The Governor presented his final mid-year budget briefing today, and no new ground was broken. His report highlights the dire situation that the commonwealth faces, with an unbalanced budget, and a structural deficiency of more than $2 billion in one time gimmicks, that will lead to significant stress next year.

2014-15 Tax Revenues:

Revenue collections for the General Fund, through the end of November, are $109 million or 1% over the Governor's official estimate which was made in June. Two of the three biggest tax sources, corporate net income and sales, are over the estimate by $86 million and $49 million respectively. The personal income tax is trailing the estimate by $11 million, which is only .2% off the official estimate. The Independent Fiscal Office (IFO) continues to express doubt that revenues will reach estimate by the end of the fiscal year. The IFO estimates that general fund revenues will be below the official estimate by $237 million. The IFO sees nearly half of their predicted shortfall coming from corporate tax receipts. The big corporate tax collection months begin in March.

Long Term Structural Budget Deficit

The table below itemizes the $2.2 billion in one-time revenue and spending changes that holds the 2014-15 budget together.

2014-15 One Time Revenues	(in Thousands)
Tobacco Settlement to Pensions	$225,000
Oil and Gas Lease Fund Transfers	$100,294
Natural Gas Lease Revenue in State Parks	$95,000
DCED Loan Fund Transfers	$180,000
Unclaimed Property	$150,000
Additional Transfers out of Tobacco Settlement Fund	$150,330
Changing DPW Cycle Payments	$393,000
Home and Community Services From Lottery	$159,990
Prior Year Lapses	$400,000
Transfer from Lottery Fund	$163,130
Casino License Transfers	$125,000
Additional Other Fund Transfers	$63,555
Total 2014-15	**$2,205,299**

The problem may be worse. More than $250 million of one-time revenue options may not be realized. The Administration did admit that $220 million of these one-time revenue sources, specifically the casino licenses transfer and the lease revenue from drilling in state parks are not likely to occur. Furthermore the levels of spending for some appropriations are clearly not sufficient for this fiscal year. It is expected that a significant amount of supplemental appropriations will be necessary to operate state government for the rest of this fiscal year. These further complications will be discussed in more detail later in this report.

The Governor's office did admit at the mid- year budget briefing that the heavy reliance on these one-time revenues will inevitably make crafting a balanced budget in 2015-16 much more difficult. Such insight might have been much more helpful in June instead of today.

The IFO clearly stated in their November 2013 presentation that Pennsylvania has a structural budget deficit. The revenues collected from existing taxes are not enough to provide for the desired level of spending. Through four years of the Corbett Administration this structural deficit became significantly worse. Tax cuts that yielded no job creation, yet depleted the Treasury by about $2.7 billion in total, were coupled with a lack of investment in job creation programs to exacerbate our budget problem. The IFO, in their November presentation estimates that the structural deficit is $1.85 billion. That may be an optimistic estimate. Given the haphazard approach to this current budget the real deficit is likely more than $2 billion.

According to the National Conference of State Legislatures, many other states in the nation and nearly all of our neighboring states are enjoying real revenue growth and easier times balancing their budgets. They report 42 states finished their 2013-14 fiscal year either reaching or exceeding their revenue projections. Eight states did not reach their revenue projection and Pennsylvania was one of those 8 states. Only West Virginia of our neighboring states joined Pennsylvania in that dubious accomplishment. Pennsylvania joins only four other states with a continuing budget deficit for the short term future. The remaining 45 states appear to be finally coming out of the 2008 recession with strength.

That is not the case in Pennsylvania where tax collections ended the 2013-14 fiscal year in June at a level lower than the taxes collected in 2012-13. While the Governor expected $468 million more in revenue, it turned out to be $50 million less. What was expected to be 3.4% growth turned out to be a .3% decline. It is very rare that tax revenues actually decline from one fiscal year to the next during a time of economic growth. Every major tax source was below the estimate: Corporate tax collections were $80 million below estimate, Sales tax was $111 million below and the personal income tax was a whopping $310 million below the estimate.

Jobs Update

Total employment in the commonwealth remains below its December 2007 level, otherwise known as the official start of the recession. Conversely, the national economy has recovered all the jobs it lost since the official start of the recession now surpassing its December 2007 employment level by more than 1.3 million new jobs. What's more, year-over-year employment growth in the commonwealth remains sub-par with only 48,200 new jobs added since October 2013. As the table on the next page demonstrates when looking back to January 2011, PA ranks last among all 50 states. The data, from the US Bureau of Labor Statistics, shows percentage change in total state employment. The employment growth is in thousands of jobs.

Rank % Growth 01/11-10/14	State	Total Emp. Jan. 2011	Total Emp. Oct. 2014	Net Emp. Growth	Net % Change
1	North Dakota	386	472	86.20	22.36%
2	Utah	1,193	1,350	156.50	13.12%
3	Texas	10,449	11,708	1,259.80	12.06%
4	Colorado	2,240	2,462	221.80	9.90%
5	Florida	7,214	7,857	643.10	8.91%
6	California	14,297	15,568	1,270.70	8.89%
7	Nevada	1,124	1,214	90.00	8.01%
8	Arizona	2,399	2,591	191.80	8.00%
9	Georgia	3,851	4,150	298.50	7.75%
10	South Carolina	1,811	1,950	139.10	7.68%
11	Washington	2,857	3,076	219.10	7.67%
12	North Carolina	3,887	4,184	296.60	7.63%
13	Tennessee	2,630	2,826	196.00	7.45%
14	Oregon	1,615	1,734	118.70	7.35%
15	Idaho	606	649	43.10	7.11%
16	Oklahoma	1,564	1,674	110.20	7.05%
17	Minnesota	2,663	2,847	184.30	6.92%
18	Montana	427	455	27.70	6.48%
19	Hawaii	589	627	37.90	6.44%
20	**Delaware**	**417**	**444**	**26.60**	**6.38%**
21	Indiana	2,825	3,004	178.40	6.31%
22	Michigan	3,910	4,150	240.10	6.14%
23	Massachusetts	3,236	3,425	188.50	5.82%
24	Wyoming	283	298	15.50	5.48%
25	Iowa	1,476	1,557	80.70	5.47%
26	Kentucky	1,779	1,873	94.00	5.28%
27	Louisiana	1,893	1,989	96.40	5.09%
28	**New York**	**8,619**	**9,044**	**424.60**	**4.93%**
29	**Ohio**	**5,062**	**5,307**	**245.80**	**4.86%**
30	Missouri	2,661	2,789	128.20	4.82%
31	Nebraska	947	992	44.40	4.69%
32	South Dakota	405	423	18.20	4.50%
33	Kansas	1,338	1,397	58.60	4.38%
34	Wisconsin	2,748	2,868	120.20	4.37%
35	Alabama	1,864	1,942	78.20	4.19%
36	Rhode Island	458	477	18.20	3.97%
37	**West Virginia**	**747**	**777**	**29.50**	**3.95%**
38	Connecticut	1,618	1,682	63.70	3.94%
39	Illinois	5,648	5,856	208.20	3.69%
40	New Hampshire	626	647	21.10	3.37%
41	**Maryland**	**2,530**	**2,612**	**82.30**	**3.25%**
42	Vermont	299	308	9.20	3.08%
43	**New Jersey**	**3,834**	**3,952**	**117.40**	**3.06%**
44	Mississippi	1,091	1,124	32.50	2.98%
45	Maine	593	610	16.90	2.85%
46	Virginia	3,673	3,776	102.30	2.78%
47	New Mexico	800	821	21.40	2.68%
48	Arkansas	1,165	1,195	30.80	2.64%
49	Alaska	328	337	8.10	2.47%
50	**Pennsylvania**	**5,665**	**5,802**	**137.40**	**2.43%**
	Total	**130,338**	**138,867**	**8,528.50**	**6.54%**

In terms of private sector job growth, the commonwealth has added 185,000 new private sector jobs since Governor Corbett came into office in January 2011. While some may point to this number as an indicator of progress, the total of 185,000 new private sector jobs ranks PA last among all surrounding states for percentage private sector employment gains since January 2011. Additionally, this total does not factor in public sector jobs that have been lost over the last four years. PA's public sector employment has shrunk by 48,000 jobs since January 2011. When these losses are accounted for, the total amount of jobs PA has added since January 2011 only stands at 137,000. This translates to employment growth of only 2.4% since January 2011, well below national employment growth of 6.8% seen over the same time frame. Had PA simply kept pace with national growth over this period, it would have created 385,000 jobs, or 248,000 more jobs than the 137,000 actually created.

PENSIONS

The mid-year briefing contained the usual diatribe about the uncontrollable growth of the pensions. Again, according to the Corbett Administration, the increase has made it impossible to balance the budget, fund schools or make any investments in the future of the commonwealth. While each year's increase is significant it is a payment on a debt that cannot be avoided. The IFO in their November Economic Budget and Outlook report highlights that the expansive growth in the pension cost is nearly over. These upcoming two fiscal years, 2015-16 and 2016-17, are the last years of significant growth. Then the growth of the cost slows dramatically. The reforms in Act 120 are working and will guarantee the promise made to retirees and restore the pension funds to solvency. There is no easy solution to rectify the state and the school districts failure to provide the actuarially required investment into our pension funds for the past 15 years.

The enacted budget did not reduce the required contribution to the two pension funds by reducing the collars as the Governor proposed. As was done in last year's budget small amounts were added to many of the personnel lines throughout the budget to provide for increased pension costs.

The state's payment to the school retirement system was originally calculated at $1.525 billion. It is instead $1.1578 billion due to a combination of some one time funding and some reforms that will reduce the commonwealth's share of the pension obligation. First the Governor proposed, and the General Assembly went along with, transferring the remaining investments in the Tobacco Settlement Fund and the Health Ventures Investment Account to PSERS for the retirement obligation. This investment is valued by the Governor's office at $225 million, although that amount is disputed as its true value. This gimmick is non-recurring and will make next year's increase that much larger. This would mark the second time that one-time revenues have been used to supplement a growing expenditure of the General Fund that the Governor finds too difficult to provide money for. The reforms include a savings of $76 million from ending the charter school double dip to further reduce the payment. There are excess funds from last year's appropriation which is about $68 million due to an overestimation of payroll growth. These continuing reductions will help control pension costs in future years.

GIMMICKS EXPOSED

The commonwealth also faces an anticipated shortfall of $95 million from the shortsighted and ill-conceived "Non-Surface Impact" lease proposal. Under this proposal, DCNR was to lease additional mineral rights under state park and forest lands for natural gas development that could be accessed from existing drilling sites, so long as there are no new surface impacts. The proposal was to generate a total of $95 million for the 2014-15 fiscal year, all of which was to be transferred to the General Fund to help balance the budget.

However, at the time of passing the 2014-15 budget, few, if any, expected this revenue to materialize. The proposal had not been properly vetted, its details were murky, at best, and it is highly unlikely that the state even had enough land available to lease to satisfy the required revenue. What's more, a lawsuit currently working its way through the legal system challenging the use of lease money for General Fund purposes has prevented the implementation of the proposal. If the lawsuit is left unresolved before Governor-elect Wolf is sworn into office, it is unlikely that he will follow through with this gimmick of a proposal, meaning the commonwealth will already be $95 million in the hole entering the 2015-16 fiscal year. This amount could grow exponentially into the hundreds of millions if the aforementioned lawsuit is successful in challenging the past use of lease money for General Fund purposes.

DEPARTMENT OF CORRECTIONS

The Department of Corrections (DOC) will require a supplemental appropriation of $51.75 million in the 2014-15 fiscal year (FY) to continue its current level of operations. Roughly $30 million of this increase is a direct result of a recent arbitration award for certain employees dating retroactively to July 1, 2014. The remainder of the increase is simply needed due to a lack of funding in DOC's enacted budget. This marks the second consecutive budget that the DOC has required a significant increase over its enacted state appropriation (also needed more than $50 million in supplemental funding in FY 2013-14), calling into question whether the Corbett Administration has been purposely underfunding the Department for the sake of balancing budgets at the time of passage.

In addition to this supplemental appropriation, the DOC estimates it will need an additional $215 million over its enacted FY 2014-15 state funding total to continue its current level of operations into FY 2015-16. The majority of this increase will be needed for rising Department costs in the coming fiscal year (operating, pensions, salary increases, etc). A portion of this increase will also be needed to fulfill obligations to certain employees in FY 2015-16 as a result of the aforementioned arbitration award. The total increase of $215 million would raise DOC's total state appropriation to nearly $2.3 billion in the 2015-16 fiscal year.

DEPARTMENT OF HUMAN SERVICES

Act 132 of 2014 officially changed the name of the PA Department of Public Welfare (DPW) to the PA Department of Human Services (DHS) effective Nov. 24, 2014.

The 2014-15 budget relies heavily on one-time funding maneuvers, revenue sources and special fund revenues to greatly reduce state General Fund expenditures in DHS. The 2015-16 budget will need to address these one-time savings and unsustainable special fund transfers. Examples include, but are not limited to:

- $394 million in savings realized by pushing a 2014-15 payment for Health Choices managed care organizations into the 2015-16 fiscal year.
- $171.5 million in additional Lottery Funds used to offset General Fund expenditures for Long Term Care, Home and Community Based Services and MA Transportation.
- $143.8 million in additional Tobacco Settlement Funds used to offset General Fund expenditures for Long Term Care.
- Over $50 million in budget year savings from other accounting measures; such as making early payments to maximize a higher federal Medicaid match, rolling back payments to the prior fiscal year, using surpluses in federal block grant funding and utilizing prior year federal revenues to offset costs.

Section 10202 of the Affordable Care Act (ACA) established the Balancing Incentive Program (BIP) to create a financial incentive for states to move from institutionally-based long term care to home and community-based services. States could benefit from additional federal funding beginning October 1, 2011 through September 2015. Gov. Corbett applied for the program in April 2014 for state fiscal year 2014-15 -- missing out on several years of federal funding. The 2014-15 budget includes state savings of nearly $75 million by utilizing the BIP enhanced federal match. Only one quarter of enhanced federal match will be available in 2015-16; therefore, state funds will be needed in the upcoming budget year to replace the federal funds that disappear beginning Oct. 1, 2015.

Under the ACA, as interpreted by the U.S. Supreme Court, states have the option of expanding Medicaid eligibility for adults ages 19-65 with incomes under 138% of federal poverty. From Jan. 1, 2014 through calendar year 2016, the federal government will cover 100% of the costs to cover this expansion population. Beginning in 2017, states will contribute 5% of the costs gradually phasing in a 10% state share after 2020.

In February 2014, a month after Medicaid expansion was permitted under the ACA, Gov. Corbett submitted an 1115 Demonstration Waiver reflecting the Corbett Administration’s revised version of Medicaid expansion and changes to the health benefits provided under the traditional Medicaid program. On Aug. 28, 2014, the Centers for Medicare & Medicaid Services (CMS) approved the waiver, which included many changes to the initial application.

Like traditional Medicaid expansion, Healthy PA provides health coverage for individuals who are too poor to qualify for federal subsidies on the health care exchange yet not poor enough to qualify for traditional Medicaid. An estimated 600,000 eligible Pennsylvanians became eligible to enroll on Dec. 1, 2014 for coverage beginning on Jan. 1, 2015. Eligible individuals have household incomes less than 138% of federal poverty ($16,105 for an individual or $32,913 for a family of four).

Healthy PA builds on the proven managed care delivery model used in Pennsylvania's current HealthChoices Medicaid program which provides physical health benefits through contracts with private managed care organizations (MCOs) statewide within five service regions. Healthy PA's "private coverage option" or PCO builds upon this model by contracting with insurers to provide coverage using the nine service regions of the federal health exchange. All but one PCO currently provides coverage through its Medicaid MCO under HealthChoices. That insurer, Capital Blue Cross, does not participate in HealthChoices but does provide coverage under Pennsylvania's Children's Health Insurance Program (CHIP).

In Pennsylvania, Medicaid expansion not only provides for healthier citizens, job creation and workforce stability it also saves hundreds of millions of dollars by shifting a fully state-funded General Assistance program to a fully federally-funded expansion program. The 2014-15 budget assumed $125 million in partial year savings resulting from Medicaid expansion through the Healthy PA program. Full year state savings for 2015-16 currently are estimated to be in excess of $500 million. Unfortunately, savings realized from expansion barely make a dent in replacing the one-time funding issues mentioned previously.

In addition to replacing one-time revenue sources and savings initiatives, the 2015-16 DHS budget will need to address increasing caseloads, mandated rate adjustments and other annual cost-drivers. The Corbett Administration's mid-year briefing estimates at least $910 million in additional funds will be needed in 2015-16 to cover DHS costs, even with Medicaid Expansion savings. A new administration may also begin to address the hundreds of millions dollars in program cuts and unsustainable rate freezes imposed during the four years of Gov. Corbett's tenure.

LOTTERY FUND

The Lottery Fund benefitted from a record-breaking year in 2013-14 with sales growing 2.7% over the prior year. As a result, the Lottery Fund ended 2013-14 with an end balance of over $200 million.

The 2014-15 budget relies heavily on the Lottery Fund to offset expenditures in the General Fund. Most notably, the Department of Human Services (DHS) budget uses over $500 million from the Lottery Fund to cover program costs that would otherwise be funded through the General Fund.

The 2014-15 Lottery Financial statement assumes sales growth of 4.2% compared to the 2.7% growth seen in 2013-14. The Department of Revenue (DoR) sought passage of profit margin relief legislation to generate additional profits for senior programs. Act 201 of 2014 permanently reduced this profit rate, but was enacted Oct. 31, too late for consideration when structuring Lottery instant games for the busy winter holiday season. The Lottery also launched a new multi-state game, Monopoly Millionaire's Club, on Oct. 19. To date, Lottery sales have not shown a rate of growth on par with reaching the 4.2% growth assumption. The combination of profit margin relief, a new multi-state game and holiday sales may help sales in the remaining months of the fiscal year, but revenues will need to be monitored throughout.

In addition to relying on 4.2% growth in sales, 2014-15 Lottery Fund expenditures nearly deplete the prior year end balance/surplus. At the end of 2014-15, the Lottery Fund will be left with an estimated ending balance of only $9.4 million, after placing $75 million in reserve historically held for unanticipated expenditures and/or lagging sales. This represents the lowest ending balance in the Lottery Fund since 1994-95.

EDUCATION

Governor Corbett's first budget reduced classroom education aid by more than $1 billion, including over $600 million in targeted line item appropriations that were cut for programs including charter school reimbursement, tutoring, and Accountability Block Grants. These program cuts disproportionately hurt poorer, struggling school districts. The modest restorations that have been made during the subsequent three years have provided unequal relief to wealthier schools and a small number of handpicked Republican school districts.

Governor Corbett's budget choices have left classroom spending lag almost $700 million below 2010-11 funding levels. Cumulatively, these cuts total nearly $3.5 billion. Pennsylvania was the only state in the country with rising test scores at all grade levels from 2003 through 2010. Moreover, the learning gap for poorer and minority students was reduced by more than 50% during that time period. Following the Corbett Administration's education cuts, PSSA results declined for the first time in a decade and have remained lower for the last three years.

The newly released School Performance Profile scores show that for the state's nearly 3,000 public schools, more schools saw their score decline last year from the prior year. Specifically, 1,539 schools experienced a drop in their score and 1,405 either improved or stayed the same. Traditional public schools averaged scores of 76.9 points, while brick-and-mortar charter schools averaged 65.1 points and cyber charter schools, 48.9 points. PDE considers 70 a "mark of moving toward success". Districts have been forced to increase class sizes, tutoring programs have been reduced or eliminated, summer school programs have been curtailed and early learning initiatives have been scaled back. It would have been highly improbable for student learning and achievement to not be impacted.

Next year's school district budgets will be difficult to balance, especially with increased pension obligations. The PSERS Board is expected to set 25.84% of payroll as the total employer contribution for 2015-16 for each school district, up 4.4% from the current year's rate.

Clearly it is time for Pennsylvania to develop and implement a sensible education funding formula that addresses real classroom costs, meets real student needs, and builds successful schools and successful communities. A Basic Education Funding Commission has been established with the mission of creating a new "equitable" formula that considers the economic, geographic and cultural constraints preventing each of the state's 500 school districts from achieving academic proficiency. It is too soon to tell if the commission will make recommendations as to an "adequate" level of funding which addresses the funding gaps holding students back. A final report of the commission is due June 2015.

HIGHER EDUCATION

In Governor Corbett's first budget proposal, he recommended cuts to our state owned and state related institutions of more than 50% and gained national attention for proposing the nation's biggest cuts in higher education – unprecedented for any Governor in the country. The legislature was able to negotiate cuts of 18% for PASSHE and 19% for the state-related institutions. The following year he proposed cuts of 20% for PASSHE and 30% for the state-relateds – the legislature was able to hold off these cuts and the institutions were level funded. But these sustained cuts require the universities to reduce faculty, decrease program offerings and raise tuition.

Among public institutions, the cost at four-year institutions in the state ranks third-highest in the nation, behind only New Hampshire and Vermont; for two-year schools, Pennsylvania comes in at seventh highest. Students who attend private, nonprofit universities also pay far more than the national average, ranking sixth.

According to a report released by the Keystone Research Center, Pennsylvania is ranked third-highest in terms of the amount of debt students have when they graduate from a four-year college. College educated Pennsylvanians earn almost twice what those with just a high school diploma earn and are half as likely to be unemployed. The demonstrated benefits include increased lifetime earnings and tax revenues, and increased purchases such as homes and cars. The benefits also relate to improvements in quality of life such as decreased crime and incarceration rates.

The growing need for higher education is coming at a time when the cost of college is rising to levels that are increasingly unaffordable for many American families. The challenges related to "college access" go well beyond being accepted into post-secondary programs, to include the hurdles that prevent many students, particularly minority and low-income students, from completing degrees. Rising cost of tuition, social disadvantages, and lack of adequate academic preparedness, have contributed to under-representation of these groups of students on college and university campuses. Earning a college degree is the clearest path to the American dream and the benefits and security of the middle class — it is an economic necessity.