



Fiscal Year 2006-07 Governor's Executive Budget Commonwealth of Pennsylvania

**United Way of Southeastern Pennsylvania
March 24 2006**

*Edward G. Rendell
Governor*

*Michael Masch
Secretary of the Budget*



The Rendell Administration's Major Budget Goals

- ✓ Return Pennsylvania to prosperity — increase job creation & economic opportunity
- ✓ Improve academic achievement in Pennsylvania's elementary & secondary schools
- ✓ Lower local property taxes
- ✓ Improve the quality of life in Pennsylvania's communities
- ✓ Maintain the social safety net to protect Pennsylvania's most vulnerable citizens
- ✓ Make Pennsylvania government more efficient and citizen-friendly

Major Initiatives in the 2006-07 Budget

- **Education:** \$601 million, or 6 percent, increase in funding for educational programs
- Historic level of investment in P.A. **libraries** - \$75.5M
- **Cover All Kids:** affordable health insurance coverage for all uninsured Pennsylvania children
- **PACE Plus Medicare:** Prescription drug coverage for an additional 120,000 seniors
- **Jonas Salk Legacy Fund:** \$500 million investment to accelerate bioscience research in Pennsylvania
- **World Trade P.A.:** \$15M to increase Pennsylvania's competitiveness worldwide
- An additional \$130 million to continue **improvements to Pennsylvania's highways and bridges**
- **90 additional state troopers** to support public safety.

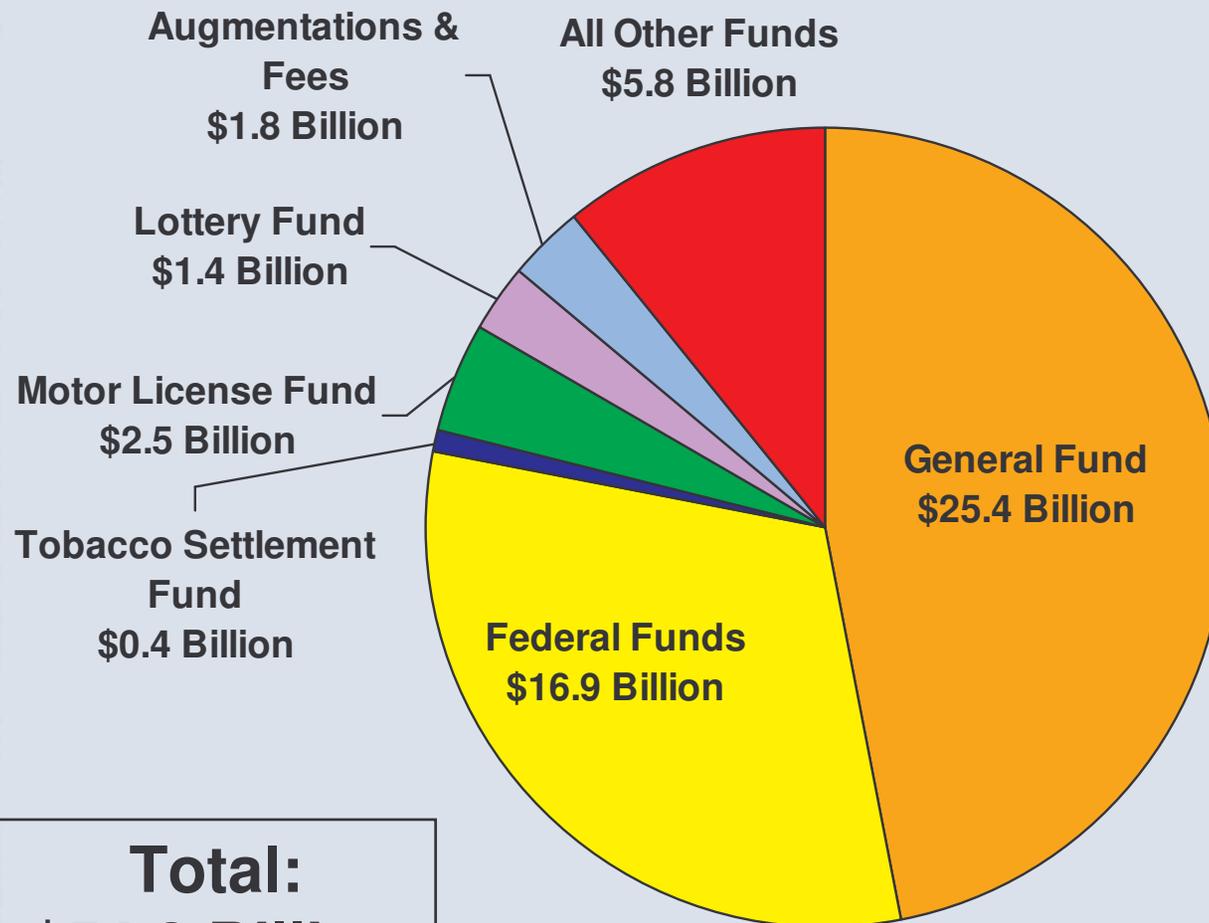
Additional 2006-07 Budget Highlights

- **No new taxes or tax increases**
- More than \$221 million in new business tax cuts, for a cumulative total of \$1 billion during the Rendell administration
 - **Capital Stock and Franchise Tax** – accelerates the phase-out by one-tenth of a mill (\$18.3 million) to lower the rate to 4.89 mills, a total savings of \$204 million
 - **Research and Development Tax Credit** – \$40 million, an increase of \$10 million
 - **Net Operating Loss** carry-forward – \$7.3 million, by increasing the cap from \$2 million to \$3 million
- Holds the line on administrative spending – zero increase
- Re-invests savings realized through innovation and efficiencies in government operations, with \$841 million in annual savings in 2006-07, \$1 billion by December 2006
- Brings the total reduction in the Commonwealth's authorized complement to 4,000 positions since January 2003.



2006-07 Budget Overview

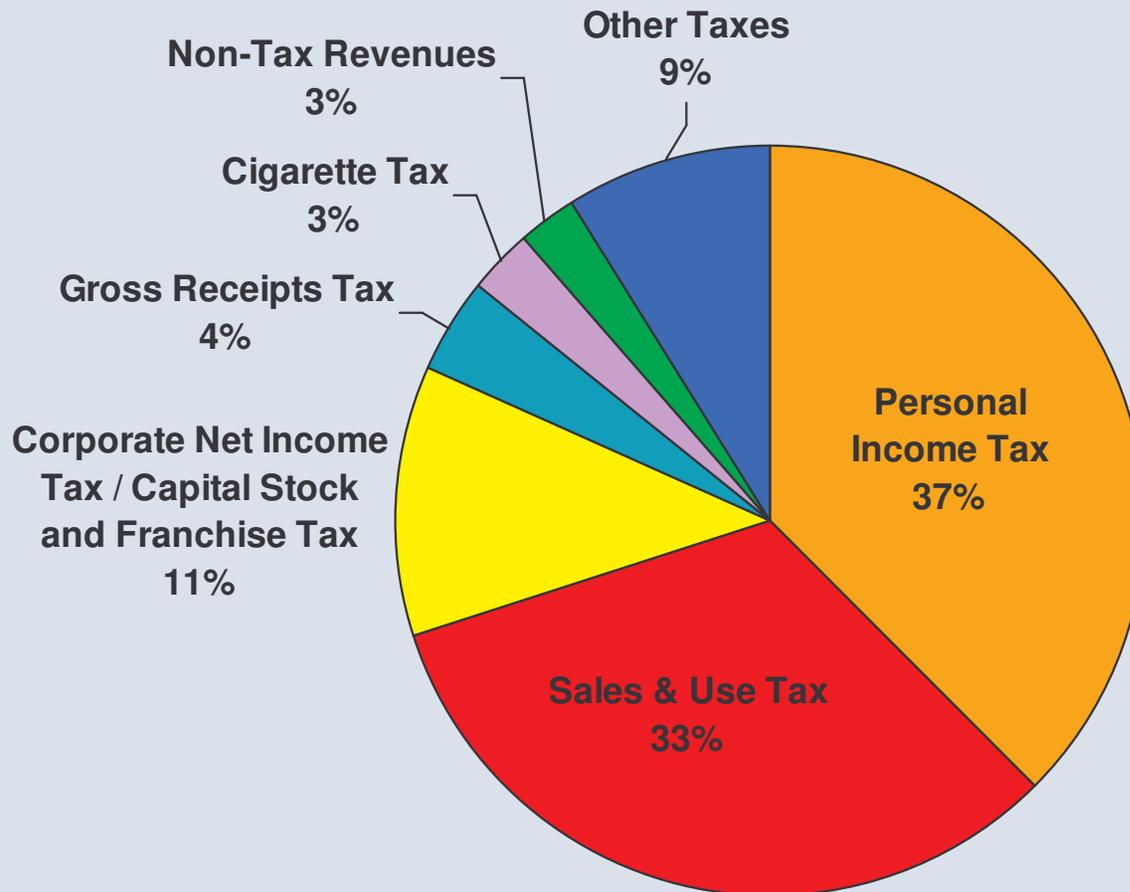
2006-07 Total Operating Budget



The total Fiscal Year 2006-07 operating budget, including all Commonwealth funds, is \$54.2 billion. The General Fund represents 47 percent of this amount.

**Total:
\$54.2 Billion**

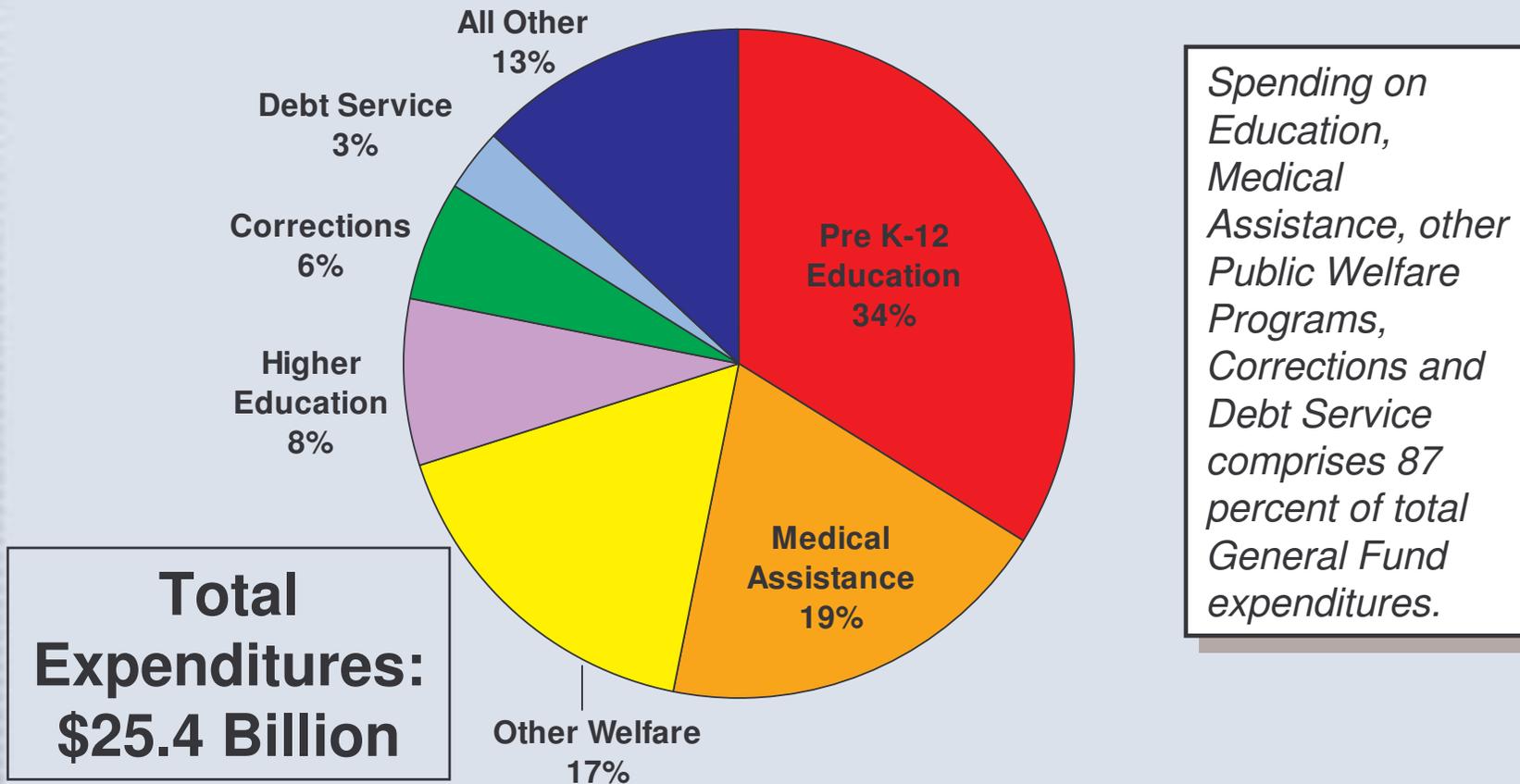
2006-07 General Fund Revenue Sources



More than two-thirds (70 percent) of General Fund revenues are derived from the Personal Income Tax and the Sales & Use Tax.

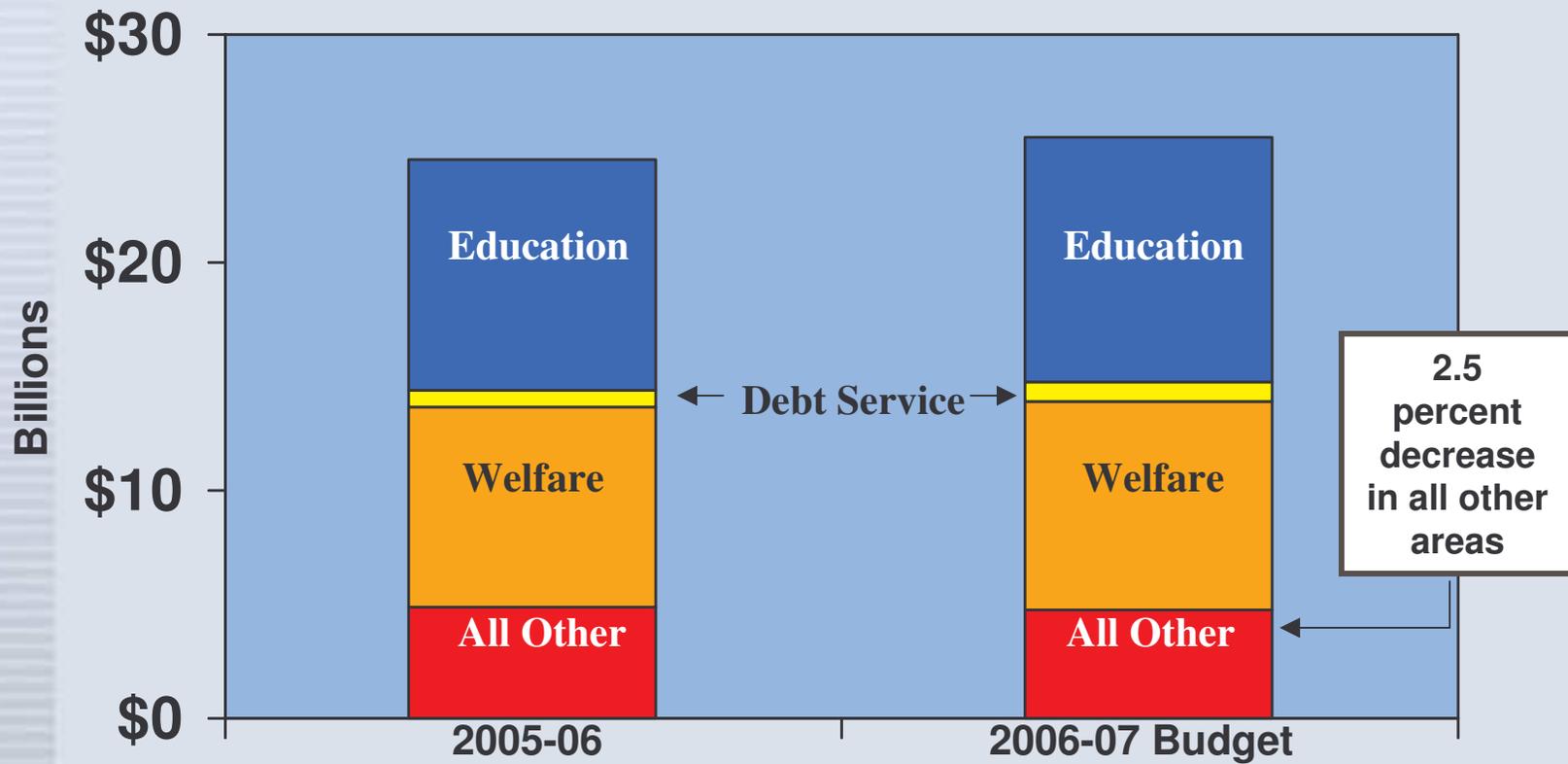
2006-07 General Fund Expenditures

The proposed General Fund budget increases State spending by \$924 million, or 3.8 percent. Removing increases for education, welfare and debt service, the budget proposes a 2.5 percent decrease in funding for all other Commonwealth agencies and programs.



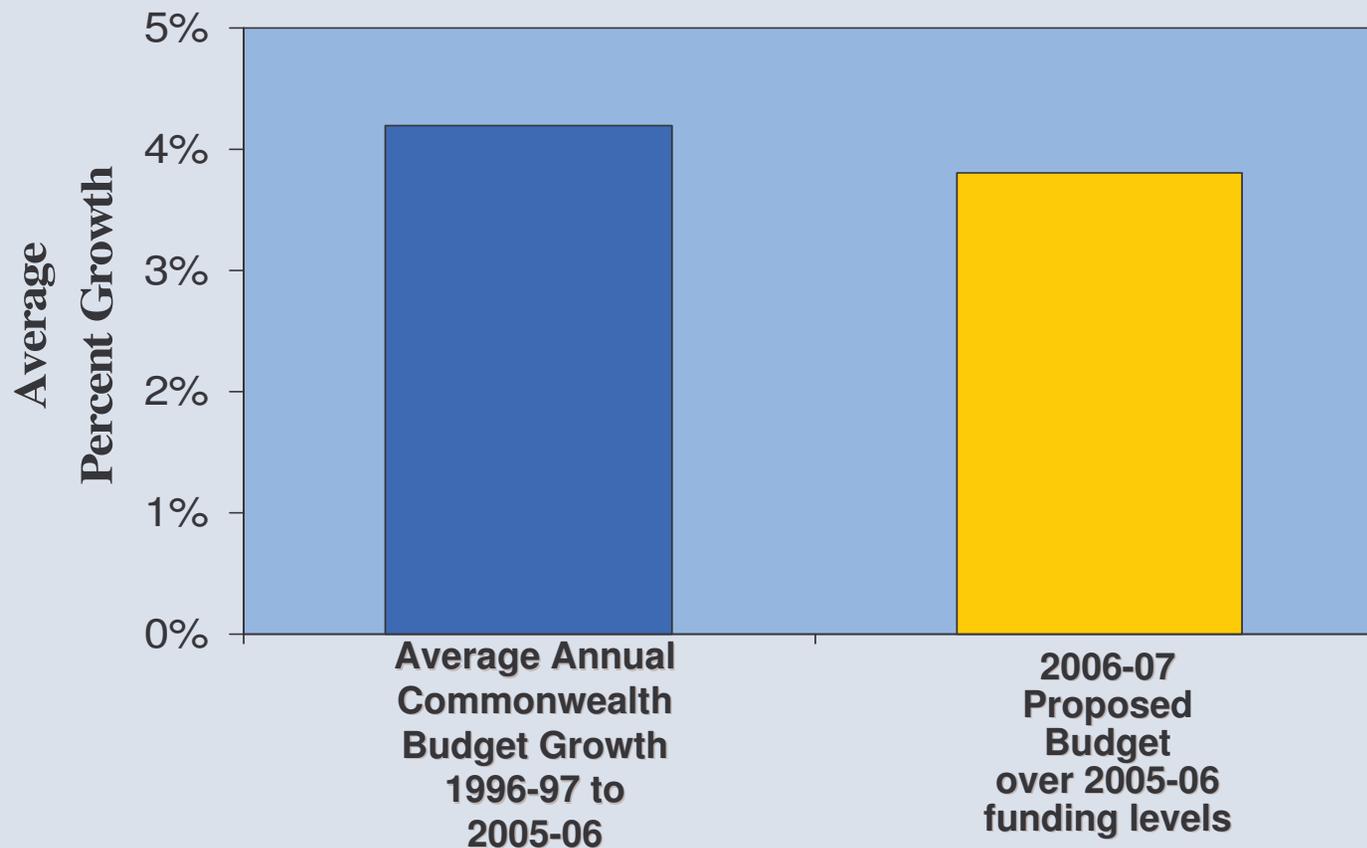
Growth in 2006-07 Expenditures

If increases of more than \$1 billion for Public Welfare, Education and Debt Service are removed for 2006-07, all other expenditures actually decline by 2.5 percent relative to the 2005-06 budget.



Growth in 2006-07 General Fund Expenditures Compared to Other Recent Growth Trends

The 2006-07 budget increases spending by 3.8 percent compared to the 2005-06 budget. That rate is lower than the average annual growth in the Commonwealth budget from 1996-97 to 2005-06.



2006-07 General Fund Financial Statement

	\$ Millions		
	<u>2004-05</u>	<u>2005-06</u>	<u>2006-07</u>
	Actual	Available	Budget
Beginning Balance	\$ 77	\$ 365	\$ 204
Receipts	23,309	24,278	25,225
Prior Year Lapses	<u>97</u>	<u>120</u>	<u>. . . .</u>
Funds Available	\$ 23,483	\$ 24,763	\$ 25,429
Expenditures	\$ - 23,054	\$ - 24,304	\$ - 25,425
Supplemental Appropriations	-197
Current Year Lapses	10
Preliminary Balance	<u>\$ 429</u>	<u>272</u>	<u>\$ 4</u>
Transfer To Rainy Day Fund	<u>-64</u>	<u>-68</u>	<u>- 1</u>
Ending Balance	<u><u>\$ 365</u></u>	<u><u>\$ 204</u></u>	<u><u>\$ 3</u></u>



2005-06
Supplemental

2005-06 Supplemental Appropriations

(Dollar Amounts in Thousands)
2005-06 Available

Pennsylvania Housing Finance Agency	
Homeowners Emergency Mortgage Assistance	\$ 3,000
Education	
Special Education Approved Private Schools	\$ 1,330
Pennsylvania Emergency Management Agency	
July 2003 Storm Relief	\$ 75
Volunteer Company Grants	\$ 25,000
Public Welfare	\$ <u>168,014</u>
<i>Mental Health Services ~ \$3.6 million decrease due to increased federal funds</i>	
<i>Cash Grants ~ \$44.4 million increase due to increased utilization and cost</i>	
<i>Supplemental Grants ~ \$3.5 million decrease due to lower utilization</i>	
<i>Capitation ~ \$10.2 million increase due to higher cost.</i>	
<i>Long-Term Care ~ \$127.9 million increase due to increased utilization and cost</i>	
<i>Intermediate Care Facilities ~ \$7.5 million decrease due to reduced need</i>	
Total Supplemental Appropriations.	\$ <u>197,419</u>
Previously Enacted Funding	
Law Enforcement and Emergency Response Personnel	
Death Benefits	\$ 1,632
Low-Income Home Energy Assistance	\$ 19,300



The Problems We Inherited

The Projected 2003-04 General Fund Budget

Prior to Corrective Action

Millions

Beginning Balance	\$	- 36
Receipts		20,279
		20,243
Funds Available	\$	20,243
Expenditures		- 22,646
		- 2,403
Ending Balance	\$	- 2,403

In January 2003 when Governor Rendell took office, the 2003-04 deficit was projected to be in excess of 10% of estimated expenditures. This projection was based on a forecast of state revenues that assumed no changes in tax structure or tax rates, combined with an expenditure forecast that assumed the continuation of all existing state programs and activities, an upwards adjustment for inflation, no assumed savings from improvements in government efficiency, and growth in caseloads for all mandated services such as Medical Assistance.



Factors Contributing to the Projected FY2003-04 Deficit

Factors Contributing to the Projected FY2003-04 Deficit

Tax Collection Trends - Major General Fund Taxes

Actual General Fund tax collections were lower in FY2001-02 and FY2002-03 than they were in 2000-01.

Dollars in Millions	Actual Collections 2000-01	Actual Collections 2001-02	Actual Collections 2002-03
Personal Income Tax	\$ 7,491.5	\$ 7,138.7	\$ 7,105.9
Corporate Net Income	1,603.4	1,418.5	1,396.6
Capital Stock & Franchise	1,063.0	913.4	896.3
Sales and Use	7,203.7	7,292.5	7,519.6
Motor Vehicle	1,080.0	1,161.8	1,245.9
Non-Motor Vehicle	6,123.7	6,130.7	6,273.7
Total	\$17,361.6	\$16,763.1	\$16,918.4
Difference from 2000-01		\$ -598.5	\$ -443.2
<i>Percentage Difference</i>		<i>-3.4%</i>	<i>-2.6%</i>

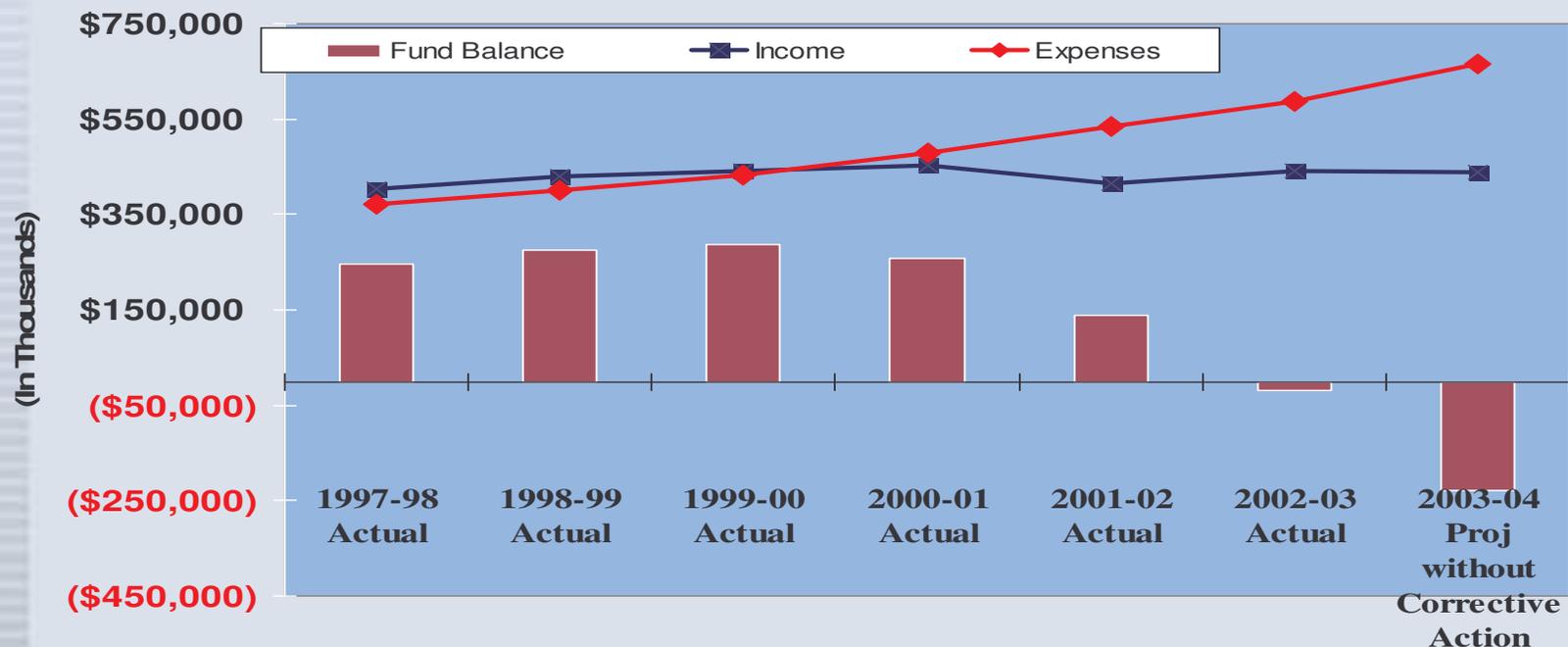
One-Time Revenues Utilized to Balance the 2002-03 General Fund Budget

Millions

One-Time Benefit – Decoupling from Federal Depreciation Tax Treatment. . . .	\$ 350.1
One-Time Benefit – Various Escheat Changes.	197.6
Reduction in Scheduled Rate Cut – Capital Stock and Franchise Tax	144.5
One-Time Extraordinary Increase –	
Transfer from State Stores Fund (over \$50M regular transfer)	105.0
Loan from Underground Storage Tank Fund.	100.0
Other	91
Total	\$ 988.5

2003 Forecast for the Active Employee Health Program – Prior to Corrective Action

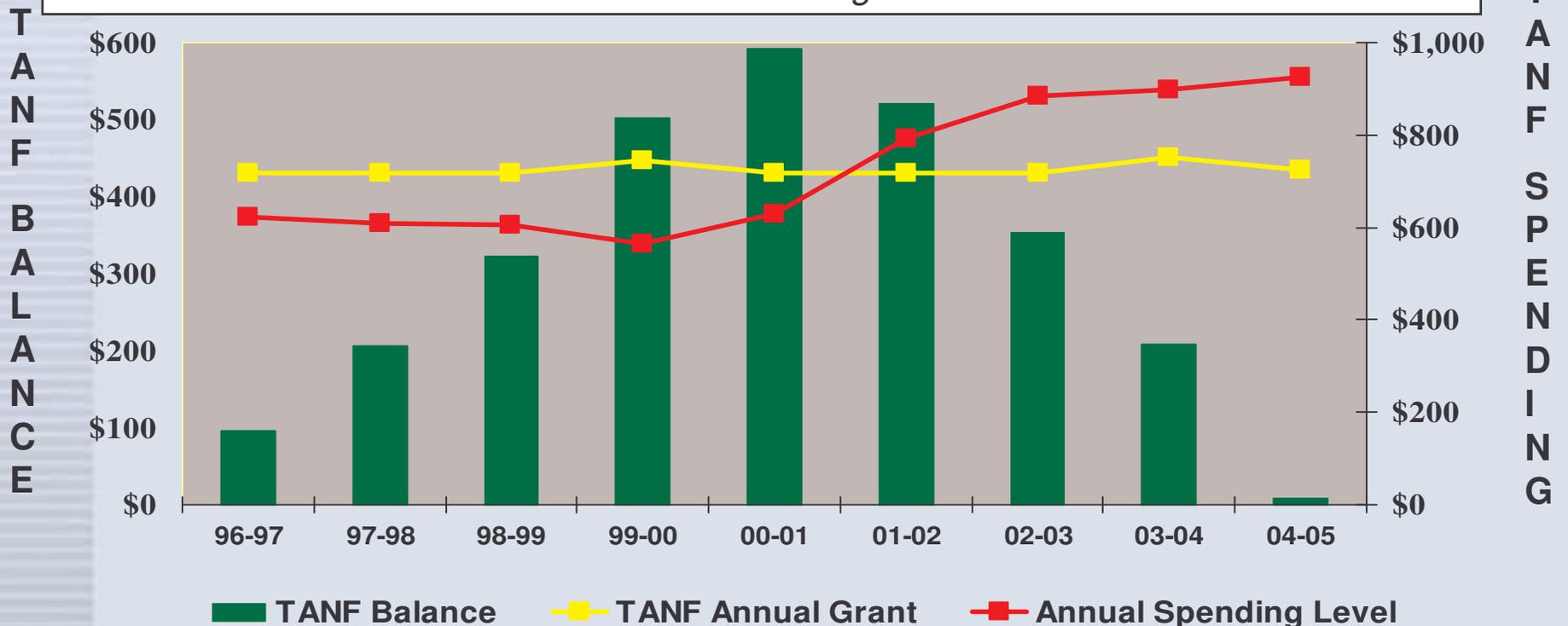
As health care costs escalated for Commonwealth employees in the late 1990s, state contributions to the Pennsylvania Employees Benefit Trust Fund (PEBTF) were not increased to compensate. On the contrary, rates were frozen from 1995 to 2002, and several “contribution holidays” actually reduced state contributions. The “savings” were used to cover negotiated increases in wage and salary costs. PEBTF reserves were depleted to make up the difference. By January 2003, PEBTF reserves had been depleted, and the PEBTF was on the verge of insolvency.



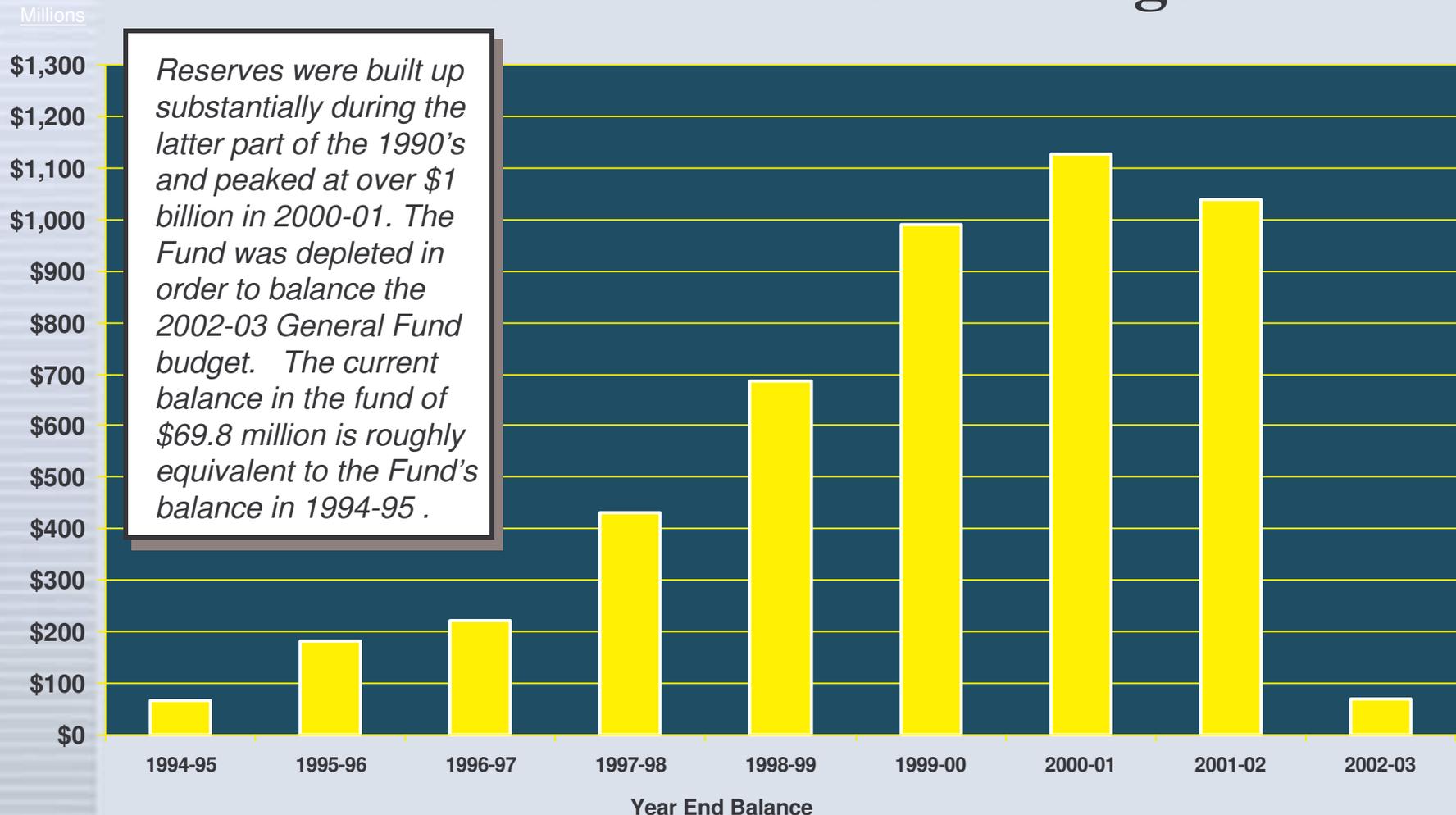
Status of TANF Fund Balance

When the Temporary Assistance to Needy Families (TANF) program began, the Commonwealth's annual TANF expenditures were less than the annual TANF grant, resulting in the build-up of a significant reserve balance.

In more recent years that trend was reversed, and annual expenditures exceeded the annual grant amount, causing the reserve balance to be nearly eliminated. Future TANF expenditures will have to be decreased to keep TANF expenditures in balance with the annual TANF grant level.



Elimination of the State's Rainy Day Fund to Balance the FY2003-04 Budget





How the 2003-04 Budget Was Balanced



How the FY2003-04 General Fund Budget was Balanced

- ✓ Tax increases and other revenue enhancements
- ✓ Limited use of non-recurring revenue
- ✓ Expenditure cuts in important programs
(smaller because of tax increases but still not completely avoided)
- ✓ Position eliminations
- ✓ Salary and benefit concessions achieved through collective bargaining agreements
- ✓ These actions permitted the Commonwealth to make important investments to preserve Pennsylvania's basic social safety net, improve academic achievement, and promote economic development

Major Revenue Enhancements

2003-04/2004-05

As a result of the slow-growing national economy, Commonwealth General Fund base revenue growth has been negative since 2000-01. Revenue enhancements enacted in December 2003 will bring recurring General Fund revenue back into alignment with recurring General Fund expenditures.

Projected Impact - Revenue Enhancements (Dec. '03)	2003-04	2004-05
Increase Personal Income Tax rate from 2.8% to 3.07%	\$ 301.7	\$ 728.9
Extend Gross Receipts Tax to cellular and interstate calls	\$ 222.4	\$ 362.3
Increase Cigarette Tax to \$1.35 from \$1.00.	\$ 118.1	\$ 241.3
<i>\$0.25 of Cigarette Tax to Healthcare Provider Retention Account</i>	\$ (88.4)	\$ (191.9)
Revise Escheats Program - Insurance Co. Demutualization	\$ 190.0	\$ -
Fee Increases	\$ 13.5	\$ 24.8
Various Other Revisions	\$ 36.7	\$ (11.1)
Total	\$ 794.0	\$ 1,154.3

Significant Expenditure Cuts were Made to Achieve Budget Balance in FY2003-04

- Selected Funding Reductions in the General Fund in FY2003-04:

10% Cut in General Government Administration.	\$ -211.8 M
Sewage Treatment Plant Operations Grants.	\$ -52.1 M
State-Related Universities.	\$ -32.6 M
Library Services	\$ -27.5 M
State System of Higher Education.	\$ -22.9 M
Safe and Alternative Schools.	\$ - 6.7 M
Behavioral Health Services.	\$ -4.8 M
Total	\$ 358.4 M



Summary of Major Provisions

PA Collective Bargaining Agreements

- **Pay Increases**

- **General Salary**
- **Pay Increases:**

- 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
- FY 2004-05 \$270
- FY 2005-06 \$275
- FY 2006-07 \$300

* (plus an \$80 million lump sum contribution in 2003-04)

- **Significant Health Plan Re-Design and Restructuring**



2006-07 Budget Highlights



Nearly \$1 Billion in Federal Cuts

In 2006-07, federal cuts continue...

\$113 M Federal Nursing Home Transfer Fund Cuts

\$348 M Federal Bill to P.A. for Medicare Part D

\$ 27 M Lower Federal Match for M A

\$ 13 M Federal Reduction in Health Grants

\$531 M in new Federal cuts in 2006-07

...on top of last year's \$456 million cut in Federal aid



2006-07 Budget Highlights

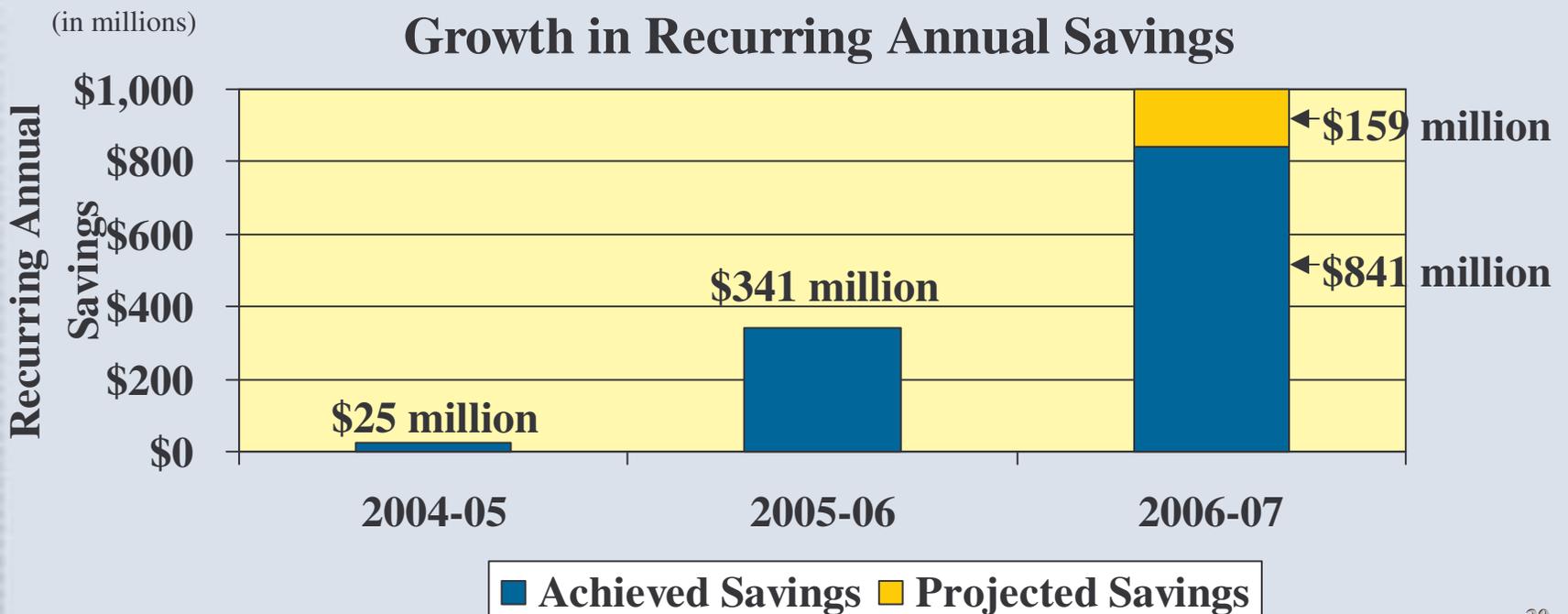
Making Government Work Smarter

\$1 Billion In Lower Costs for
Government Administration

Making Government Work Smarter

Reaching Governor Rendell's Goal to Remove \$1 Billion Annually from the Cost of State Government

Governor Rendell pledged to cut the cost of government and change the way the Commonwealth works. The results of those efforts are impressive. In just three years, by developing new business practices and focusing on innovation and efficiency throughout the government, this administration has already generated recurring savings totaling \$841 million, and is on target to meet Governor Rendell's goal of reducing the cost of state government by \$1 billion by 2006-07.





Making Government Work Smarter

Because it is the largest state agency, the Department of Public Welfare has been the primary focus of the administration's management and productivity efforts for the past year. Other areas of focus have been reducing the size of the Commonwealth's fleet, the Get Healthy Initiative and revenue generation activities at the Liquor Control Board and State Lottery.

Increasing Savings: Department of Public Welfare

- ✓ Pharmacy Savings (\$51M)
- ✓ Pharmacy Reimbursements (\$32M)
- ✓ Collecting Money Owed from Private Insurance Companies (\$16M)
- ✓ Fraudulent Claims Denied (\$16M)
- ✓ Using Electronic Payments Instead of Paper Checks (\$2M)

Creating A More Efficient Government

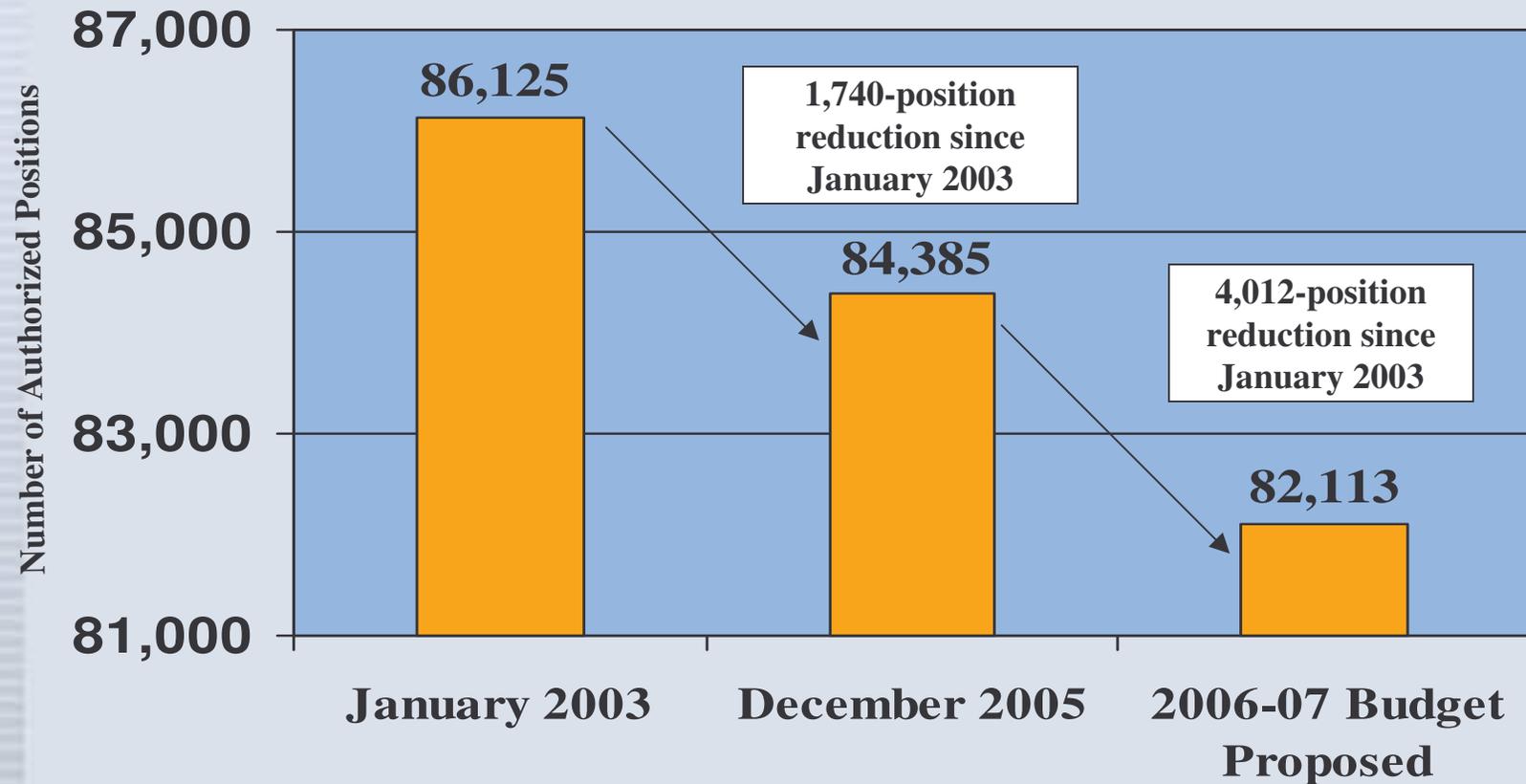
- ✓ Reducing Fleet Costs (\$33M)
- ✓ Get Healthy Initiative (\$18M)

Generating New Revenues

- ✓ Revenue Increases from Consumer-Oriented Business Practices at the Liquor Control Board (\$34M)
- ✓ Expanded Lottery Venues (\$8M)

Authorized Complement Levels

Between January 2003 and December 2005, the number of authorized positions has decreased from 86,125 to 84,385. The 2006-07 budget proposes an additional reduction of 2,272 positions. Since the beginning of the Rendell administration, the total number of authorized positions has decreased by 4,012 – or 4.7 percent.





2006-07 Budget Highlights

Education



Investing In Pennsylvania's Future

The 2006-07 budget increases total State education funding by more than \$601 million, or 6 percent. Since 2002-03, the Rendell Administration has boosted investments in education by \$1.8 billion, or more than 20 percent.

- \$224.6 million increase (5 percent) in **Basic Education Funding** - \$4.7 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.
- \$38.1 million increase (4 percent) in **Special Education Funding** - \$991 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.
- \$45 million, a 50 percent increase in state funding for **Head Start** pre-kindergarten classrooms, to serve nearly 6,250 children.
- *Job Ready P.A.*: \$66 million for **tutoring** in the most academically challenged school districts.
- *Job Ready P.A.*: \$12.6 million increase for **community colleges**.



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 P.A.:* \$7 million for dual enrollment programs that let high school students earn college credit while they complete their graduation requirements.
- *Job Ready P.A.:* \$9 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.



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.

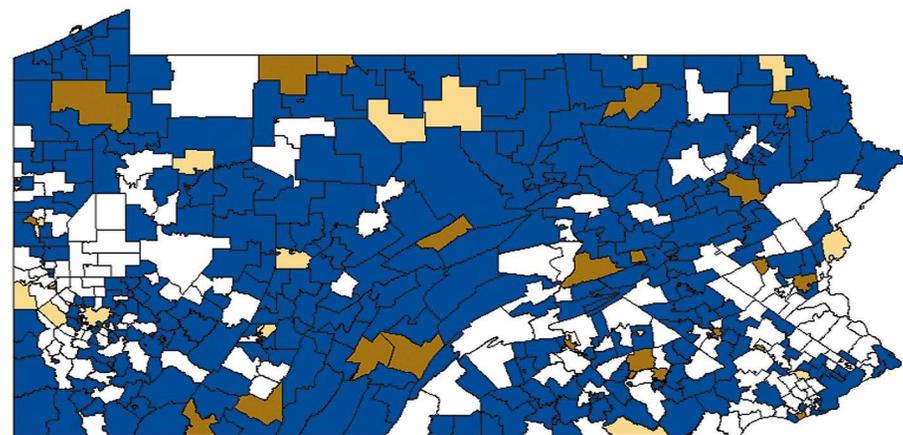
Investing In Pennsylvania's Future

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 50 percent increase in funding for Head Start expansion so that this proven program can serve nearly 6,250 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.



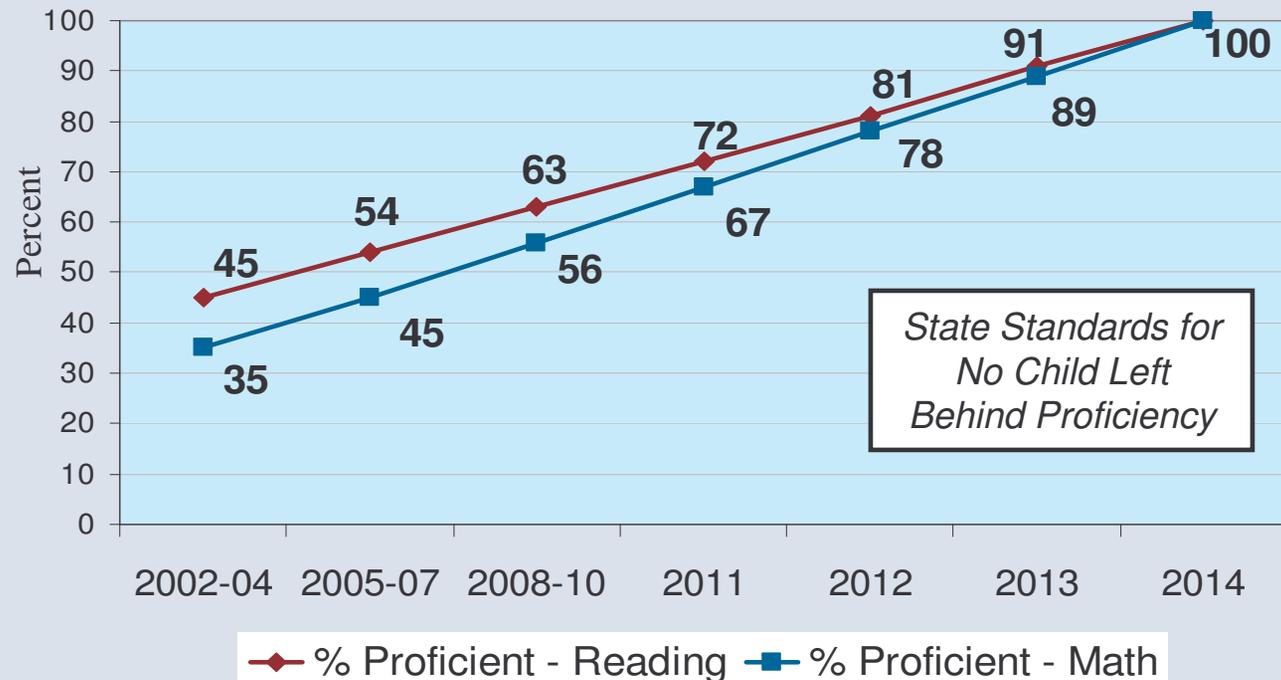
Accountability Block Grant
Early Childhood Education

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

No Child Left Behind Reading & Math Targets

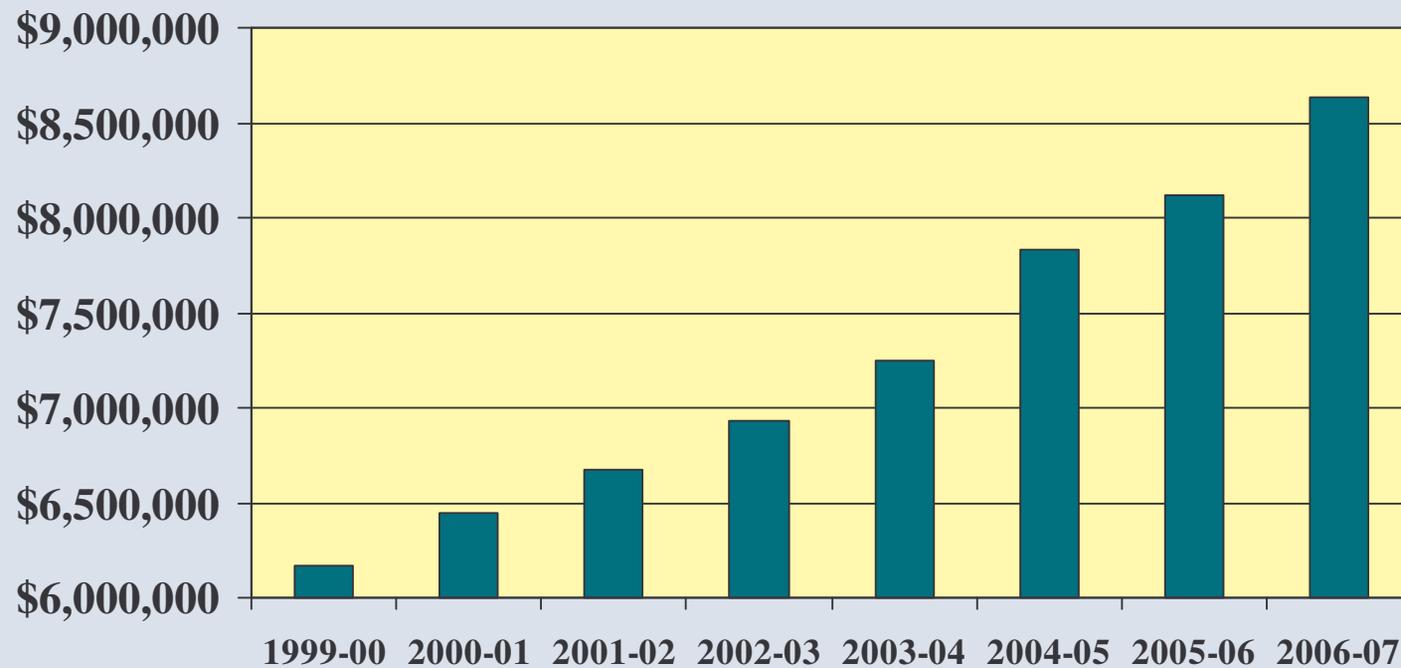
Pennsylvania has until 2014 to reach 100 percent proficiency in reading and math, as required by the federal No Child Left Behind standards. Our investment in proven educational programs must keep pace if Pennsylvania schools are to reach these achievement goals. These investments are already showing results. The number of fifth-graders meeting state standards in math has increased from 53 percent of our students in 2002 to 69 percent last year, and fifth-grade reading scores have increased 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.



Pre K-12/Basic Education Funding

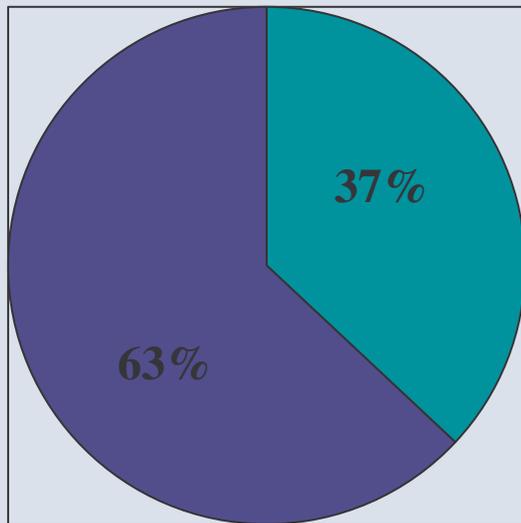
(State dollars in thousands)



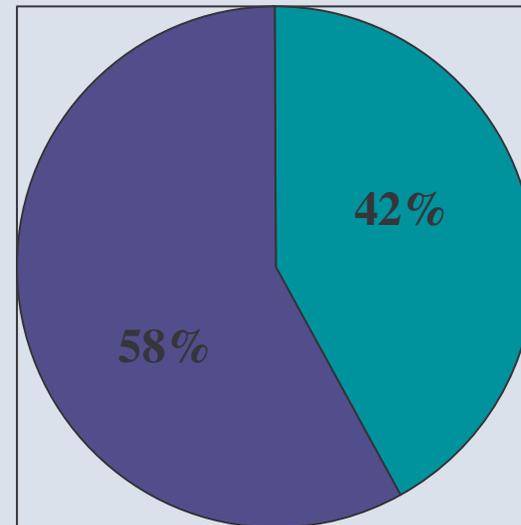
Source: Amounts are Pre K-12/Basic Education subcategory state funds totals as shown in Gov. budget.

Pennsylvania's Share of Public Education Funding is Increasing

Gaming expansion will shift \$1 Billion more from Local to State funding by 2007-08.



■ State Share ■ Local Share



■ State Share ■ Local Share



Pre K-12 Education Funding

Impact of State Funding in Southeastern P.A.

With the PreK-12 Education funding proposed by Governor Rendell for FY2006-07, PreK-12 Education funding will increase \$1.7 billion statewide since FY2002-03. Targeted investments in PreK-12 proven educational programs have made student success possible. Fifth graders meeting State math standards have increased from 53% in 2002 to 69% in 2005 and from 57% to 64% in reading for the same period. African-American, Hispanic, Asian, white, limited-English-proficiency, special education and low income students all are making gains in reading and math at all grade levels.

County	Kindergarten Students in Full-Day Programs		Schools Making Adequate Yearly Progress under No Child Left Behind	
	2002-03	2004-05	2002-03	2004-05
Berks	2%	18%	70	81
Chester	2%	4%	62	77
Delaware	26%	27%	53	70
Montgomery	22%	33%	94	130

Higher Education in the 2006-07 Budget

Pennsylvania is making significant investments in higher education funding in the 2006-07 budget, increasing funding by 3.7 percent. According to a 2005-06 study by the College Board, Pennsylvania had the best national ranking for tuition at four-year public institutions.

5.0% increase for the Community Colleges	\$ 264.7 M
4.5% operating increase for State System of Higher Education	\$ 483.0 M
4.0% operating increases for the State-Related Universities	
Penn State University	\$ 322.4 M
University of Pittsburgh	163.1 M
Temple University	168.7 M
Lincoln University	13.5 M
Total – State-Related Universities	\$ 667.7 M
3.0% for Non-State Related Universities and Colleges	\$ 87.5 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 a projected shortage of nurses	\$ 10.0 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 budget recommends a 23 percent increase in the Public Library Subsidy – to \$75.5 million. This will be the greatest 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 Highlights

Caring for
Pennsylvanians
in Need



Guiding Principles for Preserving and Reforming the Safety Net

- **No changes will be made to the array of health services and social services provided to children.**
- **No one currently receiving health care services from the Commonwealth will lose their eligibility.**
- **Pennsylvania will be able to meet the increase in demand anticipated this coming year for services to low-income children, chronically ill adults, uninsured working families, disabled individuals, the infirm elderly and other Pennsylvanians in need.**



Caring for All Pennsylvanians

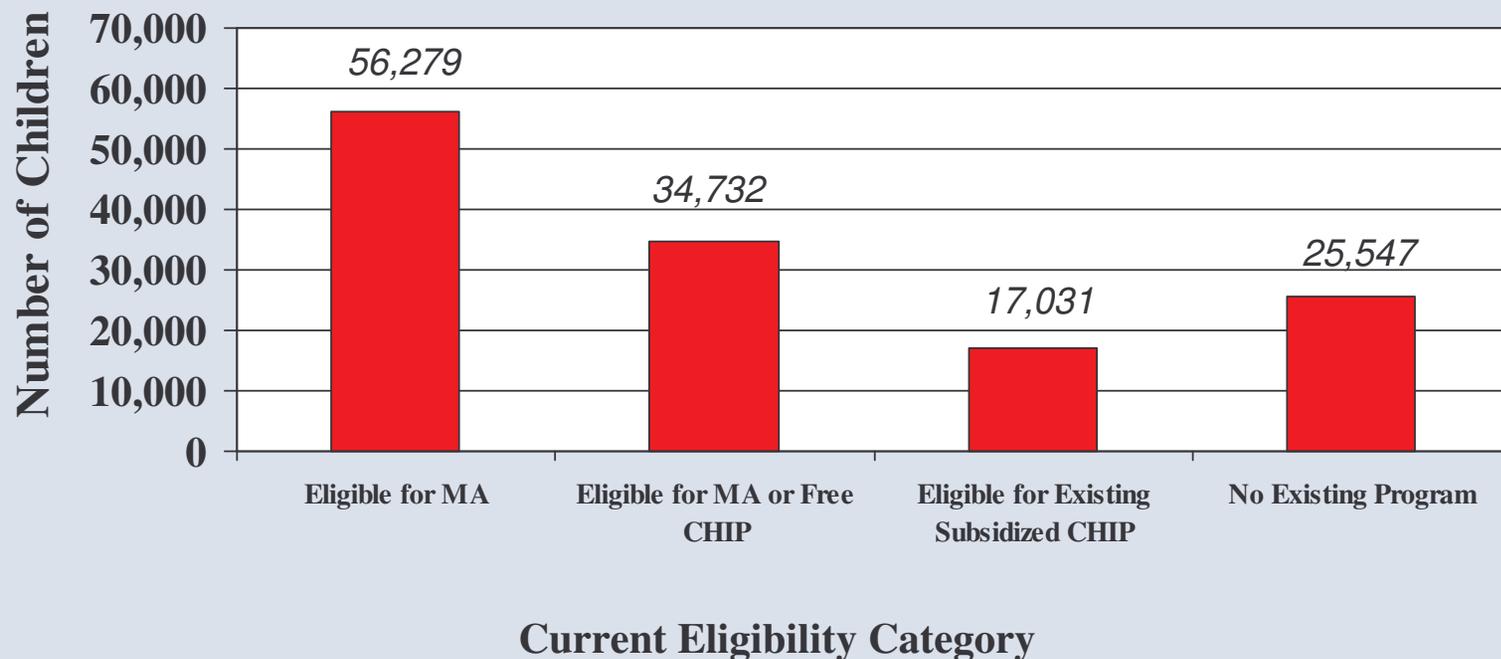
Additional People Served in 2006-2007 (Projections)

Medical Assistance	49,671
Children in Child Welfare System	2,827
Children in Child Care	17,000
Community Mental Retardation Programs	885
Behavioral Health Community Programs	498
Children's Health Insurance Program (CHIP) <i>(Including Cover All Kids)</i>	17,118
Uninsured Working Pennsylvanians (adultBasic)	8,575
PACE Plus Medicare <i>Prescription Drug Coverage for Older Pennsylvanians</i>	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). Others are children of working parents who are caught between public programs they are not eligible for because of their parents' income limits and private health insurance their parents cannot afford.

Pennsylvania's Uninsured Children





Cover All Kids

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.

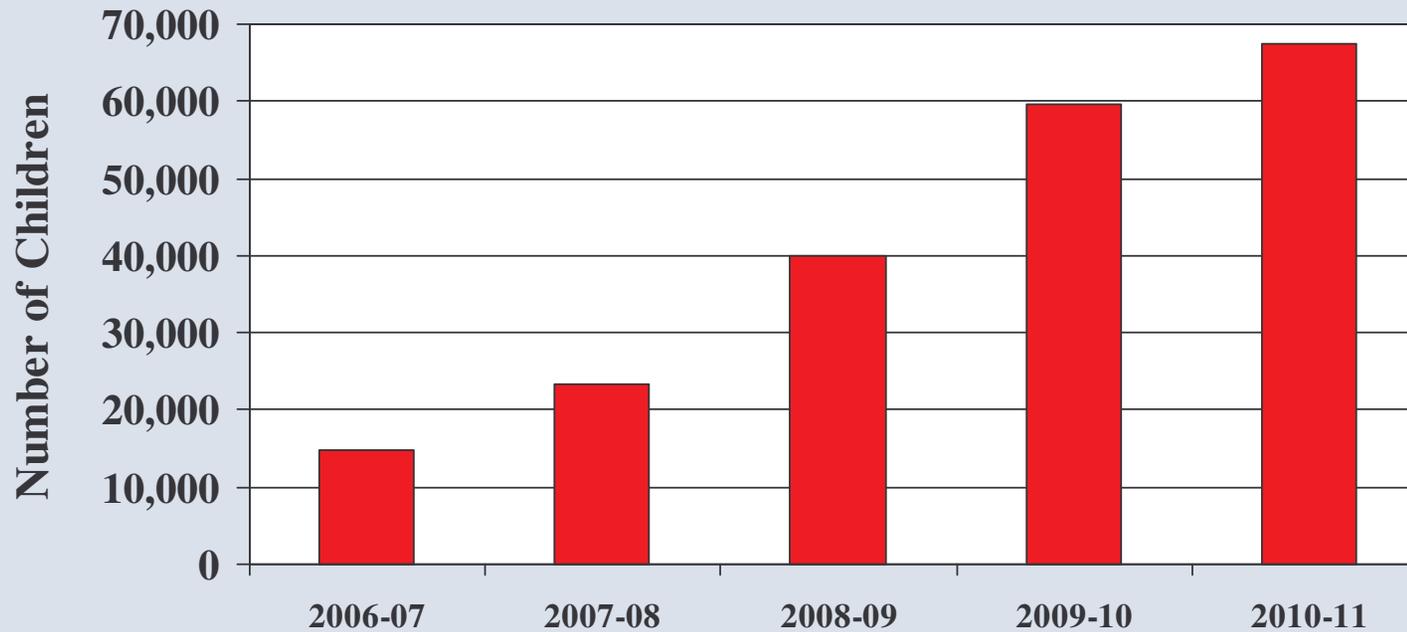
Cover All Kids will:

- 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 350 percent of the federal poverty level (\$70,000 for a family of four). Family premiums will range, on average, between \$23 and \$32 per month per child.
- Offer at-cost coverage for children in families whose income exceeds 350 percent of poverty (on average, \$143 per month per child).
- Begin January 1, 2007, assuming federal approval.

Cover All Kids

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





Expanding CHIP Health Coverage for Kids in Southeastern P.A.

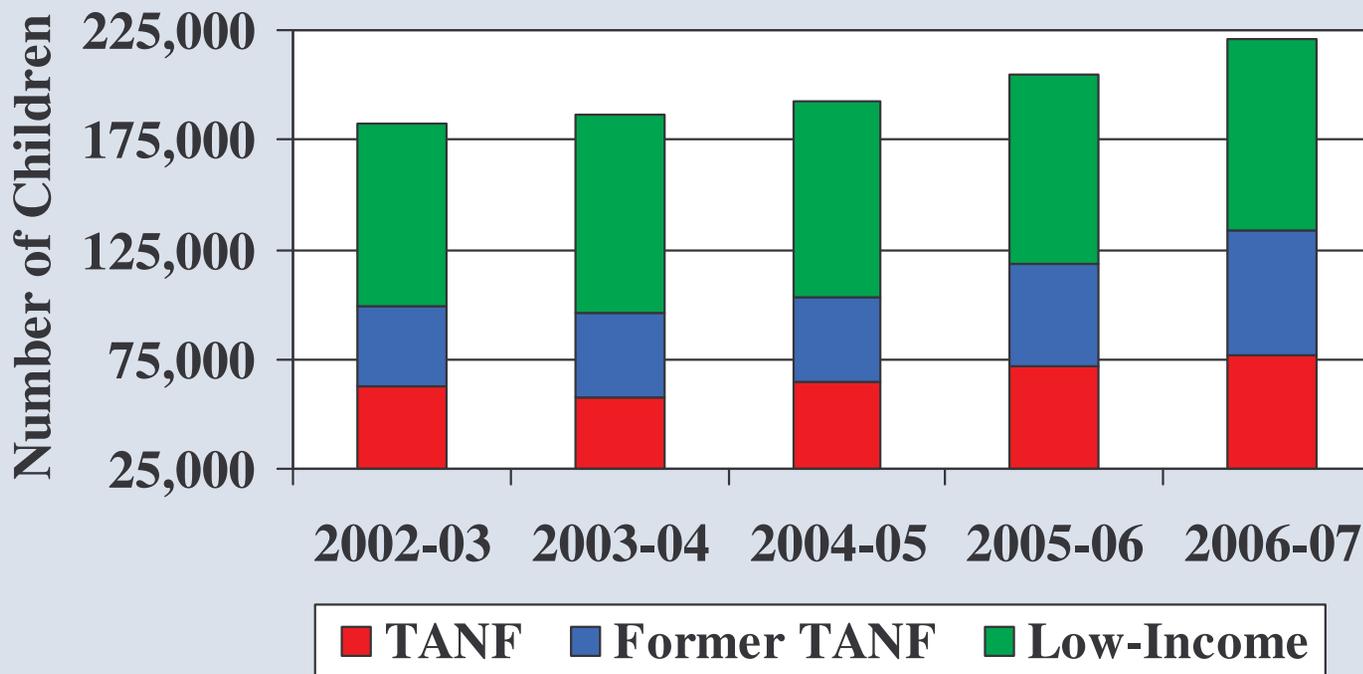
Pennsylvania's Children's Health Insurance Program (CHIP) is the oldest and most successful in the nation. The 2006-07 Governor's Budget proposes to increase the average CHIP enrollment to 156,748 children statewide with a total investment of \$255.8 million in 2006-07. This represents a 25% increase in enrollment since 2002-03.

County	2002-03 Average Enrollment	2006-07 Average Enrollment	Percentage Increase
Berks	3,171	4,194	32%
Bucks	5,308	6,533	23%
Chester	3,646	4,710	29%
Delaware	4,448	5,807	31%
Montgomery	5,575	7,173	29%

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 221,000 – an increase of more than 20 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.

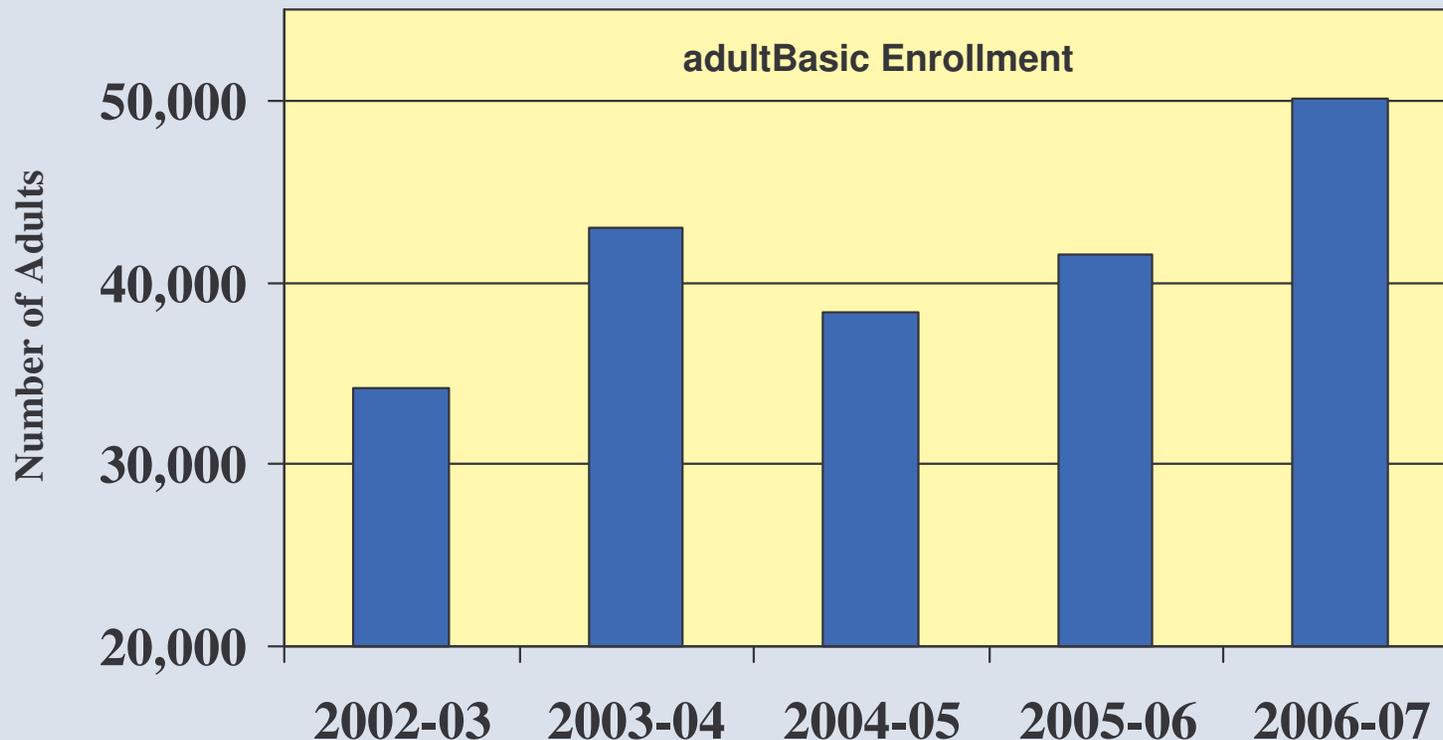
Pennsylvania Children in Subsidized Child Care



TANF = Temporary Assistance to Needy Families

adultBasic Enrollment

The 2006-07 budget recommends \$16.7 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 nearly 8,600 additional low-income working adults. Since the beginning of the Rendell administration, enrollment has grown from 34,171 adults to 50,146 adults – a 47 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.





FY 2006-07 adultBasic Total Funding

2006-07 adultBasic Funding Sources	
Community Health Reinvestment Fund 2006-07	\$90,000
Tobacco Settlement Fund 2006-07	\$72,819
Tobacco Settlement Fund Carryover from 2005-06	\$9,500
Projected Total 2006-07 Available Funding	\$172,319

- In 2005-06, the adultBasic program will provide low-cost health care coverage for an average of approximately 41,570 low-income working adults per month.
- With funding provided in the 06-07 budget proposal, the number of individuals enrolled in adultBasic will increase by 8,500, covering on average 50,000 people per month.



adultBasic

Coverage Growth in Southeastern P.A.

The adultBasic program is providing low-cost health care coverage to an average of approximately 41,570 low-income working adults per month. The 2006-07 Governor's Budget proposes to invest a total of \$177 million to increase enrollment in the adultBasic program to an average of 50,000 recipients per month.

County	2002-03 Average Enrollment	2006-07 Average Enrollment	Percentage Increase
Berks	625	923	48%
Bucks	1,189	1,647	38%
Chester	595	798	34%
Delaware	1,307	1,857	42%
Montgomery	1,429	2,180	53%



Expanding Long-Term Living Choices for Older Pennsylvanians in Southeast P.A.

In response to the preferences of older consumers, the Commonwealth is investing more resources to allow seniors to remain in their homes. This also benefits taxpayers because in-home services are typically provided at a lower cost than nursing home care. The 2006-07 Governor's Budget invests \$352 million in home and community-based long-term living services (HCBS).

County	2002-03 HCBS Slots	2005-06 HCBS Slots	Percentage Increase
Berks	131	325	148%
Bucks	150	311	107%
Chester	65	232	257%
Delaware	258	809	214%
Montgomery	285	503	76%



Caring for All Pennsylvanians

The 2006-07 budget recommends \$97 million to increase services for children, adults and families in need. In addition, this budget proposes the statewide expansion of the Behavioral Health HealthChoices program, which will provide managed mental health and substance abuse services to more than 200,000 additional Medical Assistance recipients in 2006-07.

- \$1.7 million to provide **breast and cervical cancer screening** for 4,209 additional low-income, high-risk women ages 40 to 49.
- \$5.5 million to provide **subsidized child care services** to 1,861 additional low-income families – a total state investment of \$107.7 million.
- \$16 million to provide **early intervention services** for 5,174 additional children from birth through age five – a total state investment of \$236.6 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.
- \$5.8 million to **expand quality early learning experiences** to 12,000 additional children through the Keystone STARS Program – a total investment of \$32.4 million.



Caring for All Pennsylvanians

The 2006-07 budget recommends \$97 million to increase services for children, adults and families in need. In addition, this budget proposes the statewide expansion of the Behavioral Health HealthChoices program, which will provide managed mental health and substance abuse services to more than 200,000 additional Medical Assistance recipients in 2006-07.

- \$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 \$155.5 million.
- \$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 \$789.4 million.
- \$16.7 million to provide **subsidized health care insurance** for 8,757 additional **uninsured working adults** – a total investment of \$177.3 million.
- \$16 million to provide **early intervention services** for 5,174 additional children from birth through age five – a total state investment of \$236.6 million.



2006-07 Budget Highlights

Prescription Drug
Coverage for Older
Pennsylvanians



PACE Plus Medicare Prescription Drug Program

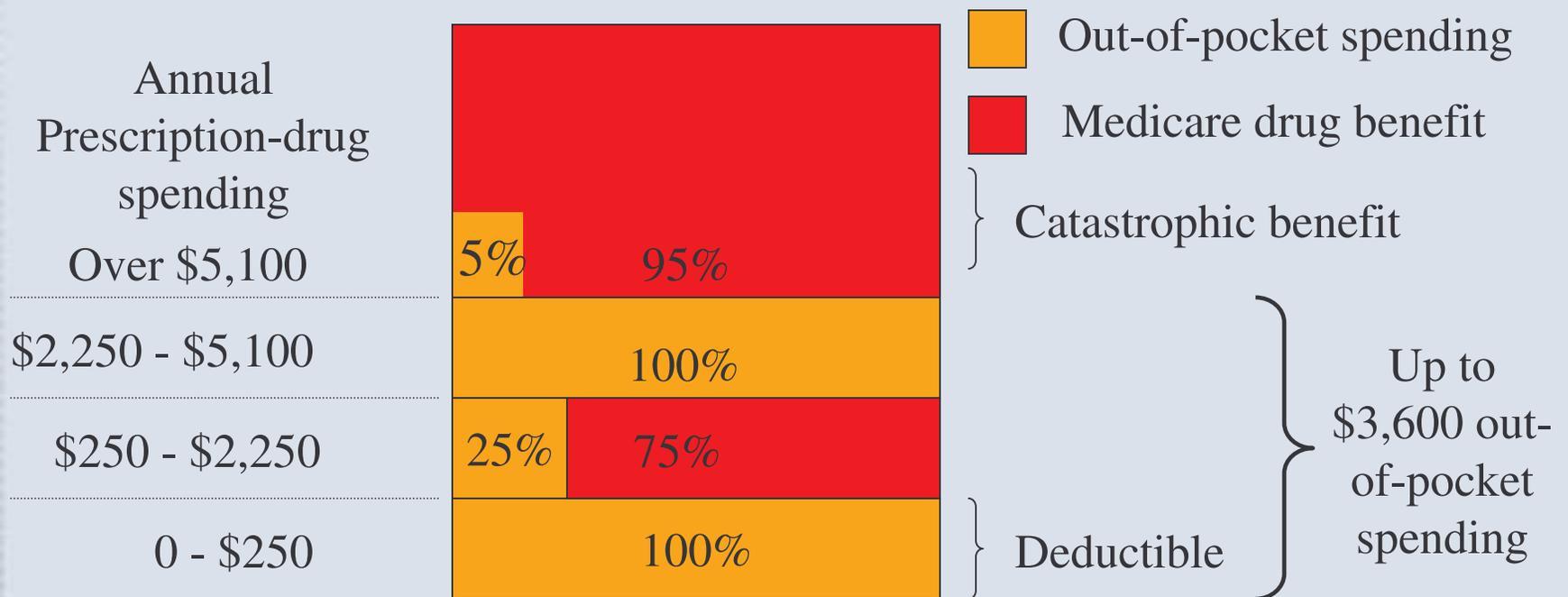
Integrating PACE/PACENET Benefits with Medicare Part D

Current estimates are that between 60,000 and 80,000 PACE enrollees became eligible for the Medicare Part D Low-Income Subsidy Program beginning January 1, 2006. The 2005-06 state budget assumes \$87 million in PACE program savings from enrolling the lowest-income PACE recipients in the Medicare Prescription Drug Low-Income Subsidy Program, which offers a comprehensive benefit.

- ✓ On November 30, 2005, Governor Rendell and Secretary Leavitt of the U.S. Department of Health and Human Services announced that PACE and PACENET recipients eligible for the Medicare Part D Low-Income Subsidy Program should apply for federal low-income subsidy prescription drug benefits and continue to benefit from PACE/PACENET.
- ✓ The Department of Aging is working with the eligible PACE beneficiaries to ensure that they enroll in the Medicare Part D Low-Income Subsidy Program.
- ✓ The Department of Aging is working with the federal government on final approval of the prescription drug plans, thereby making it easier to direct PACE and PACENET enrollees to the Medicare prescription plan that best suits their needs.
- ✓ This budget assumes that 120,000 people who are eligible for but not currently enrolled in PACE and who do not have credible coverage will enroll in PACE Plus Medicare over the next 18 months.

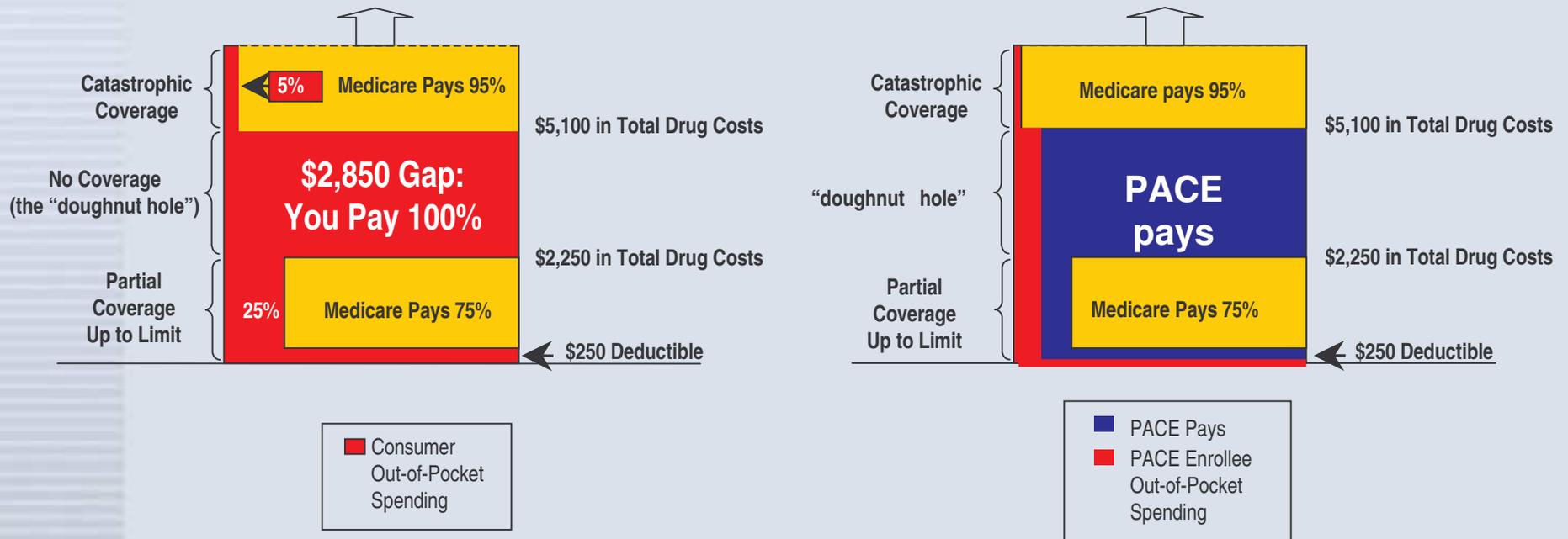
Medicare Part D Prescription Drug Program

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



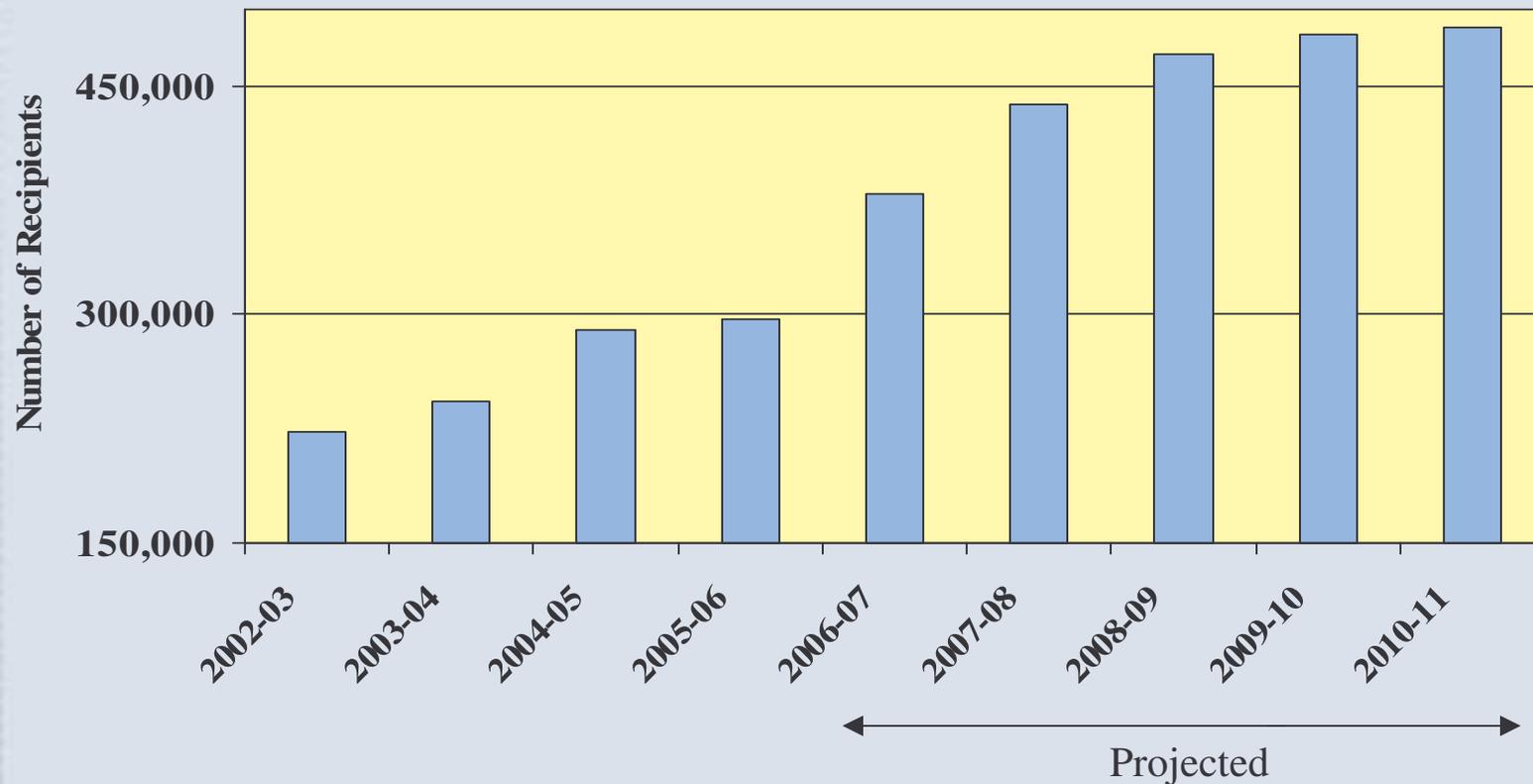
Medicare Part D plans may offer alternative options as long as they are actuarially equivalent.

PACE Plus Closes the Federal Gaps



PACE/PACE NET Enrollment

The 2006-07 budget provides funding to extend PACE coverage 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 enrollment has already increased by 110,000 seniors since 2002-03.





2006-07 Budget Highlights

Promoting Economic
Growth, Job Creation
and Business
Competitiveness



Improving Pennsylvania's Business Tax Climate and Economic Competitiveness

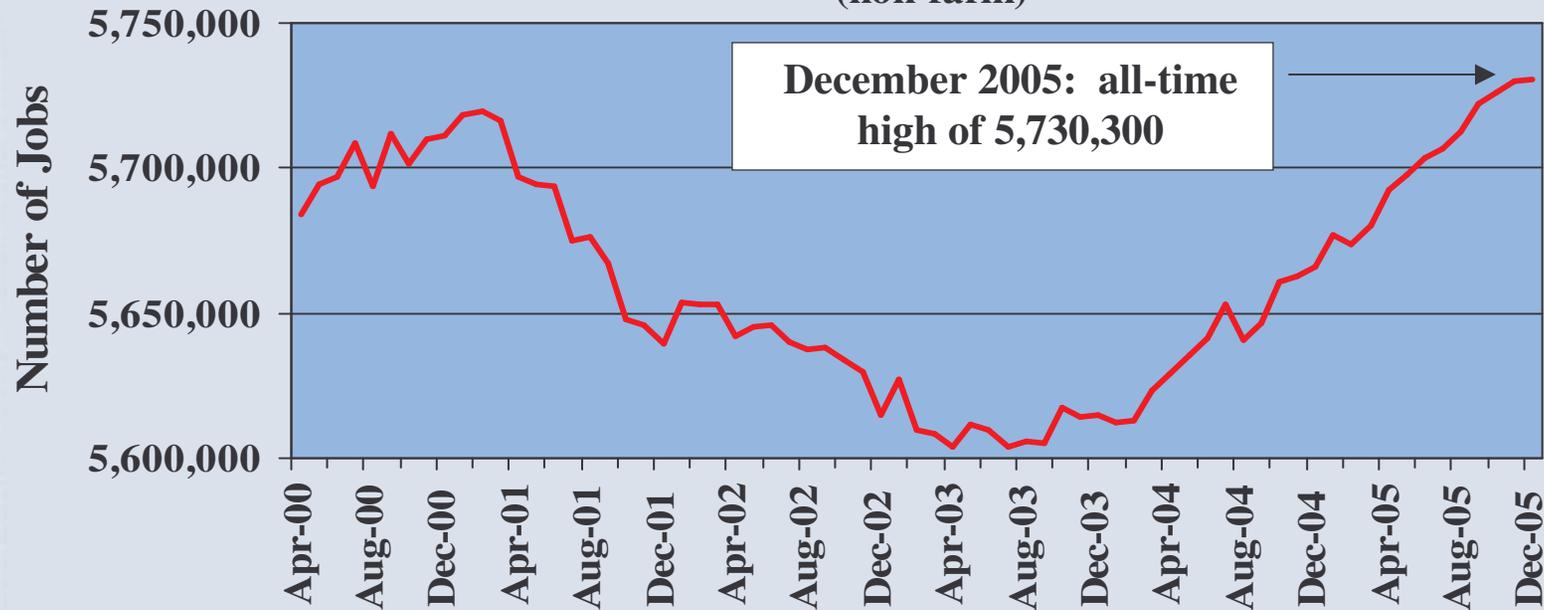
In 2006-07, the Commonwealth will lower business taxes by more than \$221 million, raising the total value of business tax cuts since the beginning of the administration to nearly \$1 billion. According to the Washington, D.C.-based Corporation for Economic Development, Pennsylvania advanced in a national ranking from 46th to 15th for short-term economic growth from 2003 to 2004.

- **The Jonas Salk Legacy Fund:** *Accelerating Medical Research in Pennsylvania.* Leverage a portion of Pennsylvania's Tobacco Settlement Fund to provide up to \$500 million over the next two years to invest in life sciences research and commercialization.
- **World Trade P.A.:** \$15 million to increase Pennsylvania's global engagement. Create a World Trade P.A. Operations Center. Attract new foreign direct investment to secure jobs and capital. Leverage global networks from Pennsylvania colleges and universities.
- Accelerating the phase-out of the **Capital Stock and Franchise Tax** by an additional one-tenth of a mill, saving companies a total of \$204 million.
- Increase the **Research and Development Tax Credit** cap from \$30 million to \$40 million.
- Increase the **Net Operating Loss** tax benefit from \$2 million to \$3 million in losses per year.

Pennsylvania Job Growth

The brightest spot in the economic outlook for Pennsylvania is job growth. In December 2005, Pennsylvania reached a historic high in the number of non-farm jobs, seasonally adjusted. Also in December, the unemployment rate dropped to 4.9 percent – down by eight-tenths of a percent from a year ago. Since January 2003, the Pennsylvania economy has generated a net increase of 102,900 jobs. State investments, including the Economic Stimulus program, have been a major factor behind the turnaround.

Steady Rise in Pennsylvania Jobs (non-farm)



Economic Stimulus Program

The Rendell Administration and the Pennsylvania General Assembly have enacted several pieces of legislation that together make up the Commonwealth's Economic Stimulus Program, a comprehensive integrated set of programs in which the Commonwealth is investing \$2.3 billion to jump-start Pennsylvania's economy and leverage at least \$5 billion in private investment. Funds are targeted towards the following areas: site preparation, infrastructure and construction; community revitalization and business development.

- ✓ **Act 12 of 2004**
 - Expands Machinery and Equipment Loans to make biotech and medical facilities eligible for loans.
 - Creates Keystone Innovation Zones (KIZs) to encourage research and development in cooperation with institutions of higher education.
- ✓ **Act 22 of 2004 creates the Commonwealth Financing Authority (CFA) to issue economic development bonds to finance several major Stimulus programs.**
- ✓ **Act 23 of 2004 establishes Tax Increment Financing- Multi year grants to issuing authorities toward payment of debt service on local projects. Grants are based on anticipated sales, hotel occupancy, and personal income taxes to be generated.**

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	85	\$210,000	Homeownership Choice	24	\$25,000
PennWorks	30	\$80,340	Hometown Streets	226	\$128,500
Tax Increment Financing	1	\$5,000	Business and Other Private-Sector Investments:		
Infrastructure Facilities Improvement Program	6	\$3,500	First Industries Fund (Agriculture/Tourism)	148	\$23,000
Redevelopment Assistance Capital Program	241	\$656,000	Second State Loan Program	2	\$375
Community Revitalization:			Venture Capital Guarantee Program	8	\$31,000
Main Street Downtown Business Renewal	178	\$16,987	Keystone Innovation Zones	16	\$4,200
Elm Street Downtown Residential Renewal	75	\$13,206	Base Realignment and Closures	Multiple Sites	\$4,460
Enterprise Zones	103	\$15,826	TOTAL	1,380	\$1,290,258
Housing and Redevelopment Assistance	253	\$72,864			

Update on the Economic Stimulus Program

(Projected Jobs Created/Retained)

Program	Projects Funded	Proj. Jobs Created/Retained	Program	Projects Funded	Proj. Jobs Created/Retained
Infrastructure Projects:			Community Revitalization:		
Business in Our Sites	85	89,030	Homeownership Choice	24	NA
PennWorks	30	26,000	Hometown Streets	226	NA
Tax Increment Financing	1	1,200	Business and Other Private-Sector Investments:		
Infrastructure Facilities Improvement Program	6	4,899	First Industries Fund (Agriculture/Tourism)	148	1,290
Redevelopment Assistance Capital Program	241	NA	Second State Loan Program	2	10
Community Revitalization:			Venture Capital Guarantee Program	8	NA
Main Street Downtown Business Renewal	178	417	Keystone Innovation Zones	16	1,500
Elm Street Downtown Residential Renewal	75	NA	Base Realignment and Closures	Multiple Sites	237
Enterprise Zones	103	883	TOTAL	1,380	125,588
Housing and Redevelopment Assistance	253	122			



The Jonas Salk Legacy Fund

*Accelerating Medical Research in
Pennsylvania*



Building on our leadership position in the biosciences

- The Legacy Fund is a \$500 million initiative to accelerate research, build cutting edge facilities, and attract world-class researchers to set up shop in Pennsylvania:
 - \$400 million for the construction of labs and incubators
 - \$100 million for “Starter Kits” to help research universities recruit new faculty with funds for equipment & facilities
- 1:1 match requirement yields \$1 billion total investment.

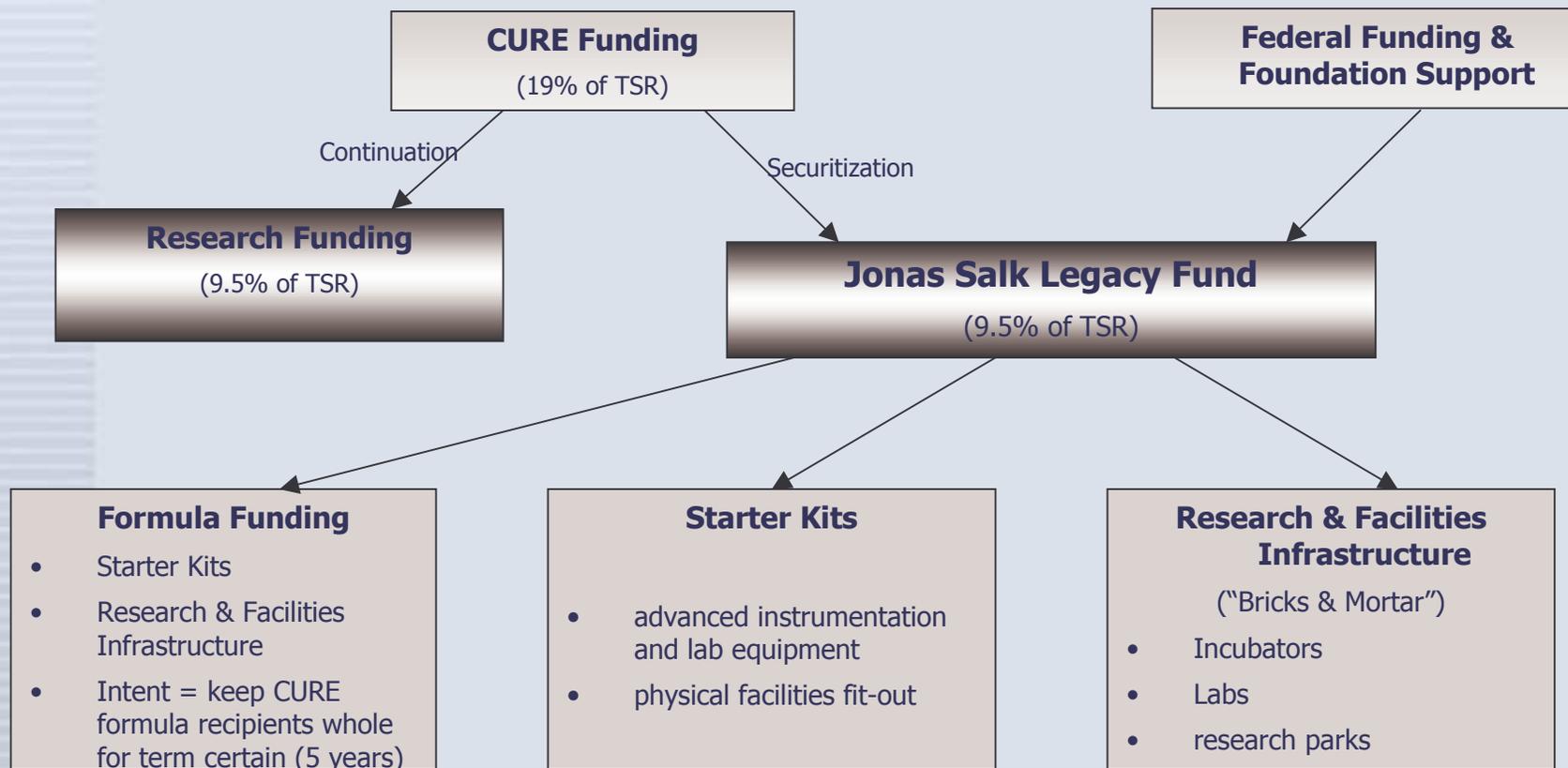


Goals: Jonas Salk Legacy Fund

- Solidify P.A.'s leadership position in the field of biosciences
- Increase the level of research in biosciences in Pennsylvania
- Increase the rate of commercialization of biosciences research through improved research
- Increase the number of start-ups and the number of major bioscience company attractions to the state

Jonas Salk Legacy Fund

\$500 Million of Accelerated Funding:





Setting the stage for major medical and scientific breakthroughs

➤ The Jonas Salk Legacy Fund will dramatically accelerate the pace of discovery in cutting edge fields like:

- Nanotechnology
- Drug Discovery Tools
- Regenerative Medicine
- Medical Devices
- Therapeutics
- Bioinformatics

➤ Major medical breakthroughs to cure disease and reduce suffering are most likely to take place in these fields.



Economic Benefits of the Jonas Salk Fund

- \$1 billion investment in new state-of-the-art research infrastructure
- Research dollars will support 12,000 jobs
- Attract 400-600 new top research faculty through Starter Kits
- Increase federal R&D funding into PA's universities



Growing Greener II

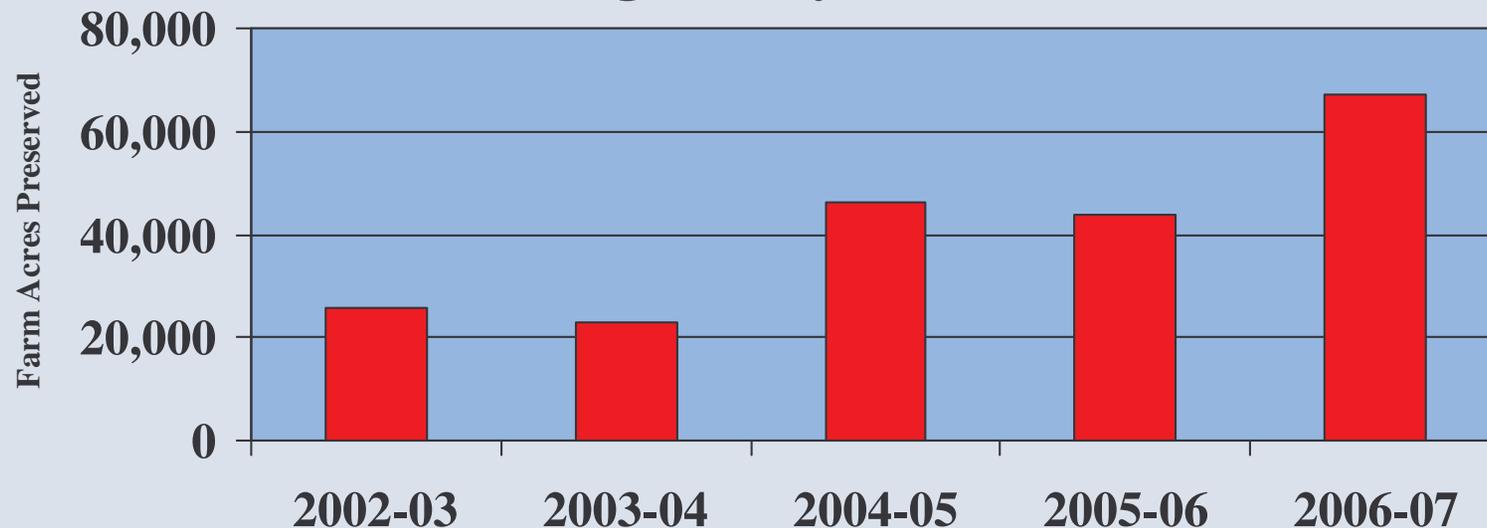
To address Pennsylvania's critical environmental concerns, Governor Rendell proposed Growing Greener II, a 6-year, \$625 million plan enacted by the General Assembly and approved by voters in 2005. Growing Greener II represents one of the largest investments ever in improving Pennsylvania's environment. Thus far, \$65M in commitments have been made in 2005-06 -- \$33.5M for DEP and \$31.5M for DCNR -- and an additional \$50M is expected by year's end. By the end of 2006-07, commitments are expected to reach \$300M.

- **\$230 million** 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** to the **Department of Conservation and Natural Resources** to preserve natural areas and open spaces, improve state parks and enhance local recreational needs.
- **\$80 million** to the **Department of Agriculture** to protect working farms.
- **\$50 million** to the **Department of Community and Economic Development** to revitalize communities through investments in housing and mixed-use redevelopment projects.
- **\$27.5 million** to the **Pennsylvania Fish and Boat Commission** to repair fish hatcheries and aging dams.
- **\$20 million** 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 67,000 acres of farmland will be preserved in 2006-07, an increase of nearly 160 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 Highlights

Public Safety
and
Security



Pennsylvania Safety and Security – A Commonwealth Priority

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

- ✓ \$80.8 million federal funds for **bio-terrorism preparedness**
- ✓ \$25.0 million State funds for **volunteer company grants**
- ✓ \$16.9 million State funds for **statewide radio system**
- ✓ \$12.3 million federal funds for **pandemic influenza preparedness**
- ✓ \$8.8 million State funds to increase **driver's license security**
- ✓ \$8.0 million total funds for **hazard mitigation**
- ✓ \$4.0 million State funds for **statewide digital map**
- ✓ \$2.1 million State funds for five **new correctional housing units**



Pennsylvania is Supporting Those Who Defend Our State and Nation

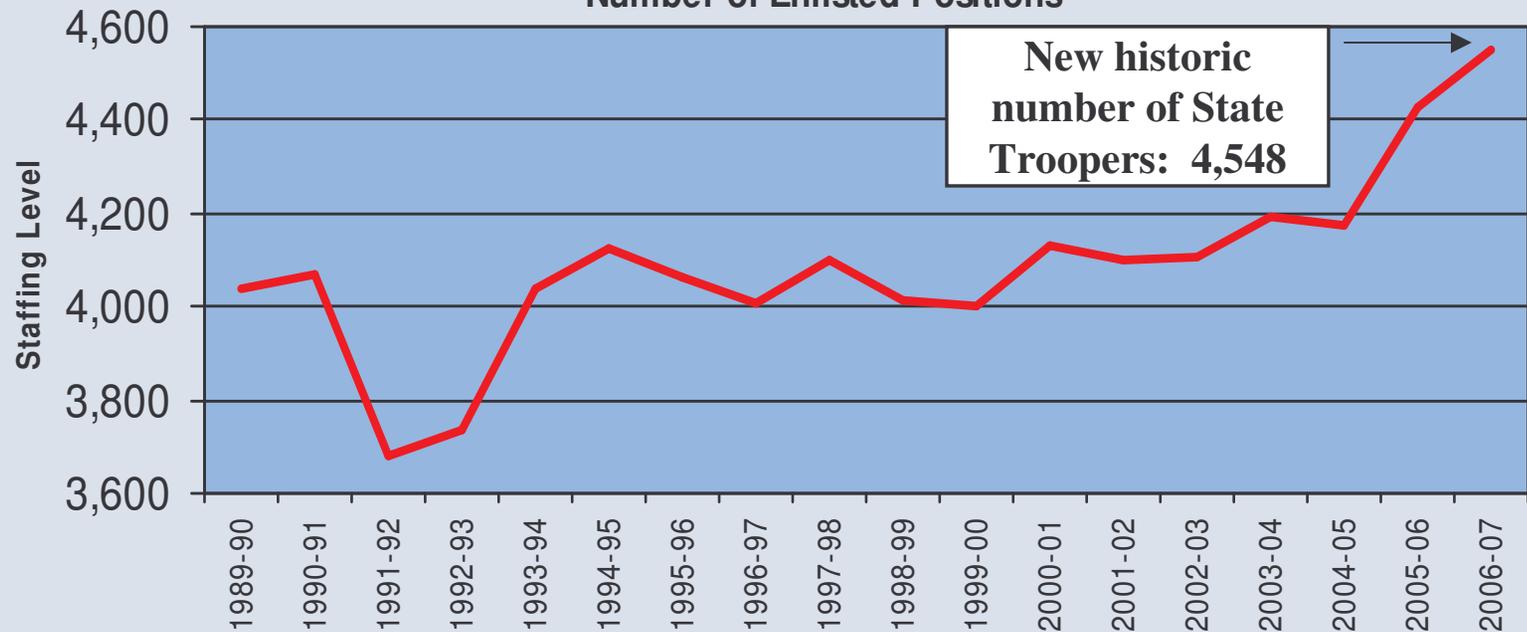
The 2006-07 budget continues Governor Rendell's efforts to support the men and women of Pennsylvania's National Guard. The Pennsylvania National Guard has been called upon to join in the global war on terror and to support hurricane-ravaged areas of the Gulf Coast, providing the largest number of troops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

- ✓ \$275,000 continued funding 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's Educational Assistance Program*** has been improved by extending benefits
- ✓ **New protections for soldiers:**
 - allowing soldiers to qualify for their parents' health insurance coverage when they return to school after deployment
 - supporting soldiers who defer their 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, Governor Rendell is proposing an additional 90 trooper positions in 2006-07, bringing the State Police to its highest enlisted complement ever – 4,548. Reaching this unprecedented number of enlisted personnel at the State Police, however, is dependent on the Pennsylvania State Troopers Association accepting a proposal from the State Police. This proposal would add 30 new troopers in 2005-06 (adding to 90 already added this year), move an additional 68 enlisted personnel currently performing desk duties to active law enforcement duties and keep 45 experienced corporals on the road rather than in dispatch centers answering calls.

**Pennsylvania State Police
Number of Enlisted Positions**

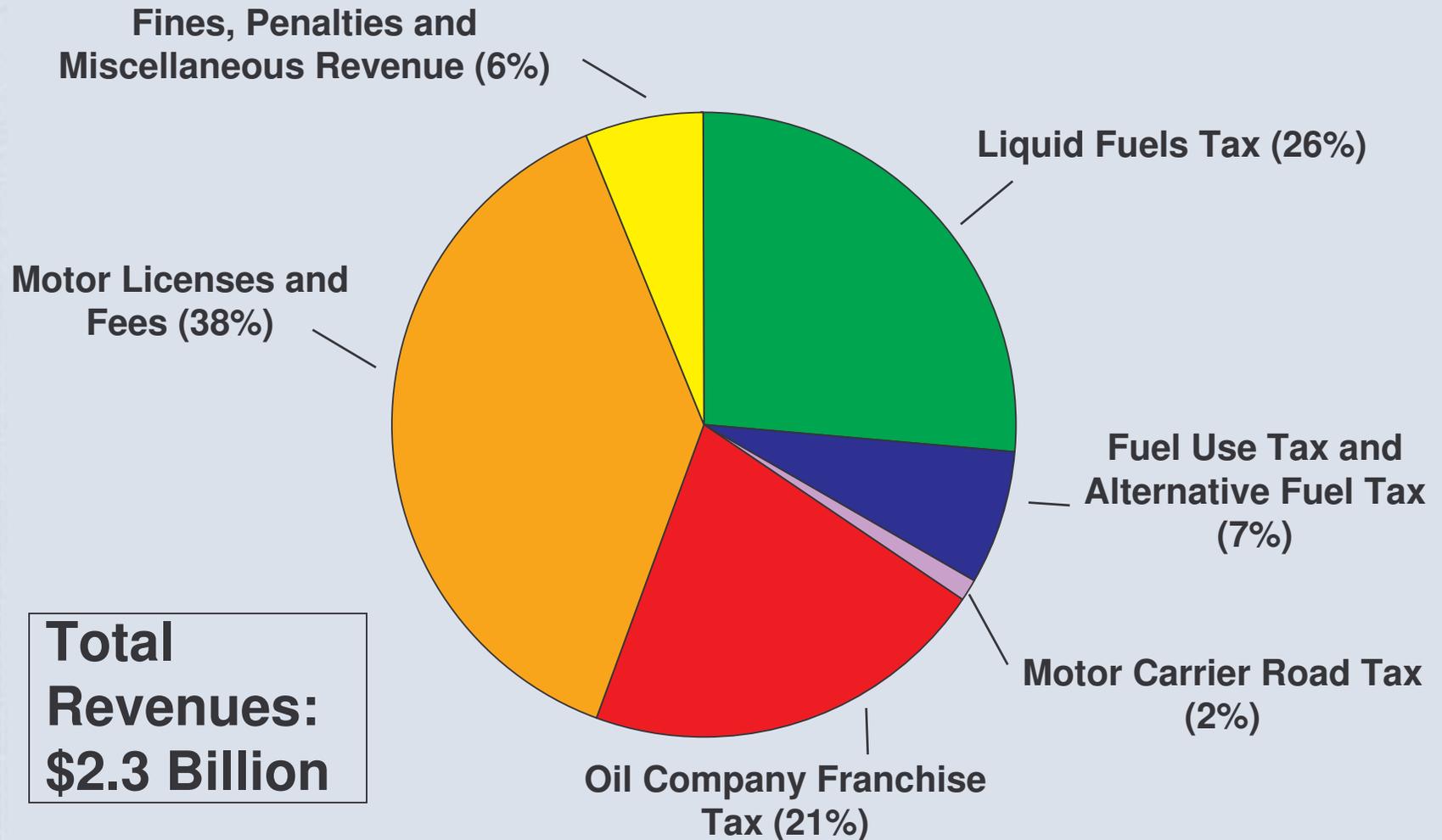




2006-07 Budget Highlights

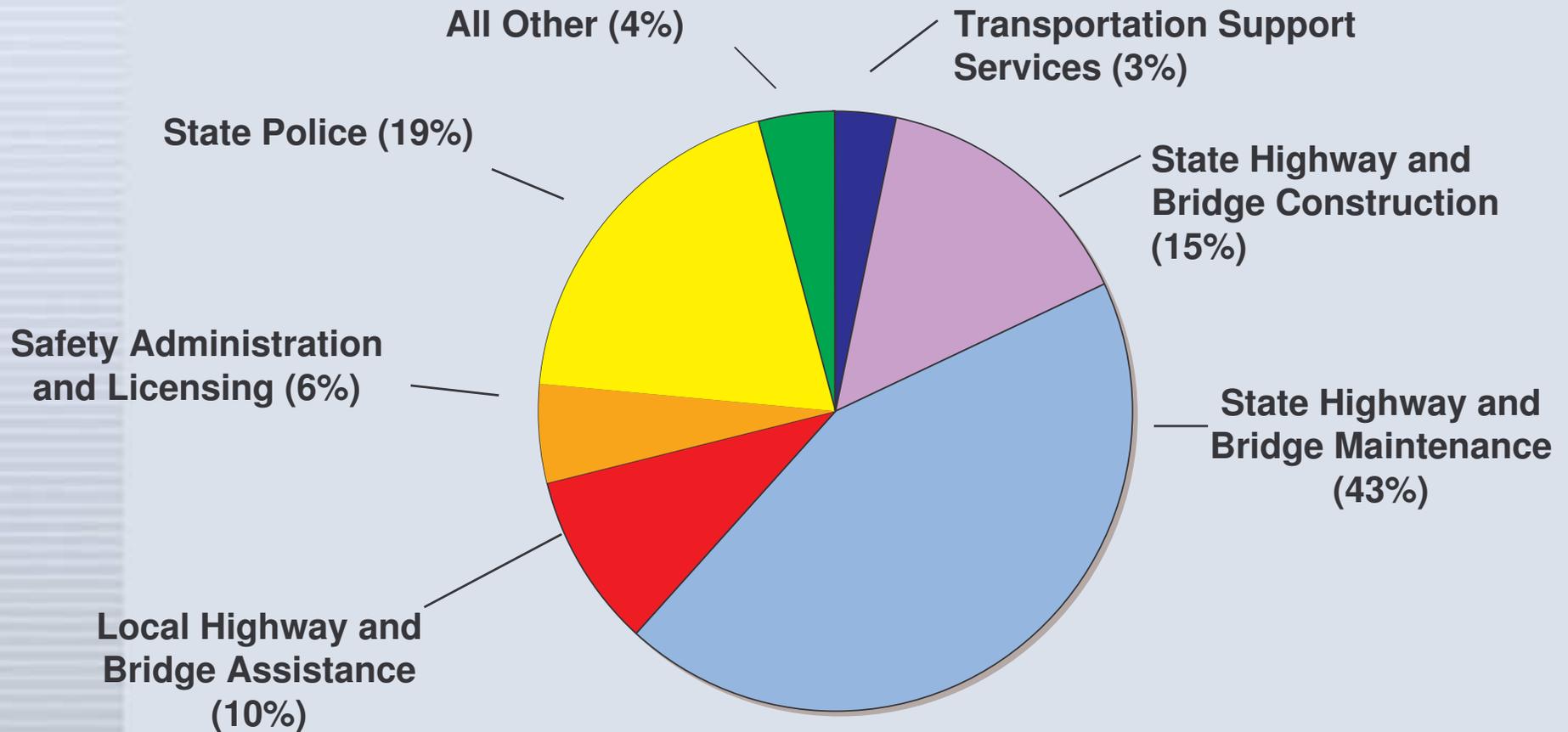
Transportation

2006-07 Motor License Fund Revenue Sources



2006-07 Motor License Fund Expenditures

About 68 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.





Temporarily Averting a Transit Catastrophe

In February 2005, Governor Rendell announced a plan to make available more than \$400 million in non-recurring funding for Pennsylvania's transit agencies over the next two years. These funds from federal transportation monies provided to Pennsylvania, a major portion of which can be used either for roads or for public transit. Without the use of this federal "flex" funding, 16 transit agencies would have faced a total \$343 million funding gap that would have shut down their major transit operations.

- The total service-area population of these systems is 7.9 million, or 64.7 percent of Pennsylvania's population.
- Not flexing highway funds would have affected 1.6 million disabled and 1.2 million elderly riders.
- Flex funding is a temporary measure to be followed by development of a permanent, long-term solution.
- The Transportation Funding and Reform Commission, with four legislative appointees, represents a cooperative effort to solve the transit crisis.



Transportation Funding and Reform Commission

Having achieved a temporary resolution of the transit funding crisis, the Governor formed a commission to recommend appropriate funding for transit, roads and bridges.

- The Commission is composed of five members appointed by the Governor, including the Secretary of Transportation, and four members appointed by the General Assembly. Its focus thus far has been on hearing transit agency perspectives and on the road and bridge program.
- The Commission has met three times in Harrisburg and once in Erie. Seven more meetings have been scheduled, including in Pittsburgh and Philadelphia. A final report is scheduled for November 2006.
- The Commission plans to:
 - Conduct transit agency operational audits and identify opportunities for cost efficiencies, revenue enhancement and service improvements.
 - Evaluate transit agency structure and competitive contracting.
 - Assess relationship between growth patterns and transportation systems with the goal of reducing congestion and improving transit access.
 - Recommend appropriate long-term funding sources and levels.

Highway Funds Continue Strong Growth Trend

Even after “flexing” some additional federal transportation funds to keep the state’s 13 transit agencies operating, Pennsylvania highway spending is still growing substantially, with an anticipated \$252 million increase in total funds in 2006-07. Pennsylvania highway spending in 2006-07 is 23 percent, or \$980 million, higher than when Governor Rendell took office. From 2002 to 2004, Pennsylvania’s highways improved by 6 percent on the widely used International Roughness Index.

	(in millions of dollars)				(in millions of dollars)		
	State Funding	Federal Funding	Total Funding	Dollar Change from Previous Year	Percent Change from Previous Year	Standard Federal Funds Flexed for Transit	“Crisis” Federal Funds Flexed for Transit
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	.08%	\$48	\$74
2005-06	\$3,518	\$1,424	\$4,942	\$737	17.5%	\$25	\$202
2006-07	\$3,758	\$1,436	\$5,194	\$252	5.1%	\$25	\$138

Pennsylvania's Bridges

The 2006-07 budget proposes an additional \$130 million in state funds for the Commonwealth's highway and bridge infrastructure, including \$100 million for the Smoother Roads and Bridges program, \$20 million for the Bridge Preservation program and \$10 million for the Emergency Highway and Bridge Maintenance Repair program. Department of Transportation spending on bridges will increase \$241 million, or 93 percent, from 2002 through 2006.

Amounts in
Millions

Department of Transportation Bridge Program





2006-07 Budget Highlights

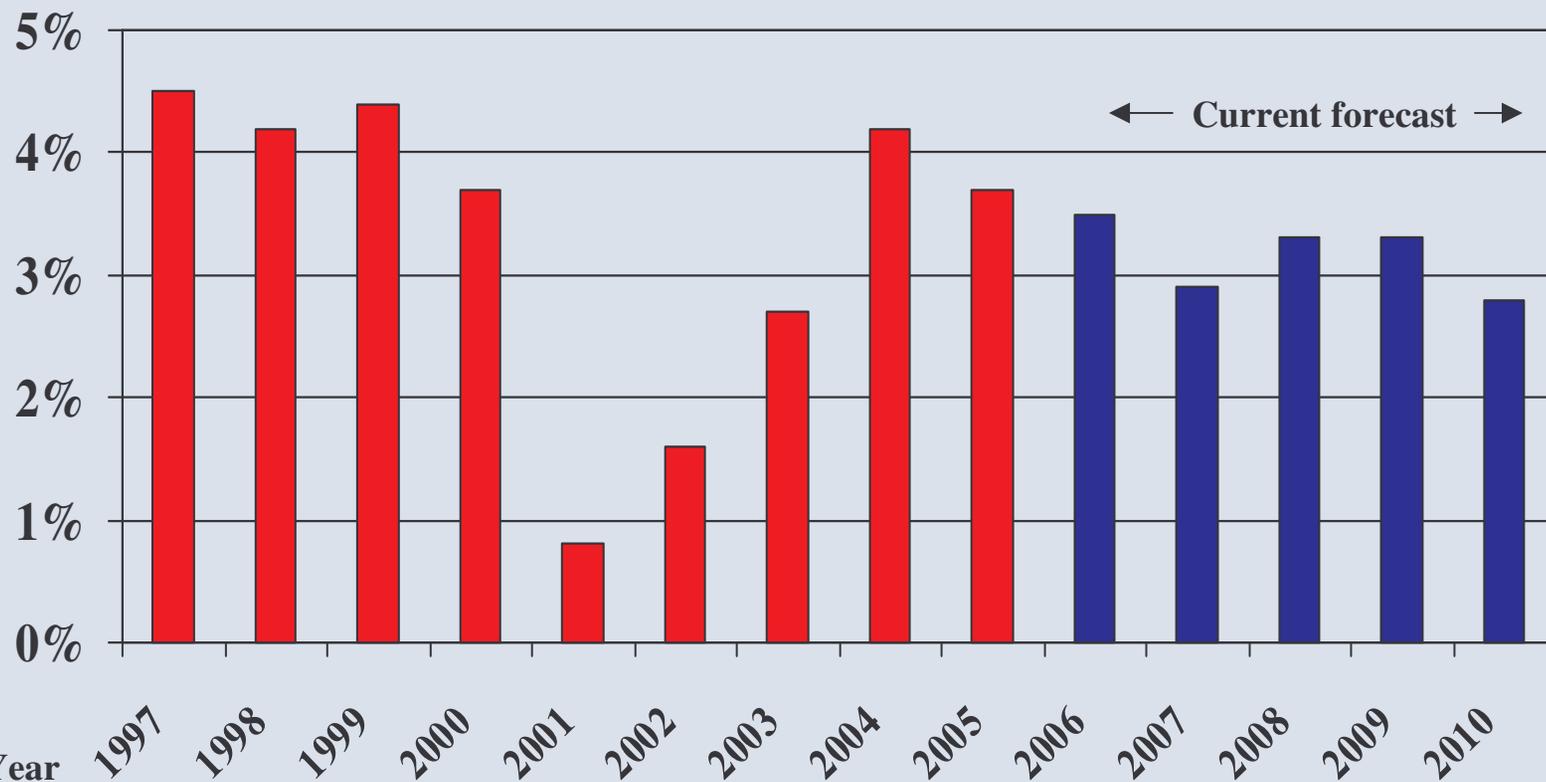
General Fund Revenues

Economic Outlook

Real U.S. Gross Domestic Product

Annual Growth

Calendar year 2005 GDP growth was 3.7 percent. Current GDP forecasts for 2006 estimate the annualized growth rate at 3.5 percent. Economic forecasting firms project that peak GDP growth occurred in 2004 and that real U.S. GDP growth will slow, staying close to 3 percent annually through 2010.



Calendar Year

Forecast Change in Key U.S. Economic Indicators

Annual Percentage Growth*

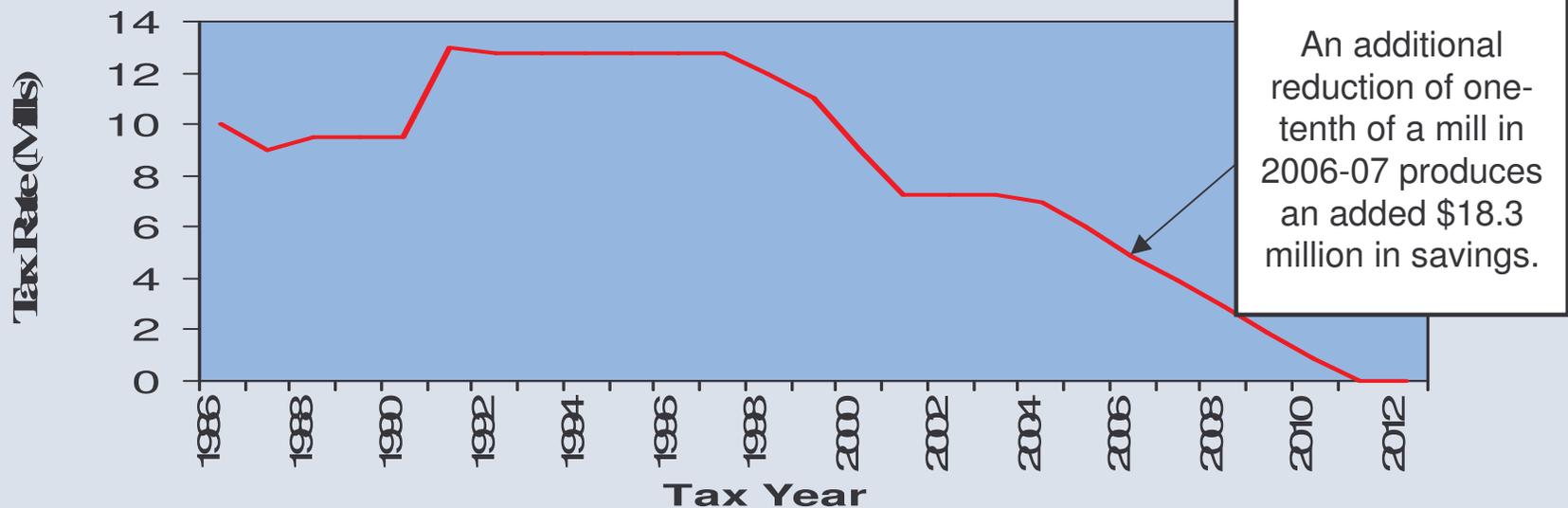
The most recent Index of State Economic Momentum, published by State Policy Reports, indicates that the Commonwealth vaulted twelve spots to 30th in total economic momentum in the 2005 Index, as measured by the combination of population growth, personal income and employment growth.

Indicator	2004	2005	2006p	2007p
Nominal GDP	7.0	6.5	6.1	4.8
Real GDP	4.2	3.7	3.5	2.9
Real Personal Consumption	3.9	3.5	3.2	3.3
Corporate Profits (After Tax)	11.8	35.3	5.8	-2.0
Unemployment Rate (Rate)	5.5	5.1	4.8	4.9
CPI	2.7	3.4	2.5	1.4
Federal Funds (Rate)	1.3	3.2	4.7	4.8

* Assumptions contained herein as well as others are incorporated in the 2006-07 fiscal year revenue estimates.

p=projected

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, saving businesses a total of \$204 million in the 2006 fiscal year.
- Cumulative business tax reductions from major tax savings initiatives for 2003-04 through 2006-07 will total nearly \$1 billion, including nearly \$700 million from the Capital Stock and Franchise Tax reductions.
- An additional \$1.2 billion in revenue would have been collected in 2006-07 if the Capital Stock and Franchise Tax rate had remained at 12.25 mills.

National Trends in State Tax Revenue Growth

Rates of Revenue Growth – Third Quarter 2005 Compared to Third Quarter 2004

Nationwide, states are generally realizing healthy revenue growth that is increasing faster than the rate of inflation. In Sales tax and Personal Income tax, Pennsylvania is achieving rates of growth similar to the nationwide median. However, Pennsylvania's rate of growth for the Corporate Net Income tax is nearly 50 percent lower than the median growth other states are experiencing, additional evidence that Pennsylvania's Corporate Net Income tax needs to be reformed.

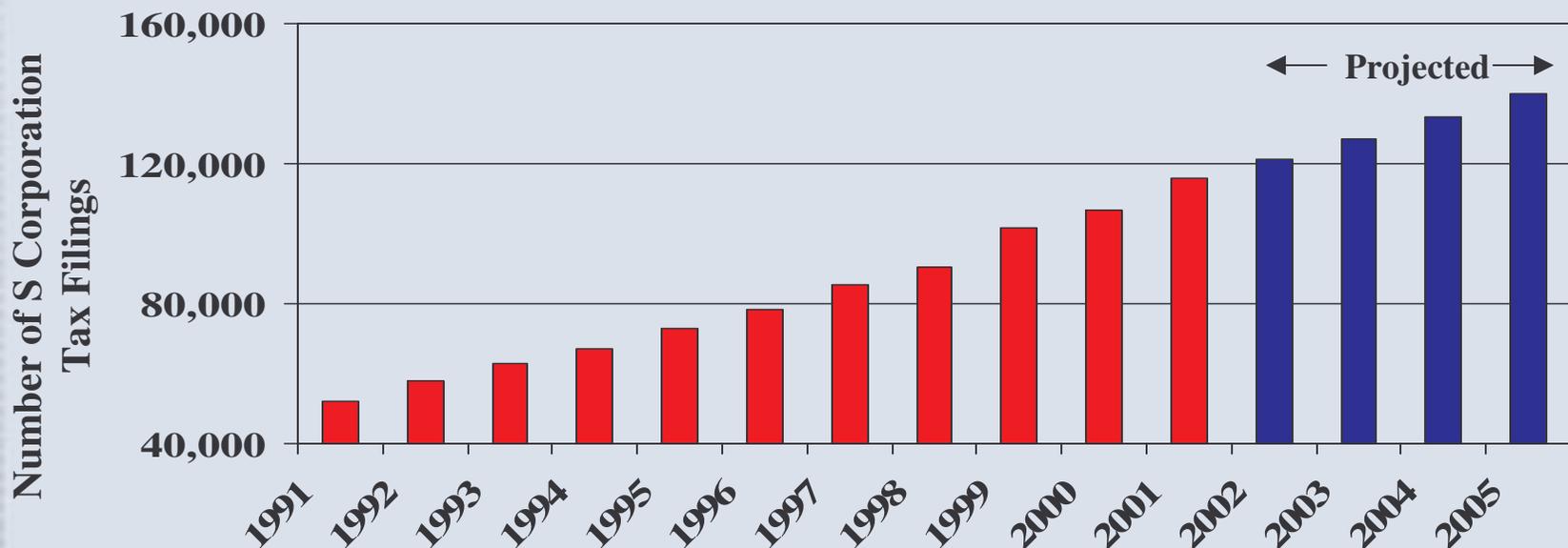
	Sales Tax	Personal Income Tax	Corporate Net Income Tax
Median (among states that levy)	5.9%	8.3%	34.6%
Pennsylvania	5.5%	7.7%	17.8%
States in sample	41	38	42
States with higher tax growth than PA	21	21	35
Percentage of states in sample higher than Pennsylvania	51%	55%	83%

Source: Rockefeller Institute of Government, State Revenue Report, December 2005.

No data from Louisiana, Missouri, New Mexico and Wyoming.

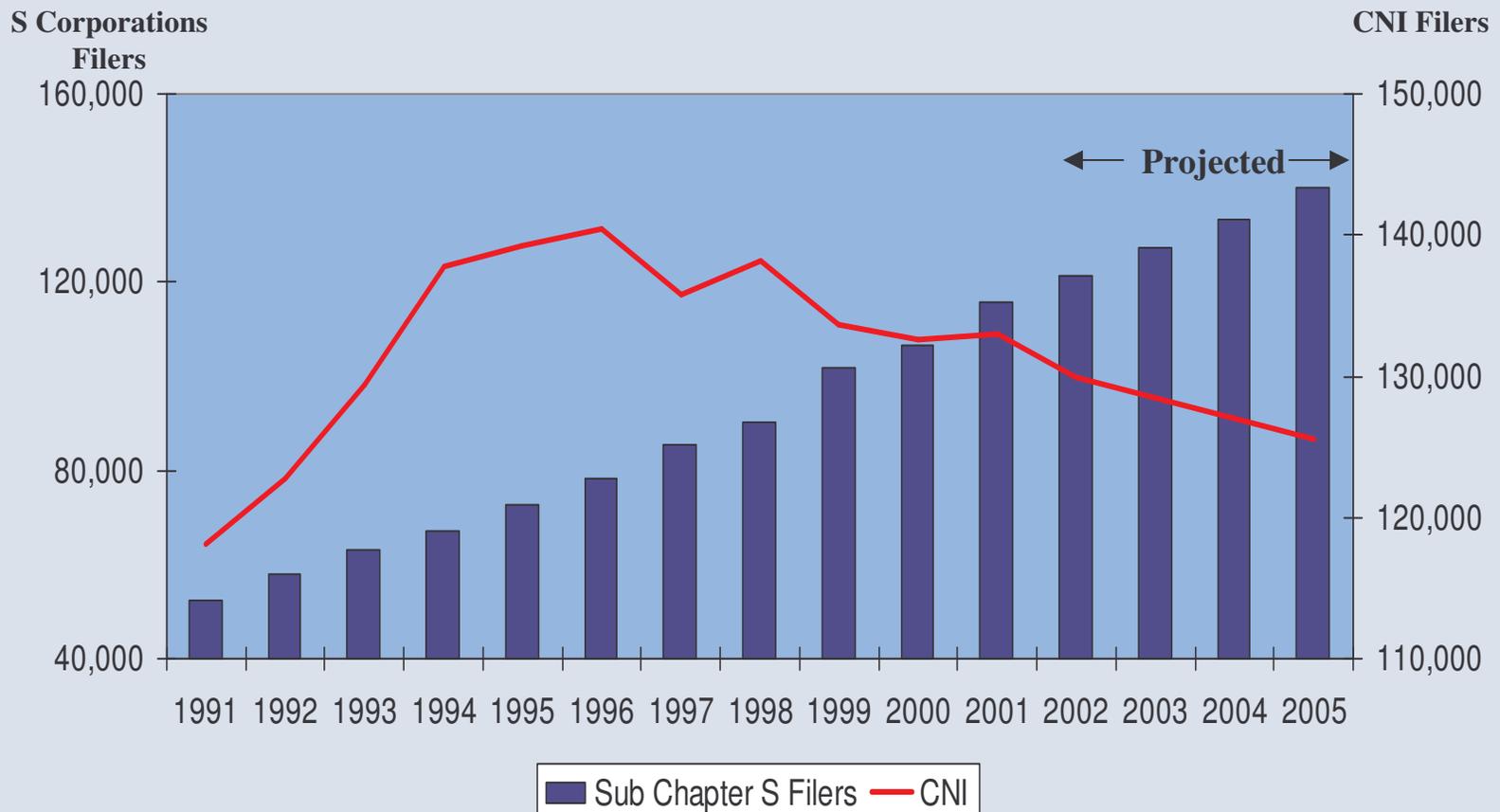
Pennsylvania S Corporation Tax Filings

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.



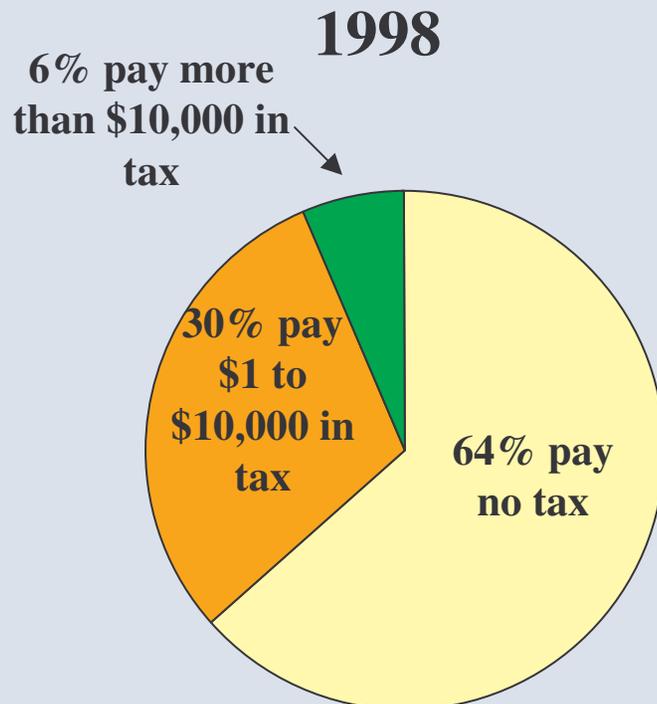
Pennsylvania S Corporation and Corporate Net Income Tax Filings

At the same time the number of S corporations has been increasing, the number of Corporate Net Income tax filers has decreased.



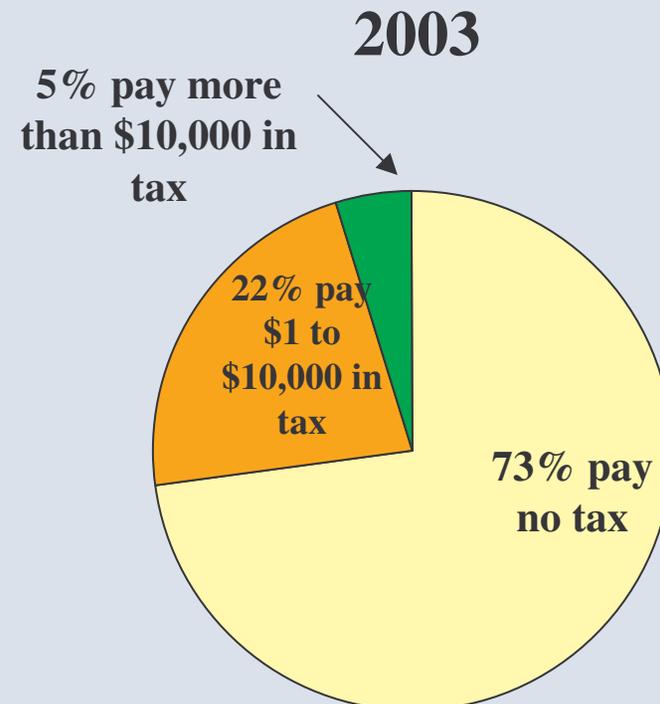
Corporate Net Income Tax

The percentage of Corporate Net Income tax filers with no taxable 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.



Amount of tax paid

□ \$0 □ \$1 to \$10,000 □ > \$10,000

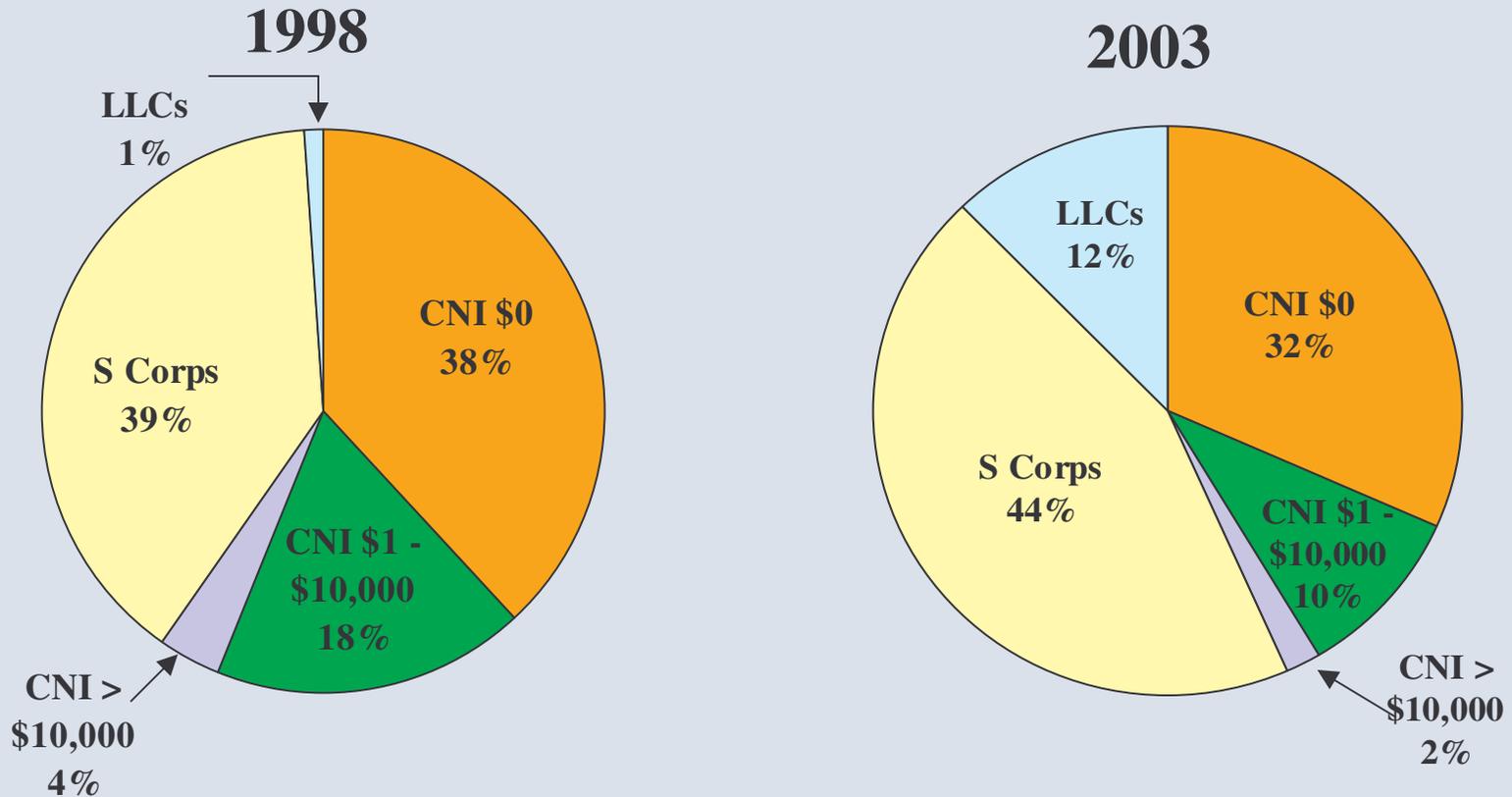


Amount of tax paid

□ \$0 □ \$1 to \$10,000 □ > \$10,000

Business Tax Filers

An increasing percentage of the Commonwealth's business taxpayers are electing pass-through status (S corporations or LLCs) and are paying their business taxes at the personal income tax rate of 3.07% or are paying less Corporate Net Income tax.



Note: Business Tax Filers defined as those filing the RCT-101 – S Corporations, C Corporations, and Limited Liability Companies.



Business Tax Reform – Still Needed

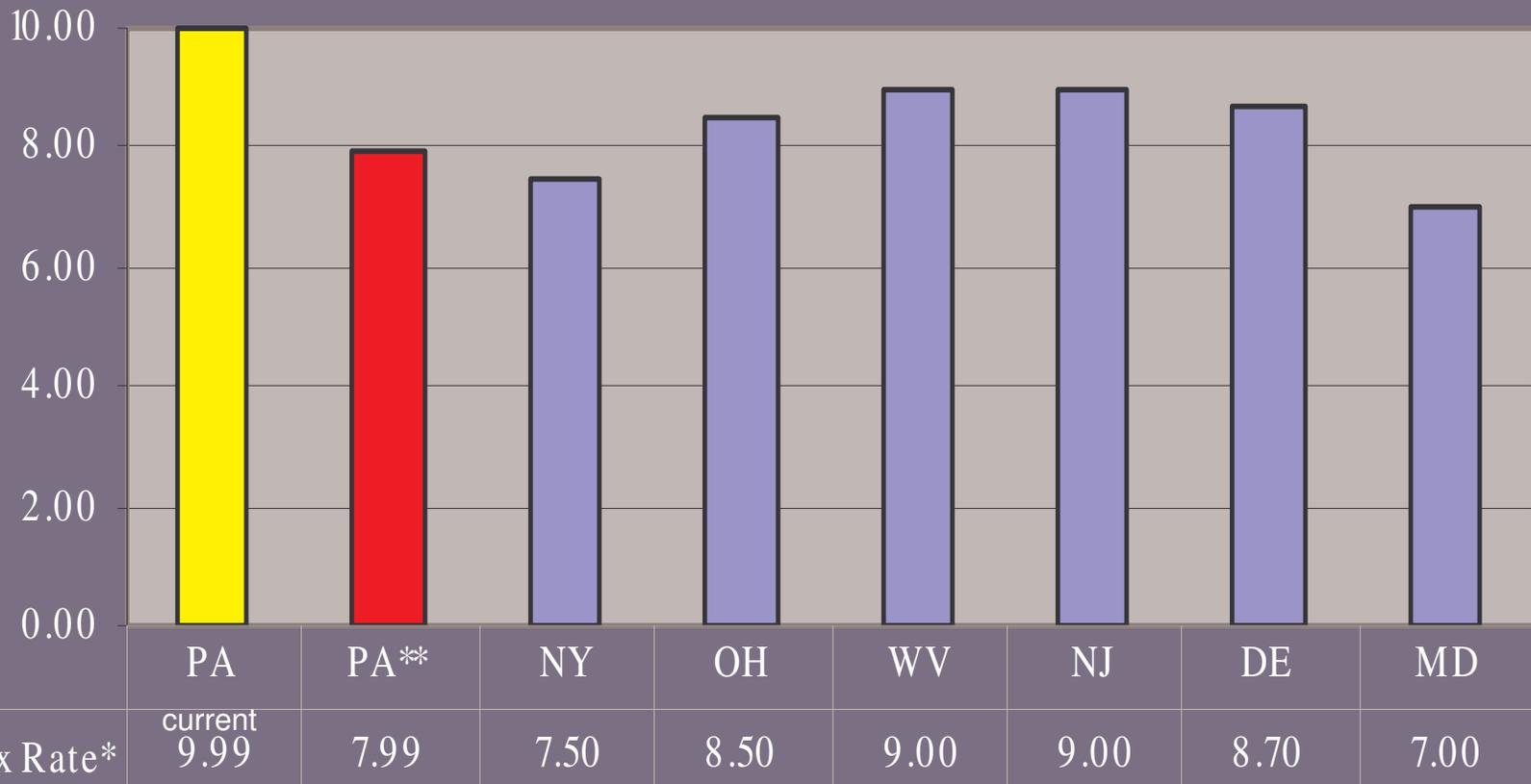
In March 2004, the Governor created the Business Tax Reform Commission to recommend changes to make Pennsylvania's business tax structure more competitive. The Commission made the following unanimous recommendations to improve Pennsylvania's business tax climate.

- ✓ Reduce the 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 \$2 million 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 from 60 percent 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.**

Comparison of Corporate Income Tax Rates

PA versus Neighboring and Major States That Impose Corporate Income Taxes

*Pennsylvania currently has the second highest Corporate Income Tax rate in the U.S.
At 7.99% PA's rate would be comparable to or lower than the rates charged in competing states.*



* Based on comparison of top tax rate per state.

** Proposed rate

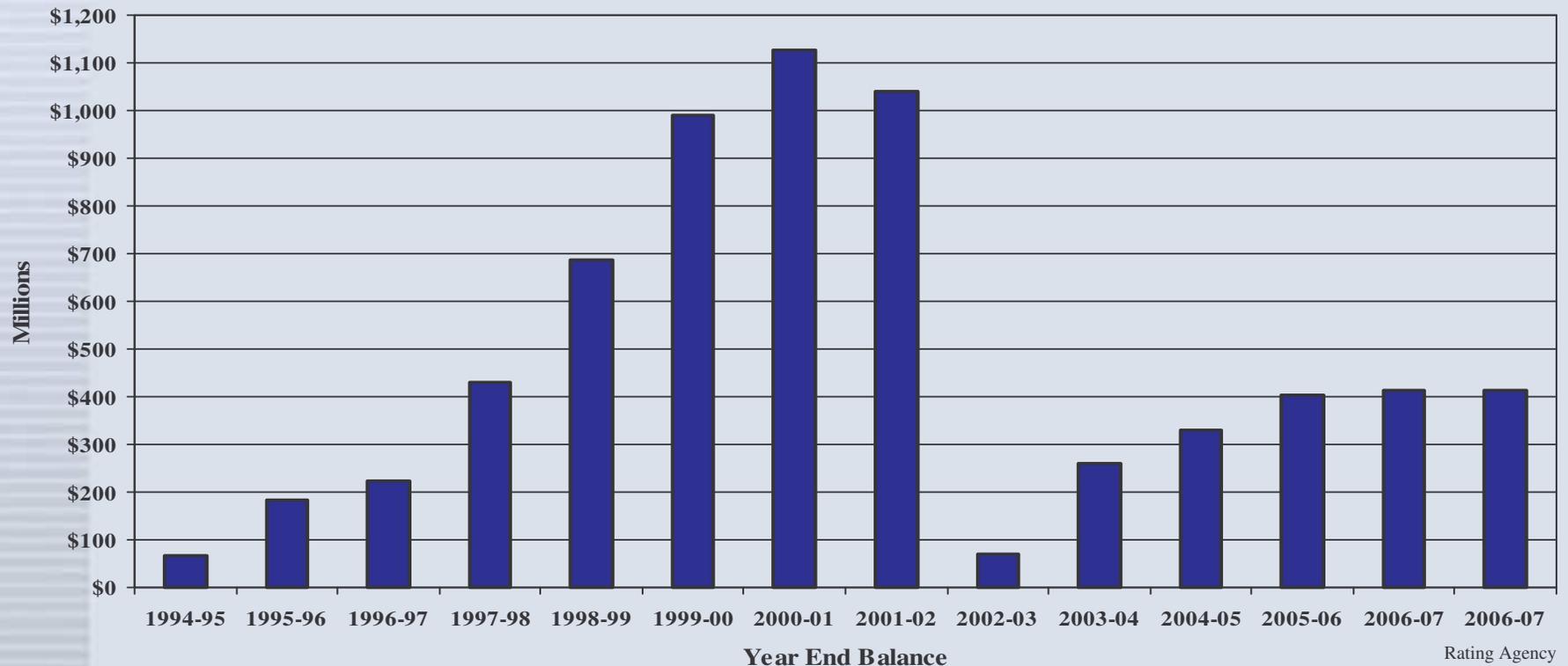


2006-07 Budget Highlights

The Rainy Day Fund

Status of PA's Rainy Day Fund

The 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 2002-03 General Fund budget. The current balance in the Fund is \$334 million. This budget projects statutory transfers of \$68 million from 2005-06. In addition, in order to meet rating agency requirements for reserves of at least 5 percent of annual revenues and maintain the Commonwealth's bond rating, Pennsylvania would need to increase the Rainy Day Fund balance to \$1.32 Billion, an increase of \$918 million.



Rating Agency Requirement



The Rendell Administration's Major Budget Goals

- ✓ Return Pennsylvania to prosperity — increase job creation & economic opportunity
- ✓ Improve academic achievement in Pennsylvania's elementary & secondary schools
- ✓ Lower local property taxes
- ✓ Improve the quality of life in Pennsylvania's communities
- ✓ Maintain the social safety net to protect Pennsylvania's most vulnerable citizens
- ✓ Make Pennsylvania government more efficient and citizen-friendly



Fiscal Year 2006-07 Governor's Executive Budget Commonwealth of Pennsylvania

**United Way of Southeastern Pennsylvania
March 24 2006**

*Edward G. Rendell
Governor*

*Michael Masch
Secretary of the Budget*