

ANNUAL REPORT 2012

A Citizen's Guide To the State of The States

PENNSYLVANIA



THE STATE OF THE STATES

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The State of the States
THE ANNUAL REPORT OF PENNSYLVANIA
2012

PRESENTED BY

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2012

Dear Citizens of the State of Pennsylvania,

We are pleased to present to you the Annual Report of Pennsylvania 2012, a joint venture of the University of Pennsylvania's Fels Institute of Government, Harvard University's Institute of Politics at the Kennedy School, and the American Education Foundation for the fiscal year ending June 30, 2011, the last year for which data is available. The data in this report were drawn from Pennsylvania's Comprehensive Annual Financial Reports ("CAFRs") from 2002 to 2011, FY 2012 and FY 2013 state budgets, the 2010 United States Census, and other official data sets and reports that we have found to be reliable sources on state finance.

This report was designed to synthesize the complicated financial information available from many sources into one easy-to-read document that can provide context and create a comprehensive analysis of trends in state government finance. We believe that citizens deserve to know "the state of the state" and we hope that our report will help inform you about the basics of state finance and the challenges that lie ahead. We did our best to ensure that this report reflects a nonpartisan analysis of the state's fiscal health. With all the politics and noise surrounding budgeting and state financial planning, we believe that this neutral perspective is vital when assessing budgets.

We begin the report by looking at basic demographic and financial information about the state to provide a snapshot of Pennsylvania's financial position. The report then moves on to discuss key budget topics that we believe are crucial to understanding financial trends: health care, education, and pensions.

We hope that this document is both an informative and useful guide for understanding the many challenges that Pennsylvania faces. To find out more about the States Project and how you can get involved, please visit our website at <http://www.thestatesproject.org>.

Sincerely,

Meredith Bagby
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OVERVIEW

Across the country, states are grappling with difficult fiscal issues. The financial crisis of 2008 and subsequent years of stagnant economic growth have brought state finances to a near critical condition. As tax revenue fell, the country saw mass layoffs of state workers, from teachers to police officers to judiciary employees. Nevertheless, the demand for public services continued to increase. A stagnant economy sent more Americans toward public programs like unemployment insurance and Medicaid. Health care costs swelled and our educational capacity was stretched. Infrastructure, including government buildings, schools, roads, and bridges, continued to suffer with little funding left for repair. In 2009, the federal government stepped in with much needed stimulus for the states, but those funds will expire in FY 2012, leaving states with even bigger deficits to fill, despite an improving economy.

“The state of Pennsylvania suffers from many of the same issues that plague other states: underfunded pensions, high health care costs, stretched educational resources, and stagnating revenues.”

The state of Pennsylvania suffers from many of the same issues that plague other states: underfunded pensions, high health care costs, stretched educational resources, and stagnating revenues. Though Pennsylvania’s unemployment rate is below the national average, the manufacturing sector is in a state of extended decline, and rural areas of the state are losing population as young people seek out opportunities elsewhere. The state is also one of the oldest in the nation, and all signs indicate that the commonwealth is only getting older — posing further problems for an economy that is sputtering and a system of public benefits, including Medicaid, pensions, and other post-employment benefits for public employees, that is stretched to the limit. Though policymakers have sought to address some of these issues by trimming budget deficits and reforming the state’s public employee pension system, the fact that Pennsylvania’s debt bonds have already been downgraded by all the major credit agencies indicates that the state’s reforms are not nearly enough to put the state on solid financial ground.

REVENUES AND EXPENDITURES

The state collected \$72.7 billion in revenues in FY 2011 primarily through operating grants, taxes, and charges for sales and services. Operating grants and contributions from the federal government made up 43% of the state’s revenues in FY 2011, more than any other revenue source. The state spent a total of \$72.4 billion in FY 2011.¹ After five straight years of spending increases,

¹ Pennsylvania CAFR 2011.

{ executive summary }

expenditures as a whole decreased by \$2.5 billion, or 3.3%, between FY 2010 and FY 2011, largely due to a decrease in unemployment compensation expenses.

In FY 2011, Pennsylvania reported a surplus, which is a significant improvement from the previous year's \$1.5 billion deficit. This net surplus was due to a drop in expenses — most notably unemployment insurance — as well as modest increases in revenues from taxes, including a 3.8% gain in income taxes and a notable 7.8% gain in corporate income taxes. While numbers are still being finalized, FY 2012 looks to have been a more difficult year for the state than FY 2011. Pennsylvania is set to end FY 2012 with a \$162.8 million deficit due to tax revenue coming in 0.6% lower than expected,² largely because corporate tax revenue fell short.³

“Because of the state’s high debt as well as its high level of unfunded liabilities in its pension and health care systems, Moody’s downgraded Pennsylvania’s credit rating from Aa1 to Aa2. Standard & Poor’s and Fitch followed suit.”

NET WORTH, ASSETS AND LIABILITIES

According to the State Comptroller, in FY 2011 Pennsylvania had a positive net worth of \$22.7 billion. The state’s net worth is calculated by taking the difference between the state’s total assets (\$54 billion) and total liabilities (\$31.3 billion). Using a broader a measure of liabilities as calculated by the U.S. Census Bureau, the state debt for Pennsylvania was close to \$45 billion, or \$3,533 per capita. Because of the state’s high debt as well as its high level of unfunded liabilities in its pension and health care systems, Moody’s downgraded Pennsylvania’s credit rating from Aa1 to Aa2. Standard & Poor’s and Fitch followed suit. Though the state has taken some steps to improve its creditworthiness, Pennsylvania has a long way to go to reach sound fiscal footing.

DEMOGRAPHICS

Pennsylvania’s total population is 12.7 million, making Pennsylvania the sixth most populous state in the nation.⁴ However, like many states in the eastern United States, Pennsylvania has experienced slow population growth in recent years. Between 2000 and 2010, the total population of the United States grew by 9.7%. Pennsylvania’s population, on the other hand, grew only 3.4%.⁵ This slow growth is due in part to an exodus of young people from the rural counties, a trend that has also led Pennsylvania to rank as the second-oldest state in the nation. The median household

² Thomson Reuters. “Pennsylvania deficit was \$162.8 mln in fiscal 2012.” [<http://www.reuters.com/article/2012/07/03/pennsylvania-deficit-idUSL2E813F4W20120703>]. July 3, 2012.

³ Pennsylvania Budget and Policy Center. “Revenue Tracker: Tax Revenues Up Over Last Year, But Corporate Collections Disappoint.” Jan 12, 2012. [<http://pennbpc.org/revenue-tracker-12-2011>].

⁴ “United States Census Bureau. “2010 Census Interactive Population Search.” [<http://2010.census.gov/2010census/popmap/ipmtext.php?fl=34>].

⁵ “Population Distribution and Change: 2000 to 2010.” United States Census Bureau. Page 2. [<http://www.census.gov/prod/cen2010/briefs/c2010br-01.pdf>].

{ executive summary }

income is \$50,398, slightly below the national average of \$51,914. As of July 2012, the state had an unemployment rate of 7.9%, below the national average of 8.3% in the same month.⁶

HEALTH CARE

As in many states, health care is Pennsylvania's biggest expense. In FY 2011, total spending on Health and Human Services was \$30.4 billion, or nearly 42% of total spending.⁷ Health and Human Services receives twice as much as education, the second largest state expenditure. While health care costs in Pennsylvania have grown more slowly than in other states, the state has higher health spending per capita (\$7,730 vs. \$6,815) than the rest of the nation.⁸

“The Great Recession and the retirement of Baby Boomers have driven up the costs associated with funding public health programs such as Medicaid, but the federal government has borne most of the cost increases.”

The Great Recession and the retirement of Baby Boomers have driven up the costs associated with funding public health programs such as Medicaid, but the federal government has borne most of the cost increases. In 2008, the state covered 46% of Medicaid spending, or \$7.4 billion. By 2009, however, the state was covering only 36% of Medicaid spending, or \$6.2 billion. Still, Medicaid currently comprises nearly one-quarter of the state budget. By some accounts, if current policies remain, Medicaid could account for over 90% of the state budget by 2075.⁹

EDUCATION

In FY 2011, Pennsylvania spent \$14.9 billion on public education (20.5% of the state budget), making public education the second largest area of state spending. In recent years, public education spending has grown relatively slowly, from \$14 billion in FY 2009 to \$14.9 in FY 2011. Education spending as a percentage of the state budget has remained relatively constant, at around 20%.¹⁰ At \$15,612 per pupil, Pennsylvania spends well above the national average of \$12,306.¹¹ School districts in Pennsylvania rely more heavily on local property taxes for funding than state or federal funding.¹² Pennsylvania ranks 42nd among the 50 states in the percentage of public school costs that are funded by the state versus localities.

6 Bureau of Labor Statistics. [www.bls.gov].

7 PA CAFR 2011, page 48.

8 “Pennsylvania.” Kaiser Family Foundation. [<http://www.statehealthfacts.org/profileglance.jsp?rgn=40>] and “Pennsylvania: Medicare Spending.” Kaiser Family Foundation. [<http://www.statehealthfacts.org/profileind.jsp?cat=6&sub=72&rgn=40>].

9 Policy Points. “Pennsylvania Welfare Spending & Medicaid.” [www.commonwealthfoundation.org. Commonwealth Foundation]. [<http://www.commonwealthfoundation.org/research/detail/pennsylvania-welfare-spending-medicaid>]. May 20, 2011.

10 Pennsylvania CAFR 2009, 42; and Pennsylvania CAFR 2010, 46.

11 “Public Education Finances: 2010.” The United States Census Bureau. [<http://www2.census.gov/govs/school/10f33pub.pdf>]. Page 11.

12 Ibid.

{ executive summary }

“Pennsylvania ranks 42nd among the 50 states in the percentage of public school costs that are funded by the state.”

Higher education in Pennsylvania is housed within the Office of the Secretary of Education. There are fourteen universities in the Pennsylvania State System, along with four state-related universities and sixteen community colleges. The budgets of higher education institutions have been cut in recent years and, as a result, students have seen their tuition skyrocket to make up for the loss of funds. According to the Project on Student Debt, 70% of Pennsylvania’s higher education students graduate with debt, the sixth-highest percentage in the country.

PENSIONS

In Pennsylvania, there are three separate pension systems for retired public employees. The largest pension fund — the Public School Employees’ Retirement System (PSERS) — serves over 600,000 members (all current or retired public school workers or their beneficiaries). The fund’s funded ratio — the ratio of the net assets to its net liabilities — has suffered in the years since 2008 and is now considered “underfunded” with a fund ratio below 75%.¹³ The second largest public employee pension system in Pennsylvania is the State Employees’ Retirement System (SERS), which serves over 200,000 retirees, workers, and beneficiaries.¹⁴ At the end of 2011, the fund reported serious underfunding with a funded ratio of just 65.3%.¹⁵

“By early 2012, however, state leaders acknowledged that the 2010 pension reforms were not enough to solve the state’s pension crisis.”

Major pension reform, passed in November 2010, included reducing retirement benefits for new employees, mandating an “actuarial fresh start,” and capping future employer contribution increases. In the long term, legislators hope that these changes will help bring the state’s unfunded pension liabilities under control.¹⁶ As a result of the reform, the state’s portion of the pension obligation will increase dramatically. The FY 2012 budget calls for \$1.1 billion in pension payments, but by FY 2016 this figure will increase to more than \$4 billion annually.¹⁷ By early 2012, however, state leaders acknowledged that the 2010 pension reforms were not enough to solve the state’s pension crisis.

¹³ Pennsylvania PSERS CAFR 2011, 28.

¹⁴ Pennsylvania State Employees’ Retirement System (SERS) CAFR 2011, iii.

¹⁵ Pennsylvania SERS CAFR, iii.

¹⁶ Pennsylvania SERS CAFR 2011, iii-iv.

¹⁷ Olson, Laura. “Gov. Corbett adds pension reform to budget agenda.” Pittsburgh Post-Gazette. [<http://www.post-gazette.com/stories/local/state/gov-corbett-adds-pension-reform-to-budget-agenda-636794/>].

{ executive summary }

THE FUTURE

The state's FY 2013 budget provides an indication of the course Pennsylvania will chart. Governor Corbett signed the \$27.7 billion budget into law on June 30, 2012. The governor said his budget prioritizes economic growth, education, and human services, while containing spending. Spending will increase by only 1.7% over the FY 2011 budget. The budget also includes no new taxes or tax increases. Critics argue that the budget contains too little spending for public education (still down from FY 2011 levels) and health and human services. Given that the Federal Reserve predicts two more years of slow national economic growth and that federal stimulus has ended, it is unlikely that Pennsylvania will restore these cuts anytime soon. ★

{ income statement }

The income statement, or profit and loss statement, shows a snapshot of all the state's revenues for a given year, set against all the state's expenditures. In FY 2011, Pennsylvania reported a surplus, which is a significant improvement from the previous year's \$1.5 billion deficit. This net surplus was due to a drop in expenses — most notably unemployment insurance — as well as modest increases in revenues from taxes, including a 3.8% gain in income taxes and a notable 7.8% gain in corporate income taxes. The state also made significant cuts to other programs, including public safety, transportation, and environment and recreation.

While numbers are still being tallied, FY 2012 has proven to be a much more difficult year for the state. Pennsylvania is set to end FY 2012 with a \$162.8 million deficit due to revenue coming in 0.6% lower than expected, according to the latest data available.¹⁸ Sales tax and income tax both fell below projections, but the majority of the shortfall may have come from a fall in corporate tax revenue.¹⁹

18 Thomson Reuters. "Pennsylvania deficit was \$162.8 mln in fiscal 2012." [<http://www.reuters.com/article/2012/07/03/pennsylvania-deficit-idUSL2E813F4W20120703>]. July 3, 2012.]

19 Pennsylvania Budget and Policy Center. "Revenue Tracker: Tax Revenues Up Over Last Year, But Corporate Collections Disappoint." [<http://pennbpc.org/revenue-tracker-12-2011>]. Jan 12, 2012.

{ income statement }

FISCAL YEAR ENDING 6/30

	2009 <small>(IN THOUSANDS)</small>	2010 <small>(IN THOUSANDS)</small>	2011 <small>(IN THOUSANDS)</small>
REVENUES			
Income Tax	\$9,553,538	\$9,414,864	\$9,771,269
Sales and Use Tax	\$8,417,292	\$8,309,905	\$8,610,603
Corporation Tax	\$4,209,705	\$4,146,477	\$4,469,094
Liquid Fuels & Motor Carriers	\$1,975,678	\$2,045,505	\$2,092,645
Gaming	\$999,247	\$1,232,829	\$1,409,388
Inheritance	\$733,405	\$698,980	\$783,824
Cigarette	\$1,000,987	\$1,088,405	\$1,104,355
Realty Transfer	\$348,003	\$346,094	\$328,997
Other	\$492,420	\$1,035,935	\$1,167,804
Total Revenues (excluding user fees & grants)	\$27,730,275	\$28,318,994	\$29,737,979
User Fees	\$11,489,433	\$14,358,762	\$11,805,226
Operating & Capital Grants & Contributions	\$22,178,360	\$30,648,754	\$31,150,783
Total Revenue	\$61,398,068	\$73,326,510	\$72,693,988
EXPENDITURES			
Governmental Activities:			
Direction & Supportive Services	\$1,492,541	\$1,950,908	\$2,052,743
Protection of Persons and Property	\$5,480,770	\$5,682,950	\$5,384,710
Public Education	\$14,045,890	\$14,520,733	\$14,864,360
Health & Human Services	\$26,615,566	\$28,321,389	\$30,388,529
Economic Development	\$1,614,214	\$1,580,654	\$1,598,596
Transportation Programs	\$4,278,022	\$4,951,010	\$4,465,639
Recreation & Enrichment	\$602,365	\$559,311	\$491,082
Interest	\$382,065	\$395,305	\$440,428
Business Type Activities:			
State Lottery Fund	\$3,173,322	\$3,079,381	\$3,155,903
State Workers' Insurance	\$388,424	\$338,229	\$306,318
Tuition Payment	\$100,028	\$235,876	\$259,069
Unemployment Compensation	\$6,250,213	\$11,750,605	\$7,460,707
Liquor Control	\$1,437,168	\$1,478,971	\$1,504,517
Economic Development & Other	\$14,171	\$13,706	\$23,635
Total Expenditures	\$65,874,759	\$74,859,028	\$72,396,236
Net Gain (Deficit)	(\$4,476,691)	(\$1,532,518)	\$297,752

OVERVIEW

The State of Pennsylvania collected \$72.7 billion in revenues in FY 2011. The majority of revenues can be categorized into three groups: operating grants, taxes, and charges for sales and services.

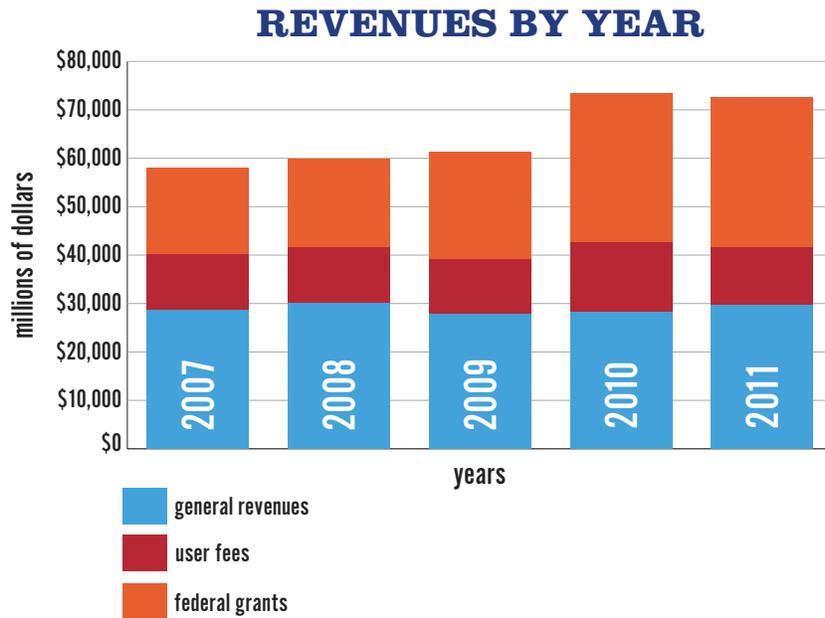


Figure 1 SOURCE: PENNSYLVANIA CAFRS 2007-2011

The revenue trends in Pennsylvania over the last five years (2007-2011) strongly resemble those in other states. Specifically, FY 2009 marked a key moment in the way the state paid for services for its citizens. General Revenues dropped off in FY 2009, falling almost 8% in a year.²⁰ This drop-off was driven primarily by decreases in state income tax revenues and corporate tax revenues from FY 2008 to FY 2009, as a result of the Great Recession. To maintain adequate funding for state services, the federal government stepped in, with federal grants to the state rising by nearly \$4 billion (21%) from FY 2008 to FY 2009 and \$8.5 billion (38%) the year after.²¹

OPERATING GRANTS

Operating grants and contributions from the federal government make up 43% of the state's revenues in FY 2011, more than any other revenue source. These funds help pay for such programs as Medicaid, highway improvement, mass-transit, and unemployment insurance. During the financial crisis, the federal government passed the American Recovery and Reinvestment Act (ARRA), commonly referred to as the "stimulus," in order to help prevent states from laying off workers, provide funds for research and infrastructure, help states provide extra unemployment

²⁰ Pennsylvania CAFR 2009.

²¹ Pennsylvania CAFR 2009, 2010.

{ revenues }

compensation, and fund health and education programs.²² Pennsylvania received \$33.8 billion in federal stimulus funds between the passage of the stimulus and mid-2011.²³

“Operating grants and contributions from the federal government make up 43% of the state’s revenues in FY 2011, more than any other revenue source.”

ARRA money expired on June 30, 2011, but tax revenues have yet to recover from the Great Recession. In 2012 and in coming years, the state must either cut expenses by reducing funding to programs like Medicaid and education that were supported by federal funds or increase revenue collection from other sources in order to make up the difference between revenue and expenses.

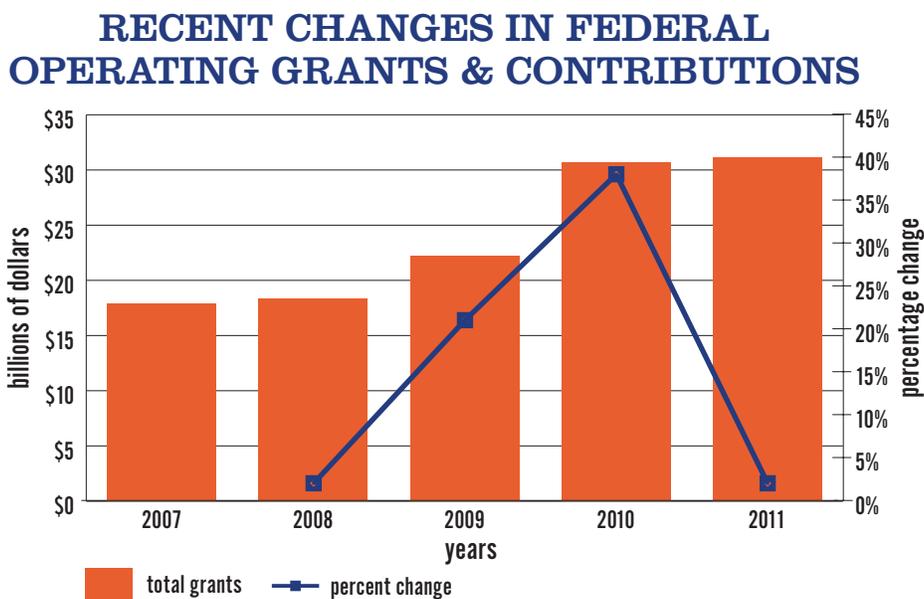


Figure 2 SOURCE: PENNSYLVANIA CAFRS 2007-2011

TAXES

The state’s second major revenue stream comes from taxes — income tax, sales tax, and corporate tax. While total tax revenue in Pennsylvania has declined since the recession in 2008, revenues have begun to rebound moderately in FY 2010 and FY 2011.

22 American Recovery and Reinvestment Act of 2009. Pub. L. 111-5. 123 Stat. 115. [<http://www.gpo.gov/fdsys/pkg/PLAW-111publ5/pdf/PLAW-111publ5.pdf>]. February 17, 2009

23 The Recovery Act in Pennsylvania. [http://www.recovery.pa.gov/portal/server.pt/community/recovery_pa_gov/5994].

Income Taxes

Pennsylvania's marginal personal income tax rate is much lower than in most other states. Of the 43 states that do collect state income taxes, Pennsylvania ties for the lowest rate with Oklahoma at 3% in FY 2012.²⁴ Income taxes in Pennsylvania produced \$9.8 billion in revenue in FY 2011, up from FY 2009 and FY 2010.²⁵ Still, income tax revenue has not rebounded to 2008 levels, when income taxes generated \$10.4 billion in revenue. The continued slump in income tax revenue can be attributed mainly to the higher unemployment rate in Pennsylvania in 2011 compared to 2008.²⁶

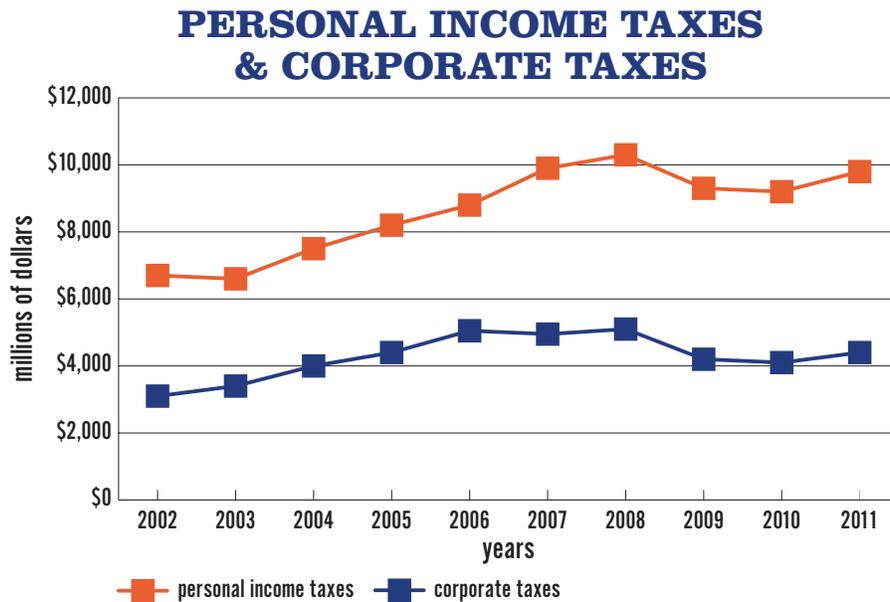


Figure 3

SOURCE: PENNSYLVANIA CAFRS 2001-2011

Sales Taxes

In Pennsylvania, the sales tax is 7%. Revenue from sales taxes rose from \$7.4 billion in FY 2002, peaking at \$8.8 billion in FY 2008, right before the financial crisis. Sales tax revenue then bottomed out in FY 2010 at \$8.3 billion before rebounding to \$8.6 billion in FY 2011.

Corporate Taxes

The corporate net income tax rate in Pennsylvania is 9.99%.²⁷ In FY 2011, the state collected \$4.5 billion in corporate taxes, an increase from the \$4.2 billion collected in FY 2010. Still, corporate tax revenues have not rebounded to their 2008 levels.

²⁴ Tax-Rates.org. State Tax Rates 2012. [<http://www.tax-rates.org/taxtables/income-tax-by-state>].

²⁵ Pennsylvania CAFRS, 2007-2011.

²⁶ Ibid.

²⁷ Pennsylvania Department of Revenue. [http://www.revenue.state.pa.us/portal/server.pt/community/businesses/11406/tax_rates/580557].

{ revenues }

Property Taxes

Property taxes are collected by local governments such as towns, counties, and municipalities to pay for essential services like schools. If the state provides less funding to local government to pay for services, local governments often increase property taxes to make up the difference. Low state income taxes are often offset by high property taxes. The median property tax rate in Pennsylvania is 1.35% of property value. The state has the 11th highest median property tax rate in the country.²⁸ Because the government levies property taxes based on property value without taking into account earned income, many complain that property taxes are regressive.²⁹ Another worry is that a reliance on property taxes leads to inadequate funding for schools in poorer neighborhoods, which have lower property values, and therefore generate less property tax revenue.

USER FEES

Pennsylvania, like all other states, collects significant fees from its citizens in direct exchange for the services it provides. In FY 2011, these collections totaled nearly \$11.8 billion. The State Lottery and Unemployment Compensation Fund comprise the largest portions of Pennsylvania's user fees at nearly \$5.8 billion. Health and Human Services also brought in \$1.6 billion in FY 2011.³⁰ ★

28 "2012 State Tax Rates & Exemptions." [<http://www.tax-rates.org/taxtables/property-tax-by-state>].

29 Wood, Anthony. "Pennsylvania property tax under new attack in legislature." [http://articles.philly.com/2012-04-09/news/31313426_1_property-tax-property-levy-property-owners]. April 9, 2012.

30 Pennsylvania CAFR 2011.

OVERVIEW

The state of Pennsylvania spent a total of \$72.4 billion in FY 2011.³¹ After five straight years of spending increases, expenditures as a whole decreased by \$2.5 billion, or 3.3%, between FY 2010 and FY 2011, largely due to a decrease in unemployment compensation expenses.

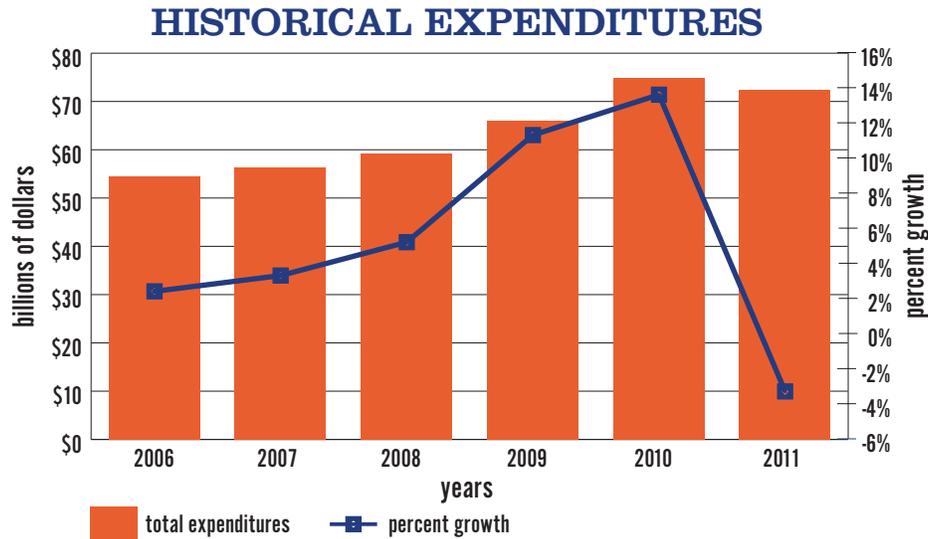


Figure 4 SOURCE: PENNSYLVANIA CAFR 2011

Pennsylvania’s largest expense was Health and Human Services, which accounts for 42% of the state’s total expenditures and is largely driven by high Medicaid costs. The next largest expenditure category is public education, accounting for 20.5% of spending, or less than half of what is spent on Health and Human Services.

Unemployment Compensation accounts for another 10% of the budget. From FY 2007 to FY 2011, unemployment compensation grew by \$5.4 billion – a staggering 259% – accounting for almost one-third of the total dollar increase in expenditures from FY 2007 - FY2011. The rise in unemployment compensation (largely in FY 2009) was driven by the Great Recession, which sent more citizens to the rolls of unemployment. Public Safety takes up 8%.

“The rise in unemployment compensation (largely in FY 2009) was driven by the Great Recession.”

Governor Tom Corbett explains that he envisions running a “state government that lives within its means and knows that taxpayer funding is your hard earned money, not ours.”³² Therefore, Governor

³¹ Pennsylvania CAFR 2011.

³² PCast.com. “Ask the Governor.” [http://www.pacast.com/players/cmsplayer.asp?video_filename=9247_AsktheGovernor_CostCutting2.m4v].

{ expenditures }

Corbett has addressed shoring up his state’s political fiscal position through spending cuts, rather than tax increases.³³ For instance, in FY 2011, the governor made cuts to transportation and public safety. Transportation saw a 9.8% decrease in spending, and public safety a 5.2% decrease, or \$485 million and \$298 million, respectively. These cuts were aimed in large part at bridging the year-end government deficit.

EXPENDITURE BY CATEGORY, AS A PERCENTAGE OF TOTAL EXPENDITURE 2011

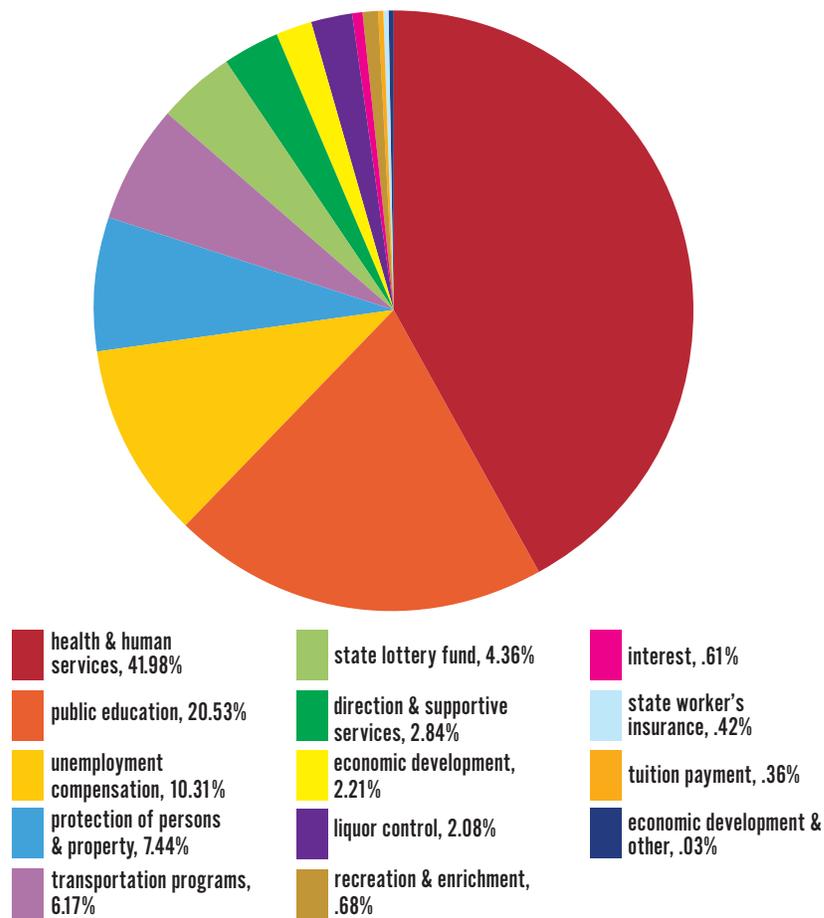


Figure 5

SOURCE: PENNSYLVANIA CAFR 2011

³³ Office of the Governor, Pennsylvania. "Rebuilding Pennsylvania". [<http://www.portal.state.pa.us/portal/server.pt?open=514&objID=1071707&parentname=ObjMgr&parentid=7&mode=2>].

{ expenditures }

“The biggest reduction in spending, however, was in unemployment insurance, which decreased by \$4.5 billion.”

The biggest reduction in spending, however, was in unemployment insurance, which decreased by \$4.5 billion. This fall was driven largely by a decrease in benefits as recipients moved off unemployment rolls or ran out of benefits.³⁴ The improved economy decreased the state’s unemployment rate from a historic high of 8.7% in March 2010 to 7.9% in April of 2011.³⁵ This drop was equivalent to nearly 39,000 newly created jobs in the state. While the state unemployment rate has fluctuated in the time since, the unemployment rate stood at 7.9% in July 2012.

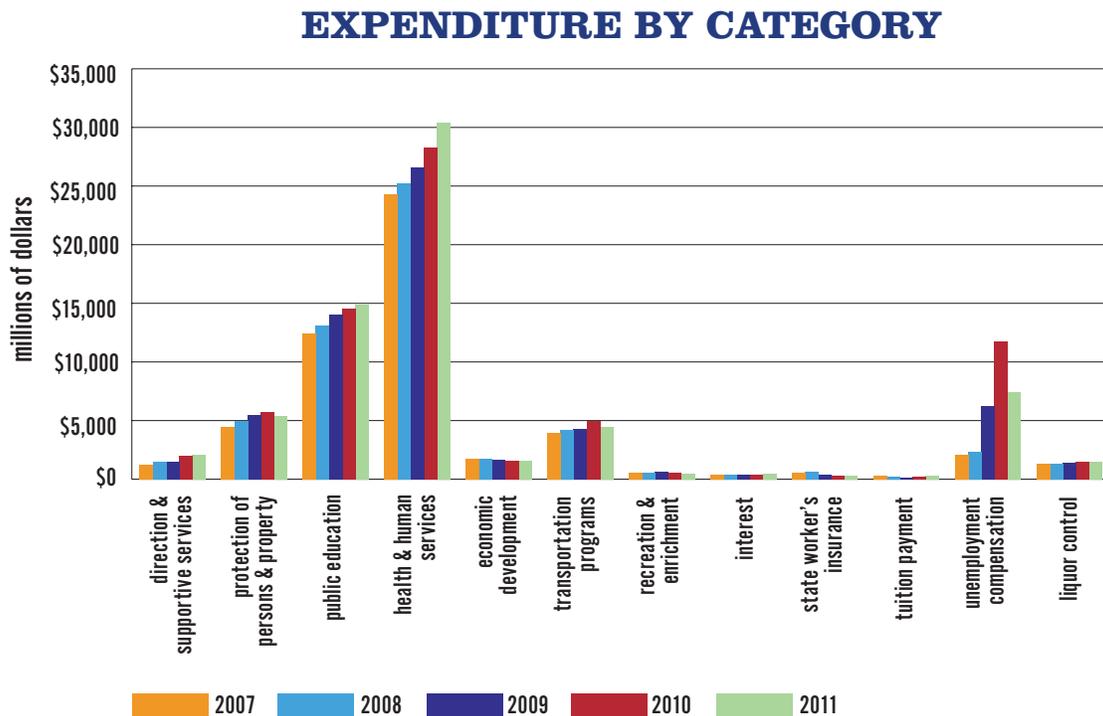


Figure 6 SOURCE: PENNSYLVANIA CAFRS 2007 - 2011

³⁴ Pennsylvania CAFR 2011.

³⁵ Bureau of Labor Statistics. “Pennsylvania Local Area Unemployment Statistics.” [<http://data.bls.gov/timeseries/LASST42000003>].

{ expenditures }

Spending Category	Increase/Decrease in Spending 2007 to 2011 (in Dollars)	Increase/Decrease in Spending 2007 to 2011 (in Percentage Terms)
Governmental Activities		
Direction and supportive services	\$844,344	69.87%
Protection of persons and property	\$897,077	19.99%
Public education	\$2,399,697	19.25%
Health and human services	\$6,123,596	25.24%
Economic development	-\$139,576	-8.03%
Transportation programs	\$543,122	13.85%
Recreation and enrichment	-\$78,428	-13.77%
Interest	\$95,871	27.82%
Business Type Activities		
State lottery fund	\$55,380	1.79%
State workers' insurance	-\$247,194	-44.66%
Tuition payment	(\$8,972)	-3.31%
Unemployment compensation	\$5,386,325	259.66%
Liquor control	\$226,646	17.74%
Economic development and other	\$9,165	63.34%
Total	\$16,107,143	28.62%

SOURCE: PENNSYLVANIA'S CAFRS, STATEMENT OF ACTIVITIES, 2007 - 2011

BUDGETING AND DEFICITS

Most states, including Pennsylvania, require that the budget be “balanced,” meaning that lawmakers cannot plan to spend more money than they predict to take in through taxes and fees.³⁶ In order to pass a balanced budget, gaps between planned spending and revenue need to be closed. The Governor of Pennsylvania has a “line-item” veto, meaning he can remove specific expenditures or even specific words from appropriations bills, which is often used to force a balanced budget.³⁷ Budgeting issues are almost always resolved relatively close to the July 1st deadline each year. If, however, legislators and the governor’s office are unable to come to an agreement, a governmental shutdown can take place. While this did not happen for the most recent fiscal year, it did happen in 2008, which led to tens of thousands of state employees being sent home, state parks and beaches being closed, and only essential emergency services remaining open.³⁸

³⁶ Pennsylvania. Office of the Budget. Community Action Association of Pennsylvania. [<http://www.thecaap.org/lib/images/photos/BudgetProcess%5B1%5D.pdf>].

³⁷ Ibid.

³⁸ Urbina, Ian. “Government Shutdown in Pennsylvania.” [http://www.nytimes.com/2007/07/09/us/09cnd-penn.html?_r=1&hp]. July 9, 2007.

{ expenditures }

The FY 2012 state budget was actually the first in the past nine years that was signed before the July 1st deadline — just 15 minutes before to be exact.³⁹ Governor Corbett said the overall budget had been reduced to FY 2009 spending levels in order to deal with the loss of federal funds, as the federal stimulus came to an end.⁴⁰ Corbett's office stressed that his budget “cuts government spending, does not raise taxes, includes property tax reform, and restores common sense to the state spending process.”⁴¹ Governor Corbett's budget included a 10% cut to human services and deep cuts to public education (between 7% and 10% across school districts). The final numbers for FY 2012 have yet to be released.

“Governor Corbett's budget included a 10% cut to human services and deep cuts to public education (between 7% and 10% across school districts).”

In June 2012, Governor Corbett passed a FY 2013 budget, which reflected a modest 1.7% increase in spending across the board from FY 2012.⁴² In education, K-12 funding remained relatively flat from its FY 2011 levels. The state's network of colleges and universities avoided the massive cuts originally proposed by the governor (of 20%-30%) by agreeing to increase tuition which will defray state spending.⁴³ Governor Corbett did win a 10% cut to county mental health services, homeless assistance, and services for people with intellectual disabilities, as well as a corporate tax break to fund private school vouchers.⁴⁴ ★

39 USA Today. “Pa. Gov. Signs Budget Ahead of Midnight Deadline.” [http://www.usatoday.com/news/nation/2011-07-01-pennsylvania-budget_n.htm]. July 1, 2011.

40 Honan, Edith. “Pennsylvania Governor Signs On-time Budget.” [<http://www.reuters.com/article/2011/07/01/pennsylvania-budget-idUSN1E76000H20110701>]. July 1, 2011.

41 Harley, Kevin. “Pennsylvania Governor Corbett Signs Budget, Cutting Spending, Without Tax Increases.” [<http://www.prnewswire.com/news-releases/pennsylvania-governor-corbett-signs-budget-cutting-spending-without-tax-increases-124833409.html>]. July 1, 2011.

42 Ibid.

43 “Final 2012-2013 Budget Analysis.” Pennsylvania Budget and Policy Center. 13 July. 2012. [<http://pennbpc.org/final-2012-13-budget-analysis>].

44 Ibid.

{ balance sheet }

FISCAL YEAR ENDING 6/30

ASSETS (IN THOUSANDS)	2011 TOTAL GOVERNMENT	2010 TOTAL GOVERNMENT	% CHANGE FROM 2010 TO 2011
Current Assets:			
Cash	\$1,351,494	\$1,124,376	20.2%
Temporary Investments	\$10,450,776	\$10,689,035	-2.2%
Receivables	\$3,836,118	\$4,153,870	-7.6%
Due From Other Governments & Accounts	\$2,550,261	\$3,287,186	-22.4%
Inventory	\$370,558	\$410,064	-9.6%
Prepaid & Deferred Expenses	\$2,336	\$4,430	-47.3%
Other	\$30,381	\$24,315	24.9%
Total Current Assets	\$18,591,924	\$19,693,276	-5.6%
Noncurrent Assets:			
Long Term Investment	\$3,479,359	\$3,498,409	-0.5%
Receivables	\$1,519,740	\$1,543,348	-1.5%
Due From Component Units	\$74,663	\$79,208	-5.7%
Non-Depreciable Capital Assets	\$6,053,980	\$5,870,507	3.1%
Depreciable Capital Assets	\$24,311,805	\$22,842,372	6.4%
Total Noncurrent Assets	\$35,439,547	\$33,833,844	4.7%
TOTAL ASSETS	\$54,031,471	\$53,527,120	0.9%
LIABILITIES			
Current Liabilities:			
Accounts Payable & Accrued Liabilities	\$6,316,812	\$6,769,254	-6.7%
Due to Other Governments & Accounts	\$5,204,329	\$4,698,953	10.8%
Unearned Revenue	\$195,062	\$142,583	36.8%
Debt Payable & Related Obligations & Liabilities	\$2,857,012	\$3,210,414	-11.0%
Other	\$202,405	\$209,989	-3.6%
Total Current Liabilities	\$14,775,620	\$15,031,193	-1.7%
Noncurrent Liabilities:			
Pension & Post-Employment Benefits	\$1,384,611	\$997,064	38.9%
Lease-Purchase & Other Financing Obligations	\$94,407	\$99,458	-5.1%
Debt Payable & Related Obligations & Liabilities	\$13,903,818	\$997,064	38.9%
Other	\$1,184,142	\$1,151,621	2.8%
Total Noncurrent Liabilities	\$16,566,978	\$16,156,935	2.5%
TOTAL LIABILITIES	\$31,342,598	\$31,188,128	0.5%
TOTAL NET ASSETS	\$22,688,873	\$37,370,185	-39.3%

{ balance sheet }

NET WORTH

The Pennsylvania balance sheet compares all the state's assets to its liabilities in order to calculate a "net worth" for the state. Calculating the net worth for a public sector entity is not equivalent to calculating the net worth of a company. However, the calculation is still an important determinant of liquidity and creditworthiness because it gives a snapshot of both the state's ability to generate revenue as well as its spending habits over time. According to the State Comptroller, in FY 2011 Pennsylvania had assets totaling \$54 billion and liabilities totaling \$31.3 billion. Thus, Pennsylvania had a year-end positive net worth of \$22.7 billion.⁴⁵

"Pennsylvania had a year-end positive net worth of \$22.7 billion."

ASSETS

At the end of FY 2011, Pennsylvania reported \$54 billion in assets, made up of \$18.6 billion in current assets and \$35.4 billion in noncurrent assets.⁴⁶ Pennsylvania saw a reduction in current assets of 5.6% in FY 2011, but an increase in noncurrent assets of 4.7% – largely driven by a 6.4% increase in depreciable capital assets. Total assets, therefore, saw little change, increasing by 0.9% from FY 2010 to FY 2011.⁴⁷

Current assets are short-term assets which can readily be turned into hard dollars, such as cash, receivables that the states expects to be redeemed within 12 months (e.g. taxes due), or investments (e.g. Treasury bills or other stocks, bonds, or market positions).

Non-current assets are holdings that the state is unlikely to turn into a liquid asset within a short time frame. These assets include investments such as real estate, schools, roads and long-term bonds (although long-term bonds can often be securitized into liquid assets for a fee). The largest component of the non-current asset class is "Capital Assets." These capital assets, like schools, parks, and roads, make up a large part of the state's overall assets, and their valuations are highly debated. Some argue that these assets are undervalued, as they are valued at the cost of the asset, and not the market price. This means that capital assets do not capture the appreciation, for instance, in the value of state land. However, others argue that capital assets like schools and roads could be worth significantly more in the public domain than the private domain, meaning these asset values would likely be overstated if measured in today's dollars.

⁴⁵ Pennsylvania CAFR 2011, Statement of Net Assets.

⁴⁶ Ibid.

⁴⁷ Ibid.

{ balance sheet }

LIABILITIES

In FY 2011, Pennsylvania's total liabilities were estimated at \$31.3 billion, which included \$14.8 billion of current liabilities and \$16.5 billion of non-current liabilities.⁴⁸ Pennsylvania's overall liabilities increased slightly (by 0.5%) in 2011 due to the rising costs of government pension and other post-employment benefit funds. The liabilities of these funds increased by 39%, or almost \$400 million, from FY 2010 to FY 2011.

Current liabilities are obligations that require payment within twelve months. Examples of current liabilities include salaries to government workers, payments to companies contracted by the government to provide services (such as private contractors who build and run prisons), entitlement and welfare payments to citizens (such as payments to Medicaid recipients or unemployment beneficiaries), or debts to other levels of government (negotiated payments for government goods and services).

Non-current liabilities are comprised of obligations that the state owes in the long term, i.e., outside a twelve-month horizon. Non-current liabilities include bond obligations, leasing agreements for financed projects, and employee pension and health care liabilities. These long-term liabilities generally represent the state's current spending and obligations that will be carried into the future as debt.

“Using a broader measure of debt as tabulated by the U.S. Census Bureau, the state debt for Pennsylvania was closer to \$45 billion, representing \$3,533 of debt per capita.”

THE DEBT

States can raise debt in a variety of ways. They can issue general bonds in which investors bet on the full faith and credit of the state or they can issue special purpose bonds that are secured by a specific project like road construction or the building of a school. Additionally, a state can sometimes borrow from federal grants that it expects to receive in the future.

At the end of FY 2011, Pennsylvania had roughly \$10.4 billion in general bonds outstanding. According to the Commonwealth Foundation, a conservative-leaning research group, “Since 2002, total outstanding state general obligation debt has increased 54%, from \$6.8 billion. Annual debt payments on general obligation bonds increased from \$349 million in FY 2002-03 to \$1.2 billion in the proposed FY 2012-13 budget, an increase of 198% in annual debt payments in nine years.”⁴⁹

⁴⁸ Ibid.

⁴⁹ The Commonwealth Foundation. [<http://www.commonwealthfoundation.org/research/detail/pennsylvania-government-debt>].

{ balance sheet }

Using a broader measure of debt as tabulated by the U.S. Census Bureau, the state debt for Pennsylvania was closer to \$45 billion, representing \$3,533 of debt per capita. This broader measure includes all debts owed by the state and its agencies, whether fully backed by the credit of the state or not. Many of these debts include tuition repayment bonds, transportation bonds, and other bonds that the state is not technically liable for, but may assist state agencies in repaying. While this per capita figure is high, it does not compare to some other states, like Massachusetts, which is the largest per capita debtor state with liabilities of \$11,357 per citizen through FY 2009.⁵⁰ Pennsylvania ranks 24th in the nation by this measure of debt.

Pennsylvania State & Local Government Debt		
Debtor	Debt Outstanding	Per Person
Total State	\$45,020,310,000	\$3,533
State	\$10,356,710,000	\$813
State Agencies & Authorities	\$34,663,600,000	\$2,720
Total Local	\$75,759,706,000	\$5,945
School Districts	\$26,618,928,378	\$2,089
County/Municipal/Twp/Other	\$49,140,777,622	\$3,856
Total	\$120,780,016,000	\$9,478

SOURCES: THE COMMONWEALTH FOUNDATION; GOVERNOR'S EXECUTIVE BUDGET ([HTTP://WWW.BUDGET.STATE.PA.US](http://www.budget.state.pa.us)) DECEMBER 2011 DATA; PA DEPT OF EDUCATION ([HTTP://WWW.PDE.STATE.PA.US](http://www.pde.state.pa.us)) JUNE 2010 DATA; U.S. CENSUS BUREAU ([HTTP://WWW.CENSUS.GOV/GOVS/WWW/ESTIMATE.HTML](http://www.census.gov/govs/www/estimate.html)) 2009 DATA

The Commonwealth Foundation reports: “More than three-fourths of Pennsylvania’s state-level borrowing is done by off-budget state agencies and authorities, like the Turnpike Commission and the Commonwealth Financing Authority, which issue their own debt to the extent authorized by the legislature. Debt held by state agencies and authorities increased from \$16.8 billion in 2002 to nearly \$34.7 billion in 2011 — an increase of 106%. Total Pennsylvania state and state agencies’ and authorities’ debt increased from \$23.7 billion to more than \$45 billion in the last nine years — representing a total state-level increase of 90%.”⁵¹

If one adds local debt to the mix, Pennsylvanians owe \$121 billion in debt, according to the Commonwealth Foundation.⁵²

50 U.S. Census Bureau, “State and Local Government Finances by Level of Government and by State”. 2010.

51 The Commonwealth Foundation. [<http://www.commonwealthfoundation.org/research/detail/pennsylvania-government-debt>].

52 Ibid.

{ balance sheet }

OUTSTANDING LIABILITIES (%)

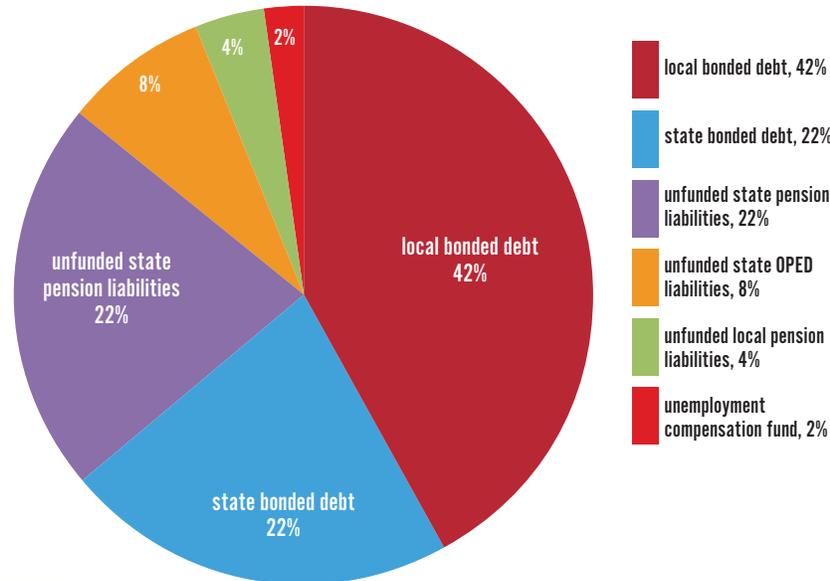


Figure 7 SOURCE: THE COMMONWEALTH FOUNDATION

CREDIT RATING

Credit rating agencies have been carefully watching Pennsylvania's financial situation. In particular, the state's burdened pension system and slowing economy have put pressure on the three main agencies to reevaluate current ratings for the commonwealth. The state's current pension is funded at 75%, below the recommended level of 80%.⁵³

In July 2012, Standard & Poor's changed its outlook to negative from stable, saying it was concerned in part about mounting spending pressure for public pensions amid a slow-growth economy. While S&P affirmed the long-term 'AA' credit rating on the state's general obligation debt, it warned that the rating could drop a notch if Pennsylvania does not enact pension reform. Fitch has followed suit with a AA rating and a negative outlook.⁵⁴

"In July 2012, Standard & Poor's changed its outlook to negative from stable, saying it was concerned in part about mounting spending pressure for public pensions amid a slow-growth economy."

53 Reuters. "Moody's downgrades Pennsylvania on pensions, economy." [<http://news.yahoo.com/moodys-downgrades-pennsylvania-pensions-economy-192631948.html>]. July 16, 2012.

54 Reuters. "S&P revises Pennsylvania's outlook to negative." [<http://www.moneynews.com/FinanceNews/s-p-pennsylvania-outlook-negative/2012/07/19/id/445948>]. July 19, 2012.

{ balance sheet }

Moody's downgraded Pennsylvania's credit from Aa1 to Aa2, citing concerns similar to those expressed by Standard & Poor's. An Aa2 rating from Moody's is the equivalent of an S&P AA. The downgrade to Aa2 on general obligation bonds is based on the state's "weakened financial position, and the expectation that large and growing pension liabilities and moderate economic growth will challenge the return to structural balance, contributing to a protracted financial recovery."⁵⁵ Other negative factors influencing Moody's downgrade include the Commonwealth's high debt obligation. However, the rating also incorporates the state's "demonstrated resilience post-recession," strong revenue growth trends, and improved governance in budgetary decisions. While many believed the downgrade would greatly hurt the state's borrowing costs, its \$363 million sale of refunding bonds one week after the downgrade — priced at similar levels to previous issues — indicated that investors still have confidence in Pennsylvania's ability to repay its debts. ★

⁵⁵ Reuters. "Moody's downgrades Pennsylvania on pensions, economy." [<http://news.yahoo.com/moodys-downgrades-pennsylvania-pensions-economy-192631948.html>]. July 16, 2012.

OVERVIEW

Pennsylvania's total population is 12.7 million, making Pennsylvania the sixth most populous state in the nation.⁵⁶ However, like many states in the eastern United States, Pennsylvania has experienced slow population growth in recent years. Between 2000 and 2010, the total population of the United States grew by 9.7%. Pennsylvania's population, on the other hand, grew only 3.4%.⁵⁷ Notably, population growth was uneven across the state over the last decade. The eastern and southern counties of the state grew rapidly, many by more than 15%, mainly by attracting Maryland and New Jersey residents who were changing their commuting patterns or seeking lower property taxes. Most of the western and northern counties, though, experienced population loss due to difficult economic conditions in those communities.⁵⁸

RACE, ETHNICITY, AND IMMIGRATION

Pennsylvania's citizens identify primarily as white at 81.9% of state residents.⁵⁹ This figure has decreased slightly since the 2000 Census, when 85.4% of state residents identified as white.⁶⁰ During the same time period, the percentage of state residents identifying as black, Asian, or two or more races has grown rapidly. Since 2000, the percentage of the population identifying as Asian has increased by 58.8% to 2.7% of the state's total population, and the percentage identifying as two or more races has grown by 67.2%.⁶¹ The growth in the percentage of the population identifying as Hispanic or Latino has been especially notable. Between 2000 and 2010, the Hispanic or Latino population grew by 82.6%.⁶² The foreign-born population has also increased rapidly, from 5.6% in 2000 to 12.7% in 2010.⁶³

The shifting racial makeup of the state has significant political implications. The growing prominence of minorities in the population will bring issues that these groups care about into public focus, while also changing the makeup of the State Legislature. The changing demographics of Pennsylvania are particularly important politically because the state is a swing state in presidential elections, with many electoral votes up for grabs. The number of registered Hispanic voters in Pennsylvania doubled between 2004 and 2008 alone. According to Manuel Pastor, professor of American Studies and Ethnicity at the University of Southern California, the Hispanic vote in swing states like Pennsylvania "will have a significant impact in a very close election."⁶⁴

56 "2010 Census Interactive Population Search." United States Census Bureau. [<http://2010.census.gov/2010census/popmap/ipmtext.php?fl=34>].

57 "Population Distribution and Change: 2000 to 2010." United States Census Bureau. [<http://www.census.gov/prod/cen2010/briefs/c2010br-01.pdf>]. Page 2.

58 "Local 2010 Census Data Released for Pennsylvania." Pennsylvania State Data Center. [<http://pasdc.hbg.psu.edu/Data/Census2010/tabid/1489/Default.aspx>].

59 "2010 Census Interactive Population Search." United States Census Bureau. [<http://2010.census.gov/2010census/popmap/ipmtext.php?fl=34>].

60 "Pennsylvania: 2000." United States Census Bureau. [<http://www.census.gov/prod/2002pubs/c2kprof00-pa.pdf>]. Page 2.

61 "Local 2010 Census Data Released for Pennsylvania." Pennsylvania State Data Center. [<http://pasdc.hbg.psu.edu/Data/Census2010/tabid/1489/Default.aspx>].

62 "Ibid.

63 "2010 Census Interactive Population Search." United States Census Bureau. [<http://2010.census.gov/2010census/popmap/ipmtext.php?fl=34>].

64 Bolton, Alexander. "Hispanic population soars in presidential swing states." The Hill. [<http://thehill.com/homenews/news/234231-hispanic-population-soars-in-presidential-swing-states>].

{ demographics }

Immigration has been a driving force behind Pennsylvania's overall population growth and changing racial and ethnic makeup. Philadelphia in particular has one of the biggest, most diverse, and fastest growing immigrant populations in the United States.⁶⁵ According to William H. Frey, a demographer at the Brookings Institution, Philadelphia has long drawn many African Americans, Hispanics and Asians to the city.⁶⁶

While Hispanics and African Americans have moved to Pennsylvania in high numbers, Pennsylvania's non-Hispanic White population has decreased by 0.7%. This decline occurred due to a combination of comparatively low birth rates and emigration, mostly of young people. This trend of young people leaving the state has caused concern among Pennsylvania lawmakers, as disappearing youth populations are often associated with stagnant economies.

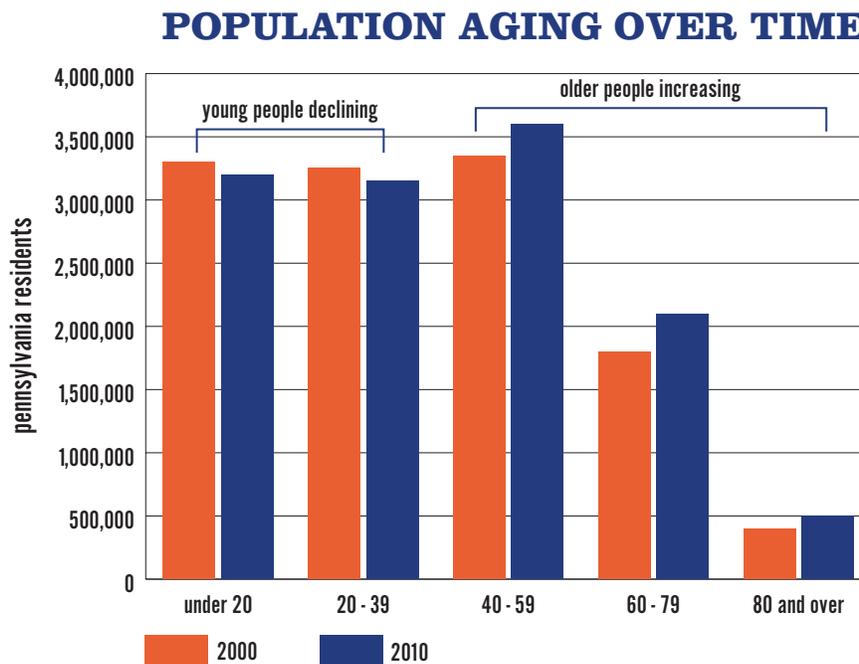


Figure 8 SOURCE: CENSUS 2010

Indeed, the Population Reference Bureau ranks Pennsylvania as the second-oldest state in the nation, behind only Florida.⁶⁷ The state is experiencing a prolonged exodus of young people, especially from rural areas, which is a worrying statistic, given that Pennsylvania is ranked third

65 Singer, Audrey, Domenic Vitiello, Michael Katz, and David Park. "Recent Immigration to Philadelphia: Regional Change in a Re-Emerging Gateway." Metropolitan Policy Program at Brookings, Nov. 2008. Web. [<http://www.philafound.org/>].

66 Frey, William H. "The New Metro Minority Map: Regional Shifts in Hispanics, Asians, and Blacks from Census 2010." Metropolitan Policy Program at Brookings, Aug. 2011. Web.

67 Himes, Christine L. "Which U.S. States Are the 'Oldest'?" Population Reference Bureau. [<http://www.prb.org/Articles/2003/WhichUSStatesAretheOldest.aspx>].

{ demographics }

nationally in terms of the number of people living in rural areas. Many rural counties are projected to have more residents 65 or over than 20 or younger by 2022.⁶⁸

“The Population Reference Bureau ranks Pennsylvania as the second-oldest state in the nation, behind only Florida.”

WEALTH BREAKDOWN

Overall, Pennsylvania households follow a bell-shaped income distribution. This means that there are very few rich and very few poor households. Most households cluster in the middle of the income scale, earning between \$50,000 and \$75,000 per year.

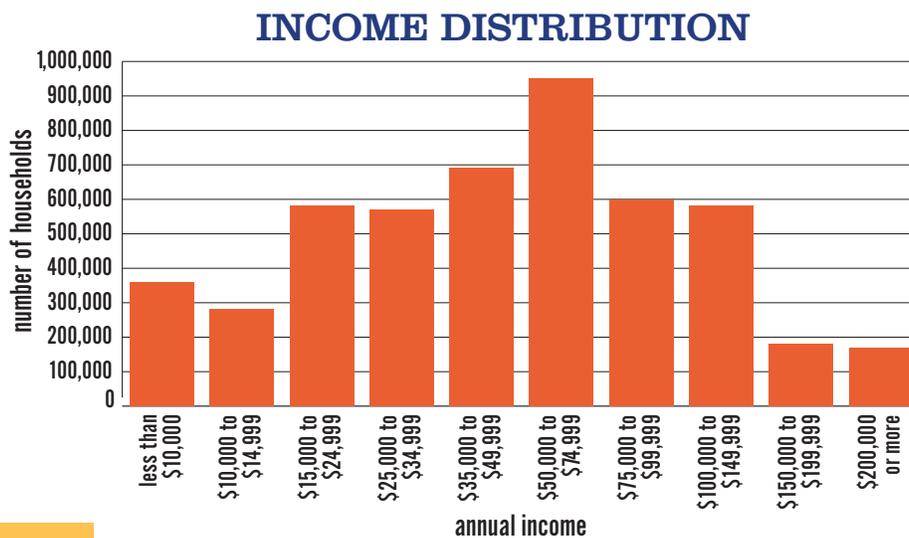


Figure 9 SOURCE: CENSUS 2010

However, Pennsylvania has significantly more households that make less than \$10,000 per year than it does households that make over \$200,000 per year. Not surprisingly, Pennsylvania ranks near the middle of the pack nationally in terms of median income, with the state ranked 22nd among the states. The median household income in the state, \$50,398, is slightly below the national average of \$51,914. Nonetheless, Pennsylvania has a lower percentage of citizens below the poverty rate (12.4%) than the national average of 13.8%.⁶⁹ According to the U.S. Census Bureau, in 2010, a family of four was considered to be living in poverty if the household made less than \$22,314 per year.⁷⁰

68 Krebs, Jeanette. “Rural Pa. losing next generation.” Pennlive.com [http://www.pennlive.com/editorials/index.ssf/2010/03/rural_pa_losing_next_generation.html].

69 “Pennsylvania.” United States Census Bureau. [<http://quickfacts.census.gov/qfd/states/42000.html>].

70 U.S. Census Bureau. “Poverty Thresholds for 2010 by Size of Family and Number of Related Children Under 18 Years.” [www.census.gov/hhes/www/poverty/data/threshld/thresh10.xls].

{ demographics }

“The income gap between urban and rural Pennsylvania has widened since the 1980s, caused by migration and differences in educational and economic opportunities for each set of communities.”

EDUCATIONAL ATTAINMENT

Pennsylvania is one of the most educated states in the nation, as measured by the percent of the adult population that holds a college degree. About a third of Pennsylvanians hold some form of a college degree, with a fourth having at least a Bachelor’s degree; 37% of state citizens have only obtained a high school degree, and 12% of the state lack any form of degree.

EDUCATIONAL ATTAINMENT

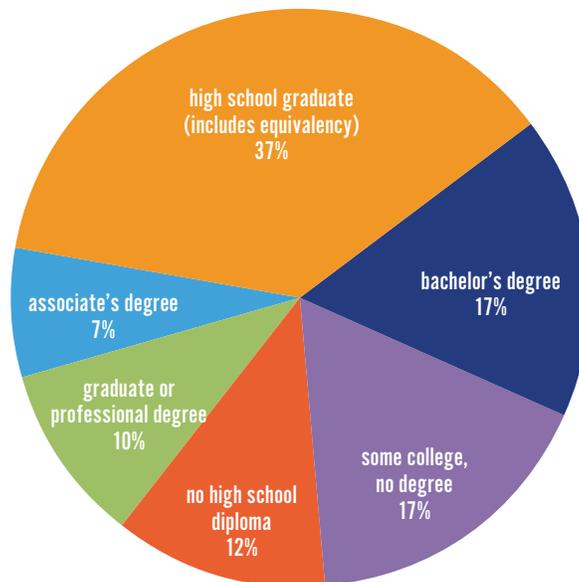


Figure 10

SOURCE: CENSUS 2010

To some extent, differences in income among households in Pennsylvania can be traced to differences in education. This difference is particularly notable between urban and rural Pennsylvania. The income gap between urban and rural Pennsylvania has widened since the 1980s, caused by migration and differences in educational and economic opportunities for each set of communities. Rural areas of Pennsylvania, mostly in the west, were hit hard by the deep recession of the early 1980s, from which the region never fully recovered; combined with the shrinking manufacturing industry in the United States and the changing needs of the global economy, these factors have led

{ demographics }

to the relative decline of rural Pennsylvania compared to more urban areas, where businesses and universities attract more highly-educated workers.⁷¹

The increases in wages for high earners have further skewed this income gap, reflecting the growing importance of higher education in the state. People with bachelor's degrees earn on average \$20,000 more than those without one. Workers in Pennsylvania with bachelor's degrees have experienced a 26% wage increase since the 1980's, while the wages of workers without a high school degree have declined by 25%.⁷²

UNEMPLOYMENT

Out of its 12.7 million citizens, Pennsylvania has a civilian labor force of approximately 6.4 million people.⁷³ As of May 2012, the state had an unemployment rate of 7.4%, well below the national average of 8.2% in the same month.⁷⁴ Thus, job prospects are slightly better in Pennsylvania than in the rest of the country. Over the past decade, fluctuations in Pennsylvania's unemployment rate have mirrored fluctuations in the national unemployment rate. However, Pennsylvania's unemployment rate has consistently remained below the national level.

“As of May 2012, the state had an unemployment rate of 7.4%, well below the national average of 8.2% in the same month.”

Pennsylvania's transition from a manufacturing to a service-based economy over the past 30 years has significantly changed the types of jobs available in the state. Specifically, health care and social assistance, public administration, and retail trade are growing industries in Pennsylvania and have helped protect Pennsylvania from the worst of the economic crisis.

The transition from a manufacturing to a service-based economy has been difficult for the Pennsylvania economy. In 1965, manufacturing accounted for 36% of total state GDP; by 1997, this share had fallen to 21%; and by 2008, to 14%. As a result, manufacturing employment has declined steadily, leaving many workers struggling to find new jobs. By 2009, 10% of employed Pennsylvania workers were in manufacturing, compared to 20% in education and health services, 14% in government, and 12% in professional and business services.⁷⁵

71 “The State of Rural PA.” Keystone Research Center. [<http://keystoneresearch.org/issues-guides/state-rural-pa>].

72 “Under Attack: Pennsylvania's Middle Class and the Jobs Crisis.” The Keystone Research Center, 2010. [<http://www.ourfiscalsecurity.org/storage/PA%20Final%20Report.pdf>].

73 “Databases, Tables & Calculators by Subject.” Bureau of Labor Statistics. [http://data.bls.gov/timeseries/LASST42000006?data_tool=XGtable].

74 Ibid.

75 “Manufacturing in Pennsylvania.” International Trade Administration, Department of Commerce. [http://trade.gov/manufactureamerica/facts/tg_mana_003057.asp].

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PRISON POPULATION

There are 26 state correctional facilities currently in Pennsylvania, and 63 county prisons. The inmate population in Pennsylvania has grown at a fast pace over the last decade, from 36,816 in 2000 to 51,487 in 2010 — an increase of over 40%. Pennsylvania ranked 7th in the nation in the growth of inmate population. By 2010, the inmate population had grown to 117% of the system's physical capacity.⁷⁶ To keep up with a growing population, the corrections budget for FY 2012 increased by \$186.5 million. The majority of this increase in state funding will replace the federal stimulus funds, which are expiring.⁷⁷ The funding that replaces the ARRA expired funds will go towards housing for over 1,000 new inmates and additional correction officers.⁷⁸

MARRIAGE AND DIVORCE

In 2009, the latest year for which such data was available, the marriage rate per 1,000 men in Pennsylvania was 15.5, well below the national average of 19.1. The same was true for women, for whom the marriage rate per 1,000 women was 14.3 compared to the national average of 17.6. However, the state also has a much lower divorce rate than the national average: 7.7 and 7.4 per 1,000 men and women in Pennsylvania, respectively, compared to 9.2 and 9.7 across the nation.⁷⁹ ★

76 Guerino, Paul, Paige M. Harrison, and William J. Sabol. "Prisoners in 2010." [<http://bjs.ojp.usdoj.gov/content/pub/pdf/p10.pdf>]. December 2011. "2010 Annual Statistical Report", Pennsylvania Department of Corrections." . December 2011.

77 Pennsylvania Budget and Policy Center. "Budget Analysis: Governor's Proposed 2011-12 Budget." [<http://pennbpc.org/budget-analysis-governor-s-proposed-2011-12-budget>]. March 10, 2011.

78 Ibid.

79 "Marriage and Divorce." United States Centers for Disease Control. [<http://www.cdc.gov/nchs/fastats/divorce.htm>].

OVERVIEW

In Pennsylvania, public health spending is overseen principally by the Department of Health. However, the Department of Public Welfare also administers a number of important health-related programs, including “purchasing health care for more than 2.3 million Pennsylvania residents and enrolling Medical Assistant providers who administer the care.”⁸⁰ In the state’s Comprehensive Annual Financial Report (CAFR), produced by the Comptroller, health-related spending by these two departments is grouped under “health and human services.”

“In FY 2011, total spending on Health and Human Services was \$30.4 billion.”

As in many states across the country, health care is Pennsylvania’s biggest expense. In FY 2011, total spending on Health and Human Services was \$30.4 billion, or nearly 42% of total primary government spending.⁸¹ Health and Human Services receives twice as much funding as education, the second-largest single expenditure.

CONTAINING HIGH COSTS

State spending on health care has grown in recent years, especially as the Great Recession and the retirement of many Baby Boomers have driven more Pennsylvania citizens to enroll in state programs like Medicaid. In FY 2009, the state spent \$26.6 billion on health care; by FY 2011 this figure had grown by nearly \$4 billion, an increase of over 14%. By contrast, spending on public education, the second largest area of state expenditure, grew only 6.4% during the same period.⁸²

The state has higher health spending per capita (\$7,730 vs. \$6,815) and per enrollee Medicare spending (\$10,555 vs. \$10,365) than the rest of the nation.⁸³ The state’s spending per capita on hospital care, prescription drugs, and nursing home care are also particularly high compared to national averages. These higher costs are the result of Pennsylvania’s aging population.⁸⁴ Indeed, data from the Population Reference Bureau shows that Pennsylvania is the second-oldest state in the country.⁸⁵ As of 2010, 18% of the state’s population was enrolled in Medicare, as opposed to the national average of 15%.⁸⁶ Over 15% of Pennsylvania’s population is 65 or older. As young adults leave the state’s rural areas, that percentage is expected to rise.⁸⁷

80 “Learn About the Department of Public Welfare.” Pennsylvania Department of Public Welfare. [<http://www.dpw.state.pa.us/learnaboutdpw/index.htm>].

81 Pennsylvania CAFR 2011, page 48.

82 Pennsylvania CAFR 2009, page 40; PA CAFR 2011, page 48.

83 “Pennsylvania.” Kaiser Family Foundation. [<http://www.statehealthfacts.org/profileglance.jsp?rgn=40>] and “Pennsylvania: Medicare Spending.” Kaiser Family Foundation. [<http://www.statehealthfacts.org/profileind.jsp?cat=6&sub=72&rgn=40>].

84 “Pennsylvania: Health Expenditures by State of Residence.” Kaiser Family Foundation. [<http://www.statehealthfacts.org/profileind.jsp?cat=5&sub=143&rgn=40>].

85 Himes, Christine L. “Which U.S. States Are the ‘Oldest?’” Population Reference Bureau. [<http://www.prb.org/Articles/2003/WhichUSStatesAretheOldest.aspx>].

86 “Pennsylvania: Medicare Enrollment.” Kaiser Family Foundation. [<http://www.statehealthfacts.org/profileind.jsp?cat=6&sub=74&rgn=40>].

87 Krebs, Jeanette. “Rural Pa. losing next generation.” Pennlive.com [http://www.pennlive.com/editorials/index.ssf/2010/03/rural_pa_losing_next_generatio.html].

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Fortunately for the state, health care costs are growing more slowly in Pennsylvania than in the rest of the country. The state's average annual growth in total Medicare spending between 1991 and 2009 of 5.8% is well below the national average of 8%, and the state's average annual growth in Medicare spending per enrollee is also below the national average (5.1% vs. 6.3%).⁸⁸ More broadly, Pennsylvania's average annual growth in health care expenditures is, at 5.7%, below the national average of 6.5%.⁸⁹ The state also has a lower percentage of uninsured residents and children than the national average.⁹⁰

“Medicaid takes up the largest portion of the health care budget, at \$18.8 billion in FY 2010, up over 10% from FY 2006.”

MEDICAID AND REFORM

The Pennsylvania Medicaid program, which primarily provides medical care to low-income families and people with disabilities, is jointly funded by the federal government and the state, and is administered by the state. Medicaid takes up the largest portion of the health care budget, at \$18.8 billion in FY 2010, up over 10% from FY 2006. The rise in Medicaid costs is due to a spike in enrollees as a result of the Great Recession and the rise of health care costs overall.

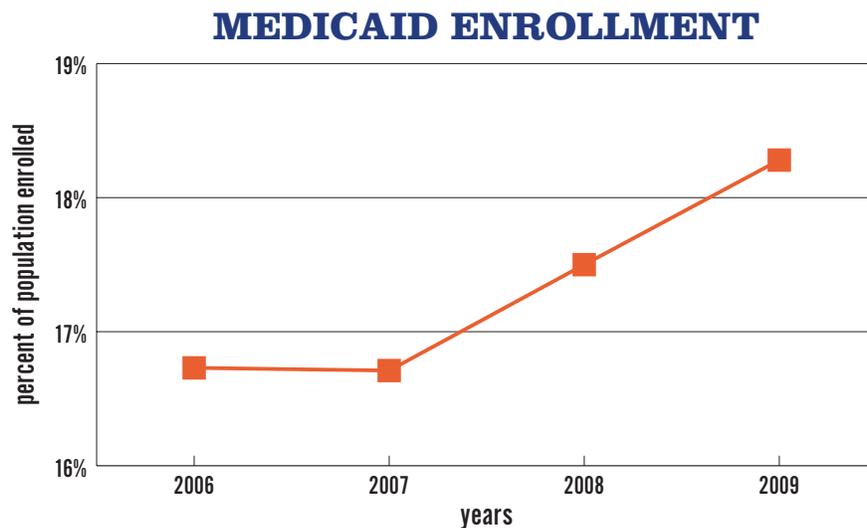


Figure 11 SOURCE: MEDICAID.GOV

88 "Pennsylvania: Medicare Spending." Kaiser Family Foundation. [<http://www.statehealthfacts.org/profileind.jsp?cat=6&sub=72&rgn=40>].

89 "Pennsylvania: Health Expenditures by State of Residence." Kaiser Family Foundation. [<http://www.statehealthfacts.org/profileind.jsp?cat=5&sub=143&rgn=40>].

90 "Pennsylvania." Kaiser Family Foundation. [<http://www.statehealthfacts.org/profileglance.jsp?rgn=40>].

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Between FY 2006 and FY 2009, Pennsylvania saw an increase of nearly 217,000 Medicaid enrollees.⁹¹ Medicaid currently comprises nearly one-quarter of the state budget, almost double the percentage of the state budget allocated to the program in 1980. By some accounts, if current policies remain, Medicaid could account for over 90% of the state budget by 2075.⁹²

Medicaid costs to the state have fluctuated in recent years as the percentage of the financial burden for the program borne by the federal government has increased. In FY 2008, the state covered 45.7% of Medicaid spending, or \$7.4 billion. By FY 2009, however, the state covered 36.2% of Medicaid spending, or \$6.2 billion. The federal government — through the 2009 federal stimulus bill — began to foot more of the bill for Medicaid in order to keep pace with growing needs. Between FY 2009 and FY 2010, the federal government contributed \$5.5 billion in federal stimulus money to Medicaid.⁹³

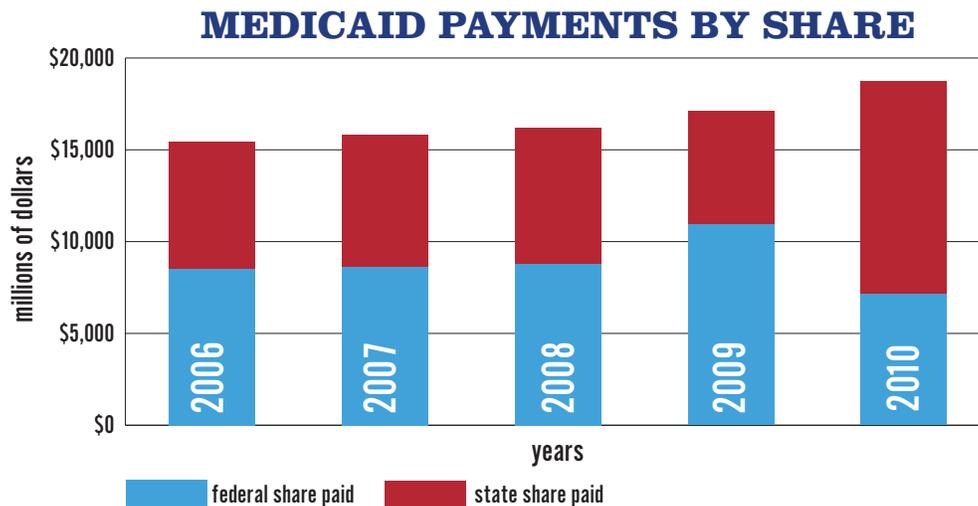


Figure 12 SOURCE: MEDICAID.GOV

To contain costs, Governor Tom Corbett reduced the Medicaid enrollment numbers by 150,000 people in the second half of 2011. According to the Department of Public Welfare, these cuts simply removed the deceased, those who had moved out of state, and ineligible recipients from the Medicaid enrollment database, but the governor's office could provide no breakdown of those affected. "Advocacy groups, clients, and representatives for caseworkers paint a different picture. Pressure to quickly review a backlog of files and close cases overwhelmed the system as reams of paperwork were lost and computer programs automatically ended benefits when patients' responses

91 "Pennsylvania Statistics: Medicaid Enrollments and Payments." Medicaid.gov. [<http://medicaid.gov/Medicaid-CHIP-Program-Information/By-State/pennsylvania.html>].

92 Policy Points. "Pennsylvania Welfare Spending & Medicaid." [www.commonwealthfoundation.org/research/detail/pennsylvania-welfare-spending-medicaid]. May 20, 2011.

93 "Pennsylvania Statistics: Medicaid Enrollments and Payments." Medicaid.gov. [<http://medicaid.gov/Medicaid-CHIP-Program-Information/By-State/pennsylvania.html>] and "Where is Your Money Going?" Recovery.gov. [http://www.recovery.pa.gov/portal/server.pt/community/recovery_pa_gov/5994].

had not been entered by preset deadlines,” reported The Philadelphia Inquirer.⁹⁴ Because of so many complaints, the federal agency that monitors Medicaid has launched an investigation as to whether benefits were wrongly terminated.⁹⁵

THE AFFORDABLE CARE ACT AND MEDICAID

Governor Corbett joined with 25 other governors in challenging the President’s Patient Protection and Affordable Care Act (ACA) in the U.S. Supreme Court. Under the President’s plan, states would be required to expand Medicaid coverage in the state in order to receive federal funds. Now that the law has been upheld, Governor Corbett faces a tough decision as to whether to take the federal funds and expand Medicaid coverage, or to keep Medicaid coverage rates at the status quo. “The ruling, in effect, makes ... Medicaid expansion optional for states,” wrote Matt Salo, executive director of the National Association of Medicaid Directors in Washington, D.C. ⁹⁶

“Governor Corbett joined with 25 other governors in challenging the President’s Patient Protection and Affordable Care Act (ACA) in the U.S. Supreme Court.”

In FY 2014, the federal government will reimburse states 100% of the cost of expanding Medicaid eligibility to 133% of federal poverty guidelines. The reimbursement decreases to 95% in FY 2017, and 90% in FY 2020. With such generous federal funding, “We would expect Pennsylvania to go ahead and take up the expanded Medicaid,” said Ann Bacharach, special projects director for the Pennsylvania Health Law Project. According to her estimates, 800,000 more Pennsylvanians would be eligible for medical assistance beginning in FY 2014.

However, Governor Corbett, a fierce critic of the President’s plan, has withheld his decision on the matter.⁹⁷ Corbett and critics of the ACA are worried that the federal government may provide generous funding in the early years of the program, but might have to cut funding in subsequent years to meet the federal government’s own budget obligations, leaving states to cover a greater number of Medicaid recipients with less federal funding.

Those who lobby for taking the federal deal also point to the importance of Medicaid to the economy of the state. Medicaid provides significant revenue to the state’s hospitals and hospital workers. On average, 11% of all hospital revenue comes from Medicaid payments, and some projections predict that as little as a 5% cut could cause a \$1.5 billion dollar decline in spending at hospitals, resulting in over 12,000 people losing jobs.

94 Sapatkin, Don. “Pa.’s Drop in Medicaid Rolls Stirs Controversy.” [http://articles.philly.com/2011-12-15/news/30520624_1_advocacy-groups-welfare-office-caseworkers]. December 15, 2011.

95 The Philadelphia Inquirer. July 12, 2012. “U.S. Agency asks about the sharp drop in Pa’s Medicaid rolls.” [http://articles.philly.com/2012-07-12/news/32633443_1_medicaid-rolls-eligibility-dpw].

96 Twedt, Steve. Pittsburgh’s Post Gazzette. “States must decide whether to expand Medicaid programs.” July 1, 2012.

97 Ibid.

FEDERAL REFORM IN PENNSYLVANIA

With the passage of the Patient Protection and Affordable Care Act (ACA) through Congress in 2010, a host of new health care programs and policies now affect Pennsylvania. Because of ACA, for instance, young adults are allowed to remain on their parents' health care coverage plans until age 26, and a larger number of rebates and discounts have become available to seniors to help pay for their prescription drugs.

The ACA also requires insurance companies to spend at least 80% of premium dollars on spending that directly benefits patient health, rather than on administrative and managerial costs. Furthermore, the law prevents large premium increases. More generally, the ACA aims to place a greater emphasis on wellness and preventive care rather than on last-step interventions like surgeries, which tend to be more drastic and expensive than prevention. Though the full effects of the ACA remain to be seen, all of these measures are designed to help improve access to quality care for citizens in the state.⁹⁸

There is already concern, however, that looming budget cuts may undermine some of the reforms put in place by the ACA. For instance, the ACA requires all Americans to have health coverage that includes mental health services, but cuts to mental health funding in Pennsylvania may make it more difficult for people to actually access these services. The FY 2013 state budget, for instance, included 10% cuts to seven mental health programs in the state.⁹⁹

HEALTH BENEFITS FOR STATE EMPLOYEES

Across the country, one of the most contentious areas of health care spending is expenditure on health benefits for state employees – also called other post-employment benefits (OPEB).

“Pennsylvania has unfunded OPEB liabilities in excess of \$17 billion. Further, the state has saved less than 1% of the money needed to cover these costs.”

Many analysts point out that OPEB benefits have not been properly budgeted for or funded by state governments. According to data from State Budget Solutions and the Pew Center on the States, Pennsylvania has unfunded OPEB liabilities in excess of \$17 billion. Further, the state has saved less than 1% of the money needed to cover these costs. According to the Pew report, 17 states have virtually no money set aside to pay OPEB benefits, and only seven states have at least 25% of retiree health-care costs funded.¹⁰⁰

98 “How the Health Care Law is Making a Difference for the People of Pennsylvania.” HealthCare.gov. [<http://www.healthcare.gov/law/resources/pa.html>].

99 “Affordable Care Act will expand mental health coverage, but budget cuts a worry.” The Philadelphia Inquirer. [http://articles.philly.com/2012-07-24/news/32805654_1_mental-health-mentally-ill-people-health-coverage].

100 Guevara, Andrew. “Report reveals aggregate state debt exceeds \$4 trillion.” State Budget Solutions. [<http://www.statebudgetsolutions.org/publications/detail/report-reveals-aggregate-state-debt-exceeds-4-trillion-2>].

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The state uses a pay-as-you-go system for OPEB benefits, meaning there is no requirement that money be set aside to cover future expenses.¹⁰¹ As a result, the state has the 10th largest OPEB deficit in the country. More worrying still, the state has not taken any significant steps to address this issue.

In Pennsylvania, state employee health benefits are administered by the Pennsylvania Employees Benefit Trust Fund (PEBTF), which is responsible for 144,000 state employees, retirees, and dependents.¹⁰² The fund was established in 1988 after an agreement was reached between the state of Pennsylvania and Council 13 of the American Federation of State, County, and Municipal Employees, AFL-CIO (AFSCME). The state contributes money to the fund, which is then used to provide health benefits for state workers, retired state workers, and their dependents.¹⁰³

State workers with more than 20 years of service qualify for the health benefits, and contribute 5% of their pay toward the program. In return, workers are able to retain health-care benefits from the time they retire until age 65, at which point the benefits decrease and become a supplemental Medicare benefit. Currently, the state contributes \$400 per year per employee to the health care fund, but this figure may change as Governor Corbett and union leaders negotiate new agreements.¹⁰⁴

CHALLENGES AHEAD

Pennsylvania's spending on health care has grown quickly in recent years, and the state's health spending per capita and Medicaid spending per enrollee remain above national averages. That said, the state has below-average rates of spending growth in most areas of health and Medicaid spending, while also having fewer uninsured residents — including children — than most other states. Recently, however, the state has received criticism for eliminating 150,000 Medicaid recipients from its rolls without cause and is currently under investigation by the federal agency that oversees Medicaid. Also hanging in balance is whether or not Governor Corbett will accept billions of dollars in federal Medicaid funds made available through the passage of the Affordable Care Act.

If the state is to succeed, it must keep the cost of employee health benefits under control, integrate federal reform into state policies alongside budget cuts, and slow growth in health care spending, which takes up a larger and larger share of the state budget each year. These measures must also be implemented in an environment of economic uncertainty and increasing fiscal concern at the national and state level. Together, these challenges will test the strength of the state's leadership and public health care system. ★

101 Boehm, Eric. "Retiree health care costs are a hidden \$17 billion pension bomb." Pennsylvania Independent. [<http://paindependent.com/2012/06/3756/>].

102 "State Employee Health Benefits." National Conference of State Legislatures. [<http://www.ncsl.org/issues-research/health/state-employee-health-benefits-ncsl.aspx>].

103 "A Study to Determine the Feasibility and Cost Effectiveness of Placing Public School Employees Under the Commonwealth's Jurisdiction for the Purposes of Providing Health Benefits." Pennsylvania Legislative Budget and Finance Committee. [<http://www.oregoned.org/atf/cf/%7B3F7AF7EC-F984-4631-A411-148CD1FB8421%7D/Penn%20Report.pdf>]. Page 25.

104 "2011/12 Governor's Executive Budget: An Analysis of Governor Corbett's Budget Proposal." Pennsylvania House Appropriations Committee. Page 18.

OVERVIEW

States are responsible for running two massive educational systems. First, states operate a public school system with a mandate to provide free education for all children from kindergarten through twelfth grade (K-12). Second, states operate public universities and community colleges, which provide higher education at a reduced cost to state citizens and serve millions of students (and employ hundreds of thousands of people) nationally. State governments manage these two educational systems, K-12 and higher education, separately. Altogether, the states, along with cities and local governments, are responsible for the vast majority of public education financing.

While the issues plaguing states in each segment of the education system are different, there are several trends that run throughout the public education system in the United States. These include increasing tuition costs for university education, declining levels of achievement in math and science among high school students, and entrenched underperformance at all levels by schools in impoverished areas. In Pennsylvania, the key issues facing the public education system are poor performance in poor and urban school districts, low rates of higher education funding, and increasing student debt.

K-12 EDUCATION

Structure and Funding

In Pennsylvania, the K-12 public education system is overseen by the Office of Elementary/Secondary Education, which reports to the Secretary of Education. The Secretary is also responsible for managing the funding allotted to public K-12 education in the annual budget.

“Education spending as a percentage of the state budget has remained relatively constant, at around 20% of total state spending.”

In FY 2011, Pennsylvania spent \$14.9 billion on public education, making public education the second largest area of state spending behind Health and Human Services. Public education constituted 20.5% of the state’s budget in FY 2011. In recent years, public education spending has grown relatively slowly, from \$14 billion in FY 2009 to \$14.5 billion in FY 2010 and \$14.9 in FY 2011. Education spending as a percentage of the state budget has remained relatively constant, at around 20% of total state spending.¹⁰⁵

¹⁰⁵ Pennsylvania CAFR 2009, 42; and Pennsylvania CAFR 2010, 46.

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According to data from the U.S. Census Bureau from the 2009-2010 school year, Pennsylvania ranks tenth among the states in per pupil public school funding. At \$15,612 per pupil, Pennsylvania spends well above the national average of \$12,306.¹⁰⁶

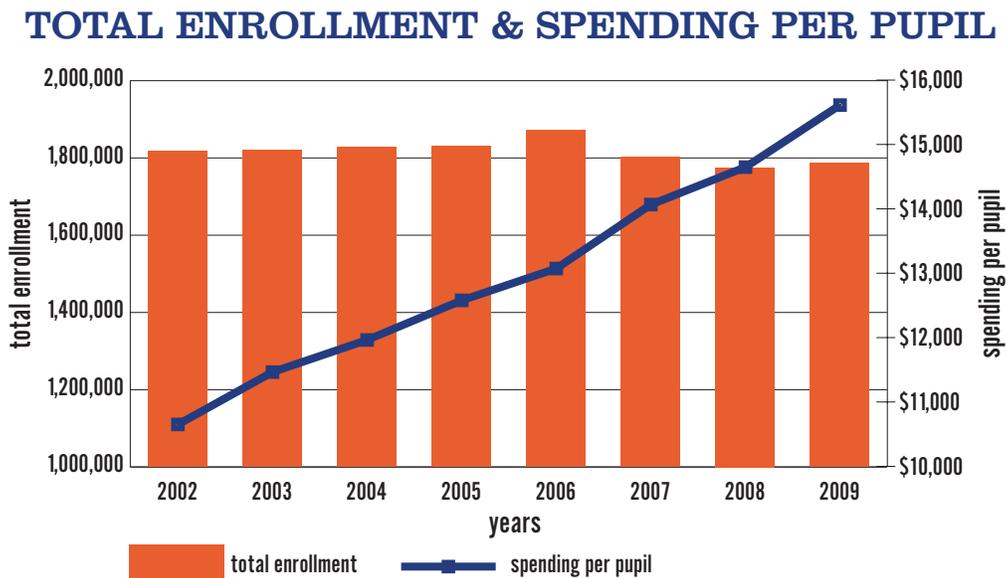


Figure 13

SOURCE: NATIONAL CENTER FOR EDUCATION STATISTICS, 2011

Achievement

Compared to other states, Pennsylvania reports high student achievement and graduation rates. Based on data from the National Assessment of Educational Progress (NAEP), a national standardized test given to 4th and 8th grade students, Pennsylvania students rank seventh in the country, with 8% of the state's 4th graders scoring "advanced" in math, and 10% in reading. Ten percent of the state's 8th graders score "advanced" in math and 3% score "advanced" in reading.¹⁰⁷

The state's high school graduation rate is relatively high. For the class of 2008, the national high school graduation rate was 74.9%, according to data collected by The New York Times. For Pennsylvania students, however, the high school graduation rate was 82.7%, putting the state in the company of some of the nation's highest achieving states in terms of education.¹⁰⁸ The state also has a student-to-teacher ratio of 14.6 to 1, below the national average of 15.4, ranking 28th nationally.¹⁰⁹

Despite relatively high spending and high achievement scores, the state's students still struggle on the SAT, a national standardized test used in the college admissions process. In 2010, the average

¹⁰⁶ "Public Education Finances: 2010." The United States Census Bureau. [<http://www2.census.gov/govs/school/10f33pub.pdf>]. Page 11.

¹⁰⁷ "America's Smartest Kids." The Daily Beast. [<http://www.thedailybeast.com/galleries/2011/01/21/america-s-smartest-kids.html#slide7>].

¹⁰⁸ Rampell, Catherine. "Graduation Rates, by State and Race." The New York Times. [<http://economix.blogs.nytimes.com/2010/06/02/graduation-rates-by-state-and-race/>].

¹⁰⁹ Luckle, Mark S. "Comparing student-to-teacher ratio nationwide." California Watch. [<http://californiawatch.org/k-12/interactive-comparing-student-teacher-ratio-nationwide>].

combined SAT score of Pennsylvania's students was 1473 out of a possible 2400. This score put Pennsylvania 40th in the nation, a disappointingly low rank.¹¹⁰ The Allegheny Institute for Public Policy notes that SAT scores have remained almost unchanged in the state since 1998 despite a 76% increase in public school spending, and calls the scores "appallingly inadequate."¹¹¹

"Despite relatively high spending and high achievement scores, the state's students still struggle on the SAT."

The state's students fared better on the ACT, another national standardized test used in the college admissions process. Out of a total possible score of 36, Pennsylvania students averaged 22.4, twelfth highest in the nation. However, this relative success was likely due to the small number of Pennsylvania students who were tested: only 18% of Pennsylvania high school students took the test. In contrast, 71% of Wisconsin students took the ACT, and the state averaged a 22.1.¹¹²

Spending Sources

Public school districts receive funding from three sources: the state budget, local property taxes, and federal grants. On average across the nation, school districts receive 43.5% of their funding from state governments, 43.9% from local sources, and 12.5% from the federal government.¹¹³

In Pennsylvania, however, only 35.7% of district money comes from the state, compared to 53.1% from local sources and 11.3% from federal sources. Thus, school districts in Pennsylvania make up for relatively low levels of state and federal funding by relying more heavily on property taxes to fund public education.¹¹⁴ The state ranks in the bottom 10 states in terms of the state's financial support of public school education.

Though the share of education funding contributed by federal sources in Pennsylvania is below the national average, the state has become increasingly reliant on federal funds in recent years. Between FY 1999 and FY 2004, the state saw an increase in real federal revenue per pupil of 49%, well above the national average of 39.6%.¹¹⁵ Moreover, the state received \$3 billion in education funding from the FY 2009 federal stimulus package.¹¹⁶

Despite Pennsylvania's already low levels of state spending on public education, the Great Recession put further pressure on the state government to trim its finances and spend less in all sectors, with

110 Benefield, Nathan. "2010 SAT Scores by State." Commonwealth Foundation. [<http://www.commonwealthfoundation.org/policyblog/detail/2010-sat-scores-by-state>].

111 "Pennsylvania SAT Scores Point to Futility of Higher Spending." The Allegheny Institute. [<http://www.alleghenyinstitute.org/component/content/article/500-pennsylvania-sat-scores-point-to-futility-of-higher-spending.html>].

112 "Average Scores by State." The ACT Test. [<http://www.act.org/newsroom/data/2012/states.html>].

113 "Public Education Finances: 2010." The United States Census Bureau. [<http://www2.census.gov/govs/school/10f33pub.pdf>]. Page 11. Note: percentages may not add to 100.0 due to rounding.

114 Ibid.

115 Prante, Gerald. "K-12 Spending More Reliant on Federal Government Since No Child Left Behind Act." [<http://taxfoundation.org/article/k-12-spending-more-reliant-federal-government-no-child-left-behind-act>].

116 "The Recovery Act in Pennsylvania." Recovery.gov. [http://www.recovery.pa.gov/portal/server.pt/community/recovery_pa_gov/5994].

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education taking a particularly big hit. Total statewide cuts for FY 2012 are estimated at \$961 million for K-12 education. Current Secretary of Education Ron Tomalis explains the reasoning behind the education budget, which passed in late June of 2011: Before the recession, districts relied on property tax increases and extra state funding to pay for more teachers. When the recession hit, the governor used federal stimulus money to cover the shortfall, a practice that Tomalis describes as unsustainable considering the \$4.2 billion deficit the governor inherited.¹¹⁷

“The Great Recession put further pressure on the state government to trim its finances and spend less in all sectors, with education taking a particularly big hit.”

Since Pennsylvania relies on property taxes for education more than most other states, this reduction in statewide funding will disproportionately affect schools and students from low-income communities. This lack of funding from the state can make it very difficult for poorer urban and rural communities to ensure adequate schools and facilities. According to data compiled by the Education Law Center, the education budget cuts mean that the Reading School District (90% student poverty) will have \$972 less to spend per student, while the Wyomissing School District (22% student poverty) will see cuts of only \$95 per student.¹¹⁸

Reform

In light of issues of achievement and funding, Pennsylvania’s state government has aggressively pursued opportunities for education reform, most notably in the form of the expanding charter school movement. As of 2009-2010, the state had 147 charter schools, the tenth most of any state, which educated 90,954 Pennsylvania K-12 students, or 5.1% of all school-age students in the state.¹¹⁹

There is a vigorous debate surrounding charter schools and their educational and social benefits. Proponents argue that charter schools provide families with an alternative to a failing school system. In addition, the competition introduced into the educational system by charter schools can help improve results for students in every type of school. Finally, proponents cite the greater flexibility and accountability of charter schools: the vast majority of charter schools are not unionized, and thus principals have the flexibility to hire, fire, and reward teachers based on merit. Also, unlike a traditional public school, if a charter school does not perform, their charter is not renewed.

117 Detrow, Scott. “Tomalis defends Corbett’s education cuts.” [<http://www.witf.org/state-house-sound-bites/tomalis-defends-corbett-s-education-cuts>]. March 30, 2011.

118 “Key Facts About the Final Education Budget for 2011-2012.” Education Law Center. [http://www.elc-pa.org/KeyFacts_FinalEducationBudget.6.28.11.pdf].

119 “Charter School Facts at a Glance.” Center for Public Education. [<http://www.centerforpubliceducation.org/Main-Menu/Organizing-a-school/Charter-schools-Finding-out-the-facts-At-a-glance/Charter-School-Data-by-State-2010-2011.pdf>].

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However, charter school critics maintain that charter schools are destroying, rather than improving, the public education system by diverting funding and talented students from traditional public schools. Funding is allocated to public schools based on the number of students that are enrolled, so every student who leaves a public school for a charter school takes with him tens of thousands of dollars in funding. There is also worrying evidence that charter schools do not, on average, perform better than traditional public schools.¹²⁰

HIGHER EDUCATION

Structure

Like K-12 education, higher education in Pennsylvania is housed within the Office of the Secretary of Education. However, the Office of Postsecondary/Higher Education oversees higher education. There are fourteen universities in the Pennsylvania State System of Higher Education, along with four state-related universities—Lincoln, Pennsylvania State, Pittsburgh, and Temple—and sixteen community colleges.

“70% of Pennsylvania’s higher education students graduate with debt, the sixth-highest percentage in the country.”

Funding — and Cuts

Although the largest education budget cuts affected K-12 education, higher education institutions and their students have also felt the impact of state budget shortfalls. In 2009, Governor Rendell closed a midyear budget shortfall of \$1.6 billion in part by reducing state appropriations to Lincoln, Pittsburgh, Temple, and Pennsylvania State by 6.0%, as well as freezing further funding and cutting the State System of Higher Education’s Budget.¹²¹

In FY 2011, Governor Corbett made further cuts to higher education. The Pennsylvania State System of Higher Education (PASSHE) was cut by 18%, or \$90.6 million; funding to the state-related universities was cut by 19%; and the budget for community colleges was reduced by 10%.¹²² The PA Higher Education Assistance Agency, which provides financial assistance to college students, is also facing \$400 million worth of budget cuts in financial assistance to college students.¹²³ While further cuts proposed by the governor in FY 2013 did not pass, tuitions paid by students were raised to defray state costs.

120 Paulson, Amanda. “Study: On average, charter schools do no better than public schools.” The Christian Science Monitor. [<http://www.csmonitor.com/USA/Education/2010/0629/Study-On-average-charter-schools-do-no-better-than-public-schools>].

121 “Pennsylvania one of 24 states to decrease state funding for higher education.” Pennsylvania Budget and Policy Center. [<http://pennbpc.org/pennsylvania-one-24-states-decrease-state-funding-higher-education>].

122 Pennsylvania School Funding Campaign. “Budget Update”. [<http://www.paschoolfunding.org/2011/06/2011-2012-budget-update-2/>].

123 Luciew, John. “College Students’ Debt Loads Keep Growing.” [http://www.pennlive.com/midstate/index.ssf/2012/02/college_students_debt_loads_ke.html]. February 8, 2012.

Student Debt

Pennsylvania's lack of support for higher education and recent budget cuts have had clear consequences for the state's students. Public colleges and universities, facing funding shortfalls, have raised tuition and other costs to students and their families. As a result, many students have taken on larger debt burdens to finance their higher education. With tuition costs on the rise, especially since 2008, a generation of students had to take on heavy loans to finance their educations. Recent estimates from the Federal Reserve Bank of New York suggest that total student loan debt is nearly \$1 trillion nationwide.¹²⁴ According to the Project on Student Debt, 70% of Pennsylvania's higher education students graduate with debt, the sixth-highest percentage in the country. The average debt burden is \$28,599, the fifth-highest average debt burden in the country.

LOOKING AHEAD

Though Pennsylvania's students have achieved high marks in academic performance in terms of NAEP performance and high school graduation rates, these positive points should not obscure negative trends in SAT performance, reduced state support of K-12 education, and increasing reliance on local and federal funding sources for public education. The state's strong academic performance has stagnated in recent years, and yet many argue that more spending has not provided the answer. If the state is to remain a national leader in K-12 education, it must find areas for reform and renewal. The state's strong support for charter schools provides one possible avenue, but the benefits remain unclear.

In higher education, large cuts to funding, brought on by a budget crisis, have shrunk funding significantly for the state's public universities and their students. In response, tuition is on the rise, and students are taking on larger and larger debt burdens to fund their education. Pennsylvania now ranks in the top ten nationally in terms of percentage of students graduating with debt and average debt load. If the state cannot find a way to support its higher education students — even while making budget cuts — the long-term consequences for the state and its citizens could be negative. ★

¹²⁴ Hamilton, Walter. "Student loan debt continues to rise" The Los Angeles Times. [<http://www.latimes.com/business/money/la-fi-mo-student-debt-rise-20120531,0,543907.story>].

OVERVIEW

Around the country, state legislatures are realizing that the pension systems of America's states are significantly underfunded. In other words, states have overpromised benefits for the level of revenues coming into the system. Legislators are beginning to take action to contain costs by increasing retirement ages, reducing benefits, and increasing costs to public employees.

“The troubling news is that Pennsylvania is worse off than most states, having the 7th highest pension debt in the country.”

The troubling news is that Pennsylvania is worse off than most states, having the 7th highest pension debt in the country. Estimates of that debt range from \$30 billion on the low end (as reported by pension fund actuaries)¹²⁵ to \$114.1 billion on the high end as calculated by outside economists.¹²⁶ Doubts over the state's ability to manage its growing unfunded pension liabilities were a key driver of the decision in July 2012 by Moody's Investors Service to downgrade Pennsylvania's general obligation bonds from Aa1 to Aa2.¹²⁷

TYPES OF PENSION PLANS

There are two major types of pension benefits: defined benefit (which entitles retirees to a monthly payment of a certain value from their former employer) and defined contribution (which involves employees and employers making set payments into a retirement fund, which the employee receives access to upon retirement). With both defined benefit pension plans and retiree healthcare, the state government can decide to either “prefund” its obligations or “pay as it goes.” Prefunding involves the state putting money aside in advance to pay for retiree benefits, which is subsequently invested. When the employees retire and the benefits come due, the state can pay for the benefits with a combination of money from the general fund and investment returns. If a state chooses to “pay as it goes,” retirement benefits are more expensive because the state must pay for all current benefits out of the general fund without investment returns to defray the cost.

PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM (PSERS)

As part of their compensation, state workers ranging from clerks to police officers receive pensions from the state upon their retirement. In Pennsylvania, there are three separate pension systems for retired public employees.

The oldest and largest pension system in Pennsylvania is the Public School Employees' Retirement System (PSERS), which was established in 1917 and now serves over 600,000 members (all current or retired

125 SERS, PSERS Say Unfunded Pension Liability Reaches \$30 billion. PA Capitol Digest. [<http://pacapitoldigestcrisci.blogspot.com/2011/03/sers-psers-say-unfunded-pension.html>].

126 State Budget Solutions. “State Budget Solutions' third annual State Debt Report shows total state debt over \$4 trillion.” August 28, 2012. [<http://www.statebudgetsolutions.org/publications/detail/state-budget-solutions-third-annual-state-debt-report-shows-total-state-debt-over-4-trillion#ixzz2507P9hXY>] and “Pension assets and pension liabilities: Calculations by Robert Novy-Marx and Joshua Rauh, as of June 2009”; Public Pension Promises: How Big Are They and What Are They Worth?” (with Robert Novy-Marx), October 2010, Journal of Finance, forthcoming [http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1352608].

127 Sichel, Jared. “Corbett says Moody's on target for blaming pensions for lower bond rating.” Pennsylvania Independent. [<http://paindependent.com/2012/07/corbett-says-moodys-on-target-for-blaming-pensions-for-lower-bond-rating/>].

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public school workers or their beneficiaries) through a defined benefit plan. Between June 30, 2010, and June 30, 2011, the fund's net assets increased by \$5.6 billion from \$45.8 billion to \$51.4 billion. The rate of return on investments during this same period was 20.4%, a notably stronger performance than the 14.6% return for FY 2010, or -26.5% for FY 2009, the height of the Great Recession.¹²⁸

The fund's funded ratio — the ratio of the fund's net assets to its net liabilities — has suffered in the years since 2008. As of June 30, 2008, the fund had a funded ratio of 86%. By June 30, 2009, this figure had decreased to 79.2%, and by June 30, 2010, it was just 75.1%.¹²⁹ All of these figures are a marked decrease from the fund's health during the booming years of the early 2000s, when the funded ratio reached a peak of 123.8% in 2000.¹³⁰ According to its actuaries, PSERS has an unfunded liability of about \$10 billion.

STATE EMPLOYEES' RETIREMENT SYSTEM (SERS)

The second largest public employee pension system in Pennsylvania is the State Employees' Retirement System (SERS), which administers both a defined benefit plan and a defined contribution plan and serves 115,000 retirees and beneficiaries and 107,000 active members as of 2011.¹³¹ The employees covered under this plan are state workers, legislators, staff, and judges. Like many large public employee pension funds across the country, SERS has suffered acutely from the Great Recession and the resulting economic stagnation. In 2008 alone, for instance, the fund lost \$10.5 billion in assets, and while the fund has recovered some of these funds in subsequent years, many issues remain.¹³²

The Chairman of the Board that oversees SERS has warned members that it may take up to 40 years for SERS to reach full funding again. At the end of 2010, the fund held \$25.9 billion in net assets, with a funded ratio of 75.2%. At the end of FY 2011, net assets were \$24.4 billion, and the funded ratio was 65.3%.¹³³ More worrying still, the fund saw only a 2.7% return on investments in FY 2011. According to its actuaries, PSERS has an unfunded liability of about \$20 billion.

PENNSYLVANIA MUNICIPAL RETIREMENT SYSTEM (PMRS)

The third and smallest public employee pension system in Pennsylvania is the Pennsylvania Municipal Retirement System (PMRS), with roughly 14,000 members.¹³⁴ As of December 31, 2011, the fund had \$1.5 billion in assets, a decrease of \$52 million from the previous year. The rate of return for the year ending December 31, 2011, was -1.9%, compared to gains of 13.8% and 18.8% for the years ending December 31, 2010 and 2009, respectively. Nonetheless, the fund

128 Pennsylvania Public School Employees' Retirement System (PSERS) CAFR 2011, 28.

129 Pennsylvania PSERS CAFR 2011, 28.

130 Pennsylvania PSERS CAFR 2011, 30.

131 Pennsylvania State Employees' Retirement System (SERS) CAFR 2011, iii.

132 Pennsylvania SERS CAFR, 79.

133 Pennsylvania SERS CAFR, iii.

134 "History." Pennsylvania Municipal Retirement System. [<http://www.pmrs.state.pa.us/about/index.html>].

has a funded ratio of 102.4% as of January 1, 2011, indicating that the fund's net assets exceed its total liabilities.¹³⁵

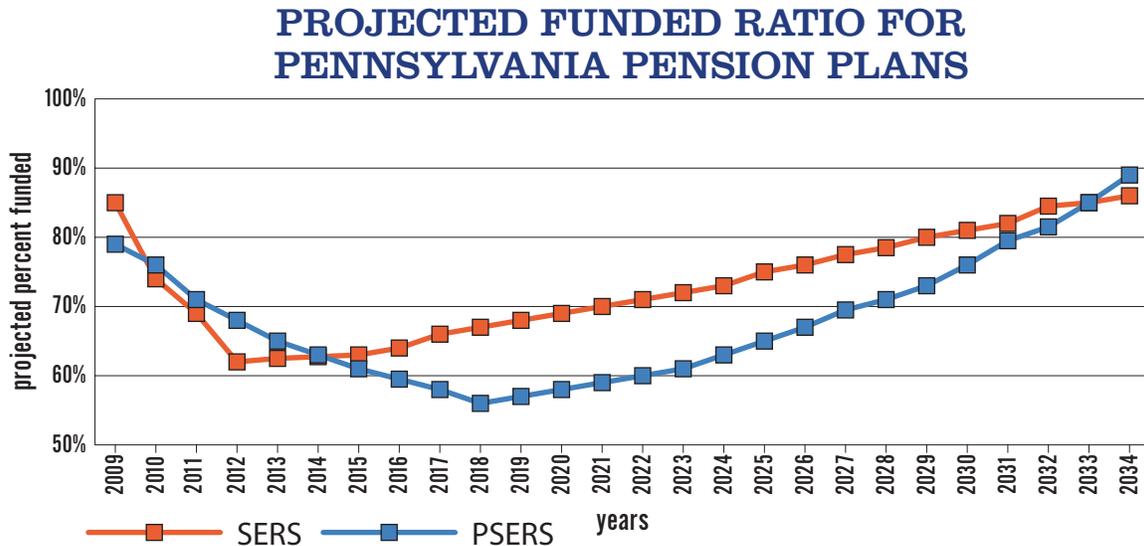


Figure 14

SOURCES: SERS, SUPPLEMENTAL BUDGET INFORMATION BOOK 2011; PSERS, CURRENT EMPLOYER CONTRIBUTION RATE AND 30-YEAR PROJECTIONS, DEC 2010

OUTLOOK

Together, liabilities from these three pension systems make up 22% of the state's total liabilities — a sign of the size of the problem. State Budget Solutions, a nonprofit research group, ranks Pennsylvania's unfunded pension liabilities as the seventh largest in the nation.¹³⁶ According to their data, as of 2012, Pennsylvania has set aside only 40% of the calculated total that it should contribute to its pensions — the lowest percentage of any state.

Pennsylvania's pension outlook deteriorated rapidly for three reasons.¹³⁷ First, much of the pension's funds are invested in the stock market. Due to the recent financial crisis, the value of the overall pension fund decreased. Second, Pennsylvania has been more generous than most states in promising benefits to employees, thus expanding liabilities through the years. Third, the state government has chosen to contribute less from its general fund to the pension program, choosing instead to pay other, more current financial obligations. As a result, there has been little cushion to soften the recent economic blows on the pension system.

REFORM

Around the country, state legislatures are realizing the incredible urgency of pension reform and are taking steps to reduce costs by increasing retirement ages, reducing benefits, and increasing

¹³⁵ Pennsylvania Municipal Retirement System (PMRS) CAFR 2011, 18.

¹³⁶ Eucalitto, Cory. "State Budget Solutions' third annual State Debt Report shows total state debt over \$4 trillion." [<http://www.statebudgetsolutions.org/publications/detail/state-budget-solutions-third-annual-state-debt-report-shows-total-state-debt-over-4-trillion#ixzz2507P9hXY>].

¹³⁷ Keith, Tamara. "Pennsylvania Pensions: From Surplus To A Deep Hole." [<http://www.npr.org/templates/story/story.php?storyId=124825100>]. March 22, 2010.

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costs for public employees. States such as Utah have moved to defined contribution plans, where workers manage their own pensions, much like private sector 401(k) plans.¹³⁸ Rhode Island, which has severe pension funding shortfalls, had to make larger cuts into its cost of living adjustment for retiree pensions.

In Pennsylvania, major pension reform was passed in November 2010. The changes included: lowering retirement benefits for new employees, mandating an “actuarial fresh start,” and capping future employer contribution increases to predictable intervals. In the short term, these reforms will drive up the unfunded liability of the SERS system until the caps on future employer contributions reach actuarially required levels. In the long term, however, legislators hope that these changes will help bring the state’s unfunded pension liabilities under control.¹³⁹

By early 2012, however, state leaders had acknowledged that the 2010 reforms were not enough to solve the state’s pension crisis. Even with the new 2010 reforms, the state’s pension obligation will increase dramatically in the coming years. The 2011-2012 budget calls for \$1.1 billion in pension payments, but by 2016 this figure will increase to more than \$4 billion annually.¹⁴⁰ Governor Corbett, speaking to local officials in Hershey, PA, said: “If we [wait], this budget battle that we go through is going to be totally driven not by increasing jobs, not by reducing taxes, not by giving money to education or to welfare recipients who may need it. It’s going to be driven by how much we have to contribute to pensions.” As of May 2012, the state owes its pension funds more than it spends on its annual operating budget.¹⁴¹

“Even with the new 2010 reforms, the state’s pension obligation will increase dramatically in the coming years.”

In addition, much debate has surrounded the assumed rate of return used to value pension assets; according to many analysts, the rates used by the Pennsylvania pension funds are overstated. Indeed, until May 2012, SERS used an assumed rate of return of 8%; forty other states use assumed rates of 8% or lower. Discount rates in the private sector tend to be much lower.¹⁴² In May 2012, the SERS board voted to lower the assumed rate of return for the fund’s investments to 7.5%.¹⁴³

138 Liljenquist, Dan. “The 2010 Utah Response: Utah State Retirement Systems.” [www.ncsl.org%2Fdocuments%2Flabor%2FLiljenquist_Pensions_LegSum2010.pdf]. July 27, 2010.

139 Pennsylvania SERS CAFR 2011, iii-iv.

140 Olson, Laura. “Gov. Corbett adds pension reform to budget agenda.” Pittsburgh Post-Gazette. [<http://www.post-gazette.com/stories/local/state/gov-corbett-adds-pension-reform-to-budget-agenda-636794/>].

141 Ibid.

142 Cheney, Kyle. “Grossman: investment losses to send unfunded pension liability higher.” [<http://www.wickedlocal.com/concord/archive/x574393759/Grossman-investment-losses-to-send-unfunded-pension-liability-higher#axzz1xdnHwGKL>]. February 7, 2012.

143 “PA SERS Board Reduces Return Assumption, Certifies Employer Contribution Rate.” Pennsylvania SERS. [http://www.portal.state.pa.us/portal/server.pt?open=512&objID=14364&PageID=432888&mode=2&contentid=http://pubcontent.state.pa.us/publishedcontent/publish/cop_general_government_operations/sers/sers_internet/news_-_media/articles/pa_sers_board_reduces_return_assumption_certifies_employer_contribution_rate.html].

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Doubts over the state's ability to manage its growing unfunded pension liabilities were a key driver of the decision in July 2012 by Moody's Investors Service to downgrade Pennsylvania's general obligation bonds — which are backed up by the state's ability to repay bonds from tax revenue — from Aa1 to Aa2.¹⁴⁴ At the same time, Standard & Poor's Rating Services changed its outlook on the state's debt from “stable” to “negative,” and further threatened to downgrade the state in the next two years if the pension issue was not addressed.¹⁴⁵

A LOOMING CHALLENGE

Though nearly every state in the country is dealing with the unavoidable reckoning over underfunded state pension funds, Pennsylvania finds itself in a particularly precarious position. The state's two largest pension funds have very low funded ratios, shrinking assets, and increasing liabilities. Both the fund leaders and state legislators have taken initial steps to return the funds to fiscal health, but these changes will require long-term discipline and sacrifice. Already, credit rating agencies are showing that Pennsylvania's pension problems have an effect on the state's economic outlook, credit rating, and reputation. According to Governor Corbett, the state's pension challenges are “an iceberg right in front of us.”¹⁴⁶ If the state cannot change its course soon, it will pay a painful price for failing to properly fund its pension promises to state employees. ★

144 Sichel, Jared. “Corbett says Moody's on target for blaming pensions for lower bond rating.” Pennsylvania Independent. [<http://paindependent.com/2012/07/corbett-says-moodys-on-target-for-blaming-pensions-for-lower-bond-rating/>].

145 Russ, Hillary. “Pennsylvania pension woes weigh on credit ratings.” Reuters. [<http://www.reuters.com/article/2012/07/19/us-pennsylvania-ratings-sp-idUSBRE8611ND20120719>].

146 Ibid.

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