2017/18 BUDGET BRIEFING

Report on Key Issues

HOUSE APPROPRIATIONS COMMITTEE (D)

JOE MARKOSEK, DEMOCRATIC CHAIRMAN

February 7, 2017

Gov. Wolf's 2017/18 Executive Budget Proposal

This document is an overview of Gov. Wolf's 2017/18 Executive Budget proposal. The Democratic House Appropriations Committee will continue to review the budget request. We will deliver briefings on specific issues and program areas as more information is shared.

Visit the Department of Education's website for spreadsheets detailing, by school district, the estimated basic and special education funding.

Overview

For nearly a decade, Pennsylvania has rolled chronic budget deficits forward year-after-year, frustrating its ability to reasonably secure the future of education and other programs that are core to any state's mission and economic success.

Each year, the Democratic House Appropriations Committee conscientiously reports on the one-time funding sources and financial gimmicks used to plug the budget hole for "*just one more year*" and we wonder, is this the last year?

It seems that Pennsylvania has become numb to the latest structural deficit announcements – the amount needed just to keep the lights on and maintain commitments we have already made, currently estimated at roughly $3 billion between the current and upcoming budget years. We cannot continue like this for the sake of our children and future generations.

The budget that Gov. Tom Wolf proposes today lays out some very tough choices that deserve our full consideration. The Democratic House Appropriations Committee reports on that proposal today and reserves judgement as we delve into the detail and comprehensively understand the implications for Pennsylvanians. We do this amid an increasingly uncertain and alarming political environment in Washington D.C. and note that the real wild card is not the latest budget proposal, but rather what President Trump and Congress will do to the $28.7 billion in federal funds that Pennsylvania counts on – and is assumed – in the budget year.

Gov. Wolf's proposed 2017/18 state General Fund budget of $32.3 billion increases state expenditures by $571.5 million, or 1.8 percent, after adjusting for proposed supplemental appropriations.

According to the administration **the 2017/18 General Fund budget will be out of balance by more than $3 billion (structural deficit)** if the commonwealth merely budgets to meet legally required obligations and just maintains other programs at current spending levels. By comparison, the IFO estimates the structural deficit to be just under $3 billion. Under either scenario, the problem is significant and demands to be fixed. Normal expenditure growth continues to outpace revenue growth. To address this problem, the administration is proposing the following:

- Roughly $2 billion in savings initiatives that include consolidations, new financing proposals, debt restructuring and revenue enhancements

- Roughly $1.0 billion in new revenue

Combined Operating Budget

Although emphasis is placed on the General Fund budget, the combined operating budget provides the most accurate representation of spending trends. Considering all funds (federal, state, special and other), the governor's proposal represents a **total commonwealth operating budget that increases by almost $874 million to $81.0 billion, including $52.3 billion in non-federal funds**.

While many cost containment initiatives are proposed throughout the budget, one of the most important that falls across many funds and departments is a reduction in the commonwealth's authorized salaried complement and elimination of vacant positions. The commonwealth's workforce will be reduced in 2017/18 by 3,442 positions to 77,594 through natural attrition or consolidation of agencies, according to the administration. The largest decreases in the proposed authorized complement would occur in the Department of Labor and Industry, followed by the consolidations of Health, Human Services, and Criminal Justice.

General Fund

Gov. Wolf's proposed 2017/18 state General Fund budget of $32.3 billion increases state expenditures by $571.5 million, or 1.8 percent (after adjusting for proposed supplemental appropriations).

Again this year, the centerpiece of the governor's proposal remains an increased commitment to pre-K-12 education. The $571 million budget-year increase is the annual **net increase;** $918 million of department increases are offset by $347 million of reductions in other departments, compared with current year spending (2016/17). See Table on page 7.

The largest components of the $918 million year-over-year **net** increase (over $10 million) are in the following departments:

- $218 million in the Department of Education, excluding $240 million in the employer contribution for the school employee pension system,
- $427 million in the Department of Health and Human Services, a new department that consolidates four existing agencies under one umbrella.

The largest components of the $347 million year-over-year **net** reduction (more than $10 million) are in the following departments:

- $154 million in Treasury, largely due to reduced debt service appropriations tied to a lease-back proposal for the Farm Show building;
- $53 million in the Department of Conservation and Natural Resources, largely due to shifting of funds;
- $43 million in the Department of Corrections, largely due to a planned prison closure;
- $34 million in the Department of Agriculture, largely due to a decision to no longer supplement the private University of Pennsylvania School of Veterinary Medicine;
- $13 million in the Department of Community and Economic Development;
- $13 million in the PA Higher Education Assistance Agency due to a cuts and matching requests for Institutional Assistance Grants; and
- $13 million in State Police funds, mostly from a proposal to require municipalities entirely dependent on state police for law enforcement to pay some of their costs.

The use of one-time funds has been significantly reduced in the proposed budget. Financing tools worth $335 million are used to fund initiatives and offset budget year costs in several agencies (mostly in the General Fund), including the $200 million lease-back proposal for the Farm Show building.

According to the agreed-to budget deal for 2016/17, the projected ending balance depends on one-time funding sources that include loans from the Workers Compensation Security Fund ($165 million) and the Joint Underwriting Association ($200 million). That budget deal also depends on $100 million from internet gaming legislation that has not yet been enacted.

A more complete tally of one-time funding sources will be provided in the near-future.

The governor expects 2016/17 General Fund base revenues to fall short of the current forecast by $639 million, which implies a lower revenue base in the 2017/18 budget year of a similar amount. This is not a surprise given that revenues are $416.8 million below estimate through the end of January 2017. The Independent Fiscal Office revised its estimates in January and projected that the fiscal year will close with revenues $716 million below the official estimate. We recommend a cautious outlook for further deterioration in revenue performance during April and May, the largest collection months. For more information on the IFO's budget outlook, read its full report.

Gov. Wolf's 2017/18 state General Fund budget projects 3.0 percent base revenue growth ($918.7 million), reflecting only the growth driven by current law. This revenue growth rate does not include Gov. Wolf's proposed:

- Revenue modifications, which total $253 million in 2016/17;
- New tax revenue worth approximately $1.0 billion in 2017/18; and
- Savings initiatives totaling $1.2 billion (a component of the $2 billion savings initiatives) in 2017/18 that come from maximizing current revenues, such as debt restructuring, expanded gaming and continued liquor modernization.

The legislature has suspended **Rainy Day Fund** transfers each year since 2008. The governor's 2017/18 proposal would transfer a nominal amount to the Rainy Day Fund this budget year. However, he said he is envisioning a plan that would result in a replenishment of $500 million in future years. Generally, public policy experts recommend that states put five to 15 percent of their General Fund spending into some type of savings account. For Pennsylvania, this would mean a Rainy Day fund balance of between $1.7 billion and $5 billion, assuming the current budget proposal. The balance today is negligible.

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Financing Tools

The executive budget proposes to use the commonwealth's assets and debt capacity to create General Fund savings over the short term. Together, these savings initiatives would provide $335 million in additional funds for the budget year, followed by $124.5 million for each of the following two years.

Two hundred million dollars in one-time revenues would be generated in the budget year through the monetization of the Farm Show complex specifically to offset General Fund debt service costs. The proposal would lease the Farm Show complex to a private entity for 29 years, and that private entity would lease back the facility to the commonwealth for the same term with an annual rental payment. The commonwealth would maintain control of the facility. As a result, the primary General Fund debt service appropriation would be reduced by a net $151.4 million, or 13.6 percent, compared to the current year.

The budget proposes to issue $387.4 million in bonds in the current year through the Commonwealth Financing Authority to support programs over the next three fiscal years. Proceeds would be used to finance current grant programs, new watershed protection efforts, and a smart cities initiative. $135.5 million of these bond proceeds would be distributed in the budget year as illustrated in the nearby table.

The proceeds would be distributed from the Pennsylvania Economic Revitalization Fund over three years. The smart cities initiative would receive a one-time $11 million investment. New watershed protection efforts would receive an estimated $15 million per year for three fiscal years.

Specifically, the proposed budget would allocate funding for watershed protection efforts as follows:

- $4.7 million to the Department of Agriculture for the development of erosion and sediment management plans on Pennsylvania farms;
- $8.3 million to the Department of Environmental Protection to address local water quality efforts, such as rebates to farmers to cover costs of erosion and sediment control; and
- $2 million to the Department of Conservation and Natural Resources to expand the Chesapeake Bay Riparian Forest Buffer program, which would include leveraging an additional federal match. These investments support the Chesapeake Bay restoration strategy launched by these agencies last February.

The balance of the proceeds would support existing grant programs historically funded by current revenues for three fiscal years in annual amounts of:

- Commonwealth Universal Research Enhancement, or CURE, Grants - $45.9 million;
- Cultural and Historical Support Grants - $2 million;
- Grants to the Arts - $9.6 million; and
- Environmental Stewardship Fund Grants - $52 million.

Projected Use of Commonwealth Finance Authority Bond Proceeds (in millions)				
	2017/18	2018/19	2019/20	**TOTAL**
Smart Cities Initiative	$ 11.0	$ -	$ -	**$ 11.0**
Watershed Protection Efforts	$ 15.0	$ 15.0	$ 15.0	**$ 45.0**
CURE Grants (health research)	$ 45.9	$ 45.9	$ 45.9	**$ 137.7**
Cultural and Historical Support Grants	$ 2.0	$ 2.0	$ 2.0	**$ 6.0**
Grants to the Arts	$ 9.6	$ 9.6	$ 9.6	**$ 28.8**
Environmental Stewardship Fund Grants	$ 52.0	$ 52.0	$ 52.0	**$ 156.0**
TOTAL	**$ 135.5**	**$ 124.5**	**$ 124.5**	**$ 384.5**

In 2017/18, the proposed $52 million transfer to the Environmental Stewardship Fund would support existing programs of the fund, while also enabling a new $37 million transfer from the ESF to the Oil and Gas Lease Fund. DCNR program costs would be shifted to the Oil and Gas Lease Fund. For more information, see the environmental section in this document.

By using bonds to pay for grant programs instead of current revenues, the budget would shift $94.5 million in General Fund costs to other funds.

Education

Gov. Wolf's 2017/18 budget proposal continues to reverse the prior administration's cuts to school districts and make new investments in high quality early learning programs.

PreK-12

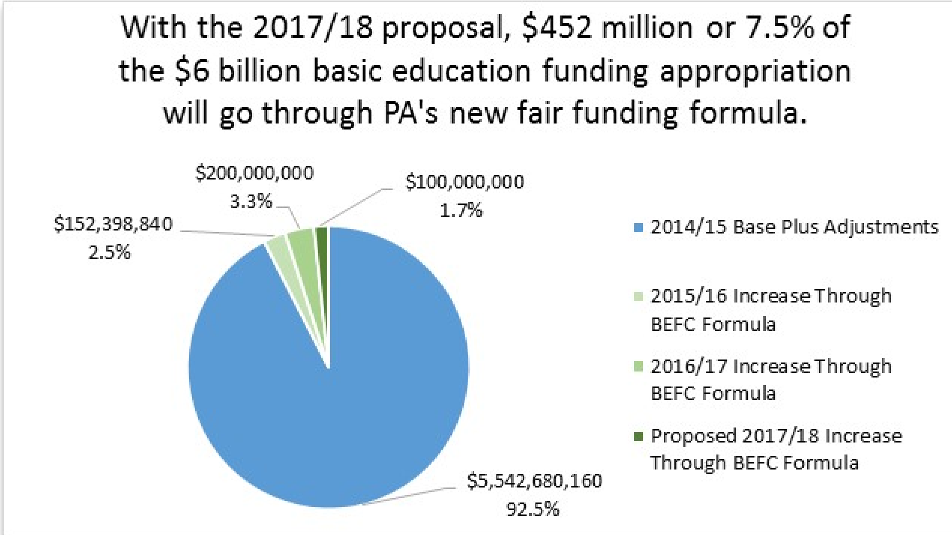
The proposed 2017/18 budget requests $9.6 billion in state General Funds for PreK-12 education (excluding pensions). This would represent an increase of $218 million, or 2.3 percent, over 2016/17, if approved.

Basic Education Funding

Gov. Wolf's 2017/18 budget proposal would add $100 million for basic education funding. Enactment of this proposal would mean more than half a billion dollars has been added back to the basic education subsidies under the governor's first three budgets. As illustrated on page 9, this investment would bring the proposed 2017/18 basic education subsidy total to within $65 million of the 2010/11 peak funding level.

Pennsylvania's new, more equitable fair funding formula only applies to funding above the 2014/15 adjusted base amount. Therefore, the proposed $100 million increase would bring the total amount distributed through the fair funding formula in 2017/18 to $452 million, or 7.5 percent of the $6 billion basic education funding appropriation.

In 2015/16 and 2016/17, the share of funding distributed through the fair funding formula were 2.7 percent and 6 percent, respectively. As more funding is added, the share distributed fairly will represent a greater portion of the entire basic education funding appropriation.



Early Childhood

The 2017/18 budget proposal includes a $75 million, or 38.2 percent, increase for early childhood education, which would allow 8,430 additional students to enroll in high quality early learning programs.

Gov. Wolf's 2017/18 budget proposal continues to prioritize investing in high quality early learning programs.		Actual FY14-15	Actual FY15-16	Available FY16-17	Budget FY17-18	FY17-18 Less FY16-17 Δ	FY17-18 Less FY16-17 %Δ	FY17-18 Less FY14-15 Δ	FY17-18 Less FY14-15 %Δ
Pre-K Counts	Funding Level	$97.3 M	$122.3 M	$147.3 M	$212.3 M	$65.0 M	44.1%	$115.0 M	118.2%
	Number of State-Funded Students	13,456	16,937	18,140	25,540	7,400	40.8%	12,084	89.8%
Head Start Supplemental Assistance	Funding Level	$39.2 M	$44.2 M	$49.2 M	$59.2 M	$10.0 M	20.3%	$20.0 M	51.0%
	Number of State-Funded Students	4,781	5,728	5,580	6,610	1,030	18.5%	1,829	38.3%
Early Childhood Education Subtotal:	Funding Level	**$136.5 M**	**$166.5 M**	**$196.5 M**	**$271.5 M**	**$75.0 M**	**38.2%**	**$135.0 M**	**98.9%**
	Number of State-Funded Students	**18,237**	**22,665**	**23,720**	**32,150**	**8,430**	**35.5%**	**13,913**	**76.3%**
Source: Governor's Executive Budgets									

Other Programs

- Gov. Wolf’s 2017/18 budget proposal would increase **special education funding** by $25 million, or 2.3 percent. This increase would be combined with the $70 million added to the program since 2013/14 (the final year of a six-year string of flat funding for special education) and distributed through the Special Education Funding Commission’s recommended formula.
- The 2017/18 budget would provide $11.7 million, or a 4.6 percent increase, for **early intervention**, building on the $14.6 million added over the previous two budgets.
- The funding source for **PlanCon** is now shared between the state’s General Fund and proceeds from bonds issued by the Commonwealth Financing Authority. The $29.7 million proposed (“authority rentals and sinking fund requirements”) for 2017/18 would go toward reducing the backlog (Part G and Part H) of projects waiting to begin receiving reimbursements from the state, as well as pay the state’s obligation for charter school leases.
    - In 2016/17, $735 million of school construction bond proceeds were made available to school districts for back-pay reimbursement and to pay 2015/16 and 2016/17 obligations for legacy projects. A second round of school construction bonds is expected to be issued in 2017/18.
- Gov. Wolf’s 2017/18 budget proposes to capture $50 million in savings through a new **pupil transportation** funding formula. Gov. Wolf has noted that the current formula is outdated and

complicated. Further, the governor is proposing to require pupil transportation contracts to be competitively bid.

  - Details on what the elements of the new formula are, how the new formula will incentivize efficiencies and best practices, and in particular, how this proposal will impact funding levels for school districts will be shared after further analysis.

- The proposed increase in the **school employees' social security** appropriation would largely reflect a return to a full 12 months of reimbursements from the state to school districts. The 2015/16 and 2016/17 budgets included gimmicks that, effectively, only funded reimbursements for 10 and 11 months, respectively.
- The budget proposal includes a $2 million initiative in **school food services** to leverage up to $20 million in federal funds to expand access to school breakfast programs through competitive grants for schools with more than 60 percent of children receiving subsidized meals. Another $2 million within **general government operations** would leverage $1 million in federal funds to bolster school improvement efforts at three yet-to-be named school districts with persistently low-achieving schools.

Higher Education

The executive budget increases funding for the Pennsylvania State System of Higher Education by $8.9 million, or 2.0 percent.

Other public institutions of higher education, including community colleges, the four state-related universities (Penn State, Pittsburgh, Temple, and Lincoln), and Thaddeus Stevens College of Technology, receive no increase. The state appropriation for PHEAA grants is also flat funded.

The budget cuts in half institutional assistance grants to private colleges and universities. This program provides additional support to private institutions enrolling students with financial need, as measured by the number of PHEAA grant recipients enrolled at the school. The governor proposes to institute a matching requirement for these grants.

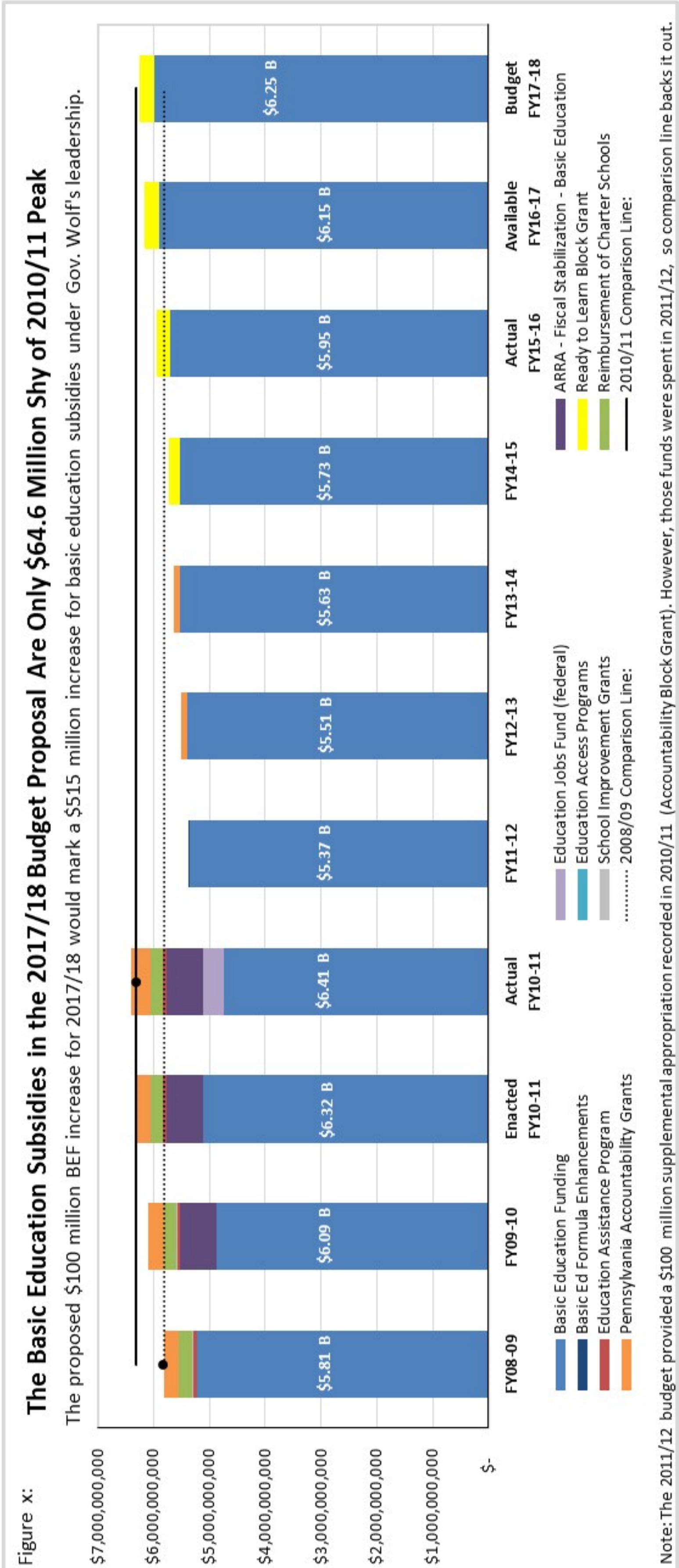


Figure x:
The Basic Education Subsidies in the 2017/18 Budget Proposal Are Only $64.6 Million Shy of 2010/11 Peak
The proposed $100 million BEF increase for 2017/18 would mark a $515 million increase for basic education subsidies under Gov. Wolf's leadership.
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FY12-13
FY13-14
FY14-15
Actual FY15-16
Available FY16-17
Budget FY17-18
Basic Education Funding
Basic Ed Formula Enhancements
Education Assistance Program
Pennsylvania Accountability Grants
Education Jobs Fund (federal)
Education Access Programs
School Improvement Grants
2008/09 Comparison Line:
ARRA - Fiscal Stabilization - Basic Education
Ready to Learn Block Grant
Reimbursement of Charter Schools
2010/11 Comparison Line:
Note: The 2011/12 budget provided a $100 million supplemental appropriation recorded in 2010/11 (Accountability Block Grant). However, those funds were spent in 2011/12, so comparison line backs it out.

Pensions

Gov. Wolf's 2017/18 budget proposes to fully pay the state's annual required contribution (ARC) to both state pension systems. This is noteworthy because **it is the first time in 16 years for the State Employees' Retirement System (SERS) and the second time in as many years for the Public School Employees' Retirement System (PSERS).**

Each system's respective increase reflects the multi-year and predictable adjustments in employer funding to pay down the state's unfunded pension liability debt pursuant to the funding schedule provided for by the Act 120 reforms of 2010.

While the contribution amount increased, the magnitude of the increase is beginning to rapidly diminish as more of the contribution goes directly to paying down the debt (e.g., for PSERS, 75 percent of the employer contribution goes to the pension debt).

For the annually required employer contribution made to the PSERS Fund, the governor's 2017/18 budget proposal requests $2.304 billion in state General Funds, which would represent an increase of $240 million, or 12 percent, from 2016/17. For the second time in 16 years, the employer contribution made by the state would provide 100 percent of the actuarially required contribution.

The annually required employer contribution made to the SERS Fund is not provided in a single appropriation, but rather is allocated throughout every appropriation that includes personnel expenditures. Across the multitude of appropriations, it is assumed the governor's 2017/18 budget proposal would include roughly $669 million in state General Funds for offices under the governor's jurisdiction, which would represent an estimated increase of $64 million, or 11 percent, from 2016/17. **For the first time in 16 years, the employer contribution made by the state will provide 100 percent of the actuarially required contribution.**

As a part of the governor's ongoing "Government that Works" theme, the proposed budget assumes savings generated by implementing an early retirement incentive program. Details necessary to comprehensively understand and analyze this proposal were not included in the governor's budget materials. Of note, a similar early retirement program in 1992 and 1993 could be a good reference when considering this course of action. A 1996 report on this program, prepared by the Public Employee Retirement Commission, concluded that overall pension savings only happens when the net salary and benefit savings from new employees exceed the cost of additional pension benefits provided by the incentive. Committee staff will closely monitor this proposal and provide updates as details become available.

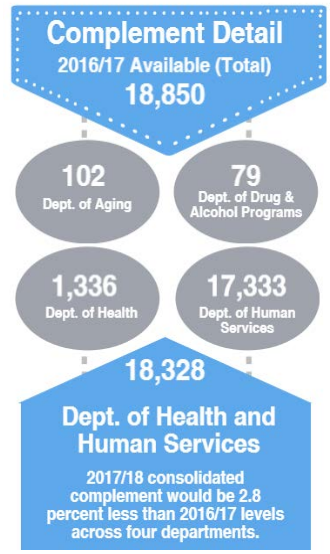
Another "Government that Works" theme proposed by the governor's budget includes consolidating the PSERS and SERS investment offices. The proposal intends to permit each Board to maintain investment decision-making, however the combined office will be charged with reducing investment management fees. The execution of this plan would require further vetting and due diligence in cooperation with the Systems and their investment advisors. Further, the potential impact this policy would have on each system's Trustee and fiduciary duties would need to be considered in full.

Health & Human Services

Closures and Consolidations

Gov. Wolf is proposing to consolidate four agencies – Human Services, Health, Drug and Alcohol Programs, and Aging – into a new Department of Health and Human Services, or DHHS.

The Executive Budget assumes this consolidation would encourage more effective service coordination and service delivery, enhance program effectiveness, reduce administrative costs and eliminate duplicative functions. To that end, the 2017/18 budget would include savings of $157 million, including:



- $90 million for moving from a fragmented service delivery system to a more seamless approach under a single agency;
- $45 million for consolidating multiple prescription drug programs, including PACE in the Department of Aging, the Medical Assistance and Children's Health Insurance Program pharmacy functions in the Department of Human Services, and the prescription drug monitoring program in the Department of Health;
- $15 million for reducing the number of state health centers and relocating community health nurses into other community-based settings, such as existing county assistance offices or local health departments; and
- $7 million from streamlining and reorganizing county assistance offices.

The new Department of Health and Human Services would have 10 deputates to oversee its various responsibilities. Today there are eight deputates in the Department of Human Services. The Executive Budget anticipates the new agency's full-time complement will decrease by 522 positions to 18,328 because of consolidation.

Human Services

Medical Assistance. State General Fund appropriations for the Medical Assistance program account for $5 billion of the Executive Budget request, and are anticipated to fund health care for 2.9 million Pennsylvanians in 2017/18, including an estimated 775,000 newly eligible adults under Medicaid expansion.

Two of the largest cost drivers in the 2017/18 budget are the increasing state share for Medical Assistance coverage provided to newly eligible adults ($205 million) and the higher monthly payments Pennsylvania must remit to the federal government for the Medicare Part D prescription drug program ($96.6 million).

These increased costs are offset by two factors in the HealthChoices managed care program which, together, are expected to reduce state spending in 2017/18 by $250 million compared to 2016/17. Most notably, an increase in the assessment levied on managed care organizations is projected to save the state $108 million. Expenses paid in 2016/17 that will not recur in 2017/18 reduce state spending by $143 million – this includes the Affordable Care Act fee on health insurers (including managed care organizations) that the federal government collected in 2016 but will not be collected in 2017 due to a moratorium signed by President Obama.

Community HealthChoices. Community HealthChoices is the name of the managed long term care program proposed by Governor Wolf in his 2015/16 budget as a way to enhance community opportunities for seniors and adults with physical disabilities. The department will contract with selected managed care organizations which will be paid a capitated rate to provide coordinated coverage of physical health and long-term care services to Community HealthChoices participants. When fully operational, the program is expected to serve an estimated 450,000 adults statewide, many in their homes and community. In the future, the program is expected to control the growth in long term care expenditures.

The Executive Budget assumes Community HealthChoices will begin operating January 1, 2018 in the southwest region of Pennsylvania and requests $44 million to fund the program, a program that is expected to save money over the long term. This funding request reflects a net increase across seven appropriations as detailed below. Please note that funding for the rates that would be paid to Community HealthChoices managed care organizations appears in the long term care appropriation, which currently funds nursing facility care.

- Appropriations for which the governor requested increases are Medical Assistance long term care ($150.6 million) and long term managed care, which funds the LIFE program ($2.8 million);
- Appropriations for which the governor requested decreases include Medical Assistance capitation ($15 million), Medical Assistance fee for service ($17.9 million), home and community-based services aging waiver ($35 million), services to persons with disabilities ($28.5 million) and attendant care ($13 million).

The department has already delayed implementation of Community HealthChoices twice, first delaying the rollout from January 2017 until July 2017 and then delaying it another six months to January 2018. It remains to be seen whether this new target date will be met.

Community Services for Seniors and Adults with Physical Disabilities. The governor is requesting $56.2 million to provide home and community-based services to an additional 4,338 seniors and adults with physical disabilities:

- $12.9 million for the Medicaid Aging Waiver to serve an additional 1,428 seniors;
- $14.1 million for the LIFE managed care program to serve an additional 600 seniors ($7 million) and to expand into nine counties ($7.1 million);
- $21.2 million for services to persons with disabilities so that an additional 1,470 adults may participate in Medicaid waiver programs; and
- $8 million for attendant care services for an additional 840 adults with disabilities.

Community Services for Individuals with Intellectual Disabilities and Adults with Autism. Gov. Wolf is proposing $25.2 million to provide home and community-based services to individuals with intellectual disabilities and adults with autism. These funds would provide Medicaid waiver services to 1,910 Pennsylvanians as follows:

- $15.4 million to serve 1,000 individuals with intellectual disabilities who currently are on the waiting list;

- $8.6 million to serve 820 students graduating from special education;
- $564,000 to serve 50 individuals with intellectual disabilities who are currently residing in state centers; and
- $642,000 to serve 50 adults with autism spectrum disorder.

The governor also proposes $1 million to provide targeted services management state plan services to 2,000 Pennsylvanians who are on the waiting list for home and community-based Medicaid waiver services. Targeted case management services include comprehensive assessment and periodic reassessment of individual needs to determine the need for any medical, social educational or other services. The target group includes individuals transitioning to a community setting. The funds would serve 455 individuals with intellectual disabilities and 1,545 adults with autism spectrum disorder.

Mental Health Services. The Executive Budget requests $4.7 million to provide community services for 90 individuals who currently reside in the state mental health hospitals.

Child Care Services. Governor Wolf is proposing $10 million to serve an additional 1,800 children on the low-income waiting list. A similar initiative was proposed last year, but was not included in the enacted budget.

Community-Based Family Centers. Once again, the governor is requesting funding to expand evidence-based home visiting services for pregnant women, infants and young children. The 2017/18 proposed budget includes $9 million for this initiative.

County Child Welfare. The Executive Budget recommends $57.4 million to fund increasing county needs-based budgets.

Health

Within the newly-consolidated Department of Health and Human Services, the governor's Executive Budget proposes an overall reduction of 30.5 percent for those appropriations formerly housed within the Department of Health. These savings, if approved, would primarily be achieved through the consolidation of services and facilities, although there are also reductions reflected in the elimination of specific appropriations that are, traditionally, added back by the legislature. Gov. Wolf's proposal would consolidate these condition- and program-specific appropriations into a new, unified appropriation for health program assistance in the new department (see chart).

Consolidated Health Lines

Appropriation (amounts in Thousands)	2016/17 Proposed	2016/17 Enacted	2017/18 Proposed
Diabetes Programs	0	100	
Cancer Screening Services	2,563	2,563	
Regional Cancer Institutes	0	600	
Adult Cystic Fibrosis & Chronic Respiratory Illnesses	350	750	
Cooley's Anemia	100	100	
Hemophilia	949	959	
Lupus	0	100	
Sickle Cell	1,200	1,260	
Regional Poison Control Centers	0	700	
Trauma Program Coordination	0	460	
Epilepsy Support Services	0	550	
Bio-Technology Research	0	6,625	
Tourette Syndrome	0	150	
Amyotrophic Lateral Sclerosis (ALS) Support Services	0	500	
Subtotal - Existing Dept. of Health Appropriations	**5,162**	**15,417**	**0**
Appropriations previously in Dept. of Health would be consolidated under a single, new appropriation in Dept. of Health and Human Services.			
Health Program Assistance			**5,162**

The Executive Budget proposal includes savings generated by streamlining the operation of 55 state health care centers, along with other departments' health facilities. The appropriation for these facilities would see a net reduction of $13.1 million, or 55.7 percent. While the Executive Budget does not clarify whether facilities would be shuttered, the Corbett administration attempted to unilaterally close a number of the state health care centers in an action that was ultimately blocked by the courts.

The 2017/18 budget proposal would reduce funding to the vital statistics appropriation, which would be offset by increased augmentation support from higher death certificate fees. The governor also proposes a $2.5 million, or 50 percent, decrease to the community-based health care subsidy appropriation.

The 2017/18 Executive Budget proposal shifts the appropriation for the primary health care practitioner loan repayment program to the Pennsylvania Higher Education Assistance Agency (PHEAA), mirroring a 2016/17 budget proposal.

Drug & Alcohol Programs

The governor's 2017/18 budget proposal rehouses the appropriation for assistance to drug and alcohol programs in the Department of Health and Human Services. This appropriation to fund drug treatment activities in counties joins the prescription drug monitoring program and healthy homes for individuals living with substance abuse disorders in the newly established DHHS. The budget proposal also increases funds to law enforcement and first responders through grants to obtain and administer overdose reversal kits.

Lottery Fund

Gov. Wolf is proposing Lottery Fund spending of $1.84 billion in 2017/18. These funds would be used to pay for lottery operations, commissions to vendors and retailers, prizes, and programs benefitting Pennsylvania's seniors.

The Executive Budget assumes enactment of Lottery Fund profit relief and implementation of internet lottery (also known as I-Lottery) to generate additional revenues, and it presumes net lottery collection growth of 4.8 percent to $1.7 billion in 2017/18. Other available revenue includes transfers from the Gaming Fund ($145.7 million), the Lottery Fund balance carried forward from the previous year ($17.4 million), and investment earnings ($1.5 million).

Current law (Act 201 of 2014) requires Lottery to contribute at least 25 percent of each dollar earned to programs benefitting seniors. Previous reductions in the profit rate (Act 53 of 2008 and Act 23 of 2011) have given Lottery the ability to offer games that maximize profits for senior programs and engage in long-term planning for introducing new games in the future. We do not yet know the specific profit rate the administration is seeking.

The proposed budget would leave the Lottery Fund with an ending balance of $29.5 million with no money held in reserve as a cushion against under-performing ticket sales or higher than anticipated program expenditures.

As part of the governor's proposed agency consolidation, all Lottery-funded senior programs would move from the Department of Aging to the new Department of Health and Human Services. The Executive Budget continues to use the Lottery Fund to pay agency expenses related to the operation of senior programs, proposing $8.9 million be appropriated from the fund for this purpose.

Gov. Wolf is requesting $1.24 billion for senior programs in 2017/18. This would be $80.7 million less than 2016/17, which included a $20 million supplemental appropriation reduction for the Pharmaceutical Assistance Fund. The 2017/18 spending reduction would be due, primarily, to proposed savings in the PACE program and the disappearance of one-time expenditures in the property tax and rent rebate program. The Executive Budget does not seek to change eligibility for services.

Lottery Fund Expenditures for Senior Programs

(Dollars in Millions)

	Executive Budget		Change from
Agency/Appropriations	**2016/17**	**2017/18**	**2016/17**
Department of Health and Human Services			
PennCARE	$325.2	$329.5	$4.3
Pre-Admission Assessment	$19.9	$19.9	-
Caregiver Support	$12.1	$12.1	-
Pharmaceutical Assistance Fund	$185.0	$125.0	-$60.0
Alzheimer's Outreach	$0.3	$0.3	-
Grants to Senior Centers	$2.0	$2.0	-
Medical Assistance Long-Term Care	$184.1	$184.1	-
Home and Community Based Services	$120.7	$120.7	-
Medical Assistance Transportation	$3.3	$3.5	$0.2
Department of Revenue:			
Property Tax and Rent Rebate	$289.9	$264.7	-$25.2
Department of Transportation:			
Transfer to Public Transportation Trust Fund (Free Ride)	$95.9	$95.9	-
Shared Ride	$83.0	$83.0	-
TOTAL	**$1,321.3**	**$1,240.6**	**-$80.7**

NOTE: Appropriations shaded in green are currently in the Department of Aging and, under the governor's agency consolidation proposal, would be merged into the new Department of Health and Human Services.

Tobacco Settlement Fund

The Executive Budget anticipates the commonwealth will receive $348 million from tobacco manufacturers in April 2018 for deposit into the Tobacco Settlement Fund. The table shows how Gov. Wolf proposes allocating these revenues to specific health-related programs in 2017/18.

Tobacco Settlement Fund			
	Act 71 of 2013	Executive Budget 2017/18	
Health-Related Programs	**Allocation %**	**Allocation %**	**$ Millions**
Home and Community-Based Services	13%	13%	$45.2
Tobacco Use Prevention and Cessation	4.5%	4.5%	$15.7
Health and Related Research (CURE)	13.6%	0.41%	$1.4
Hospital Uncompensated Care	8.18%	8.18%	$28.5
Medical Assistance for Workers with Disabilities	30%	30%	$104.4
PACEnet Transfer	8%		$0.0
Health-Related Purposes:	22.72%	43.91%	
Medical Assistance - Long Term Care			$149.8
Life Sciences Greenhouses			$3.0
TOTAL			**$348.0**

As in his previous budgets, Gov. Wolf recommends changing the statutory formula enacted in 2013 (Act 71) for allocating annual tobacco payments to specific programs. For 2017/18, the governor proposes the following changes to the statutory formula:

- Reduce the funding allocation for health and related research from 13.6 percent in Act 71 to 0.41 percent;
- Eliminate the funding allocation for the PACENET Transfer; and
- Increase the funding allocation for health-related purposes from 22.72 percent in Act 71 to 43.91 percent.

These proposed changes to the allocation formula would redirect nearly $74 million of tobacco revenue to Medical Assistance - long term care. The commonwealth would use the redirected tobacco funds to help pay for nursing home care provided to Medical Assistance recipients, thereby reducing the amount of General Fund revenue otherwise required to pay for these services.

The reduced allocation for health and related research under the Commonwealth Universal Research Enhancement, or CURE, grant program reflects the governor's proposal to fund this through a new bond issuance. The bond, to be issued through the Commonwealth Financing Authority, would offset tobacco funds to support CURE grant programs for three years.

Transportation

The 2017/18 budget proposal includes $6.1 billion in state funding for the Department of Transportation, which would be an increase of $56 million, or roughly 1 percent, over 2016/17, if approved.

The most significant funding change would reflect the reduction of bond revenues for highway and safety improvements and a commensurate increase in funding from Motor License Fund revenues. This short-term funding strategy is intentional and authorized in Act 89 of 2013.

Criminal Justice (New)

Gov. Wolf is again proposing to consolidate the Department of Corrections and the Pennsylvania Board of Probation and Parole into a single criminal justice agency. The administration estimates potential savings of $10.4 million from the merger through improved coordination between the agencies and the elimination of redundant positions. The administration assumes further savings of $85 million in the new Department of Criminal Justice that will come from closing the State Correctional Institution at Pittsburgh by June 30, 2017.

Within the new agency, the Board of Probation and Parole, which has sole authority to parole inmates from prison, would remain independent. Likewise, other core functions previously funded through the Probation and Parole GGO would be separated into distinct appropriations outside of the combined GGO to assure operational independence.

In total the governor's budget proposal includes $2.5 billion in state General Funds for Criminal Justice, which would be a decrease of $43.0 million, or 1.7 percent, if approved.

The administration reports that the combined complement of the new agency will be 17,027, a net decrease of 492 positions from improved efficiencies. This reduction will be made possible through a hiring freeze associated with the scheduled prison closure, natural rates of attrition, and changes in Probation and Parole to transition certain duplicative administrative positions into field agent positions.

Programmatic implications of closures and consolidation are further discussed in the sections below.

In addition to significant savings resulting from the closure of SCI Pittsburgh and the consolidation of the departments, the administration is assuming $68.9 million in savings from modernization, complement savings, elimination of redundancies, and the governor's GO-TIME initiative to offset annual growth in current programs.

Finally, the budget proposal would reinvest $10.2 million of the 2016/17 Justice Reinvestment savings into programs and services to reduce future justice involvement and costs, the last year of savings under JRI. The administration anticipates enactment of Justice Reinvestment II in the current legislative session will generate $108 million in savings through 2023, with the first savings realized in 2018/19.

State Police

Gov. Wolf proposes to reduce state General Fund and Motor License Fund expenditures on state police by $76.6 million or 7.2 percent. Going beyond the fiscal code requirement to appropriate no more from the Motor License Fund in 2017/18 than 2016/17, appropriations from the fund to PSP would decrease by $63.2 million.

The reduction would be offset by a $63.1 million augmentation of revenue to be generated by a new $25 per capita fee on municipalities that benefit from state police patrols but neither maintain their own local police force nor contract out for one. Twenty percent of Pennsylvanians (2.6 million people) live in one of the 1,294 municipalities (half of all municipalities) that rely on PSP for full time police coverage.

The governor's budget proposal includes funding for three new cadet classes beginning in 2017/18 to offset anticipated trooper retirements.

Commission on Crime and Delinquency

The governor's budget proposes $17.7 million in state General Funds for the Pennsylvania Commission on Crime and Delinquency, which would be an increase of $13.0 million or 2.8 times the 2016/17 appropriation.

The increased funding would be for grants to local law enforcement and first responders to provide the life-saving opioid overdose reversal drug, Naloxone ($10 million), and for grants to counties to expand specialty drug treatment courts ($3 million). Additional funding for existing drug treatment courts is also provided in the budget through the Administrative Office of Pennsylvania Courts. Together, these funds would address the opioid epidemic as it intersects with the criminal justice system and may reduce future criminal justice costs.

The budget would also deliver $23.3 million for victims' services, violence prevention, and diversionary programs administered by PCCD, a decrease of $700,000 or 2.9 percent. Up to $4.8 million from the Penn State Settlement fund is also available under existing statute for PCCD to distribute in grants for child advocacy centers.

Pennsylvania Emergency Management Agency (PEMA)

Gov. Wolf's 2017/18 budget proposes $18.99 million in General Fund spending for the Emergency Management Agency, representing a $5.3 million, or 39 percent, increase over 2016/17.

This proposed increase can be attributed to a <u>$5.2 million appropriation for disaster relief</u>, which represents a state match for federally funded projects. Specifically, this funding is tied to Gov. Wolf's request for federal aid in response to the significant flooding in north-central Pennsylvania in October 2016.

Environment

Environmental Protection

Gov. Wolf's 2017/18 budget would provide $149.6 million in state General Fund support for the Department of Environmental Protection. This represents just $1.3 million, or 1 percent, over 2016/17, if approved.

The most notable increase for the department is $1.77 million more for environmental protection operations, but this is offset by a variety of cuts in other appropriations for the department.

Conservation and Natural Resources

The total budget for DCNR across all funds would grow to $369.9 million, a 3 percent increase over 2016/17.

The governor's proposed 2017/18 budget would make a number of changes to the funding mechanisms for environmental programs because of a bond issuance initiative through the Pennsylvania Economic Revitalization Fund.

Environmental Stewardship Fund

In addition to existing revenue sources, a proposed bond initiative would direct $52 million annually to the Environmental Stewardship Fund over a three-year period. Even with this money, most environmental stewardship programs would experience some reduction. However a portion of a new

$37 million dollar transfer to the Oil and Gas Lease Fund would support an increase for state park and forest appropriations. These appropriations receive money from the Environmental Stewardship and Oil and Gas Lease Funds.

Oil and Gas Lease Fund

On top of increases for state parks and forests, the new $37 million transfer from the Environmental Stewardship Fund would allow for the full Act 13 (2012) transfer to the Hazardous Sites Cleanup Fund. This transfer is critical for the sustainability of the Hazardous Sites Cleanup Fund, which previously received $40 million annually from the capital stock and franchise tax until its elimination last year.

The Oil and Gas Lease Fund would resume the practice of covering a portion of operational expenses for state parks and forests. Across all funds, state parks and forests appropriations would increase by 7 percent over 2016/17.

Act 13 of 2012 also mandated $35 million be transferred annually to the Environmental Stewardship Fund. In 2015/16 and 2016/17, this transfer amount was reduced to $25 million each year. Under this budget proposal the Oil and Gas Lease Fund would not transfer funds to the Environmental Stewardship Fund in 2017/18.

The percentage of the department's budget that would be dependent on the Oil and Gas Lease Fund would increase from 13 percent this year to 31 percent in 2017/18. The percentage funded by the state General Fund would decline by more than half (29 percent to 14 percent) in 2017/18.

Payments in Lieu of Taxes

Gov. Wolf's budget proposal would increase the General Fund payments in lieu of taxes to school districts, counties, and municipalities for forest lands owned by the commonwealth by $5.1 million, bringing total funding in this appropriation to $7.7 million in 2017/18. This increase is the result of fiscal code changes (Act 85 of 2016) that increased the annual charge for real property located in counties, school districts and townships, from $1.20 per acre per political subdivision to $2.00 per acre per political subdivision.

Other Areas

Agriculture

Gov. Wolf's 2017/18 budget proposal would provide $109.3 million in General Fund spending for the Department of Agriculture, if approved. His request represents a $34.3 million, or 24 percent, cut over 2016/17.

The budget proposes the elimination of state subsidies to the private University of Pennsylvania School of Veterinary Medicine, which was funded at $30.1 million in 2016/17. The governor's budget proposal would, however, maintain flat funding for the university's Center for Infectious Disease at $281,000.

The governor's budget also proposes the elimination of appropriations traditionally added back by the legislature, including funding for agriculture research and shows, and funds for marketing and promotion. The budget proposal would also eliminate a $2 million appropriation for avian flu preparedness and response that was included in the 2016/17 budget.

Community & Economic Development

The governor's 2017/18 budget proposal requests $134.1 million in state General Funds for the Department of Community and Economic Development. This would be a decrease of $11.4 million, or 7.9 percent, from 2016/17. However, the $134.1 million does not account for appropriations that are traditionally added back by the legislature.

Gov. Wolf is also introducing several new program initiatives alongside changes to existing policies and practices within DCED to encourage a more cohesive, effective economic development strategy.

As he has done since taking office, the governor is proposing a new appropriation to fund the industrial resource centers independent of the Partnerships for Regional Economic Performance, or PREP. The Manufacturing PA initiative would direct $12 million to fund current functions of the industrial resource centers, new partnerships between Pennsylvania's research universities and the centers, and a new manufacturing training-to-career grant program.

The changes would not only provide an increase in funding to the industrial resource centers, but also and allow for the introduction of a $2.5 million program within the PREP appropriation that caters to the retention and expansion of businesses already operating in the commonwealth. Under Gov. Wolf's proposal, this new initiative would be housed within the $9.9 million PREP appropriation alongside the three remaining programs that make up the budget line prep appropriation.

In addition to new programs and appropriations, the governor is proposing to relocate the **Industry Partnerships** program under DCED. This shift from the Department of Labor and Industry would reflect a larger goal of centralizing services available to businesses, while also eliminating unnecessary bureaucratic overlap.

While legislative priorities typically added back into the appropriation for **marketing to attract tourists** would be eliminated, the governor is proposing an additional $6.1 million to develop a new tourism advertising strategy focused on digital and international channels with the hope of engaging a larger audience.

Although not an appropriation, the governor is recommending a number of changes to program policies within DCED to increase accountability of businesses that receive state funding. These various recommendations would reflect the broader goal of ensuring that state investments yield the job creation and private investment promised by businesses. If implemented, a portion of the funds generated by expanded claw-back provisions would be directed to a new apprenticeship grant program.

Tax & Revenue Changes

Tax Changes

Gov. Wolf is seeking a variety of changes to the tax code, which, he says, would protect the middle class and generate about $1.0 billion in new revenue, as shown in the table.

Proposed Tax Code Changes *($ Amounts in Millions)*		
Tax Type	**2017/18**	**Impact**
Corporate Net Income Tax Net operating loss cap Combined reporting with rate reductions	$ 81.2	Net Operating Loss (NOL) capped at 30% for tax year 2018 and after; combined reporting beginning in 2019. Rates: 8.99% for 2019; 7.99% for 2020; 6.99% for 2021; 6.49% for 2022 and thereafter.
Severance Tax - 6.5% of value	$ 293.8	No post production deductions. Impact fee remains in place and is credited. Effective July 1, 2017.
Insurance Premiums Tax	$ 141.5	Base expansion to include entities that are currently exempt, such as nonprofits and HMOs. Effective Jan.1, 2018.
Sales and Use Tax		
Custom programming, design and data processing	$ 330.3	Canned software purchased off the shelf is currently taxable. Effective July 1, 2017.
Commercial storage	$ 153.6	Excludes farm product, warehousing storage and transportation services. Self storage is currently taxable. Effective July 1, 2017.
Aircraft sales, use and repair	$ 5.1	Vehicles and repair are currently taxable. Effective July 1, 2017.
Airline catering	$ 0.8	All other catering is currently taxable. Effective July 1, 2017.
TOTAL PROPOSED TAX CODE CHANGES	**$ 1,006.3**	
Source: Governor's 2017/18 Executive Budget Proposal.		

The current net operating loss deduction on corporate net income is the greater of 30 percent or $5 million. Commonwealth Court ruled this to be unconstitutional in the case of *Nextel Communications of the Mid-Atlantic, Inc., v. Commonwealth of Pennsylvania* in December 2015. The governor's proposal would fix the constitutionality of the law as required by the ruling.

Non-profit insurance companies are exempt from the insurance premiums tax and, therefore, companies can merely restructure to avoid the tax. This proposal would eliminate that as a loophole.

The governor's proposed sales and use tax changes would eliminate special exemptions to equally impose tax on similar items and services. Currently, other forms of software, storage, vehicles and catering are taxable.

Additional Revenue – Savings Initiatives

The governor's budget proposal assumes a structural deficit of approximately $3 billion. To close that gap, he is proposing $2.1 billion in savings initiatives. Of those initiatives, $1.1 billion would represent revenue booked to the current and subsequent budget years as follows:

- $165 million from a Workers' Compensation Security Fund loan in 2016/17; and
- $892 million in 2017/18 from increasing the minimum wage, maximizing current revenue collections, converting tax credits to a block grant, closing and leasing facilities, and various debt and bond restructuring.

Additional Revenue - Assumed

Revenue assumptions in the proposed budget also include new revenue from liquor modernization and gaming, as follows:

- Liquor modernization - $137 million in 2016/17 (which was adjusted downward from the previous estimate of $149 million) and $125 million in 2017/18 from the continued implementation of modernization associated with license fees and increased leverage of flexible pricing.
- Gaming – $74.8 million for the proposed Philadelphia casino license fee and $250 million ($100 million in 2016 and $150 million in 2017/18) attributes to an expansion in internet gaming that would require legislation passed by the General Assembly.

T**he expanded gaming estimates depend on the General Assembly fulfilling its promise in 2016/17 to enact such authorization.** Much work remains on this issue. The casino license fees depend on action by the courts.

Gov. Wolf's 2017/18 Executive Budget proposal does not include property tax reform or privatization/leasing of the liquor system. General property tax relief from current gaming revenue is estimated to remain the same as the prior year.

Appendix

General Fund Agency Totals - State Appropriations				
Appropriations proposed to move to a different agency are totaled in the new location for all years				
Dollars in Millions				
Agency	**2016/17 With Supplemental Appropriations**	**2017/18 Executive Budget**	**$ Change**	**% Change**
Governor's Office	$ 6.9	$ 6.6	$ (0.3)	(4.1%)
Executive Offices	$ 184.1	$ 180.0	$ (4.0)	(2.2%)
Lieutenant Governor	$ 1.8	$ 1.7	$ (0.0)	(1.7%)
Attorney General	$ 95.6	$ 94.3	$ (1.3)	(1.3%)
Auditor General	$ 48.2	$ 44.8	$ (3.5)	(7.2%)
Treasury	$ 1,171.8	$ 1,018.0	$(153.8)	(13.1%)
Agriculture	$ 143.7	$ 109.3	$ (34.3)	(23.9%)
Community and Economic Development	$ 147.3	$ 134.1	$ (13.3)	(9.0%)
Conservation and Natural Resources	$ 107.0	$ 53.8	$ (53.2)	(49.7%)
Criminal Justice	$ 2,563.5	$ 2,520.5	$ (43.0)	(1.7%)
Probation and Parole	$ -	$ -	$ -	
Drug and Alcohol Programs	$ -	$ -	$ -	
Education	$ 11,781.3	$ 12,239.4	$ 458.1	3.9%
Pennsylvania State University	$ 250.5	$ 250.5	$ -	0.0%
University of Pittsburgh	$ 146.8	$ 146.8	$ -	0.0%
Temple University	$ 150.6	$ 150.6	$ -	0.0%
Lincoln University	$ 14.4	$ 14.4	$ -	0.0%
State System of Higher Education	$ 444.2	$ 453.1	$ 8.9	2.0%
Thaddeus Stevens College of Technology	$ 13.3	$ 13.3	$ -	0.0%
PA Higher Education Assistance Agency	$ 321.3	$ 308.4	$ (12.9)	(4.0%)
Environmental Protection	$ 148.4	$ 149.7	$ 1.3	0.9%
General Services	$ 119.4	$ 117.8	$ (1.5)	(1.3%)
Health	$ -	$ -	$ -	
Health and Human Services (Health, DDAP, DHS, Aging)	$ 12,469.9	$ 12,897.2	$ 427.3	3.4%
Insurance	$ -	$ 7.0	$ 7.0	100.0%
Labor and Industry	$ 77.9	$ 71.1	$ (6.8)	(8.8%)
Military and Veterans Affairs	$ 145.9	$ 144.2	$ (1.7)	(1.2%)
Revenue	$ 178.8	$ 186.2	$ 7.5	4.2%
State	$ 11.8	$ 10.5	$ (1.3)	(10.6%)
Transporation	$ 1.5	$ 1.6	$ 0.1	7.9%
State Police	$ 256.9	$ 243.6	$ (13.4)	(5.2%)
Civil Service Commission	$ 0.0	$ 0.0	$ -	0.0%
Emergency Management and Homeland Security	$ 13.6	$ 19.0	$ 5.4	39.3%
Historical and Museum Commission	$ 21.9	$ 19.6	$ (2.3)	(10.5%)
Infrastructure Investment Authority	$ -	$ -	$ -	
State Environmental Hearing Board	$ 2.5	$ 2.4	$ (0.1)	(5.3%)
eHealth Partnership Authority	$ -	$ -	$ -	
Health Care Cost Containment Council	$ 2.7	$ 4.8	$ 2.1	75.7%
State Ethics Commission	$ 2.4	$ 2.6	$ 0.2	6.5%
Judiciary	$ 355.5	$ 355.5	$ -	0.0%
Senate	$ 106.6	$ 107.1	$ 0.5	0.5%
House of Representatives	$ 206.4	$ 206.4	$ -	0.0%
Government Support Agencies	$ 51.8	$ 51.8	$ -	0.0%
General Fund - State Total	$ 31,766.2	$ 32,337.7	$ 571.5	1.8%