

Commonwealth of Pennsylvania

Long-Term Fiscal Outlook

February 10, 2017



Independent Fiscal Office

- ▶ **Office Began Operations September 2011.**
 - Similar to the Congressional Budget Office.
 - Non-partisan analysis. No governing board.

- ▶ **Our Primary Duties:**
 - General Fund Revenue Estimate: May 1 & Jun. 15.
 - Five-Year Economic and Budget Outlook: Nov. 15.
 - Actuarial analysis for pension legislation.
 - Special studies at request of General Assembly.

- ▶ **Office Makes NO Policy Recommendations.**

Post-Recession Budgets

- ▶ **The widespread 2008-2009 U.S. financial crisis significantly affected subsequent budgets.**
 - Federal ARRA funds cushioned the impact for several years.
 - Spending reductions/restraint for many program areas.
 - Recession hit pension funds, contributing to funding issues.
- ▶ **Recent budgets have utilized a succession of short-term measures.**
 - Shifts to the Lottery, Tobacco Settlement and Oil and Gas Lease funds.
 - Transfers of available monies from special funds.
 - Acceleration of revenue or deferrals of expenditures.
 - Loans or short-term revenue boosts.

November 2016 IFO Report

	15-16	16-17	17-18	...	21-22
Beginning Balance	\$257	\$2	--		--
Available Revenue	29,652	30,936	\$31,596		\$36,406
Lapses	221	75	100		100
State Expenditures	<u>-30,127</u>	<u>-31,535</u>	<u>-33,443</u>		<u>-39,486</u>
Ending Balance	2	-524	-1,746		-2,980

Note: figures in dollar millions.

Long-Term PA Economic Forecast

Economic Metric	Average Annual Growth Rates		
	2004-10	2010-16	2016-22
Real GDP	0.8%	1.7%	1.9%
Wages and Salaries	2.8%	3.3%	3.9%
Philadelphia CPI-U	2.5%	1.2%	2.1%
Payroll Job Gains (000s)	-3.8	43.2	47.5

Demographic Takeaways

▶ **Rapidly Aging Population.**

- First Baby Boomers turn age 65 in 2012.
- PA is 6th oldest state based on median age (40.7 years).

▶ **Surge in Retirements.**

- Just starting. Labor force participation rates also climb for 65+.
- Impact on economy unclear. Productivity and wages lower?

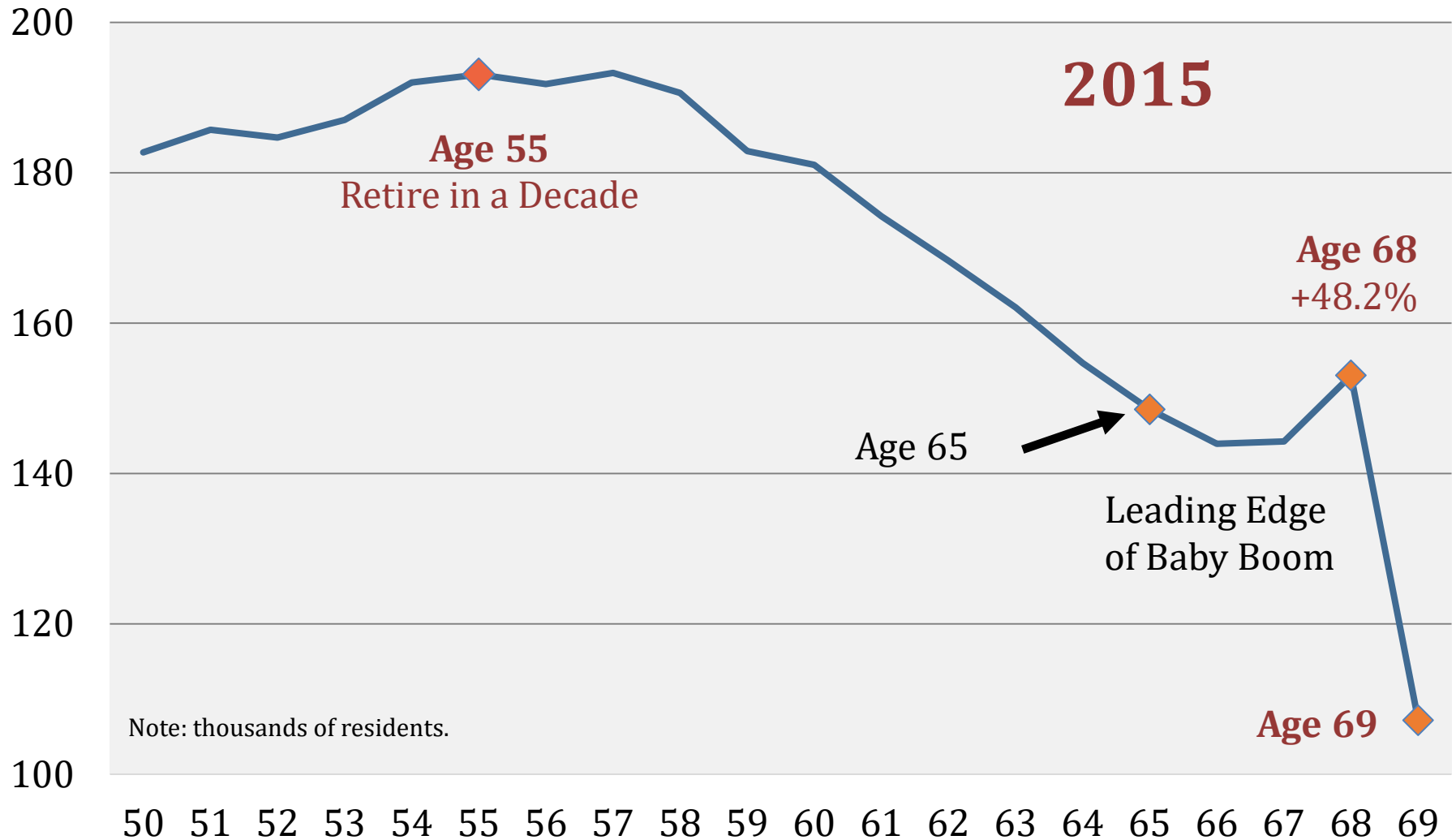
▶ **Decline in working age population.**

PA Snapshot: 2015 to 2025

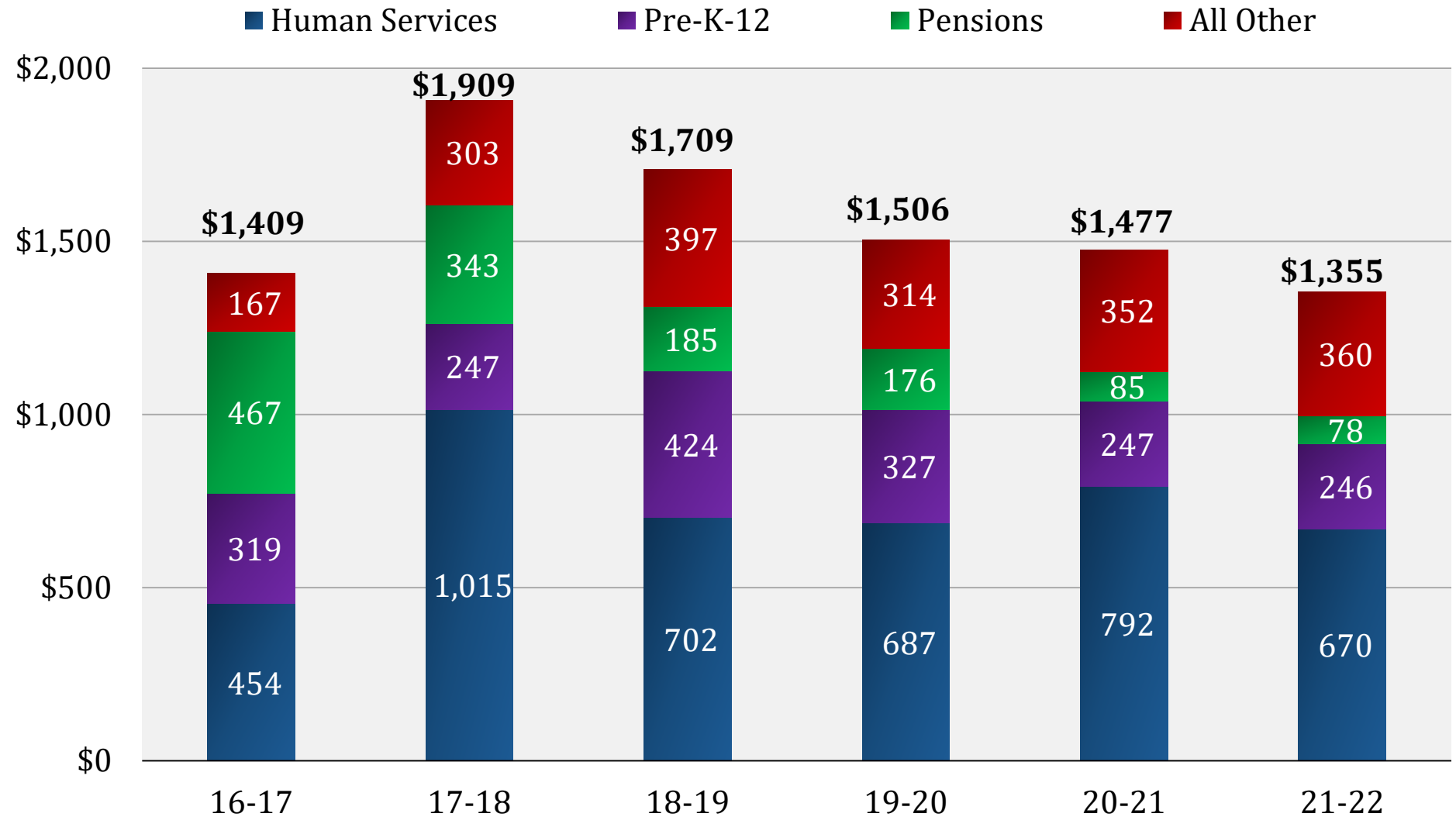
Age Cohort	Number of Residents (000s)			Gain or Loss (000s)		Avg. Annual Growth	
	2005	2015	2025	2005-15	2015-25	2005-15	2015-25
0-19	3,226	3,041	3,018	-185	-23	-0.6%	-0.1%
20-39	3,122	3,257	3,432	135	175	0.4%	0.5%
40-59	3,622	3,484	3,095	-137	-389	-0.4%	-1.2%
60-79	1,900	2,404	3,019	504	615	2.4%	2.3%
80+	<u>580</u>	<u>616</u>	<u>712</u>	<u>36</u>	<u>96</u>	<u>0.6%</u>	<u>1.5%</u>
Total	12,450	12,803	13,276	353	473	0.3%	0.4%

Note: thousands of residents.

Residents Age 50 to 69: Retirement Wave



Contributions to Expenditure Growth

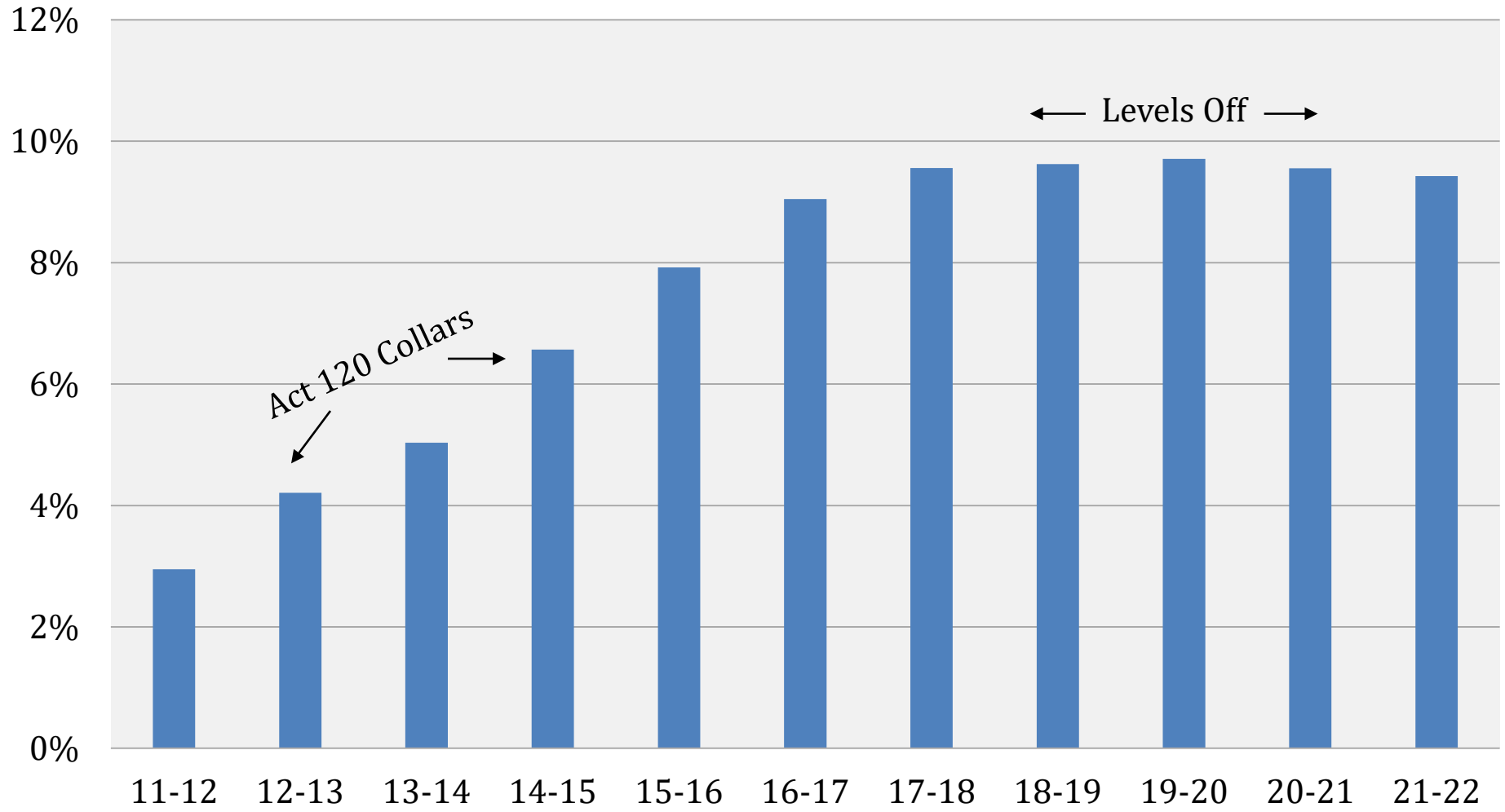


Note: figures in dollar millions.

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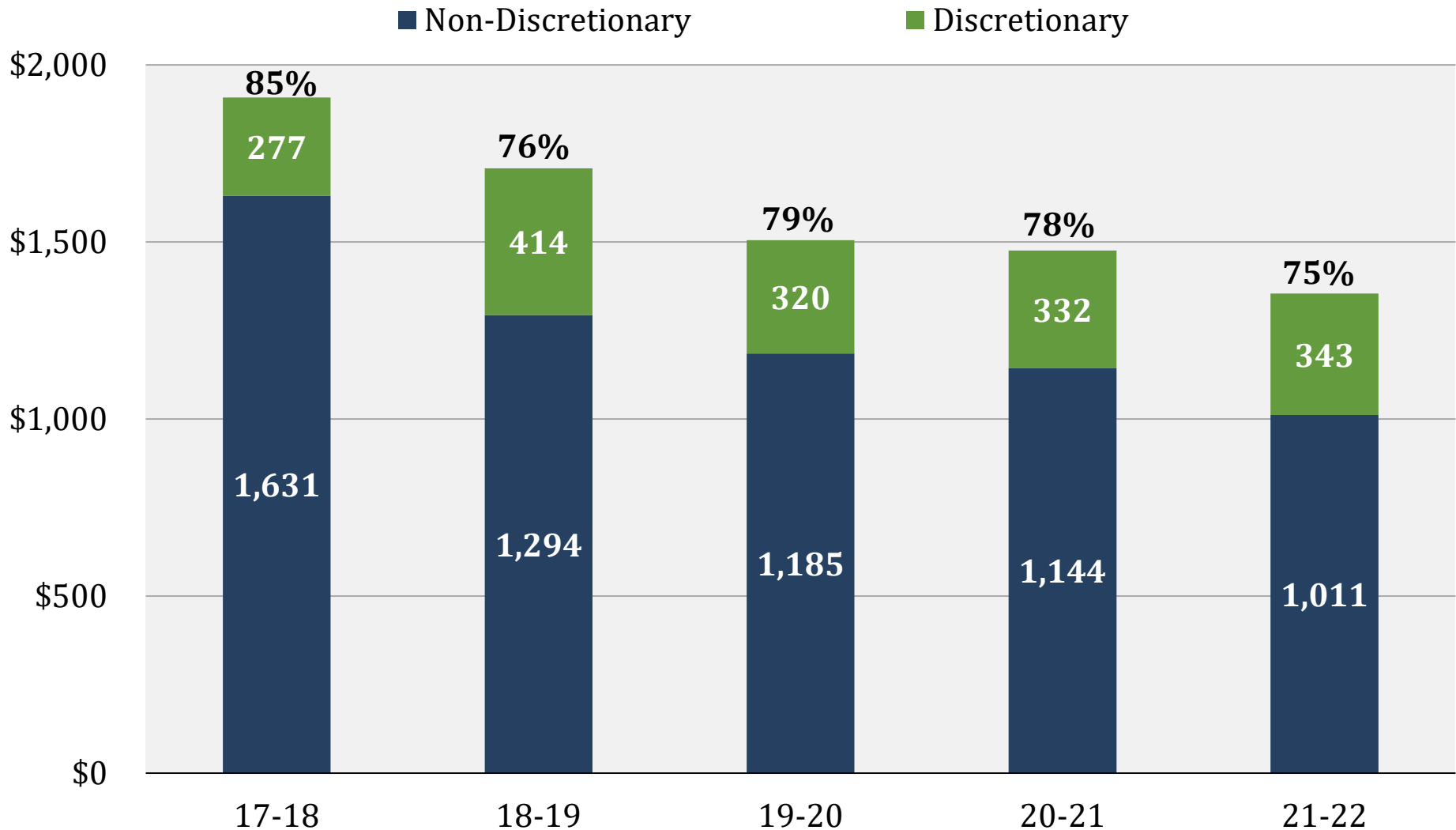
Pensions Share of GF Expenditures



Non-Discretionary Expenditures

- ▶ **Non-discretionary expenditures are mandated by federal law, constitutionally required or not easily changed.**
 - Includes the cost-to-carry (mandatory spending) and additional expenditures over which policymakers exercise limited control.
 - Includes human services, public safety, debt service, statutory funding shifts, pensions and employee compensation.
- ▶ **Remaining expenditures classified as discretionary.**
 - Includes agency operations and the basic and special education subsidies.

Discretionary vs. Non-Discretionary



Note: figures in dollar millions.

10.Feb.2017

Long-Term Outlook Summary

- ▶ **Main elements driving the structural imbalance are unchanged.**
 - Demographic trends affect revenues and expenditures.
 - Slow tax base erosion and modest revenue growth.
 - Non-discretionary spending continues to drive expenditure growth.

- ▶ **Recent policy changes (partially) addressed the short-term deficit, but the long-term imbalance remains.**

Mid-Year Revenue Update

Revised revenue projections for
FY 2016-17 and FY 2017-18

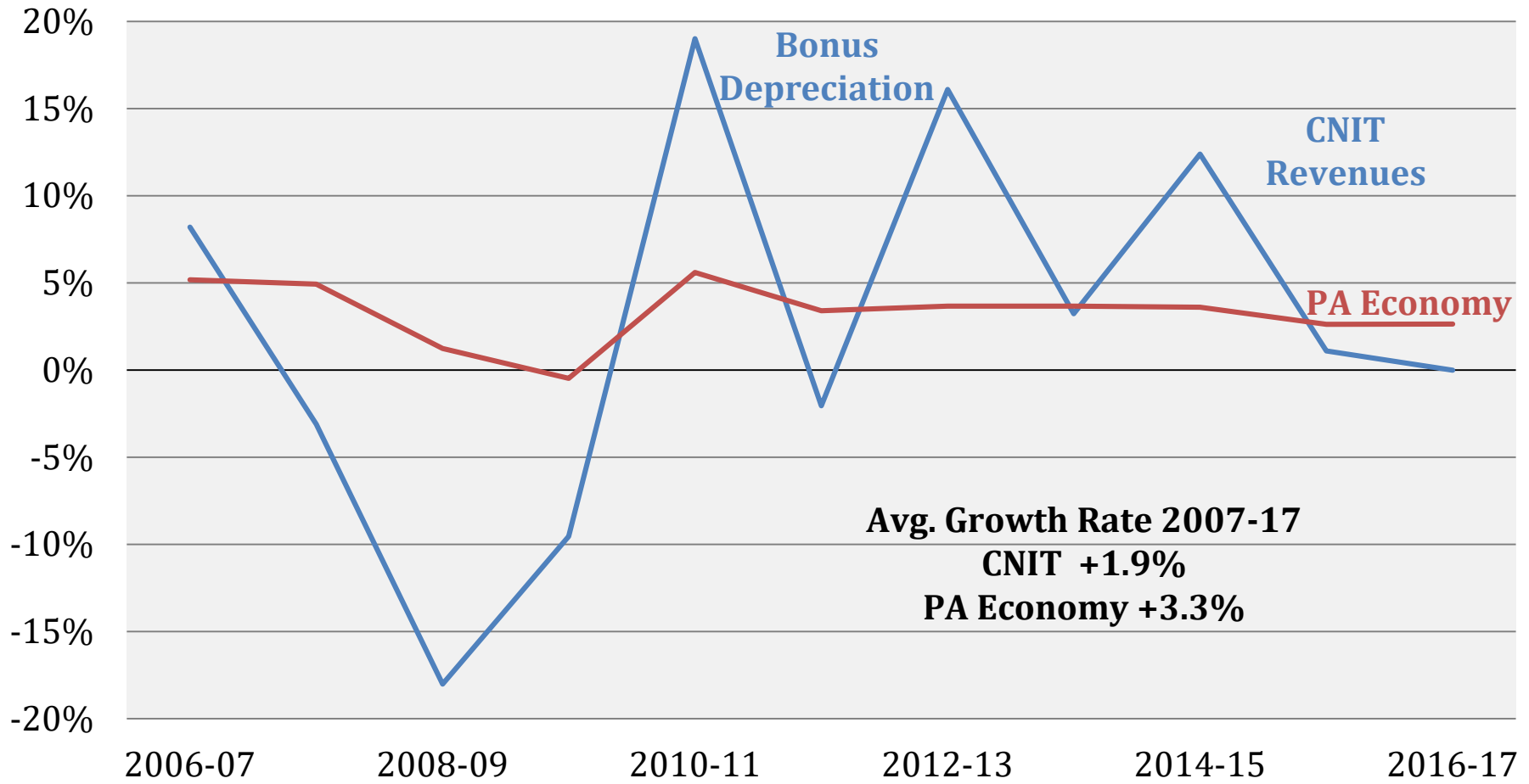
Revenues Through January

	IFO Estimated	FYTD Actual	FYTD Variance	Projected Growth	Actual Growth
General Fund	\$16,456	\$16,097	-\$359	3.5%	1.2%
Corporate Net Income	1,329	1,243	-86	-2.8	-9.1
Sales and Use	6,105	5,894	-211	4.7	1.1
Personal Income	6,808	6,723	-85	2.1	0.9
Other Tax Revenue	2,011	2,016	5	10.1	10.4
Non-Tax Revenue	203	220	17	-3.3	4.8

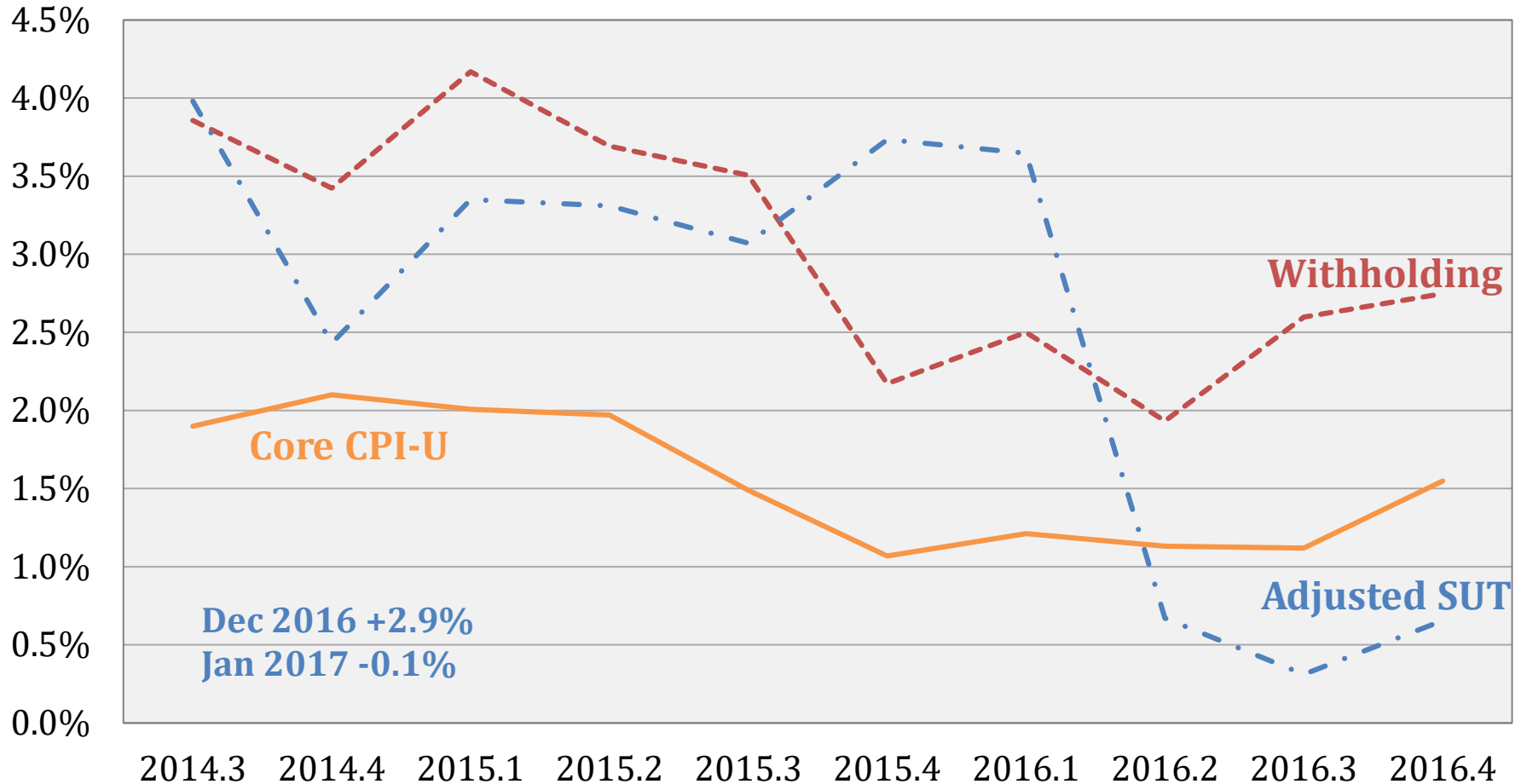
Note: dollar amounts in millions. IFO estimate based on the June 2016 forecast.

CNIT Growth Underperforms Economy

Annual Growth Rates: Corporate Net Income (CNIT) and PA Nominal GDP

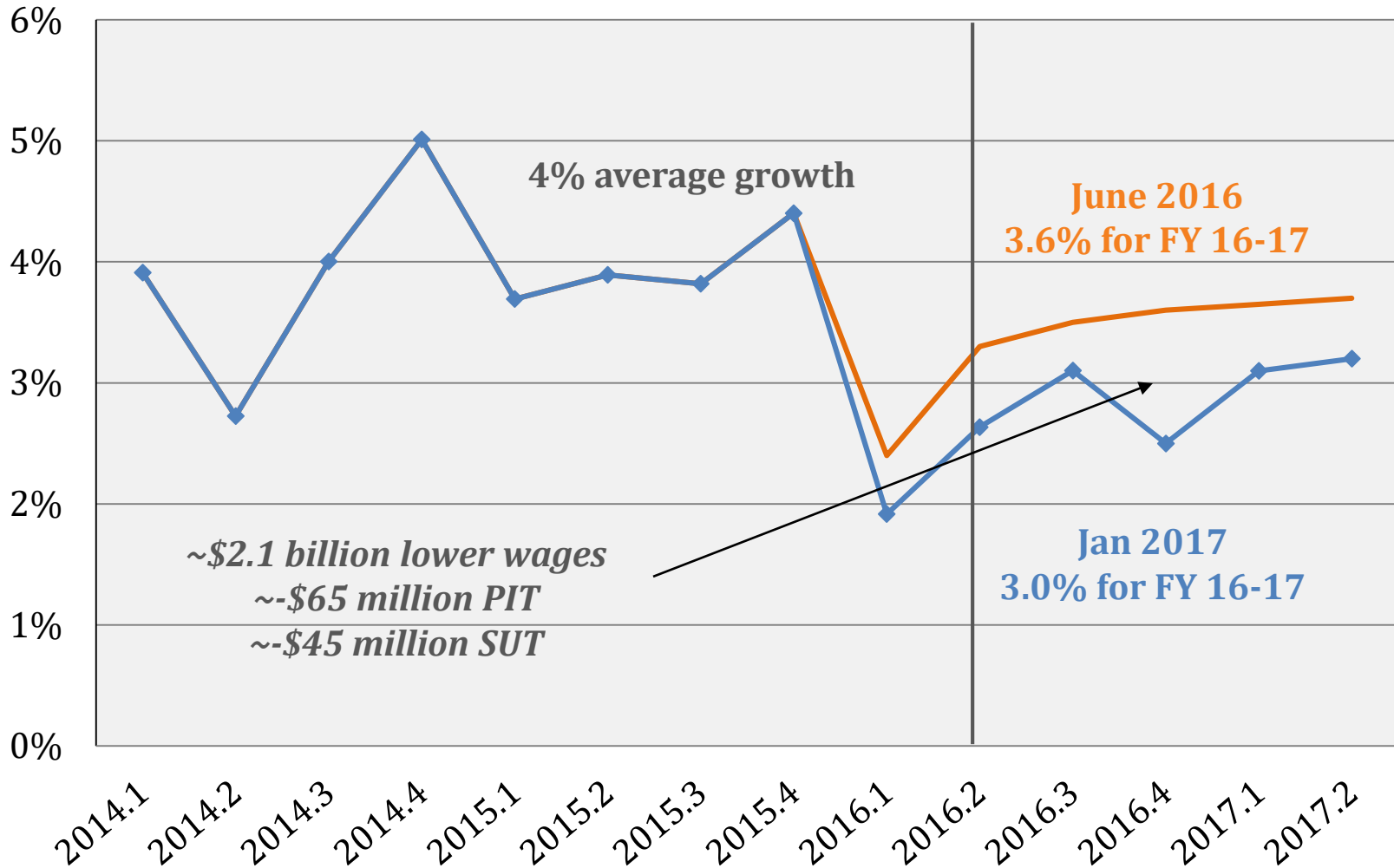


Non-Motor SUT Growth



Note: Adjusted SUT controls for expanded tax base and transfers. Uses one month lag to coincide with withholding and economic activity. Withholding growth rates are adjusted for extra deposit days during the quarter.

PA Wage Growth Underperforms



Source: U.S. Bureau of Economic Analysis. Forecast by IFO.

Changes from November Estimate

	November 2016	January 2017	Total Revision
FY 2016-17	\$32,311	\$32,060	-\$250
FY 2017-18	\$32,971	\$32,637	-\$334
Two-year revision	n.a.	n.a.	-\$584

Note: dollar amounts in millions.

The IFO's revised estimate for FY 2016-17 is \$716 million lower than the official estimate certified by the governor in July.

Long-Term Structural Imbalance

	15-16	16-17	17-18	...	21-22
Beginning Balance	\$257	\$2	--		--
Available Revenue	29,652	30,936	\$31,596		\$36,406
Lapses	221	75	100		100
State Expenditures	<u>-30,127</u>	<u>-31,535</u>	<u>-33,443</u>		<u>-39,486</u>
Ending Balance (Nov.)	2	-524	-1,746		-2,980
Revenue Adjustment (Jan.)		<u>-250</u>	<u>-334</u>		n.a.
Updated Balance (Jan.)		-774	-2,080		

Note: figures in dollar millions.

School Property Tax Projections

Estimates through FY 2021-22 issued January 9, 2017

FY14-15 School District Revenues

Source	Amount	Percent
Property Tax	\$12,285	44.5%
Earned Income	\$1,476	5.4%
Other Local Sources	\$2,126	7.7%
Act 1 Allocations (slots)	\$530	1.9%
State (exclude Act 1)	\$9,492	34.4%
Federal	\$815	3.0%
Other	<u>\$855</u>	<u>3.1%</u>
Total	\$27,578	100.0%

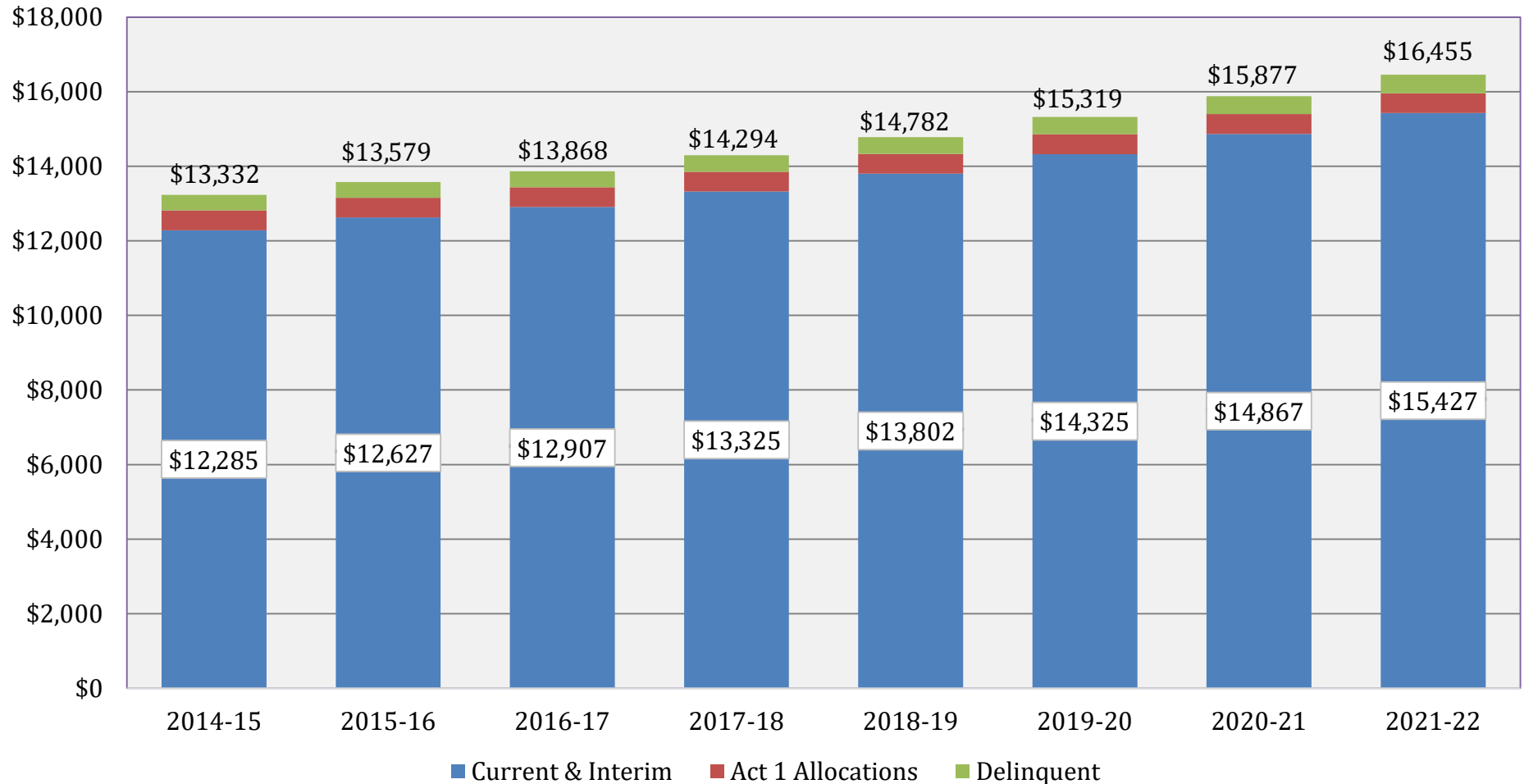
Note: dollar amounts in millions.
Source: Pennsylvania Department of Education.

Reliance on Property Tax Varies

Group	FY 14-15 Property Tax Collections	Property Tax Percent of Total Revenue
Top 25%	\$6,785	65.0%
Second 25%	\$2,767	46.9%
Third 25%	\$1,536	30.5%
Bottom 25%	<u>\$1,196</u>	<u>19.3%</u>
Total	\$12,285	44.5%

Note: dollar amounts in millions. School districts were ranked from highest to lowest based on property tax collections as a percentage of total revenue. For example, the top 25% contains the school districts with the greatest reliance on the property tax. There are 125 school districts in each group.

School Property Tax Forecast



Note: dollar amounts in millions. Act 1 allocations are \$530 million. Delinquent taxes are \$417 million in FY 14-15, increasing to \$498 million in FY 21-22.

Property Tax Elimination Proposals

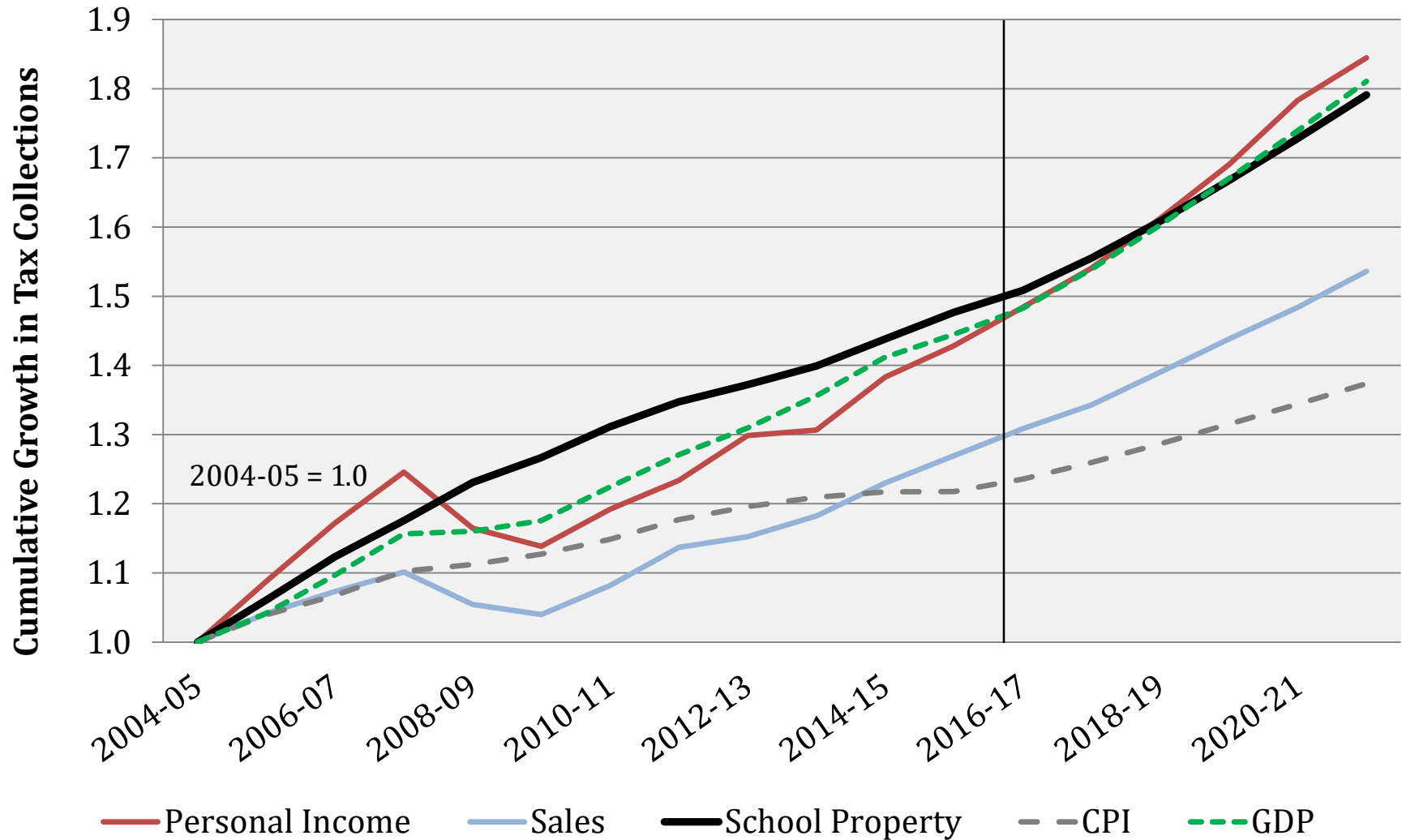
▶ **SB 76 of 2013 (IFO analysis on website).**

- Eliminates school district property taxes over time (retention for debt service).
- Increases personal income tax: 3.07% to 4.37%.
- Increases sales tax rate: 6.0% to 7.0%. Expands tax base.
- Distributions to school districts increase with inflation.

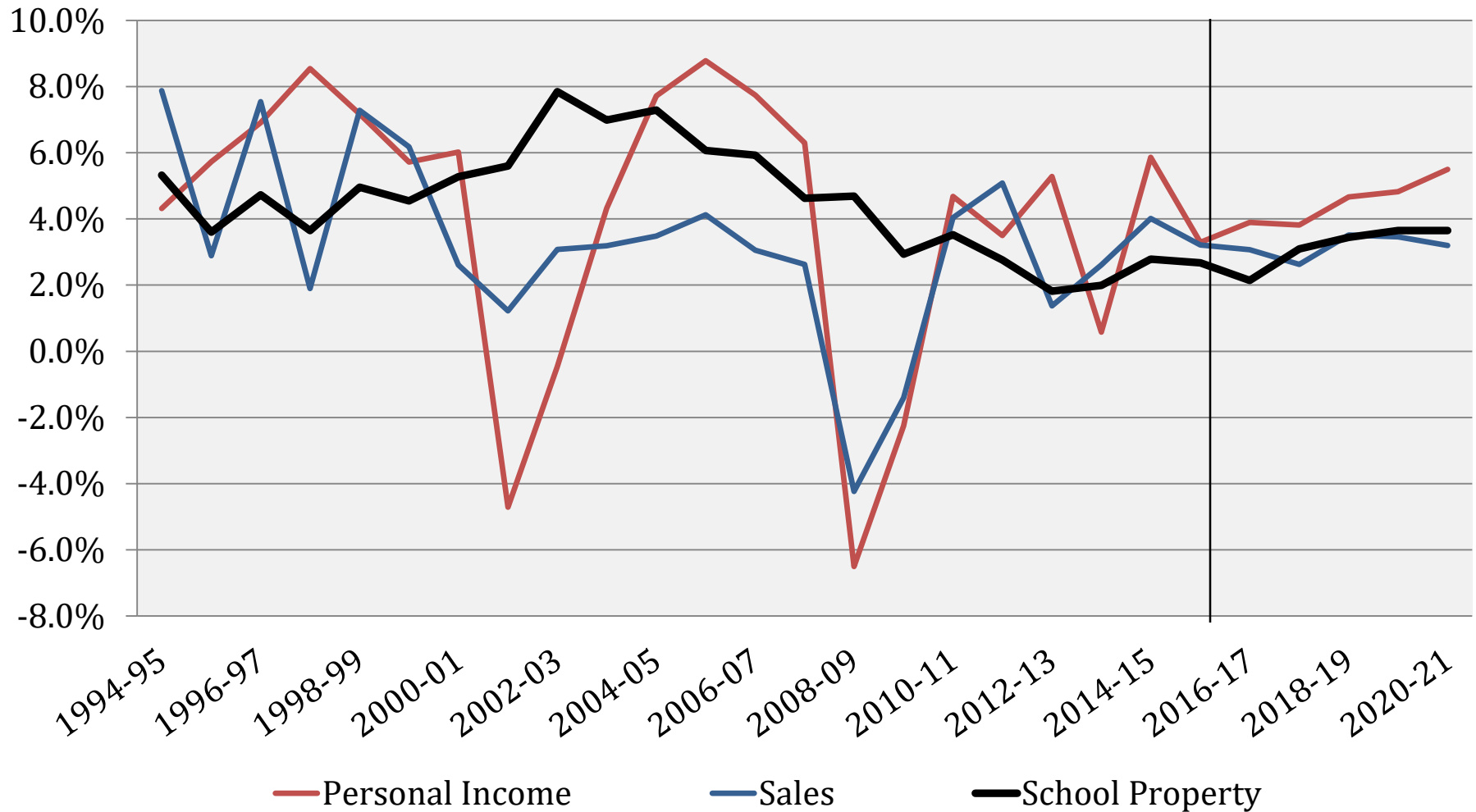
▶ **Recent proposal largely the same. Two major changes.**

- Increases personal income tax: 3.07% to 4.95%.
- Distributions to school districts increase by lesser of annual growth in (1) sales tax revenues or (2) statewide average weekly wage.

Long-Term Growth Trends



Annual Revenue Growth Rates



Questions / Discussion

Presentation to be
Posted at IFO website
www.ifo.state.pa.us