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The Program Policy Guidelines provide direction for the preparation of the Governor's 2012-13 Executive Budget, agency budget requests. Executive Budget planning for 2012-13 is to be predicated on the fact that the Pennsylvania economy is still in recovery and has not yet emerged from the "Great Recession." Therefore, agencies should not assume funding increases for the 2012-13 fiscal year and should continue to evaluate current programs and recommend changes that will improve program management and operations, reduce costs and optimize direct services.

Consistent with the direction presented in this document, agencies should:

- Request general government operations (GGO) and administrative appropriations at levels that do not exceed 2011-12 Enacted Budget amounts.
- Identify efficiencies, consolidations or other personnel cost reductions sufficient to offset in a realistic and sustainable manner any requested increase in operating and fixed asset spending.
- Assess current responsibilities and functions and propose opportunities for outsourcing, privatization, public-private partnerships or competition.

- Manage 2011-12 complement, including requests to fill 2011-12 vacancies, in a prudent manner that will keep budget requests within the levels specified by this guidance.

- Request discretionary programs not statutorily set by the state or not a federal requirement at levels that do not exceed enacted 2011-12 budget amounts.

- Keep program revision requests requiring new or increased funding within existing 2011-12 funding levels through offsetting savings that are realistic and sustainable.

- Not request additional state funding to replace lost or reduced federal funding.

Agencies are expected to respond to all aspects of these guidelines relevant to their programs and operations.

Background and Introduction

The development of the Governor's 2012-13 Executive Budget (hereinafter referred to as "Budget") follows close on the enactment of the most challenging Budget in recent Pennsylvania history. As the administration developed the 2011-12 Budget, it confronted a structural deficit of $4.2 billion in the commonwealth's General Fund, the result of years of spending greater than base revenues, and a reliance on one-time revenues such as federal stimulus funding and other short-term fixes.

To address this structural deficit, the administration and General Assembly produced a historic reset of government spending to 2008-09 Enacted Budget levels and an overall reduction in spending of four percent. The 2011-12 Enacted Budget cut $822 million in annual spending by eliminating 66 line items, reduced funding for 226 appropriations, and consolidated an additional 52 appropriations to streamline government. These steps, coupled with the substantial progress made in tackling the structural deficit and better aligning of overall spending with base revenues, has the commonwealth better placed to address its remaining fiscal challenges.

The state's fiscal recovery, however, is closely tied to national economic activity and job growth. At the writing of these Program Policy Guidelines (PPGs), it is widely acknowledged that while the national economy is showing some signs of recovery, it will likely be years before it hits pre-recession levels of performance. Having contracted for 18 months, the economy is emerging from the longest and most severe recession of the postwar era, a "Great Recession" that may take a decade or more to fully overcome its impact. After the last recession, in 2001, which lasted just eight months, it took three years for state revenues to recover. The Great Recession was more than twice as long and significantly deeper.

Recent economic forecasts project a slowing of growth in Gross Domestic Product, minimal improvement in the unemployment rate, and continued sluggishness in consumer spending. For these reasons, some economists expect it may take four to five more years for the job market and the economy to normalize. Even as the economy grows, the historical tendency has been for state revenues to lag behind the economic recovery. It appears that this combination of likely prolonged constraints in revenue growth and sluggish economic growth will be the "new normal" for state government.

The complexities created by this new environment can be seen in the impact our main cost drivers – pensions, health care, corrections, and debt service – will have on development of the 2012-13 Budget. Commonwealth contributions to the Pennsylvania Schools Employees' Retirement System (PSERS) for school employees' retirement are projected to increase by over $315 million, or 53 percent, to over $900 million. Likewise, commonwealth contributions to the State Employees' Retirement System (SERS) for state employees' retirement are projected to increase by nearly $200 million, or nearly 50 percent, across all agencies. Less fixed, though no less certain, are pressures from growth in Medical Assistance and state correctional institutions costs, which over the past five years have grown by nearly $1 billion, or 20 percent, and $400 million, or 35 percent, respectively. Finally, debt service costs will grow nearly $100 million, or 9 percent, to over $1.2 billion.

What quickly becomes evident is that the growth in these mandated costs is consuming a sizeable share – hundreds of millions of dollars – of any revenue growth before even a single dollar would be available for either tax cuts or additional spending. Fiscal Year 2012-13 may be less historic than its predecessor, but will offer its own set of challenges that will require strong management and creativity to achieve our fiscal goals.

Given this environment and the challenges it presents, fiscal discipline, limited government and free enterprise must continue to guide the administration's fiscal planning. Doing so not only better ensures Pennsylvania can successfully navigate these challenges but also best enables us to foster a climate that will expand growth and prosperity throughout the state.

Direction

The 2012-13 Budget Governor Corbett presents to the General Assembly will be a fiscally responsible one that restrains government spending and focuses on job creation. As with the current Budget, the 2012-13 Budget will contain no General Fund tax increases and will seek to cut taxes to improve the economic competitiveness of the commonwealth and allow individual Pennsylvanians to keep more of their hard-earned dollars.

General Government Operations / Administrative Appropriations

Each agency should request GGO and other Operating/Administrative appropriations at levels that do not exceed 2011-12 Enacted Budget amounts. When developing level-funded budget requests, each agency must ensure that contractually mandated salary increases and necessary increases to employee healthcare and pension contributions are incorporated into its level-funded budget request. These cost increases will need to be absorbed within the level-funded amount. For more specific instructions on how to budget in 2012-13 for salary and benefit costs please refer to the *2012-13 Budget Instructions Manual.*

- In general, agencies should not request any increases in Operating and Fixed Asset spending. Agencies wishing to increase Operating and Fixed Asset expenditures must identify efficiencies or other Personnel cost reductions sufficient to offset in a realistic and sustainable manner any requested increase in Operating and Fixed Asset spending.

- Any new position requests should be offset by proposals to eliminate other positions or move positions to the recruitment pool.

Discretionary and Other Program Spending

Discretionary programs, that is, those programs that are not statutorily set by the state or that are not a federal requirement, are to be submitted at levels not to exceed 100 percent of the state funds in the 2011-12 Enacted Budget. In addition, proposals for new or expanded programs must be offset by reducing funding in other programs.

Federal Funding not to be Replaced with State Funding

Changes in federal funding priorities often result in the loss or reduction of federal funds. In these cases, agencies should not request additional state funding to replace lost or reduced federal funding, but instead should adjust program operations and priorities to be consistent with the new federal priorities. In those rare cases where agencies request state funds to replace the anticipated loss of federal funds, agencies must include other realistic and sustainable program offsets to stay within the funding direction presented in these guidelines.

Complement Management

Governor Corbett is committed to reducing the cost of operating state government by 10 percent over four years. Therefore, agencies must continue to identify efficiencies and strategies that will result in permanently reducing overall filled complement levels. Agencies must be mindful that budgetary pressures will remain as we begin planning for the 2012-13 Budget cycle. Prudent management of complement in the current fiscal year and restraint in filling positions will be essential as agencies craft their 2012-13 Budget requests.

- The Office of Administration and the Office of the Budget will continue to review agency and total filled complement levels on an ongoing basis. Any significant increases in filled complement levels will be closely scrutinized to determine the reason for the increase. Agencies found not operating in the most prudent manner by prioritizing and filling only the most critical positions will be subject to more stringent complement controls up to and including temporary or permanent reductions in authorized complement. Agencies must ensure that filled staffing levels, for each appropriation, do not exceed the authorized complement levels established in their approved rebudget plan.

- Each agency is expected to develop a proactive complement management plan. If necessary, your agency should be prepared to implement its complement management plan during 2011-12 if this is what is required in order to meet 2012-13 Budget requirements. Agencies will be expected to share their complement management plans during this fall's review of 2012-13 agency budget requests.

Program Revision Requests for Strategic Focus Areas

As this guidance makes clear, the commonwealth's financial constraints will generally preclude adding significant new funding to agency budgets except in the highest priority areas. Agencies are to include in their budget requests fully developed Program Revision Requests (PRRs) for the strategic focus areas identified below. PRRs should clearly model the revised program, including resource allocation, anticipated outcomes and defined performance measures. PRRs and initiatives requiring new funding should identify realistic and sustainable offsets within existing agency budgets through efficiencies or other program modifications or eliminations.

Agencies considering proposals to eliminate programs that are no longer effective or otherwise not responsive to the needs of Pennsylvanians, or proposals to implement new programs or program changes as a result of changes in policy, statute, regulation or court direction, must submit preliminary PRRs for these proposals. Agencies should request additional resources for program addition or change proposals only after they have explored offsetting cost savings in other programs. In addition, agencies must justify in the request narrative why the new program or program change cannot be implemented using resources made available from the elimination or reduction of other less effective or responsive programs, or from other improvements in program efficiency.

No PRR requiring an increase in agency General Fund expenditures may be submitted unless:

- The PRR is to implement a new or expanded program required as part of a legislative or judicial mandate (which must be documented and explained as part of the budget submission); or

- The PRR is requesting new complement or other resources to maintain current staff to caseload/population ratios (which must be documented and explained as part of the budget submission); or

- The PRR that increases spending is accompanied by an “efficiency” PRR that will result in offsetting reductions in agency expenditures, so that the net impact of the two PRRs is essentially no net increase or an actual savings in planned agency expenditures.

Program Performance Measurement

Pennsylvania’s public servants are entrusted to expend and invest the public’s money on the public’s behalf. In return, our citizens expect results and accountability. As part of agency budget submissions, all PRRs must include outcome measures as well as efficiency, customer service, or activity measures where appropriate. Resources or costs proposed to achieve the desired results must also be clearly delineated. For the overall budget request, funding should be related to the high-level goals the agency is attempting to achieve as defined in its annual Agency Performance Plan. Key performance indicators should be identified along with the costs and strategies for achieving the key results. For more specific instructions concerning the preparation and submission of agency program performance measures, please refer to the *2012-13 Budget Instructions Manual*.

Information Technology Initiatives

Agencies should submit PRRs for all major new and ongoing information technology (IT) initiatives included in the IT strategic plan review process managed by the Office for Information Technology. These IT PRRs must be submitted in accordance with the PRR direction presented in this document. In addition, a Strategic Enterprise Management – Business Planning and Simulation (SEM-BPS) decision package must be created for each PRR, including corresponding SEM-BPS complement planning and commitment item layouts as specified in the *2012-13 Budget Instructions Manual*.

Guiding Principles

Fiscal Discipline

The watchword for this Budget and future Budgets is fiscal discipline. We will continue to face fiscal challenges related to limited revenue growth and increasing cost pressures to deliver government products and services. At the same time, we recognize that our citizens know best how to spend their own money, so we must refrain from imposing any greater tax burden, and our policies must allow for citizens to keep more of their hard-earned income.

Consequently, every agency must continue to diligently work to control spending. Agencies cannot assume a cost-to-carry budget, but instead should prepare for no increase in funding and develop innovative approaches or process improvements to absorb program cost increases through efficiencies. In searching for greater efficiencies, agencies should look to their employees to find better ways to do things and to identify and eliminate or modify wasteful practices or processes.

Times of great challenge are also times of great opportunity. Agencies should review their program responsibilities and functions and assess if they could better be performed through other means such as: outsourcing, privatization, public-private partnership or other competitive processes. Similarly, as an enterprise, the commonwealth should look for functional consolidations to achieve efficiencies and enhancements in customer service.

Debt service to pay for the state's bond issues is approaching $1.2 billion, almost double what it was less than ten years ago. Agencies must approach their responsibility in preparing their capital improvement plans as stewards of both the commonwealth's physical assets and its fiscal assets. In addition, funding for public policy initiatives cannot be dependent on bond financing simply because general funds are scarce or the competition for funds is intense.

Limited Government

The turnaround and refocusing of state government has progressed significantly over the past several months. Several initiatives set out in Governor Corbett's reform plan – a plan for a more efficient and responsible Pennsylvania government – have been launched or completed. The 2011-12 Budget eliminated WAMs and reduced legislative reserves. The state vehicle fleet is being reduced and the process for reimbursing state employees for travel, food and lodging has been replaced with a new process adding increased accountability. A review and audit of all boards and commissions is also underway and a number of commissions have already been eliminated. Efforts to focus resources on the work most important to our citizens and their future prosperity must continue as must efforts to eliminate activities that divert us from those priorities.

Earlier this year, the Governor charged the Office of Administration and Department of General Services to examine ways to bring broader transparency and expand accessibility of information online. Significant strides have been made to enhance the current online database to include all aspects of the state budget and allow taxpayers to search for financial information. Act 18 of 2011 provides for the establishment of a searchable database-driven website detailing certain information concerning taxpayer expenditures and investments. To comply with the provisions of this Act, the Office of Administration will lead agencies in identifying key information and, in concert with the Treasury Department and others, complete the implementation of the information portal. In addition, all agencies should continue to identify information that can be provided online, thus increasing government transparency and further reducing the volume of right-to-know requests, allowing agencies to focus on their core missions.

As with the 2011-12 Budget, agencies must not seek to expand their staff or reach. But, if deemed necessary, any new initiative or program request should include an offset through other program revisions, efficiency gains or cost savings. Agencies should seek to consolidate IT and administrative functions to achieve cost savings to support public-policy priorities.

Free Enterprise

Unleashing the innovative power of free enterprise is the key to ongoing economic prosperity for all Pennsylvanians. Enabling free enterprise to fulfill its promise and removing the impediments to job creation will require tax reform, legal reform, regulatory reform and a rethinking of our economic development, workforce development, and infrastructure systems. The 2011-12 Budget initiated a number of these improvements: tax cuts, tort reform, restructured economic development programs, and regulatory review. It is only a start. Agencies must continue these efforts.

Historically, Pennsylvania has not been competitive in terms of its business tax climate. With the 2011-12 Budget, we have begun to distance ourselves from this distinction with the reinstatement of the phase-out of the Capital Stock and Franchise Tax (CSFT). Much work remains to be done to remove our tax structure as an impediment to job creation and innovation. Continuing the phase-out of the CSFT is estimated to cost approximately $300 million in 2012-13. We will work to initiate a 0.5% reduction in the Corporate Net Income tax, the highest in the nation, which would cost more than $100 million. Another priority, a graduated reduction in the Inheritance Tax, which would support increased investment in family businesses and farms, is estimated to cost over $10 million.

Pennsylvania's tax structure has evolved into a complex framework often difficult for the average business to comply with or navigate. All tax processes should be streamlined or simplified – from reporting to filing to dispute resolution.

Streamlining the regulatory burden on job creators is important to spurring innovation and economic vitality. A number of agencies have inventoried all existing regulations and evaluated them according to the specifications in *Executive Order 1996-1, Regulatory Review and Promulgation*. Agencies must develop an agenda for the review and evaluation of all regulations. Particular attention should be given to revising or repealing those regulations that create an undue burden on job creators with little public benefit. Similarly, agencies should identify those regulations that are expensive to administer but have little public benefit and seek non-regulatory and more cost-effective approaches to achieve the intended public purpose.

Pennsylvania's economic development strategy must focus on empowering innovation, growing small businesses, and expanding Pennsylvania's international reach. The 2011-12 Budget began the process of retooling Pennsylvania's economic development arsenal; however, additional steps can be taken to upgrade, modify or replace economic development programs to make them more responsive to the needs of business and economic realities, and so they better leverage private or other resources. Consequently, initiatives to harmonize existing economic development grant and loan programs should be developed and proposed, the economic development delivery system should be rationalized further, and the results of all programs – focusing support on the creation of family-sustaining jobs – should be rigorously measured.

One industry creating jobs, investing in Pennsylvania's communities and contributing revenue to the state General Fund, is the natural gas industry. The presence of a valuable natural resource and almost unfettered free enterprise has allowed a new industry to emerge in Pennsylvania to the benefit of the entire state. To truly harness the potential of this new industry for the long-term prosperity of all Pennsylvanians, impacted agencies should begin to implement the recommendations of the Marcellus Shale Task Force.

Strategic Focus Areas

Government and Regulatory Reform

All agencies are expected to update their regulatory review agenda, identify outdated or unneeded regulations and propose their revision or elimination based on the review criteria established in *Executive Order 1996-1, Regulatory Review and Promulgation*. Agencies should particularly focus on regulations that add little value or benefit to the public and on those in which a less expensive non-regulatory approach may accomplish the same objectives. Those agencies whose regulations impact private-sector job development and investment should seek to streamline their processes to minimize the impediments to legitimate and positive job creation.

Similarly, all internal support agencies should analyze their own processes to identify burdens placed on other government agencies that if removed or modified would allow agencies to operate more efficiently or serve their customers more effectively. Agencies should identify opportunities for functional outsourcing or consolidations. The "Yellow Pages" test provides a good place to start. If a product or service that state government is currently providing can be found in the Yellow Pages and can be done less expensively by the private sector, then the commonwealth should consider offering that product or service in a different manner.

Finally, the potential for greater efficiencies through the strategic investment of resources for IT must be a key component of every agency's business plan.

Economic Development, International Trade and Agriculture

The 2011-12 Budget began the economic development retooling of the commonwealth. Significant opportunities remain to better leverage private and other public dollars. The Department of Community and Economic Development (DCED) should propose a refined plan on how to gain a greater return from current commonwealth grant and loan programs.

All agencies administering programs impacting the economic development of our communities, such as the DCED, Labor and Industry, Agriculture, Revenue and others, must rigorously scrutinize their portfolio of programs and prioritize the allocation of resources to those activities directly impacting positive economic growth in our communities.

Education and Workforce Development

At a time of constrained resources, a premium must be placed on ensuring tax dollars are spent efficiently and effectively. This is particularly true in basic education where spending and resource allocation is often misaligned with student needs and performance goals. Putting students first and better ensuring resources intended to support their education make it to the schools and classrooms they attend requires greater transparency, alignment, and coherence in our education funding and reporting systems.

Tightening the link between education funding and student needs and learning starts with an element as basic as knowing how many students our schools serve. Currently, many education appropriations, including the largest, Basic Education Funding, utilize the number of students a district or schools serves, or its average daily membership (ADM), as a component in determining funding. Yet the ADM data on which the state relies to make these determinations is dated often by as much as two years. At a time of resource scarcity and advanced technology, there is little excuse for making billion dollar spending decisions based on out-of-date data. To better ensure state education funding more accurately reflects the actual number of students our schools serve, the Department of Education should propose a plan to transition to real-time ADM reporting and utilize that data in its spending allocations.

Data quality concerns are compounded at the school level where current budget and accounting practices make it nearly impossible to know exactly how much is actually being spent at any single school, how much it costs to deliver a particular course or service, or whether dollars are even making it to the classroom. Research shows these practices often result in perverse outcomes where students and schools with the fewest educational challenges are favored at the expense of those with the most, or more is spent for extracurricular activities and non-core electives than for English, math, and other core subjects. In the end, the lack of accurate financial tools leaves policymakers at all levels flying blind and produces a finance system that cheats students and frustrates efforts to boost achievement. Therefore, it is critical that the Department of Education revise the Annual Financial Reports submitted by school districts so that they reflect actual spending at the school level and, to the extent possible, allow greater transparency into resource allocation and spending patterns.

Every student who enters our public education system comes with different needs and challenges. Our education finance system should recognize these differences by allocating funding based on these individual needs and “weighting” funding to account for these differences. Additionally, a weighted student funding approach should ensure funding is linked directly to the student and the school they attend, so as a student moves, funding moves with them. This “backpack” approach should not only allow funding to be portable, moving with the student to the school they attend, but enable funds to be unbundled as well, meaning families and students would be empowered to control and direct the dollars. The Department of Education, working with the Governor’s Budget Office, should develop a plan to move basic education funding to a weighted student funding approach that incorporates portability and unbundling.

The Department of Education should continue initiatives to improve flexibility that reprioritizes funding to support student achievement, including mandate relief or the easing of management restrictions such as: increasing bid size limits, restructuring advertising requirements, allowing for economic furloughs, and revising school medical services requirements. Likewise, the department should continue with its efforts to enhance teacher effectiveness through improved teacher evaluation and merit-based pay systems, as well as tenure reform.

Health and Human Services

Providing care and assistance for those incapable of caring for themselves is a core function of government. The compassion of Pennsylvanians is unequaled when it comes to taking care of families and children in need. The commonwealth manages a number of early childhood programs: Pre-K Counts, Head Start (Supplemental Assistance), Child Care Services and Child Care Assistance. Each is intended to serve the early childhood needs of Pennsylvania's children. Yet each has different eligibility requirements, standards of performance, and costs. The departments of Education and Public Welfare should assess the issues and identify the most pressing needs, evaluate existing programs and rationalize the spectrum of early childhood programs. The intent should be to meet the needs of our most vulnerable citizens in the most cost-effective manner.

The delivery of much of Pennsylvania's human service safety net is provided by the commonwealth's counties. Over time, increasing responsibility for this safety net has been placed with the counties. Like all others delivering public services, counties and their service providers have had to combat rising costs and more competition for resources. The 2011-12 Budget authorized the development of a pilot to allow counties to integrate many human service programs. This pilot should be implemented in 2012-13 and should provide for the breaking down of barriers between categorical human service programs. For example, homeless assistance programs, child care programs and behavioral health programs should work in concert with each other, complement each other, and serve individuals in a holistic manner or individually focused approach as opposed to a program-focused approach.

Medical Assistance long-term care and health care in general will continue to drive much of the commonwealth's budget. Therefore, the departments of Health and Public Welfare must continue to identify cost savings and efficiencies.

Criminal Justice and Public Safety

A primary responsibility of government is protecting the public health and safety of its citizens. The 2011-12 Budget reflected this priority and the 2012-13 Budget will as well. However, criminal justice and public safety agencies cannot be exempt from budget pressures and must also seek to improve efficiencies and secure cost savings.

In an effort to better align and coordinate efforts, the commonwealth's criminal justice agencies must plan to cooperate and collaborate on the various research efforts to achieve a unified outcome in providing resources to guide policy. They also should consider the consolidation of the various research operations into a single unit. This should serve not only to create greater efficiencies and save resources, but also to facilitate greater coordination in the delivery of programs to safeguard the public.

The primary cost driver in our criminal justice system is the number of inmates. As such, criminal justice reform is critical to addressing the impact on commonwealth resources. Our criminal justice agencies should propose reforms that reconsider how, when and how long to incarcerate. Process improvements need to be implemented to more effectively facilitate the transition from inmate status, to supervision, and to life as an unsupervised citizen.

Summary

Pennsylvania, like most other states, is facing a protracted economic recovery that will take considerable time and effort to address. The direction presented here is responsive to fiscal realities and addresses our 2012-13 Budget challenges head on. The principles of fiscal discipline, limited government and free enterprise will continue to guide the administration's budget planning, allowing us to focus on the core functions and responsibilities of state government and to ensure future growth and prosperity for all Pennsylvanians.