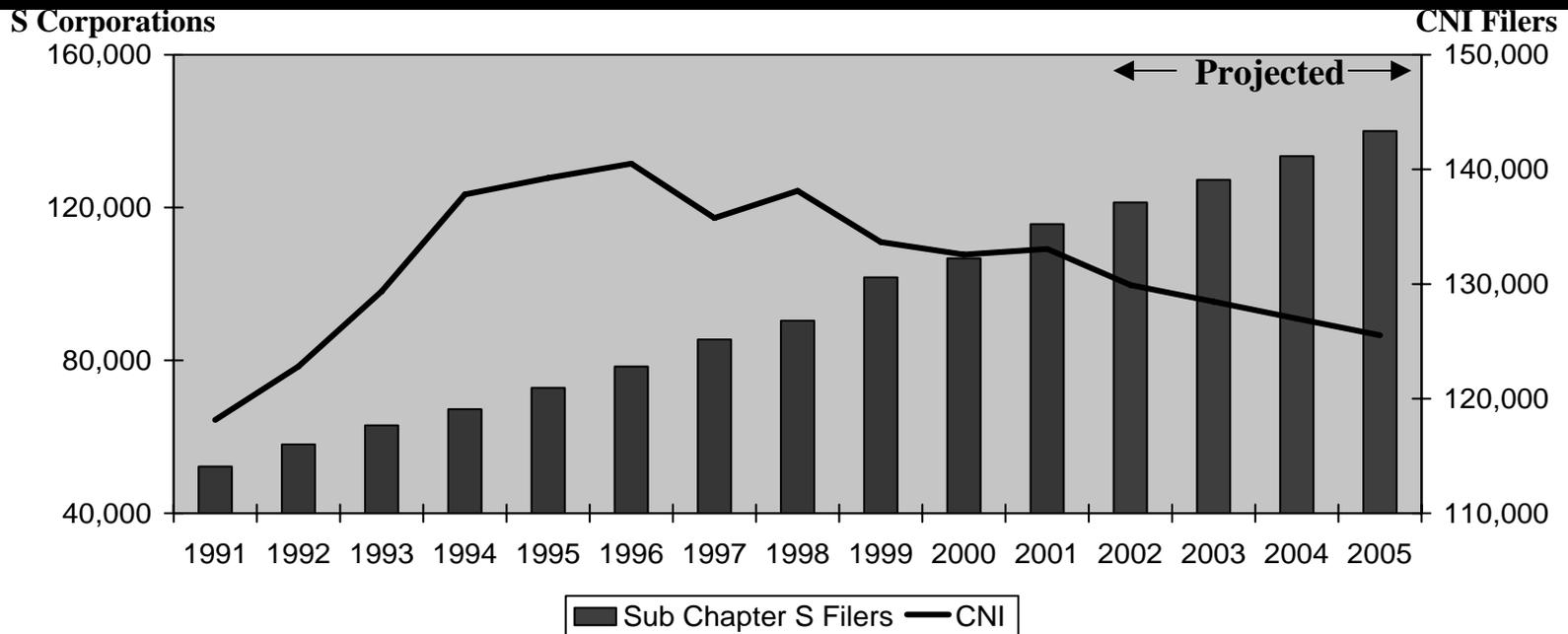
Pennsylvania S Corporation Tax Filings

Corporations that elect Pennsylvania “S corporation” status are exempt from the Corporate Net Income Tax. Pennsylvania S corporation shareholders instead include their share of Pennsylvania S corporation income in their Pennsylvania Personal Income Tax filings. This effectively allows corporations to pay their business income tax at the Personal Income Tax rate of 3.07 percent rather than the Corporate Net Income Tax rate of 9.99 percent. In 2006-07, the Department of Revenue estimates that S corporations will pay nearly \$701.5 million less in taxes to Pennsylvania because of this allowance. From 1991 to 2005, the number of S corporations is projected to grow by 168 percent, an average annual growth rate of 7.3 percent.



Pennsylvania S Corporation Tax Filings

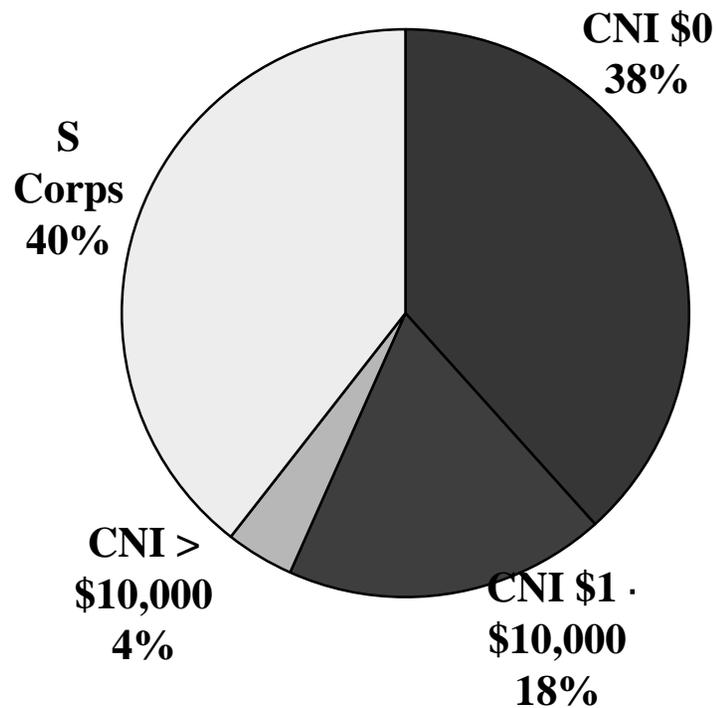
Corporations that elect Pennsylvania "S corporation" status are exempt from the Corporate Net Income Tax. Pennsylvania S corporation shareholders instead include their share of Pennsylvania S corporation income in their Pennsylvania Personal Income Tax filings. This effectively allows corporations to pay their business income tax at the Personal Income Tax rate of 3.07 percent rather than the Corporate Net Income Tax rate of 9.99 percent. In 2006-07, the Department of Revenue estimates that S corporations will pay nearly \$701.5 million less in taxes to Pennsylvania because of this allowance. From 1991 to 2005, the number of S corporations is projected to grow by 168 percent, an average annual growth rate of 7.3 percent. At the same time the number of S corporations has been increasing, the number of Corporate Net Income Tax filers has decreased.



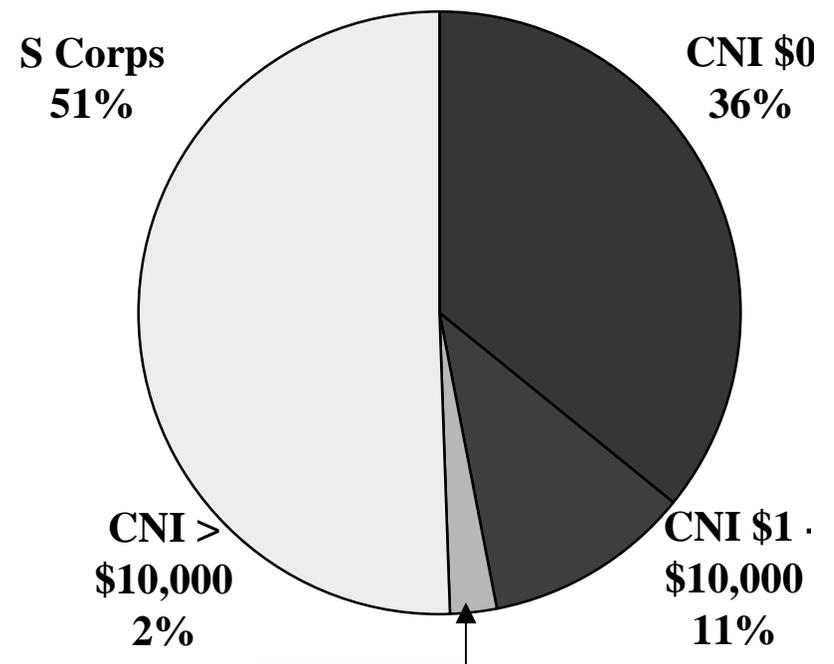
Total Business Tax Filers

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

1998



2003



Business Tax Reform – Still Needed

In March 2004, the Governor created the Business Tax Reform Commission to recommend changes to make Pennsylvania's business tax structure more competitive. The Commission made the following unanimous recommendations to improve Pennsylvania's business tax climate. Some of these recommendations have been partially implemented but implementation of the entire reform plan still needs to be accomplished.

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